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# EM Special Publication

## Dubai: Next Steps

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The Government of Dubai's intended restructuring of Dubai World and Nakheel debt obligations has crystallized the absence of a government guarantee for government related entities (GREs). The most immediate consequence has been the substantial ratings downgrades for Dubai's government related entities.

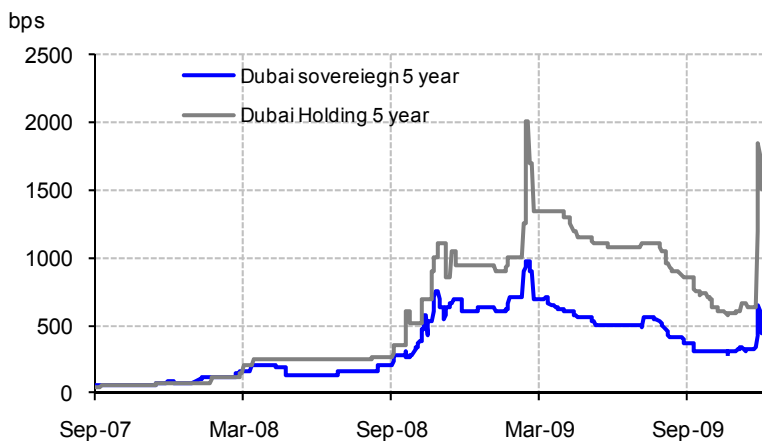
Little detail has been announced on the intended restructuring other than an approximate value of the debt at USD26bn. The lack of information combined with the timing of the announcement has undoubtedly exacerbated the negative price action.

It is unclear how a restructuring of the Nakheel 09 sukuk maturing on Dec 14 would play out. The sukuk is governed by English law but any judgement would not be enforceable in the UAE. There is no precedent for restructuring a sukuk and UAE bankruptcy law has never been tested either.

Perceived default risk on Dubai Holding has escalated since the Dubai World announcement. The debt stock that we can identify is significantly lower than Dubai World however, and none of this falls due in 2010.

The extent to which the Dubai troubles affect the ability of Abu Dhabi or Qatar to raise financing going forward remains unclear. Abu Dhabi and Qatar both have substantial natural resources and balance sheets are perceived to be significantly stronger. But the lack of transparency is a problem for all GCC countries and it is not clear that the region will be able to attract the same level of foreign investment going forward without addressing this issue.

**Figure 1: Dubai Holding – Perceived default risk has escalated**



Source: DB Global Markets Research

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## Dubai: Next Steps

### Introduction

#### The restructuring announcement by Dubai World has crystallised the absence of a blanket government guarantee for government related entities.

The November 25 announcement that the Government of Dubai intended to ask creditors for a standstill on Nakheel and Dubai World financial obligations has crystallized the absence of a blanket government guarantee for government related entities (GREs). Although the companies subject to the standstill were government owned rather than government guaranteed this has nevertheless led to sovereign creditworthiness more broadly being questioned. With neighbouring Abu Dhabi or the UAE federation yet to clarify the extent to which it will continue to offer financial support to Dubai, the emirate's financial position remains in question. Other than clarifying that the restructuring will cover USD26bn of debt, the Dubai government and the respective issuers have provided no further information on their intentions. Nakheel has yet to formally ask for a standstill on the USD3.5bn sukuk maturing on December 14 and no restructuring proposals have been put forward. The lack of information combined with the timing of the announcement (which came as UAE markets had closed for Eid and as the US was going into Thanksgiving) undoubtedly exacerbated the initial price action in response to the announcement. Dubai CDS and bonds were hit hardest but Abu Dhabi, Qatar and Saudi credit spreads also came under pressure. That Dubai (or the UAE) does not publish any official data on external debt has not helped, neither has the lack of timely and detailed financial statements for the corporate.

The Dubai World guarantee on the Nakheel 2009 has added further uncertainty because: a) Dubai World is 100% government owned leading to confusion on sovereign liability and b) to the extent that any default therefore gives creditors recourse to Dubai World assets.

### Dubai World

**Identifying the USD26bn.** Other than a government guarantee on Dubai Electricity and Water Authority (DEWA) loans (and the related Thor Asset Purchase Company), and a classification of the USD6bn syndicated loan issued by Investment Corporation of Dubai (ICD) as government debt, the Dubai government does not have obligations to third parties (nevertheless, as key elements of the 'Dubai project', the companies currently undergoing restructuring are, in perception at least, inextricably linked to the Dubai government). The degree of leverage

elsewhere among the GREs and the substantial re-financing demands that they face naturally raise questions about whether the moves to restructure debt could broaden given the average redemption for Dubai of USD12.5bn annual for the next three years.

Of the USD26bn which has been identified as subject to restructuring, we can identify USD15bn based on publically available data on bonds and loans. Out of this USD3.5bn would have been due by end 2009, USD4.5bn in 2010 and USD3.3bn in 2011 with the remainder from 2012-2015. Private bilateral debt likely makes up the remaining USD11bn. Payables on company balance sheets could well be included in this too.

**Figure 2: Dubai World restructuring details**

Dubai World portfolio	Restructuring	Amount (USDbn)
Dubai World Group Finance	Yes	5.5
<b>Transport &amp; Logistics</b>		
DP World Ltd	No	
Economic Zones World	No	
<b>Drydocks &amp; Maritime</b>		
Drydocks World	No	
Dubai Maritime City	?	
<b>Urban Development</b>		
Nakheel	Yes	8.0
Limitless LLC	Yes	1.2
Leisurecorp	?	
<b>Investment &amp; Financial Services</b>		
Istithmar World	No	
DMCC	?	
<b>Energy &amp; Natural Resources</b>		
Dubai Natural Resources World	?	
<b>Other unknown</b>	Yes	11.3
<b>Total</b>		<b>26.0</b>

Source: Dubai World, DB Global Markets Research

In terms of Dubai World's overall debt position we can identify around USD25bn in bonds and loans but given likely private bilateral obligations, in reality Dubai World's debt is probably higher. Dubai World announced balance sheet liabilities of USD59bn as of end 2008 and while no breakdown was provided we assume this would include more than just financial debt.

## What next for Nakheel 2009s

**Repay or default.** The Nakheel 2009 Sukuk with a redemption of USD 3.9bn due on 14<sup>th</sup> Dec was almost certainly the catalyst for the decision by Dubai World to consider requesting a standstill from creditors. If this sukuk is not redeemed on 14<sup>th</sup> Dec (as is likely) the issuer has a further 14 days of grace before an event of default formally occurs. When the initial announcement of a standstill was made there was a possibility that Nakheel would ask creditors to approve an Extraordinary Resolution to modify the terms of the instrument in order to obtain a standstill without triggering an explicit default. This would buy some time in order to negotiate a more comprehensive restructuring. Given that the end of the grace period is now less than 21 days away, there is no longer time to call a creditor meeting and so the only option (other than payment) is default. As a result we would move directly to a restructuring scenario rather than a standstill.

The manner in which a restructuring of Nakheel '09 would unfold is fraught with uncertainty. As with any debt restructuring, the final workout would be the result of negotiation and the existence of the collection action provisions in the instrument make it more likely that the restructuring can be resolved through negotiation rather than through the courts. The recovery value should be governed by the extent of debt relief which is required in order to ensure the company's solvency. Ultimately however, the final recovery value is also related in some way to the views on the respective parties of how successful creditors might be if they were to pursue their claims via the courts. Herein lies the problem: on many levels there is no precedent to act as guidance.

The sukuk itself is governed by English law and so an obvious avenue for creditors would be the English courts. However any judgement obtained would not be enforceable in the UAE, where the vast majority of the assets of Nakheel and Dubai World reside. Alternatively, creditors could look to the UAE courts to declare Nakheel and/or Dubai World bankrupt and seek compensation through the liquidation of either company. The UAE does have a bankruptcy law; however it has never been tested in a major corporate insolvency event. Complicating matters further is the fact that the instrument is a sukuk and there is no precedent for the restructuring of a sukuk and it is unclear how either the English or UAE courts would look upon the rights of creditors. As we discussed in an earlier article "Sukuk, Interrupted" (September 2009), there are currently three instances of default on sukuk, none of which have been resolved.

Given that default is so widely anticipated it is reasonable to ask whether there will be any impact when (and of course if) default formally occurs after the grace period

expires. There are actually two important implications. First, it is likely that CDS will be triggered on Nakheel, although the notional amount of CDS outstanding is likely to be small given that it doesn't show up in the DTCC data. Second, the event of default could lead some creditors to initiate legal proceedings. At present, since there has been no formal communication from the issuer to note holders, creditors can do nothing; once a default formally occurs, that changes. Nevertheless, any legal process is likely to be extremely protracted.

## Spreading beyond Dubai World

**Is Dubai Holding next?** The current restructuring proposals are limited to parts of Dubai World with Dubai World itself, Nakheel PJSC and Limitless LLC all included. Dubai World has confirmed that DP World, JAFZA, Infinity World and Dubai Drydocks are all excluded from the proposals. Clearly with Nakheel and Limitless both part of Dubai World's 'Urban Development' portfolio, it is the ailing real estate sector which is at the heart of the restructuring efforts. This naturally raises questions regarding the other real-estate development companies within "Dubai Inc."<sup>1</sup>

Our estimate of the external debt of Dubai is USD75.3bn<sup>2</sup> which is "Dubai Inc" plus private sector Dubai, equivalent to around 107% of Dubai's GDP. It does not, however, include the USD15bn borrowed by the Government of Dubai as part of its USD20bn bond program launched in early 2009<sup>3</sup>. Given this large debt stock the initial concerns have focused first on Dubai Holding which is also heavily exposed to Dubai's ailing real estate sector and ICD to a lesser extent. There are concerns that further restructuring announcements may be in the pipeline. This is exacerbated by the absence of external debt data and the absence of clear statements on the intentions of the government or the issuers themselves.

While Dubai CDS moved sharply wider on the restructuring news, direct government external debt is low consisting of 4 sukuk, only one of which is USD denominated (and therefore deliverable into sukuk CDS). In addition to this, as noted earlier the Dubai government has guaranteed debt of DEWA and lists ICD debt as direct

<sup>1</sup> Dubai Inc is the sobriquet used to describe the universe of Dubai's government related entities. Primarily it includes three major holding companies: Dubai World, Investment Corporation of Dubai (ICD) and Dubai Holding. Technically however, Dubai Holding is not a GRE as it is directly owned by the emirate's ruler Sheikh Mohammed.

<sup>2</sup> See EM Special Publication: The debt problem continues beyond Nakheel, 10 September 2009.

<sup>3</sup> We define debt on a residency basis and since this USD15bn was bought by local institutions (the UAE Central Bank and two Abu Dhabi-based banks) we define this as domestic debt. We assume all Eurobond and loans are held internationally which could result in some overstatement of external relative to domestic debt. But with no information on private bilateral debt our external debt estimates are lower bound estimates.

debt of the Dubai government. This takes direct government external debt to USD13.9bn and total Dubai government debt to USD28.9bn or 41% of GDP, based on the obligations of which we are aware. To the extent that the government looks to be ring-fencing its own balance sheet this should be positive for sovereign creditworthiness. This is also true at the Abu Dhabi and UAE level. But the problem over lack of transparency across the whole region, and a lack of coherent policy coordination for Dubai in general, would likely outweigh any benefits from improved sovereign creditworthiness.

While the restructuring is currently limited to certain parts of Dubai World, we have seen substantial ratings downgrades across the GREs in Dubai World, Dubai Holding and ICD. Entities within ICD (which are primarily banks and non-rated entities such as Emirates Group) have been the least affected with Emaar being the one exception. Moody's and S&P have announced two batches of downgrades for Dubai GREs in the past fortnight with the ratings now generally reflecting standalone credit profiles although most remain on negative outlook and therefore may face further downgrades. Only the banks remain investment grade.

**Figure 3: Summary of ratings downgrades since November 25**

	Moody's	S&P	Fitch
DIFC Investments	8	4	NR
Emaar	6	1	NR
Jebel Ali Free Zone (JAFZA)	6	5	NR
Dubai Holding COG	6	4	5
DEWA	5	NR	3
DP World	4	3	NR
Mashreqbank	2	2	-
National Bank of Dubai*	1	2	NR
Emirates Bank International	-	2	-
Dubai Islamic Bank	3	2	NR
Dubai Bank	-	NR	2
Tamweel	-	NR	3
TAIB Bank	NR	NR	2
Thor Asset Purchase Company	-	-	3

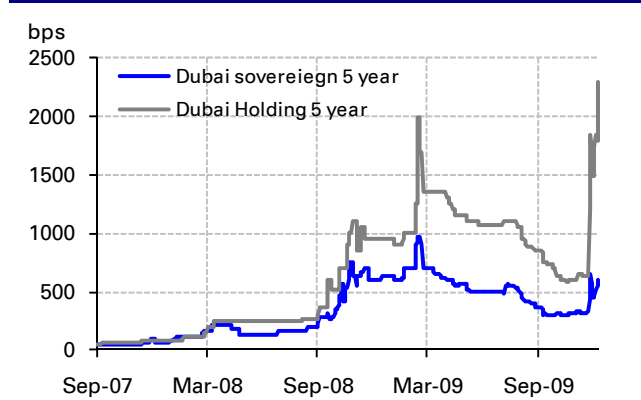
Source: Bloomberg. \*Moody's rating here refers to Emirates NBD

Moody's has announced only limited downgrades for the Dubai banks citing them as "special" because of their role in the payment system and because they are critical to the economic growth of the UAE. They estimate direct exposure of rated banks to Dubai World at 15-20% but have stated that banks are well capitalized and can cushion losses. S&P have also downgraded several the Dubai banks but, unlike the Dubai GREs they remain in investment grade territory. DIFC, Emaar, JAFZA and Dubai Holding have all seen 6-8 notch downgrades with DIFC the worst with 8 notches from S&P. While this will make it more expensive for these companies to raise financing

going forward it also raises concerns over the impact of acceleration clauses related to downgrades. This has already become evident under Thor Asset Purchase Company (a receivables securitization program by DEWA) with USD2bn now potentially coming due on December 16th. We are not aware of any other acceleration clauses in Dubai loan documentation but cannot completely rule this out.

That the companies under Dubai Holding Commercial Operations Group (DHCOG) are concentrated in real estate and hotels & leisure does not bode well for performance of the group<sup>4</sup>. CDS on Dubai Holding widened by more than any of the rest of the Dubai complex since the restructuring announcement at 1650bps although Nakheel CDS trades too infrequently to capture, and the bonds have recently traded lower than Nakheel. The ownership is different to Dubai World of ICD since this is owned by HH Sheikh Mohammed rather than the Dubai government but it is not clear to us that this distinction matters.

**Figure 4: Dubai Holding – Perceived default risk has escalated**



Source: DB Global Markets Research

In contrast to Dubai Holding, ICD holds 10 banks in its investment portfolio including Emirates NBD, the largest bank in the UAE. This suggests a systemic reason to prevent any significant liquidity problems. The UAE central bank has had a deposit guarantee in place for more than a year to ensure confidence in the system remains and has recently introduced an additional liquidity facility for the banks. ICD debt is listed as direct government debt in official documents and ICD contributes profits into the Dubai government budget. The proposed merger between the main real estate asset in ICD, Emaar, with the real estate businesses under Dubai Holding (Dubai

<sup>4</sup> DHCOG is an intermediate holding company managing Dubai Holding's commercial arm. The financial and investment arm which includes Dubai International Capital and Dubai Group is managed separately.

Properties, Sama Dubai and Tatweer) has now been rejected by Emaar's board citing a lack of economic feasibility.

The redemption profile of Dubai Holding is not as onerous as Dubai World however. For Dubai Holding, total debt is lower at USD4.6bn according to the end 2008 financials (USD2.6bn in multi-currency bonds and USD2bn in bank debt), none of which is due in 2010. Both Nakheel and Dubai Holding do however have sizeable trade payables on their balance sheets which will likely come due in the coming year. Other private obligations are possible too.

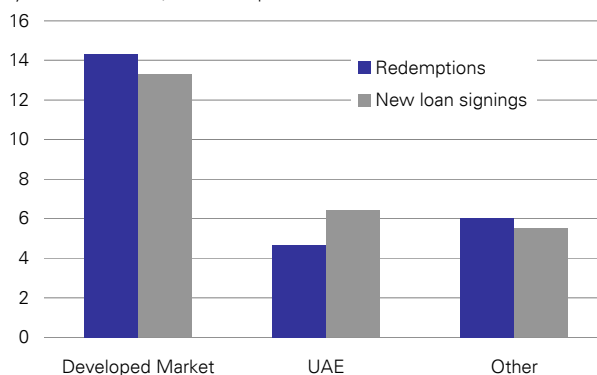
## The transparency problem

**Q1 will be key test of market access.** Even assuming that the debt restructuring is limited to what we currently know, Dubai's access to international capital markets has undoubtedly been impaired. DEWA is still discussing tapping the market in early 2010 and the USD2.5bn Borse Dubai loan redemption in mid February will also be a key test of market access. These are the only major refinancing obligations scheduled for Dubai next year (outside the USD3.3bn we know to be restructured).

As things stand, there have been no defaults on Eurobonds or syndicated loans repayments YTD in the UAE with Dubai successfully refinancing around USD16bn of the USD19.3bn coming due this year in principal repayments. Other than the USD1bn Dubai Global sukuk which matured in November the refinancing had largely been on the syndicated loan side. UAE borrowers in aggregate have been able to rollover their loan market financing, although there have certainly been some specific borrowers who were more reliant on local (often state-owned) banks for financing. Given the developments in Dubai, we would be surprised if borrowers continue to find the loan markets as accessible in 2010.

### Figure 5: UAE borrowers have been largely been able to roll over loan financing during 2009

UAE-based borrowers syndicated loan market activity in Jan-Nov 2009 by creditor location, USD bn equivalent



Source: DB Global Markets Research

To what extent the Dubai troubles will impact the ability of neighbouring Abu Dhabi or Qatar to raise financing going forward remains unclear. Abu Dhabi will face redemption of a USD2bn loan to Mubadala in April and USD2.5bn IPIC issue in June. Aldar and ADCB will also face Eurobond redemptions later in the year. Large oil and/or gas reserves mean sovereign balance sheets are assumed to be more robust but transparency is a problem across the whole region. Qatar and Abu Dhabi have been among the largest Eurobond issuers in EM this year and diversification plans under the respective development strategies suggest financing needs are likely to remain sizeable going forward. It is not clear that foreign investment will continue at the same level going forward.

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# Appendix 1

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