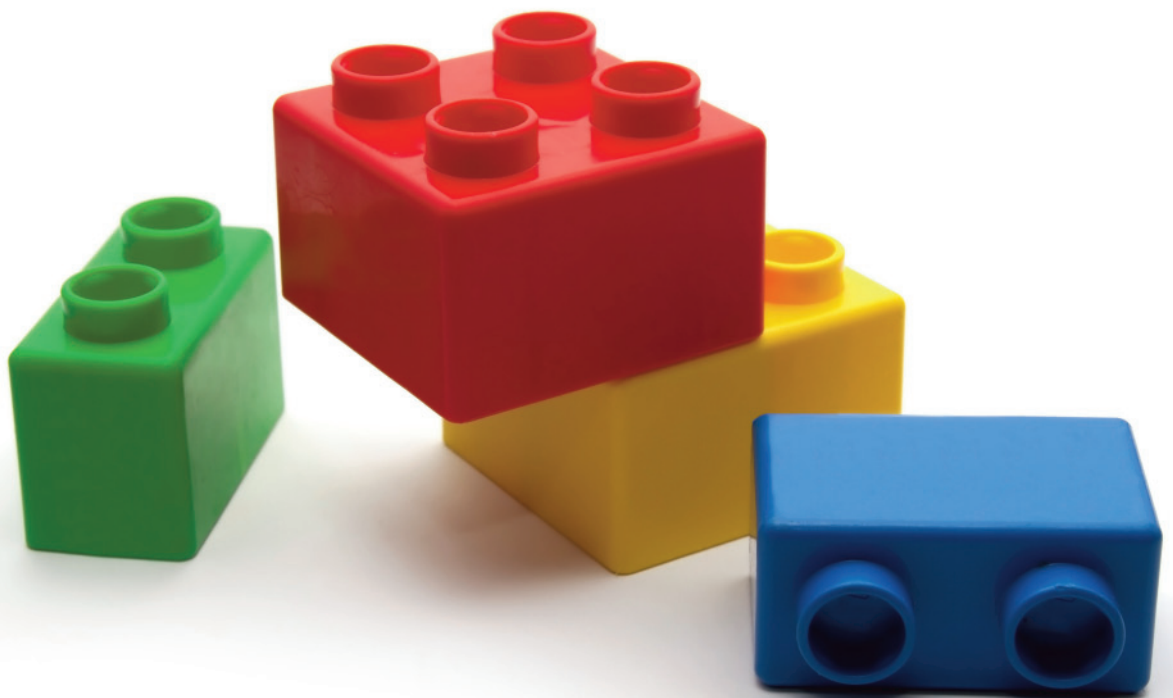


GCC powers of
construction 2010
Building the future
and growing stronger



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Executive summary



It has certainly been an interesting and challenging year. We have seen the last twelve months plagued with significant challenges in closing out suspended or canceled projects to ensure contractors were paid fairly for work done and that performance bonds were safely released as well as an inordinate amount of time being spent by management in negotiations and continuous following up to collect cash for completed or ongoing projects.

Cash resources have been stretched to the limit and contractors have been faced with two alternatives: signing a memorandum of understanding in which they agree to discounts and payment plans and thereby collect some cash and recoup most of their costs; or face arbitration proceedings coupled with huge costs and no certainty on the outcome and the length of the arbitration.

The knock-on effect has seen contractors ultimately financing the employers due to extended and renegotiated payment terms. This, in turn, has put enormous pressure on contractors who have had to negotiate extended terms with their banks, which in itself has been challenging given the overreaction to the risk associated with the construction industry.



Banks have therefore also faced this challenge and have had to balance a very delicate situation of either renegotiating terms or canceling facilities (which would have just exacerbated the already delicate economic situation).

On the up side, tenders in Abu Dhabi and Saudi Arabia have provided opportunities for contractors, although the competition is rife, with up to 12 contractors bidding for the same contracts. This has resulted in employers asking for re-tenders to drive prices even further downward; as contractors are hungry for work they have been responding to the re-tender requests in order to fill their order books and meet running costs until the markets improve.

Over the year a number of players have taken the opportunity to expand their geographical footprint in order to capture opportunities in the key markets of Abu Dhabi, Saudi Arabia and Qatar. This has contributed to the increased competition not only from players who already existed in the GCC markets but also from international players whose opportunities further afield had dried up.

All these factors are creating a distinctly advantageous employers' market, but time will tell whether these apparent "cost savings" will be at the long term cost of quality for end users.

On a positive note increasing oil prices are providing some reassuring signals in these economies. For the construction industry this means that the planned government spends on healthcare, education, power, affordable housing and infrastructure should be more realistic and achievable. The difference though when comparing these times to those of the "boom" is that the opportunities exist but decisions to award tenders and roll out development plans are not so fast. On the contrary, they could even perhaps be criticized for being too slow by eager contractors attempting to build an achievable pipeline for their stakeholders.

Over the year a number of players have taken the opportunity to expand their geographical footprint in order to capture opportunities in the key markets of Abu Dhabi, Saudi Arabia and Qatar.

This is also of course an ideal time to consolidate and realign resources, processes and work streams to maximize profitability, with a long term view to creating a well governed environment, with a focused strategy that addresses the lessons learnt and avoids the consequential risks from the past. Contractors would then be well positioned for a future IPO or bond issue when the risk appetite of investors returns and order books have returned to reassuring levels.

Cynthia Corby

UAE Construction Industry Leader

Meet the executives

Murray & Roberts on partnering successfully in the Middle East



Murray & Roberts was established in the Middle East in 1994 and in 1999 completed its first project, the iconic 7-star Burj al Arab Hotel in Dubai, which firmly established the company's reputation in the region.

Murray & Roberts chose to operate in the Middle East which, as an emerging market, offered the company the opportunity to showcase its expertise on major projects, and which is where the Company adds value and demonstrates its credentials on high end commercial buildings.

Partnering successfully in the Middle East

Over the last 16 years, Murray & Roberts has formed strategic partnerships with the Habtoor and Nass families in the United Arab Emirates (UAE) and Bahrain respectively. These relationships remain strong, bolstered in the UAE by the formation of the Habtoor Leighton Group and by the business diversity and strength of the AA Nass Group in Bahrain. In 2009, Murray & Roberts Middle East formed a strategic relationship with Saudi Oger to work together in Saudi Arabia. This is already maturing and bearing fruit with the award of two major projects in 2010, and with

the potential for significant expansion.

Choosing the right partner has been the key to our success in the Middle East and we believe it is fundamental to work with a Joint Venture partner who has appropriate experience, and is influential and well respected in their markets. The skills and experience each party brings to the Joint Venture should also be complimentary and each should have a clearly defined role based on individual strengths. These attributes we believe are the hallmarks of a successful and truly integrated Joint Venture partnership resulting in commitment to a long term relationship.

Of course any relationship you develop comes with certain challenges. The biggest challenge is often getting all parties to work together under the same framework for reporting, delivery and monitoring processes and procedures. This is an area where Murray & Roberts adds value through best-in-class practices, policies and systems in global engineering and construction. We play a vital role in the Joint Venture relationship, through implementing our well established policies and procedures and good governance practices.

The business model under which Murray & Roberts has operated since inception in the Middle East ensures that we provide key staff and intellectual property, and our partners provide the production resource (plant and labor). This model affords the company the flexibility to grow and down size with relatively little exposure, which is key in an emerging market where the environment can change rapidly.

Lessons learnt

In a market which is constantly evolving and has faced the demands of a period of immense growth and now significant downturn; I would summarize the areas for improvement as follows:

- Contracts could be drafted in a way in which they are more standardized and more equitable for both the

employer and the contractor. In the period of high demand a project was often started where the design was still under development and subject to change. Managing this change posed many challenges for the contractor including in many cases an unplanned substantial increase in the original contract value. This placed a huge burden on the contractor's cash flow as it takes time to settle the scope changes. The employer was also burdened with paying these usually unbudgeted costs.

- To avoid an adversarial relationship between the employer and the contractor, we believe it is vital to have a more clearly defined scope of work in the contract, where the design is approved and unlikely to change significantly. This will allow the costs to be better managed up front, which better manages the employer's expectations and translates into less risk for contractors. It will also allow for a better relationship between the engineer and the contractor, who can focus on delivering the approved design rather than trying to assign blame for apparent scope changes.
- Focus on creating a commercially proactive relationship with the employer. This enables the contractor to better manage the employer through regular communication, and identifying and managing any expected gaps and pitfalls which can be communicated to the employer early on. This allows all parties to better manage risk and opportunities associated with the contract.
- Creating an environment which emphasizes the importance of Health & Safety is of paramount importance to Murray & Roberts and the industry. It's an area where we continue to educate and train employees in order to ensure we minimize risks to all teams on site by creating a safe working environment. It is recognized that embracing Health, Safety, Environment and Quality throughout the Company and the Industry as a whole is our combined duty, and that each of these key elements play a central role in the success of the Industry.

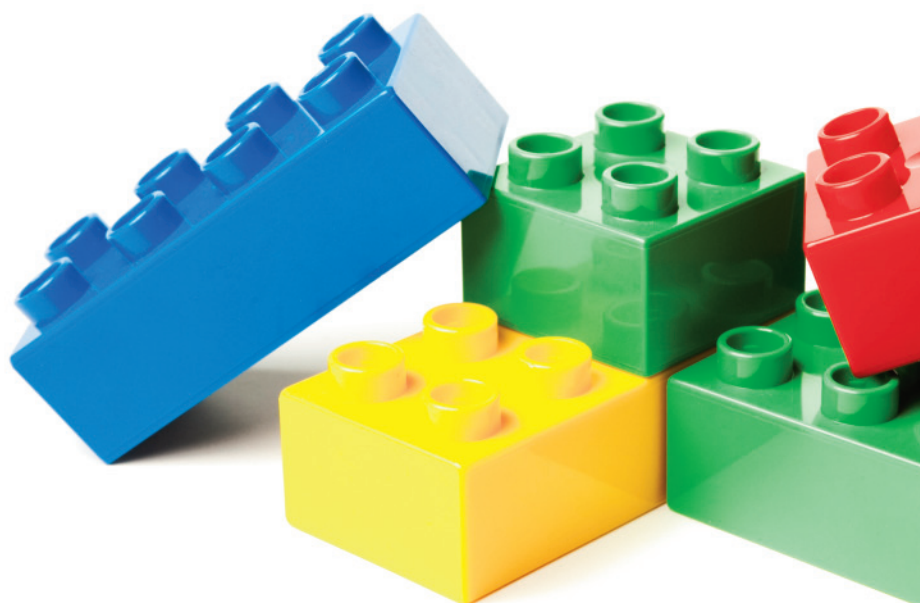
The challenges of the economic crisis

As a whole, the Middle East region has generally fared better than most global economies in 2009, with the exception of Dubai which saw its construction work brought to a comparative standstill, although there are signs of recovery in 2011 and beyond.

The liquidity crisis will continue to affect business modeling for several years to come and a short-term return to construction norms is not expected. However the local Dubai economy is buoyed by its strong brand, it's close relationship with Abu Dhabi, and its Gulf Cooperation Council (GCC) neighbors, with oil and gas prices currently at pricing levels that will support and encourage infrastructure development over time.

We believe the future opportunities will be in Abu Dhabi and the Kingdom of Saudi Arabia, which has significant investment plans to develop their infrastructure and meet their published targets. Competition in the region has continued to grow as several contractors focus on these markets to fill their order books. We have already seen evidence of this trend through an increased number of players bidding for contracts and the re-tendering of projects to drive prices down.

We continue to focus on growing our order book through our centralized Business Procurement



Department in the Middle East. This department is a key fundamental to winning new work at the right price with the right terms and conditions of contract and the right Client. It is recognized that it is at this point that the greatest risk can enter the company, so the operation and skill of this team is of paramount importance.

The current market conditions have forced us all to realign and refocus our strategies for the future. As a result of this reassessment, emphasis has been placed on effective structures that can deliver maximum efficiency and deployment of resources across a broad range of projects and the key business functions, thus driving down cost in the business. This business model also provides a platform, supporting structures and possible partnerships for Murray & Roberts Marine and into the future, other entities within the Group.

The three year outlook

After a staggering run of major project announcements in the UAE prior to 2009-10, a sense of stability has returned to the market with more realistic project timeframes and expectations. A steady flow of quality projects has sustained momentum in Abu Dhabi, despite the turbulence in global economies. Major project opportunities over the next three years will develop in Abu Dhabi and Saudi Arabia where strong government-led infrastructure growth is backed by oil revenues. As in 2009-10, conservative growth is expected in Dubai in the medium term. The Saudi Arabian market indicates many opportunities where Murray & Roberts can add substantial value along with our partner, Saudi Oger, which is a major force in the market having worked there since 1978.

The oil producing countries in the Middle East have individual price-per-barrel break-even points that draw the lines for their economy budget surpluses or deficits. This is historically a main driver for each of the GCC economies and a contraction in the oil price would

result in a construction down-turn. However, several of the countries (most notably Saudi Arabia and Abu Dhabi) have accumulated huge cash surpluses in the last three years which are now being used to drive the respective economies through the global recession. These funds have offset the construction market collapse in Dubai in particular and by focusing resources on these two regions the risk of insufficient workflow is being mitigated. Despite the current world-wide issues affecting the company, the market capacity in Abu Dhabi and Saudi Arabia is an opportunity, rather than in most other places in the world where it is a risk.

Due to its strategic location and Murray & Roberts' strong presence and history in Dubai, this will continue to be the strategic base for engaging the Middle East market. The current functional structure based in Dubai has been reshaped to meet the future needs of the market by instilling a more flexible approach led by functional responsibility across the region. We have now established ourselves over three countries in four markets namely Dubai, Abu Dhabi, Bahrain, and Saudi Arabia. This firm presence has the potential to capture substantial growth in the market and also allows for future expansion into other selected territories.

Bid competition lists have recently grown longer, fueled by an influx of international contractors from many parts of the globe seeking to replace the dips in their order books. However, market analysis indicates a reduction in the number of previously common "mega" projects across the region, due largely to the need for tighter commercial business models that are required by a project in order to provide owners with required returns on capital employed. Indeed, there has also been a perceptible change in type of the larger scale projects in infrastructure, more predominantly rail.

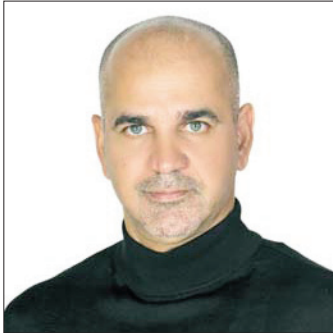
Nigel Harvey

General Manager at Murray & Roberts

The oil producing countries in the Middle East have individual price-per-barrel break-even points that draw the lines for their economy budget surpluses or deficits

Meet the executives

Al-Turki's construction sector report for the kingdom of Saudi Arabia



Overview

The construction sector in the Kingdom of Saudi Arabia (KSA) is considered the largest and fastest growing market in the Gulf region and has great potential for growth. The country shows positive macroeconomic indicators, and sustainable growth, which have led to the Kingdom's position as the safest investment and most stable market in the Gulf Cooperation Countries (GCC) region.

After a brief slowdown in activity in 1999, the construction sector has recorded consecutive positive growth rates in each year since then. The growth rate in the sector averaged 4.4% during the period 2000-2009, implying that the sector was growing faster than real GDP (which grew at 3.4% on average during the same period). The relative contribution of the sector to the whole economy averaged 6.8% during the period 2000-2008 but increased to 7.2% in 2009. During 2009, growth in the sector slowed down to 3.9% but continued to rise faster than the rest of the economy (which expanded by 0.15% in the same year).

The year 2011 is expected to witness growth of over 8% in terms of main contractor awards for the GCC countries combined.

Summary of GDP in the GCC - 2009:

Country	Budget Billions	GDP Billions	GDP Per capital	Inflation (% Change)
Qatar	Revenue: \$42.49 Expenditure: \$28.5	\$98.313	\$59.989	-4.87%
Kuwait	Revenue: \$67.67 Expenditure: \$47.86	\$98.416	\$27.835	3.95%
Oman	Revenue: \$18.75 Expenditure: \$17.86	\$46.115	\$15.996	3.54%
UAE	Revenue: \$57.70 Expenditure: \$71.87	\$223.874	\$45.615	1.21%
Bahrain	Revenue: \$46.314 Expenditure: \$6.45	\$20.589	\$19.817	2.79%
Saudi Arabia	Budget: \$158.47 Expenditure: \$158.46	\$376.23	\$14.744	5.06%

Source: International monetary fund (IMF), CIA world fact book

2009 Macroeconomic Indicators

While a significant proportion (39%) of the value of projects has been put on hold in the United Arab Emirates (UAE), the proportionate figure for Saudi Arabia is just 3%. Aside from these larger markets, growth in construction activities across the comparatively smaller countries of Qatar, Kuwait and Bahrain is expected to be steady. Qatar is likely to achieve a record growth of 48% over 2009 in terms of contracts awarded albeit on a smaller proportion compared to that of the UAE. Similar growth patterns are seen in Kuwait and Bahrain, with each experiencing decent growth of 3% and 1% respectively in 2010 despite the global economic downturn. Within the GCC construction sector, almost 67% of the total value of projects falls under the Buildings classification.

It is important to note that the Buildings classification comprises Buildings as well as Industrial projects. The proportionate percentage for Energy and Infrastructure remained at 19% and 14% respectively across all countries in the GCC in 2010.

The Kingdom has 687 current projects, 22% of which are in the execution phase, that are valued at approximately SAR2,707 billion (USD722 billion). Construction projects hold the largest share in terms of volume and value. Contracts awarded in 2010 and 2011 are forecast to reach USD64 billion and USD86 billion, respectively.

Movements in NCB Construction Contracts Index January 2008 to June 2010



Source: MEED, SES, NCB Construction contracts index Q2

NCB Construction Contracts Index in Saudi Arabia

The NCB Construction Index begins with January 2008 as its base year. The base year is assigned an index score of 100 points and the index is also measured on a six-month moving average. Therefore, scores furthest from the average are designed to have a reduced effect on the calculation of the index. In general, an index score

that is higher than the base year of 100 reflects the expansion of awarded construction contracts while any value below the base year reflects a contraction.

Value of Contracts Awarded in Saudi Arabia

Trailing Twelve Months (2009-2010)	Jul 2009	Aug	Sep	Oct	Nov	Dec	Jan 2010	Feb	Mar	Apr	May	Jun
Contract Awards Value (SR Millions)	65,985	4,281	12,478	16,409	2,469	4,731	4,483	2,929	1,376	3,406	6,748	14,003

Source: NCB Construction Contracts Index Q2 - 2010

Value of Contracts Awarded in Saudi Arabia

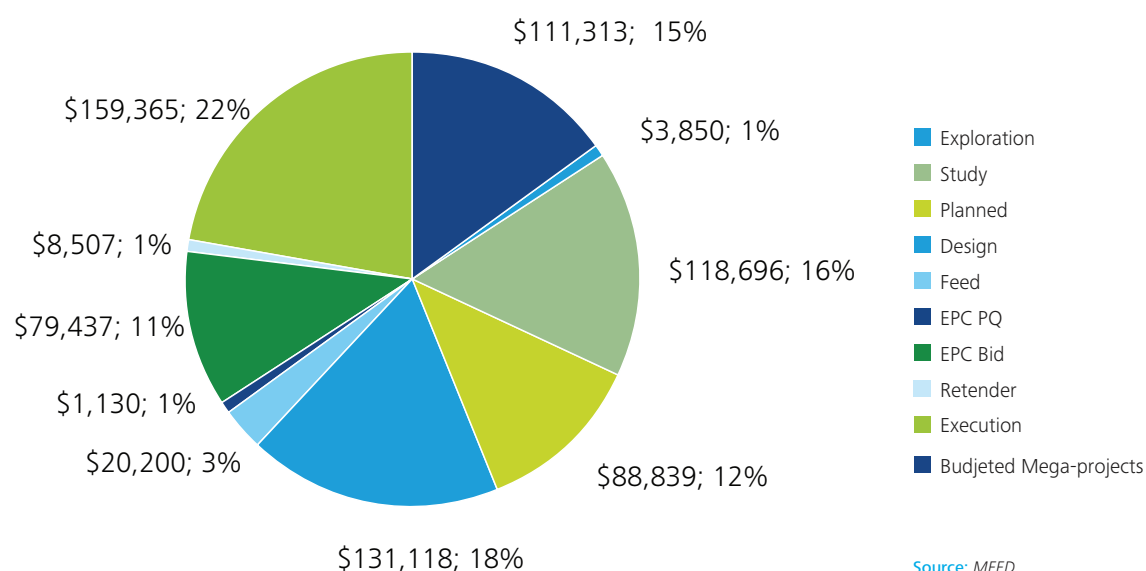
The fast population growth is expected to continue fueling demand for housing at a rate that will result in almost 1.5 million residential units needed over the next five years. Roughly 56,000 building permits were issued in 2007, accounting for 73 million square meters of floor area.

Assuming an average construction cost of SAR2,000 per square meter of floor area, the building permits issued in 2007 would potentially generate a combined construction expenditure of SAR146 billion. This was likely to be incurred between 2009 and 2011.

Saudi Arabia Projects Analysis

The following graphs and tables elaborate the current status of projects in Saudi Arabia. The projects included in the analysis have a timeframe ranging up to approximately 12 years from now. Most of the projects in the various stages will be completed within five to seven years. However there are certain budgets of mega-projects that have not been phased or announced into specific sub-mega projects.

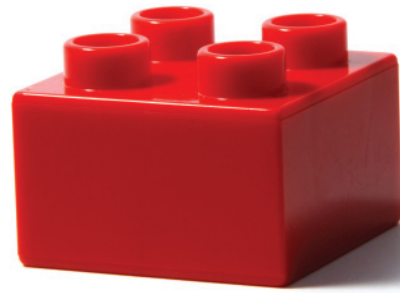
Value of key Projects by Status in Saudi Arabia - US\$ million



Summary Sheet for Value of Projects in Saudi Arabia - US\$ million

Sector	Total	Exploration	Study	Planned	Design
Construction	364,090	-	35,200	43,616	98,768
Fertilizer	1,865	-	-	-	-
Gas processing	8,951	-	-	-	-
Industrial	2,772	-	1,370	250	-
Infrastructure	82,102	-	2,885	6,300	32,350
Metal	23,139	-	13,000	2,700	-
Mining	23,139	-	13,000	2,700	-
Oil/Gas Production	29,072	3,850	5,100	2,000	-
Petrochemicals	54,857	-	21,291	2,050	-
Pipeline	7,649	-	-	-	-
Power	79,386	-	14,250	24,223	-
Refining	30,888	-	8,000	2,000	-
Water and Waste	14,545	-	4,600	3,000	-
Total	722,455	3,850	118,696	88,839	131,118

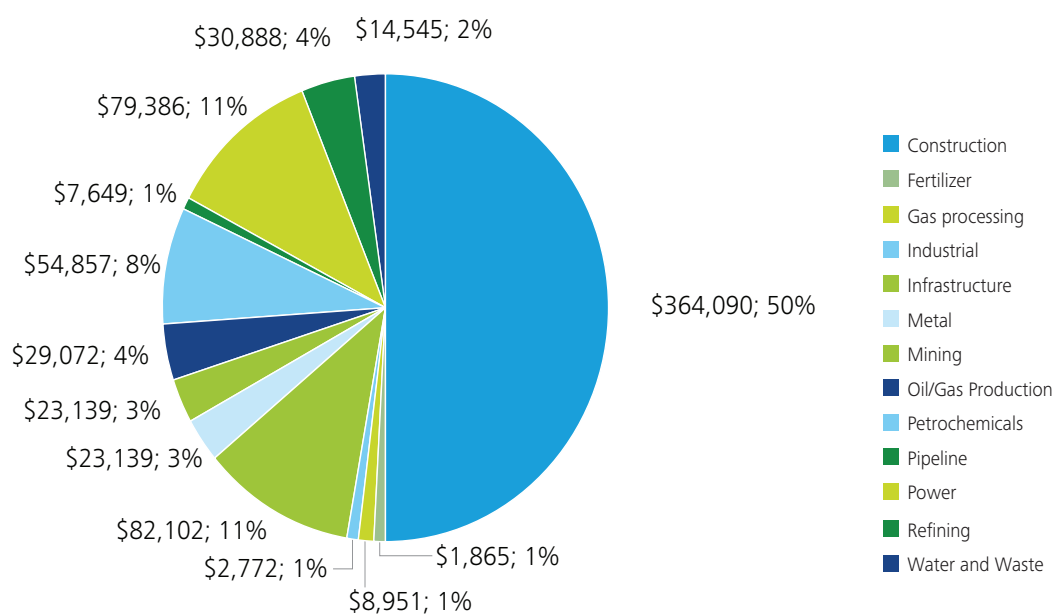
Source: MEED



FEED	EPC PQ	EPC Bid	Retender	Execution	Budgeted Megaprojects
-	-	27,257	-	53,542	105,707
-	-	500	-	1,365	-
-	700	2,000	4,040	-	2,211
-	-	100	-	1,052	-
-	-	20,840	266	18,911	550
-	-	5,000	-	2,439	-
-	-	5,000	-	2,439	-
-	-	3,900	-	11,727	2,495
17,050	-	4,300	-	9,816	350
1,150	-	450	-	6,049	-
-	80	7,390	4,000	29,443	-
2,000	350	350	-	18,188	-
-	-	2,350	201	4,394	-
20,200	1,130	79,437	8,507	159,365	111,313

Value of key projects by sector in Saudi Arabia - US\$ million

Source: MEED



Major current projects in Saudi Arabia

Project Type	Project Name and Budget
High-rise Building	King Abdullah Financial District (KAFD)
	ITCC (\$1,000m)
	Kingdom Tower (\$1,500m)
	Lamar Tower (\$533m)
	Rajhi Tower (\$500m)
	Al Faisaliah Tower 2 (\$400m)
	Kingdom Jewel Centre
	Jeddah Hills (\$11,200m)
	Jeddah Gate (\$1,600m)
	Samba Tower

Industrial, Economic Cities and Mega-projects	King Abdullah Financial District (\$8,200m)
	King Abdullah Economic City KAEC (\$27,000m)
	Jubail Industrial City (\$1,200m)
	Taif industrial City
	Sudair Industrial City (\$14,000m)
	Ras Al Zour Industrial (\$450m)
	Madinah Knowledge Economic City KEC (\$6,000m)
	Prince Abdulaziz bin Mosaed Economic City (\$8,000m)
	Jizan Economic City (\$3,500m)
Power	KAPSARC (\$2,000)
	Yanbu Power Plant Phase 3 (\$2,000m)
	Yanbu power plant II (\$1,333m)
	Qurayyah IPP (\$2,200m)
	Deba IPP
	Ras AlZoor IPP (\$4,500m)
	Al Shuqaiq – BOOT (\$1,200m)
Railway	AlShuaiba IPP (\$3,000m)
	Haramain High-Speed Rail Network (\$5,300m)
	Riyadh Light Rail (\$3,000m)
	Makkah Light rail network (\$5,400m)
	KAFD Monorail system (\$241m)
	Madinah Monorail
	Jeddah Monorail
	GCC Railway Network (\$15,500m)
	Saudi Land Bridge (\$7,000m)
	North South Rail project
	Khamis Mushyat, Jizan rail project
Water and Waste	Princess Noora Bint Abdulaziz University Riyadh metro system (\$1,000m)
	Riyadh - Alkharj expansions – BOO (200.000m3/day)
	Riyadh - Hayer Phase 1 - Concession (400,000m3/day)
	Riyadh - Hayer phase 2 – BOO (400,000 to 800,000 m3/day)
	Riyadh Drainage (\$2,900m)
	Yanbu Desalination plant (\$2,000m)
	Jeddah Khumra and Airport2 – BOO
Refineries and Petrochemical	Ras Al Zour IWPP (\$5,500m)
	Yanbu Integrated Refinery & Petrochemicals Complex (\$20,000m)
	Petro Rabigh Ethane cracker expansion (\$2,000)
	Petro Rabigh Rabigh Aromatics expansion (\$2,000m)
	SATORP Jubail Refinery
	Aramco Jizan Refinery (\$7,000m)
	Ras al Zour Topping Refinery (\$2,000m)
Construction	Jubail new petrochemical complex (\$10,000m)
	Affordable housing - 1.5million units by 2015
	Nora University (over \$ 11 billion)
	King Abdullah Sports City KASC (\$4,000m)
	Energy City (\$1,300m)
	Jebal Omar (\$1,500m)
	King AbdulAziz International Airport KAIA (\$2,500m)
	Ras Al Zour Resource City (\$25,000m)
	King Abdulaziz Centre for Knowledge and Culture (\$533m)
	Al-Uqair Tourism Development (\$10,000m)
	Madina airport expansion – BOT (\$1,500m)
	Riyadh Multi-Purpose Scheme (\$7,000m)
	Al-Shamiyah Mecca Development (\$9,300m)
	Riyadh Ajmakan development (\$6,200m)
	Metropolitan Development Strategy for Arriyadh (\$5,000m)
	KAEC – The world Academy (\$47,000m)
	Sagia investment in 5 logistic centers
Infrastructure	19 waterfronts development infrastructure work on red sea
	Taif airport development (\$100m)
	Jizan King Abdullah bin Abdulaziz airport
	Riyadh Strategic reservoir (around 2.5million m3)
	Jeddah Strategic reservoir (around 6 million m3)
	Jubail Waterfront (\$365m)
	Yanbu waterfront (\$220m)
	Sudair Industrial City: Infrastructure Works (\$14,000m)
	Multiple road networks (\$1770m)
	King Fahd causeway expansion (\$1,036m)
	Improvement of Traffic Flow Around Jeddah Islamic Port (\$1,000m)
	King Abdulaziz port expansion – BOT (\$1,333)
	Asir tourism projects (\$1,100m)
	New Port in Laith Makkah province
	King Abdullah Tunnel in Taif (\$550m)

Challenges

Emerging markets are more volatile than developed markets. Thus, doing business in emerging markets like the GCC rarely succeeds if it is short term in nature. Furthermore, market study and data collection are usually unreliable, vague and hard to find. Changing construction dynamics requires a diverse and innovative approach to the market, projects and services.

In Saudi Arabia there are low barriers of entry in the market leading to increasing competition with new entrants especially from China and Korea. Nonetheless, market intelligence and networking is vital as well as understanding government networks, policies and legislative changes.

Banks are being more conservative with lending and credit facilities. Bank lending to the construction sector has dried up as banks felt overexposed after five years of heavy lending. In 2009 bank credit to the sector fell by 17.7% to SAR44.7 billion. However, a 7.8% quarter on quarter rise in bank lending to the sector in 1Q 2010 indicates that confidence in the sector is returning.

The Saudi market is facing special challenges regarding Saudization, approval of the mortgage law and FIDIC implementation, all of which will impact the construction sector.

Brand building, improving the functions of marketing and PR, focusing on strategic partnerships and niche opportunities are key factors for success in the construction industry in the GCC and in the Saudi market in particular.

Trends

A new wave of government investment in Saudi Arabia has increased the construction sector's annual growth rate to 4.7% in 2009 and it is expected to grow even faster at 6.4% in 2010. Although growing in absolute terms, the rate of expenditure expansion in construction, measured by Gross Fixed Capital Formation (GFCF), decelerated over 2009 due to lengthy bidding processes and the retendering of contracts. The GFCF is expected to continue rising with residential building expenditure growing at a faster rate in 2009 and 2010 as the Kingdom's housing problem is addressed.

Demand for building materials, such as cement and steel, contracted in 2008 in line with declining

construction sector activity. There were also decreases in their prices, leading to the retendering of contracts. However, consumption of steel and cement is expected to rise by roughly 8.5% and 22% respectively in 2010, reaching 6.4 and 44.8 million tones.

Building partnerships with international technology providers and EPC contractors (Engineering, Procurement, Construction) as well as signing agreements with Business Development entities in different strategic countries are major trends in the Saudi market among the main contracting firms for prequalifying for the strategic potential governmental and semi-governmental projects.

Supply chain control and strengthening global procurement capabilities gave a strong edge to Saudi contractors in building their competitive bids. Horizontal/vertical growth and integration helped local groups to survive and manage the global economic crisis impact on the GCC countries.

Consolidation

The consolidation of small and medium size contractors and construction industry players helped them to participate in bigger tenders and obtain bank facilities and guarantees. This trend was supported by key project owners in Saudi Arabia to mitigate the monopoly of leading local contractors and international EPCs.

Opportunities

Some of the major opportunities in the GCC, especially in Saudi Arabia include:

- KSA 9th 5 year plan
- PPP opportunities based on BOT, BOO, BOOT for IPP, IWPP, WWTP, WTP, WDP, Airport projects.
- Renewable and sustainable energy
- Green and sustainable buildings
- Waste management projects
- Environmental studies and projects
- Smart buildings
- Waterfront on the Red Sea
- Industrial cities, Economic cities and participating in Sagia investment projects
- Mega infrastructure petrochemical and refinery projects mentioned earlier in the report
- Affordable housing sector
- Possibility of spreading footprint geographically in GCC

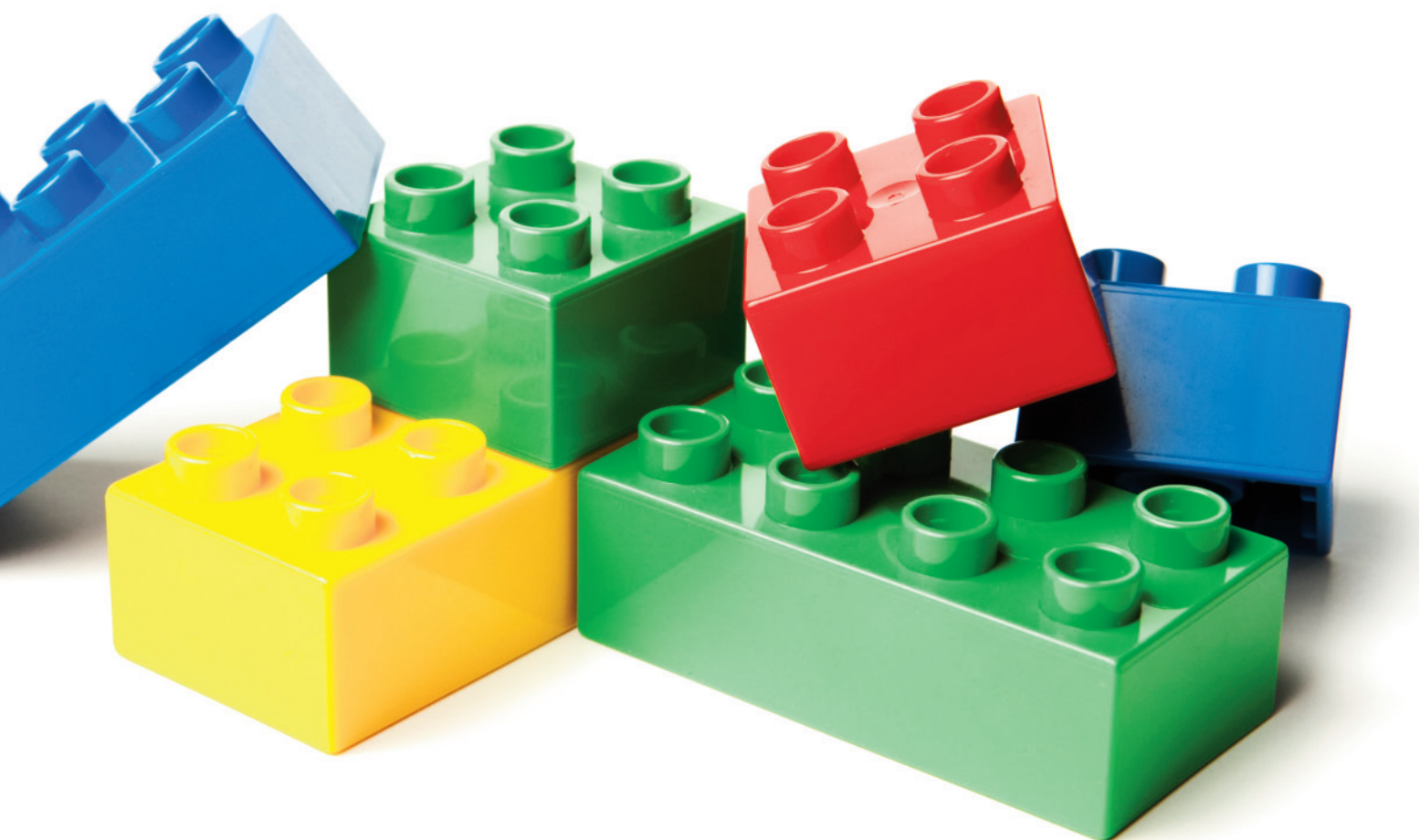
Majidi Kayyat

VP construction at Al-Turki Group

Special development projects related to the policy and strategy of each GCC country, such as in sports, education, airports, ports, tourism, and services, helped the growth of the construction sector and the attraction of investment

Setting up business in Saudi Arabia

The frequently asked questions



Establishing operations in Saudi Arabia

Despite the downturn in the construction industry which affected the globe in general and the Gulf Cooperation Council (GCC) countries in particular, Saudi Arabia still stands as the largest construction market in the whole of the Middle East with multi-billion dollar projects under way and many more in the planning stage by both the public and private sectors. This has attracted foreign investors who are considering establishing companies, or joint ventures with local companies to

capitalize on the opportunity to participate in these multi-billion dollar projects, currently valued at around \$35 billion. Consequently we are being approached by several clients and contacts for advice regarding setting up business in Saudi Arabia.

We have sought to summarize below some of the key considerations and areas that need to be addressed for stakeholders setting up in the Kingdom.

Foreign investment

Foreign investment incentives and restrictions

The Foreign Investment Act (FIA), established a broad framework within which non-Saudis are permitted to invest in the Kingdom in minority, majority or 100%-foreign-owned ventures, as well as clarifying the issue of where in the economy foreigners may invest.

The present negative list includes oil exploration, drilling and production; real-estate brokerage; and land and air transport.

The FIA undertakes to provide equal treatment for non-Saudi firms, stating that a foreign venture “shall enjoy all the benefits, incentives and guarantees enjoyed by a national project”. The FIA includes guarantees on the free repatriation of profits and capital, and it provides a clause that foreign-owned assets may be expropriated only in exceptional circumstances, in return for full compensation. It offers the right to buy property and allows ventures to sponsor their own employees.

The FIA also, importantly, established the Saudi Arabian General Investment Authority (SAGIA), an entity with sole responsibility for approving foreign-investment projects. This includes a mandate to regulate the investments made by foreign entities to ensure consistency with national interests. The SAGIA also has responsibility for developing more detailed legislation to flesh out the framework established by the FIA. But the SAGIA’s primary goal is to facilitate and encourage investment (both local and foreign) wherever possible.

The SAGIA’s Investors Service Centre (ISC) serves as a one-stop shop to facilitate the investment process for foreign companies, minimizing the number of bureaucratic steps required before investment can take place.

There are a series of labor regulations that require foreign companies operating in the Kingdom to employ and train Saudi nationals; this trend will remain the continuing drive for the “Saudization” of the private sector. All investment schemes must show that they meet requirements on employing and training Saudi nationals.

Exchange controls

The government is committed to maintaining the free convertibility of the riyal. There are thus no significant restrictions on the inward or outward movement of funds by companies or individuals. Transfer operations are increasingly sophisticated and rapid, although occasional constraints on working hours or working days may cause a delay of one or two days in implementing orders.

Although there are no restrictions, the Saudi Arabian Monetary Authority (SAMA—the Central Bank) closely monitors foreign-exchange transactions to deter speculation, fraud and money-laundering. Banks must report the export of riyal bank notes to SAMA and gain approval prior to the participation of foreign banks in riyal-denominated syndicated loans or foreign-currency syndicated transactions arranged for non-residents. SAMA has shown considerable flexibility in its approach to such arrangements, and has co-operated speedily with the vast majority of transactions.

Choice of business entity

Principal forms of doing business

The Regulations for Companies govern company formation and operation. The eight possible forms of business organization are the general partnership, limited partnership, partnership limited by shares, limited-liability partnership, company with variable capital, joint-stock company, co-operative company and joint-venture company.

Setting up a company

The most frequently used forms of organization are the limited-liability partnership (or company) and the joint-stock company. In practice, the limited-liability company is the most appropriate form of incorporation available to foreign investors.

The Saudi Arabian limited-liability company resembles the French société à responsabilité limitée (SARL) and the German Gesellschaft mit beschränkter Haftung (GmbH). The company is established by applying to the Saudi Arabian General Investment Authority, followed by the preparation of articles of association, which should be signed before a notary public by all of the partners or their attorneys. The articles are filed with the Ministry of Commerce and Industry, and a summary is published in Umm al-Qura (the official gazette) and in commercial and company registries. Detailed information about company registration and licensing can be obtained from SAGIA (*website www.sagia.gov.sa*)

A company with a foreign shareholder usually provides in its articles for the appointment of a board of directors, with powers defined in the articles or by resolution. The board normally appoints a chairman and a general manager with responsibility for day-to-day management; the powers of both are set forth in the articles or in board resolutions. The foreign investor typically appoints the general manager; the Saudi shareholder serves as chairman.

Overview

Like most other states in the Gulf Cooperation Council (GCC), Saudi Arabia levies corporate income tax on foreign companies but not local firms, which are subject only to a nominal religious tax called Zakat (alms-giving). If a company is a joint venture between a Saudi and a foreign party, the portion of taxable income attributable to the foreign party is subject to income tax and that to the Saudi party to zakat.

The corporate tax rates for foreign companies in the Kingdom of Saudi Arabia is a flat 20%, effective for accounting years commencing on or after July 30th 2004. The tax structure offers some benefits to companies choosing to invest in limited-liability or joint-stock companies in Saudi Arabia. Such companies are free to establish branches throughout the Kingdom and need

file only one combined return, provided they are branches of only one legal entity. The tax office often scrutinizes the reported expenses and charges of a branch.

The general tax burden of a Saudi entity owned by foreign companies

The share of taxable profit owned by the non-Saudi shareholder will be subject to 20% corporate income tax in addition to 5% withholding tax applicable on the distribution of dividends to the non-resident shareholder. However, the Saudi partner will be subject to zakat, a fixed-rate tax of 2.5% levied on the higher of taxable income or what is sometime referred to as the "balance sheet" basis. A simple calculation of the balance sheet basis includes shareholder equity plus long term liabilities less fixed assets.

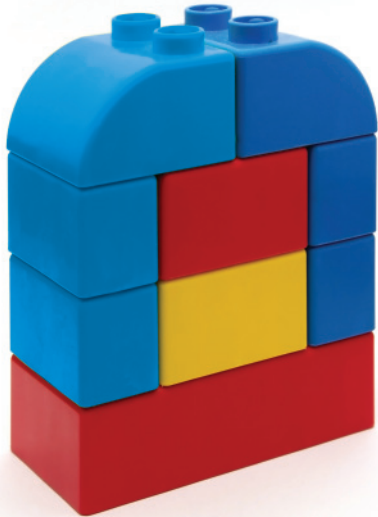
Tax returns must be submitted within 120 days of the year end. If the taxpayer's taxable income before expenses exceeds SR 1 million, the tax return must be certified by a licensed certified accountant.

Foreign income and tax treaties

In addition to the France double-tax treaty, the Kingdom of Saudi Arabia has already signed treaties with China, India, Pakistan, Malaysia, Austria and Italy, although some of these treaties are not yet in force. Negotiations are currently in progress for treaties with the United Kingdom, Germany, Netherlands, South Africa, Bangladesh and Russia. However, in certain countries such as the United States of America and United Kingdom etc., tax credits may be available for tax paid/levied in the Kingdom of Saudi Arabia.

Zakat

Zakat is payable by the Saudi (and GCC national) shareholder in his share of the Zakat base in the company. The rate is 2.5% and is calculated on the higher of the Saudi's share in the adjusted net income or his share in the "balance sheet" basis.



In conclusion, Saudi Arabia has recently been attracting more foreign investment by enacting more relaxed foreign investment laws

Turnover and other indirect taxes and duties

There are no sales or consumption taxes or stamp duties in Saudi Arabia.

This has attracted a number of regional players who have started to set up business in the Saudi Arabian construction market; as these companies are currently experiencing a slowdown in other parts of the Middle East or globally, they are now considering Saudi Arabia as a key strategic market for their future success.

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IPO readiness in the construction sector

It is essential that you are ready for the capital markets when the time is right, otherwise the window of opportunity may be missed. That means starting to prepare now...

Looking back a few years, with global demand booming, businesses across almost all sectors (including construction) were experiencing high growth. With the cost of borrowing at an all time low and a high level of liquidity in the capital markets, businesses were keen to capitalize on this opportunity. As a result this period saw a record number of businesses undertaking Initial Public Offerings (IPO).

The global economic downturn of more recent years had a dual impact on construction companies considering IPOs. First of all, it negatively impacted their pipeline of projects, hence their business outlook and valuations were likewise negatively impacted; secondly with liquidity drying up in the capital markets, even the stronger performing businesses struggled to generate interest as investors became risk averse – resulting in most companies being forced to shelve their IPO plans.

However, in every situation—even challenging ones—there is opportunity. In the Gulf Cooperation Council (GCC) and surrounding countries, the success that was achieved pre-crisis in the construction industry has been commonly acknowledged to be the result of a commitment to investment in infrastructure. Rooted primarily in financial commitments at the government level, this spending provides the foundation for development in industry, commercial services, and

tangential requirements for elements such as real estate and job creation. Companies that target these government programs effectively can target a robust pipeline and leverage capital that can be raised through a public offering to further capitalize on the planned construction spend in the region, which is projected to be in excess of USD 1 trillion dollars.

As a result, more recently the GCC capital markets have started showing signs of recovery with companies and their advisors now reconsidering the opportunity to list.

In such an environment, it is vital that management and shareholders are fully prepared to take advantage of the equity markets when the opportunity arises.

Advanced planning for an IPO can take up to 18 months, depending on the existing readiness of the business. In the construction sector, with multi-year contracts that require an effective procurement strategy, and the requirement for bid bonds and performance guarantees, there are a number of factors that must be considered before planning to list. History has shown that a number of IPOs are delayed-or even fail-because a company underestimated the amount of work required to prepare itself for the demands that would be placed on it, in the process of going public.

At best, a delay will result in the company incurring higher costs; at worst, the window of opportunity will have been missed altogether. That is why proper planning for an IPO not only pays dividends; it is an essential part of being ready for the inevitable change to your business that going public demands.



To be or not to be?

Going public represents a critical turning point for a business.

Properly evaluating and considering the requirements, processes, and pros and cons involved in filing an IPO is an important step in determining the course for your company. While public ownership offers significant advantages, such as improved access to capital, an enhanced financial position, and greater ability to raise equity, it also introduces new risks, including heightened market scrutiny, regulator oversight, decreased control, and greater management demands—all of which need to be properly understood and managed.

With regards to construction entities, requirements for transparent procurement strategy and periodic disclosure for government or public sector contracts needs to be considered before proceeding with listing. The risk of not adhering to the monitoring and reporting requirements can lead to significant penalties. Some companies continue to rebound after experiencing challenges resulting from these reporting requirements.

Are you ready to take the plunge?

The prospect of going public is an exciting moment for a company—and one that is accompanied by a host of questions on how best to proceed: What are the leading practices for managing the complex process of becoming a public company? Are your current commercial and operational functions in line with best practice, which will undoubtedly be mandated by your new shareholders? Where are the necessary internal resources and external advisors found? Who co-ordinates them? Or even: Is going public worth the effort?

Key areas for consideration

Some of the main areas that shareholders/management need to think about are set out below:



Strategy and investor story

The shareholders/management should ensure that the strategy used by a business to date would still be relevant for a public company, and, where needed, develop a clearly articulated business strategy which can be presented to investors in a compelling manner. Although your Sponsor or Lead advisor will provide guidance in this area, it is important for management to have considered the motivations for listing; whether it is to fund acquisition, organic growth or to refinance.

In all the excitement of the listing, it is easy to overlook the post listing considerations around running the business. It is important for management to have a clear vision for the future of the business as a public company.

Corporate and tax structure

What has served a business well as a private company may be inadequate or inappropriate for a public company, as far as corporate and tax structure is concerned. It is critical to use the right corporate vehicle for IPO, so that it is attractive to investors both from a control aspect as well as tax efficiency, which also needs to be addressed before coming to market. If there are non-core activities that need to be transferred or disposed of in order to maximize value for the proposed

listed entity, there might be carve-out issues that may impact the financial reporting, operational and cost base of the listing group.

Corporate governance

Management often do not consider the requirements for embedding a sound and credible corporate governance framework early in the IPO process, resulting in a possible delay in the timetable or higher costs of implementing a framework on a tight timeframe.

Many regulators provide additional requirements/guidance on corporate governance structures for listed entities, such as the Governance Rules and Corporate Discipline Standards issued by the Securities and Commodities Authority in the UAE, which emphasizes transparency, fairness and management accountability. The recommendations would include, among other things, board composition, the establishment of independent audit committees, risk management and reporting, internal audit, and requirements on reporting on the internal control environment to the shareholders in the annual report. Such practices may not be typical in most privately held construction entities, and therefore may require significant additional time and effort to comply with and instill into the company's culture.

Board composition and senior management

Family run businesses usually have family members on the board and within senior management. Whilst this arrangement is acceptable for a private business, the experience and skills of the existing board members and senior management should be considered against those expected of a public company board. There may also be regulatory requirements (or industry best practice guidelines) concerning the composition of the board, such as a requirement to have a balance of executive and non-executive directors present.

Going public exposes the business and its management to additional scrutiny from any independent non-executive directors, who are required to look after the interests of all shareholders.

Incentivization and remuneration

An important area for public companies to consider involves management incentive schemes which are used to align the objectives of employees and those of shareholders. The board should consider whether any existing incentive arrangements are appropriate for a listed company and if there are any tax implications of such arrangements at both a corporate and individual level.

Historical financial information

Management might seek to list on a capital market that requires reporting under a different financial reporting GAAP to that currently followed by the company. If this is the case, a conversion exercise needs to be undertaken to ensure that the historical financial information (as well as existing and future financial information) conforms with the rules of the market being targeted.

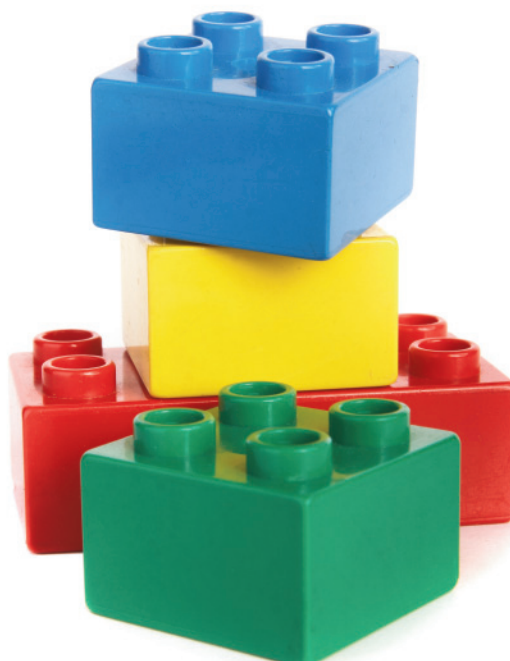
Financial reporting

Financial reporting requirements for a listed company can be far more arduous than the methods adopted by a private company. For example, under International Financial Reporting Standards, there are additional disclosure requirements such as operating segment information and earnings per share, which are required disclosures for listed entities. Not only will this enhanced level of financial reporting be required from the point of listing, but this information will largely be expected retrospectively for the purpose of preparing both the financial reports and prospectus.

Once a company is listed, there are also enhanced financial reporting requirements to adhere to and consider, depending on the target market. The Saudi Stock Exchange (Tadawul) for example, requires quarterly financial information 15 days post quarter end, and annual audited financial information 40 days post year end. These tight timeframes can be difficult to achieve if an entity does not have a strict internal control environment and is not accustomed to preparing their cost to complete and percentage of completion calculations in such a timely manner post quarter/year end.

Areas that can become show-stoppers include:

- Internal controls and procedures not being up to the standard required of a listed company.
- Capacity of the IT system to fulfill the requirements of a listed company and of the future growth expected in your company's strategy within a relatively short timeframe in order to comply with regulatory requirements.
- Inadequate process to identify, monitor and reduce risks to the business.



Tax

The tax requirements for a company can change post listing and it is essential to be aware of any potential changes to the way the group will be taxed. Additionally, with potential non-GCC investors it will be important to understand whether there may be additional withholding tax deducted from payments to such shareholders which will affect their return on investment and potentially, therefore, their willingness to invest. Specific points to ensure you have considered include:

- Will the group experience any change to the corporate tax or zakat regime of the company post IPO?
- Have you ensured that you have sought to minimize any tax leakage in respect of the investment structure?
- Are there any tax implications on disposal or carve-out in respect of pre-IPO structuring such as capital gains or capital duties? In respect of construction and real estate, asset gains can be imposed even where shares of the company which owns the property are disposed of and not the property itself;
- Are your tax compliance affairs up to date and are there any ongoing disputes with the tax authority? Investors will need to understand the tax position in this respect and weigh up any potential exposures against their investment;
- Have you considered using the IPO as an opportunity to ensure that you have sought to minimize tax leakage and tax inefficiencies within your operating group structure?

Possible issues faced by unprepared companies

- Companies often lack the resources required to collate and prepare the necessary documentation when an IPO has not been adequately planned and prepared. The sheer volume of information required including commercial, legal and financial requests can be considerable and may take a significant amount of time for the company to gather as staff try to fit this in around their day jobs.
- Systems that support effective operations and reporting need to be in place and functioning in a trusted and reliable manner over a consistent period of time.
- The company may not have the in-house knowledge and/or experience to foresee issues at the early stages of the IPO preparation. These can eventually cause delays to the timetable and/or an inefficient, more expensive process.

Effective planning within the company is critical to the success of an IPO

- The company along with their lead manager and key advisors must determine an appropriate timetable reflecting both market conditions and company readiness.
- Selecting the right advisors who understand the company's core business is very important as they will be able to help management to take the business to the next level.
- Structuring the transaction should be done effectively to maximize benefits and reach management's strategic goals.
- Assigning responsibilities for the IPO work streams within the company needs to take place.
- Key roadblocks should be identified.
- Industry best practice processes, systems and strategies should be implemented to enable the company to operate on the same level as other publicly listed and high performing privately held companies in the industry.

Where to from here?

As capital markets in the GCC show signs of recovery, companies aspiring to list can increase their chances of a successful and efficient IPO by undertaking a readiness assessment. As they look to the future, the region's governments will continue to commit spend to construction, providing the opportunity for revenue for construction companies in the region. The key for these companies is to seek the right contracts, have the optimum bidding bandwidth, and seriously consider future reporting requirements. Only in this context should companies operating in the construction sector pursue listing their companies seeking capital that can enhance their business capabilities in the future. As every business is different, it requires a unique set of solutions to address any gaps that might exist. The sooner management can bring the necessary resources and expertise to bear, the higher the likelihood of management taking advantage of the opportunity when market conditions are right to IPO.

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The tax requirements for a company can change post listing and it is essential to be aware of any potential changes to the way the group will be taxed

Regional restructuring

Is it just a very expensive lesson learned, or can participants in the region capitalize and prosper?

Regional Restructuring—is it just a very expensive lesson learned, or can participants in the region capitalize and prosper?

The much maligned impact of the global financial crisis has deeply affected some locales and sectors, and been less extreme in others. But no locale has come away completely unscathed, and this is particularly true in the Gulf Cooperation Council (GCC) region. For some countries, 30% of their budgets are allocated for infrastructure spend - and this will continue. However, for many of the massively ambitious projects that were planned, it has become readily apparent that they are no longer viable. And many of the entities that would be part of the mechanism for turning capital that was once readily available into assets—the contractors, subcontractors, suppliers, consultants—have been badly impacted by the current market conditions. For example, some invested in support functions for their projects across the region such as labor camps and also increased internal resources to support their contracts already in hand. When many of the commercial projects went on hold or were terminated, many of the costs expended to date, which were used to maximize profit over a longer duration by contracts, unfortunately will not be realized.

Many other contractors have worked on projects that were completed or close to being completed have not been fully compensated, and therefore they may have lost leverage for payments that had not yet been received. Furthermore, because they required ongoing capital to pay their subcontractors to continue work on

site, many of these contractors and subcontractors have overdrawn their credit facilities to the point that they cannot utilize any 'new cash' received to utilize on their projects going forward. As one can imagine, this further prevents these same contractors from bidding on new projects if they are unable to acquire performance bonds from banks. Also, the slim likelihood of claims that have been submitted and massive cost overruns getting resolved in the short term will further limit their ability to pursue new work, even if it is in line with their commercial objectives and their core expertise.

The basis for a successful project on a micro level is effective sharing of project risk and in many cases asset ownership. On a macro level, the recent restructuring of businesses in the region has shown the need for governments to reduce bottlenecks in terms of the legal and regulatory framework, in order to adequately support the region's long term growth. However, just as we have seen some landmark projects being successfully delivered regionally, we have also seen many fail and business partnerships unravel when the business plan or strategy was not adhered to, and when previously mutually accepted interests became unaligned. What are the key lessons we should learn from this restructuring process?

A fear of the "truth"

Many participants in the construction industry were slow to accept—and therefore react—to the shortage of liquidity and acknowledgement of the reliance on debt to complete projects. This resulted in situations in which, for example, contractors continued work on site with massive amounts due for payment not confirmed.

A moving target

Massive shifts in plans, designs, variations and the final required scope resulted in stalled projects that were not equivalent to the value that had been invested to date in respect to construction expenditures. Many costs associated with outstanding claims and variations are yet to be resolved.

Poor contract administration

Stalled projects required a close examination of project documentation to analyze and confirm what participants should be entitled to. Many contracts that were completed and still under warranty, or with incomplete punch lists, needed to be closed out, and it is now apparent that in the heyday of construction certifications of work on site were inaccurate and may have been rushed in the hopes that they would be corrected in the final statement of accounts at the conclusion of the project.

A need for controls, and the right people in the right structure

Effective decision making is key. As a result of inaccurate or poor quality information, personnel involved in these decisions in the past may have made wrong decisions or may have been reluctant to make them without the correct information. Additionally, single accountability for projects was not enforced throughout project teams, nor was there enough 'challenge' in existing governance and systems. Many projects were accepted to incur additional cost and delay, and therefore there was no certainty and control over the time and cost of projects. We have seen many owner-entities managing contracts not projects, and this missing link did not allow for accurate reporting and cash flow projections.

Reporting can be improved

Current data gathering and processes can be more timely and efficient. The quality of reports varies drastically and is rarely in line with industry best practice and not consistent across projects. Reporting—and the effectiveness of decisions that are made—will only ever be as good as the quality of data that is input and analyzed.

Managing expectations is key

From investors to banks, government departments, advisors, contractors and consultants, it is critical to effectively communicate and manage expectations to achieve a successful resolution to projects—either before, during or after a restructuring effort. The interests of all entities involved must be aligned to get organizations effectively restructured and projects back on track.

The basis for a successful project on a micro level is effective sharing of project risk and in many cases asset ownership.

Government decisions are not always financially driven

Social enhancement and other public policy initiatives play a key role in government decisions to invest in construction projects—more so than in developed markets—creating bankability challenges in capital markets. Additionally, the pressure for essential services related to infrastructure to be delivered as soon as possible puts additional strain on the risk sharing mechanism and weakens the chance of success under an alternative procurement/financing strategy, such as design-build based procurement.

Returns need to be revised based upon current projections of future demand

Some large scale projects were being built for projected future patronage levels. Private investors, however, require immediate, proven and stable revenue projections to invest. Some parts of the region have gone through a major, unprecedented correction in the real estate market based on reduced requirements, and governments may not be in a position to mitigate risk by offering subsidies or required guarantees for supporting infrastructure that was once believed to be required.

The fall of confidence in the regional real estate sector will see a significant change in the type of projects that drive construction activity

Government-funded infrastructure and building projects are set to provide the best opportunities for alternative procurement delivery methods such as Public Private Partnerships (PPP). Efforts to develop schools, hospitals and affordable housing are expected to provide significant opportunities in the coming years, particularly in Saudi Arabia, Abu Dhabi and Qatar. With high profile public-sector projects around the GCC giving rise to new opportunities, including for example major public transportation such as the Abu Dhabi surface transport master program, investments will continue in the development of power, water and wastewater projects, as well as other large scale road and land transport projects. Once the PPP model is more clearly understood by the public and private sector in the region, the implementation of greater regulation-as it becomes more accepted-should result in reduced risk and restore, enhance and then sustain private investor confidence in the construction sector.

Lessons learned—let's look towards the future

As the construction industry has become an industry that is truly global over the past decade, the contractors' previous acceptance of risk related to working directly for sovereign governments is no longer a simple decision. Therefore many international contractors that were aggressively seeking opportunities in the region are being increasingly more selective and will now sometimes shy away from governments and the government-related entities they will tender projects for. These contractors, and their related financial institutions from their home countries, do not want to be involved in projects that are perceived to be higher than normal risk and not bankable. Where once it was thought that the slowdown in construction projects would result in lower overall project cost, we are now dealing with a scenario in which there is a real risk for a potential decrease in the available pool of contractors that can be selected from for more specialized contracts.

Furthermore, the massive returns and advance payments received by contractors during the "boom" period of just a few years ago is a very distant memory for some, and for the newer market entrants it unfortunately remains the only way they know how to procure projects and manage their cash flow requirements.

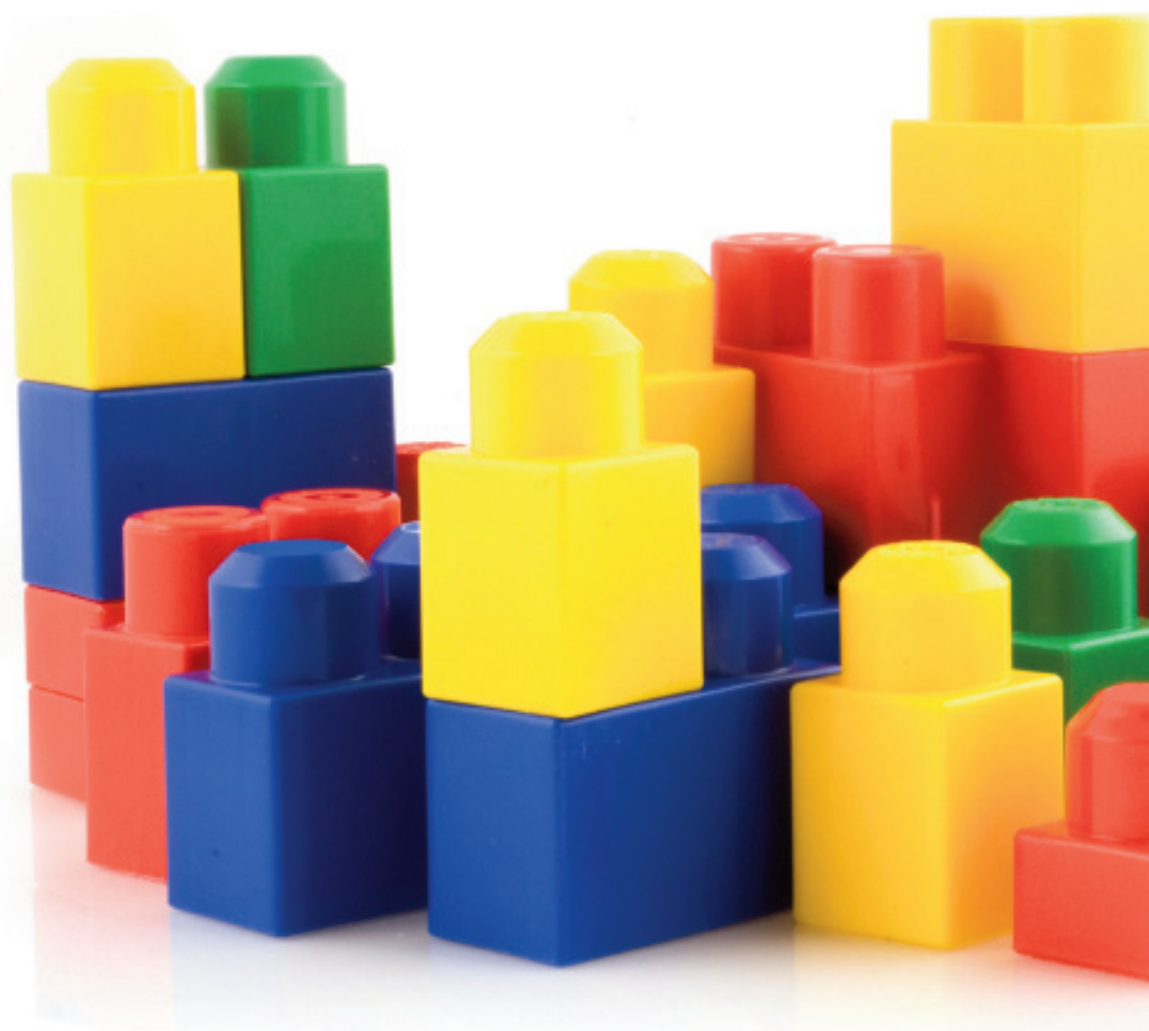
There is no doubt that some of these contractors cannot survive in the current climate for the coming few years. A greater emphasis by owners/developers, as well as contractors, will need to be placed on cost estimating and cost control, and aligning procurement strategy with contract types that share risk effectively and incentivize the private sector entities to perform dramatically better than they have in the past.

In addition, related impacts of the global economic crisis and the subsequent restructuring efforts have led to a general decrease in the number of expats in these locales. Plans for public transport usage and technical solutions, for example, will undoubtedly be impacted by the decrease in the planned growth of the population and tourism. Therefore, plans for requirements for essential services (e.g. power, water, public transport) will need to be revisited and rescheduled for optimum use and return on the equity investment that will be required to execute them.

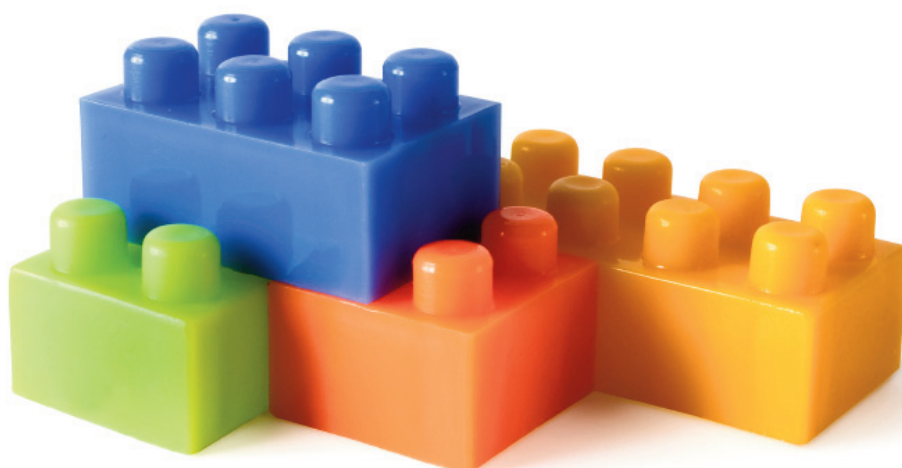
So while the regional situation sounds very bleak, the biggest positive that can be gleaned is that we have all learned from the experience. We have learned that focused spending on construction can create many jobs in the private sector, provide higher quality services and facilities for citizens and stakeholders, and lift much of the burden of development from the already over extended public sector by attracting private investment and resources. In addition, even with a number of stopped projects in the region, there is still in excess of USD 1 trillion planned for the region in construction projects, and we are beginning to see signs that the private sector can assist governments in dealing with distressed or failed projects by opening up to commercial concepts to re-launch projects in a different structure, but still achieving the services that were originally envisaged.

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Changing the game: Capitalizing on BOT/PPP: a contractor's perspective



A game changer for successful procurement of government contracts—the emergence of Public-Private Partnerships (PPP) in the region

While the emergence of Dubai has grabbed headlines over the past decade, it has long been accepted that the emirate's growth story can be attributed to its early focus and massive investment in development and infrastructure. Looking at the GCC overall, market demand for new construction in the private sector has notably fallen away in recent years due to the economic downturn. However, even with numerous projects in the region being put on hold, deferred or cancelled, the construction spend in the GCC for capital projects is still projected to be greater than USD 1 trillion. As many mature markets experience corrections in capital assets and investments, the opportunity for getting involved in the procurement of new construction contacts and projects returns the enticing gaze of the world back to the GCC, even after the impact of the recent economic crisis.

With that being said however, in this economic climate, both public and private sector participants are finding it very difficult to raise finance for commercial and residential projects as the cost to finance out-weighs any considerable foreseeable returns in an already saturated marketplace. Whilst the world holds steady in

anticipation of economic recovery, there is no magical short term solution to the decreased private sector demand resulting from the oversupply of projects and contracts in the past. So until such time as the market recovers, contractors are now being forced to ask themselves some difficult and newly strategic questions: what are the new and enticing opportunities being offered by the public sector which could act as a means of expanding our operations and utilizing our regionally based assets until we get closer to the horizon of recovery?

The region's public sector spending has typically-and through sound short term economic reasoning -been geared toward projects with the greatest returns. Buoyed by the rocketing prices of crude oil experienced in the years running up to the economic downturn, the focus on spending was inevitably directed to the oil & gas, petrochemical and real estate sectors. This has, however, led to a vacuum in the spending on 'hard' infrastructure such as transport, supply networks and plants to drive both industrial and residential growth. However, it is not just 'hard' infrastructure that has fallen behind, but also the 'soft' infrastructure, such as health, education and community enabling projects. Years of previous oversight driven by short-term and high returns can now be seen as an opportunity to grow necessary sectors such as softer infrastructure, and enabling sectors such as industry and research,

ultimately to decrease the focus on petro-dollars as the means for economic stability and resilience.

MENA closed project finance transactions 2005-2007

With rebounding government liquidity and a need to invest within the region, over \$700 billion of infrastructure projects are expected to be undertaken in the next five years. Traditionally, the majority of Middle East infrastructure projects have been financed by the public sector, but the decrease in petro dollars now presents a challenge for governments-and the construction sector-to see much needed infrastructure investment continue to come to fruition. It is therefore no surprise that the region is seeking alternative sources of funds in the form of Sukuks (Islamic Finance bonds), infrastructure funds, and sovereign wealth funds. The sources of these types of funding often previously diverted attention overseas due to considerations of palatable risk and a desire to diversify their appetite quickly, while many infrastructure funds have yet to deploy their funds in full. But signs of a willingness to invest in longer term investments regionally are apparent -the market has shown growth in Sukuks from H1 2009 to H1 2010. An increase in the costs of finance have meant governments are also recognizing the need to offload some of the long-term financial burden, which has been proven globally as something that can be achieved by engaging the private sector and working alongside global leaders in infrastructure design, construction and management when looking at the entire project life cycle.

Enter Public Private Partnerships

The history of private sector involvement in public services and infrastructure dates back to the early 1990s in countries such as the United Kingdom, Canada and Australia, when construction companies looked to take an equity interest in special purpose vehicles used to design, finance, build and operate assets for periods of up to and over 30 years. The value that can be optimized within each phase of the project life cycle becomes a compelling proposition and opportunity when it is looked to be captured in its totality. The construction sector's interest in this market was not only to profit from equity return, but to secure downstream

services for their operations providing more secure long term cash flows. In the GCC region many will agree this idea is a relatively new yet very desirable concept that has not yet reached the maturity of PPP's pioneering nations such as the UK and Canada.

But a keen willingness to pursue this route is evident from GCC governments' establishment of policy and legislation frameworks (such as Kuwait's Law no. 7 established in 2008) and various UAE infrastructure agencies initiating PPP procurement policy guides. For the time being it appears that the region's willingness to engage in PPP projects is keen with a number of requests for proposals (RFP's) already issued and expected from the GCC - even if empirical evidence to support their potential success remains scant for the time being. For construction industry participants it is therefore imperative they adapt to this change and look to capitalize on it. As a result, engineering procurement and construction (i.e. EPC) will no longer be the overriding norm in contracting, as governments look to embark on long term relationships and manage their exposure to risk by capitalizing on the knowledge, experience and equity of the private sector.

What does this mean for the contractor?

Risk and its allocation between the contractor and public sector is a key facet of the Public-Private Partnership, making it not only viable but also efficient, through ensuring that risk is borne by the party best able to manage that risk. For example, land assembly risk (e.g. permitting and approvals) is likely to be best managed through public sector agencies, but mitigating operating risk is of course a core skill of the contractor. Whilst all projects are unique and different, the technical, construction and operational risks often make up the majority of the 'value at risk' of any particular project. Therefore the private sector contractor is likely to bear most or virtually all of this risk. The contractor should also be clear that the public sector's 'value for money' comparison between public delivery versus private delivery hinges upon the contractors' ability to manage risks better than the public sector. It is the understanding and consideration of these risks, and the subsequent planning, addressing and mitigation of them through the execution of the project life cycle over many years, that will decide how appealing and successful

such a strategy will be for the contractor. And while the efficiency of risk allocation and project delivery is key in such a partnership, the private sector cannot ignore the additional requirements, preferences and project needs that will undoubtedly be driven by the public sector—needs that may change during execution. Government policy and desires will affect the allocation of risk irrespective of efficiency and cost effectiveness, likely allocating additional risk to the contractor. Contractors must be able to implement mitigating strategies as soon as risks are identified, and ensure that risks that can potentially arise in respect to changes are priced appropriately in any bid.

The public sector participants must of course recognize that due to the consideration and planning for such risks over a long term period, what now emerges is a procurement process much longer than a typical EPC contract. Determining party risk allocation is a process, only exacerbated by the impact any late variations can make to lead times and construction costs as well as the subsequent financial and contractual validity of a PPP project. It is vital that before pursuing a public partnership, contractors are confident in their ability to not only execute and deliver a project, but to do so in an efficient manner and whilst working in partnership with the public sector to fully realize the financial benefits of engaging in projects in such a manner. And confidence can be increased substantially by partnering with financial advisors that have been there before – those with global experience and best practice, learning from the battle scars that were earned fighting through successfully achieving financial close, and leveraging from the experiences that challenged construction and execution to mitigate those risks during procurement.

It is the understanding of these details and nuances of the PPP process that makes them unique partnerships

that are fostered not only on an economic understanding, but also on a political and personal level as well—where the management of expectations, relationships and developing a commitment based on an aligning of interests and a mutual understanding of each partner's needs is imperative to make them work and to establish financial and operational viability of each project. Despite these challenges however, the massive opportunity presented to capitalize on long term revenues and stable cash flows as a result of regional government's commitment to infrastructure cannot be ignored. As the saying goes, in every trying time, there is opportunity – and it is up to forward thinking contractors to capitalize on them.

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Risk and its allocation
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