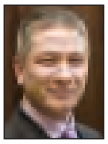
Treasurers build Gulf expertise



THE ACT MIDDLE EAST GOES FROM STRENGTH TO STRENGTH, WITH CORPORATE FINANCE AND LIQUIDITY MANAGEMENT THE SUBJECTS OF IN-DEPTH DISCUSSION AMONG TREASURERS AT *TALKINGTREASURY*. **PETER MATZA** REPORTS FROM THE DUBAI RAFFLES.

The continued strong growth of the ACT Middle East was clear at the most recent *talkingtreasury* event, which was held in February, sponsored by Emirates NBD. An audience of over 120 delegates participated in a series of lively, informative debates and continued their discussions during the various networking breaks. The luxurious surroundings of the Dubai Raffles hotel no doubt helped everyone to enjoy the day that much more!

The opening speech was a keynote address by one of the region's most respected commentators, Nasser Saidi, chief economist of the Dubai International Financial Centre (DIFC). His forthright analysis and comment was hugely entertaining.

In Saidi's view, the current volatile economic environment reflects the third of three major post-World War II events. The first was the 1956 Suez crisis, which marked the end of western colonialism; the second was the fall of the Berlin Wall in 1989, which ushered in the collapse of Soviet communism; and the third was the financial crisis of 2008, which marked the end of the US financial empire. Saidi described these events as "tectonic shifts" of world power.

In this view, the world is no longer US-driven but polycentric, especially in financial markets and standards. One of the effects of globalisation has been a fragmentation of power. Ironically the US and UK (and the West more generally) have suffered from globalisation and the BRICs (albeit Russia to a lesser extent) are the "winners". There is a case for saying that economic neo-liberalism has failed, with governments in the developed world having been forced to nationalise private financial assets and markets.

It is evident that the shift in output production and value of equity has been towards the East, or at least away from the developed world. During the current crisis, non-Western economies have sustained growth, even in Africa. The centre of economic power lies now between Mumbai and Beijing – an interesting observation from the perspective of the hydrocarbon-rich Gulf states.

The influence of the G20 on regulation is now paramount, but Saidi asked what its vision was. Capital remains constrained in regulatory systems and the impact of any Basel 3 on banks is not yet certain.

Saidi said that although Western private sector liabilities were now public, their governance structure had not changed, so the question might be whether there had been a reverse capture of the governance process by those organisations. Government spending (and borrowing) is bypassing private capital investment, with the liquidity provided by

quantitative easing being recycled into government deficits. The real downside is whether that easing will fuel inflation and whether international bodies such as the IMF will have the political support to insist on deficit control.

THE GCC. Saidi then considered the Gulf Cooperation Council (GCC). Consisting of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (a federation of the seven states of Abu Dhabi, Dubai, Sharjah, Ajman, Umm al-Quwain, Ras al-Khaimah and Fujairah), the GCC was created in 1981 to promote co-ordination and unity between member states in all fields. Placed in the middle of the scale of developing economies, the GCC's carbon wealth has mainly been invested in infrastructure and building a mixed economy – in education, transport and newer industries such as medical sciences. The GCC's main trading partner is now Asia rather than Europe, and its single biggest partner is India. While the GCC has avoided the worst effects of leverage in financial assets, the UAE has suffered from falls in international credit provision, leading to a credit squeeze, especially in real estate. Dubai, however, remains a critical regional trading and financial services hub.

Looking to the future, Saidi suggested that the GCC needed to consider wholesale changes in its business and economic infrastructure: transparency in governance, more consistent economic and market regulation, and professional financial management in government spending especially a "safety net/markets insurance" programme. In particular, he said that insolvency frameworks were inadequate or non-existent and would constrain inward investment until properly developed.

GCC fiscal policy is based on spending – there are no income or sales taxes – and will need to move to be countercyclical (spending to replace or augment credit and trade flows). There is also a need to develop government debt and private equity markets to supply liquidity and to harness local/regional capital. As a first step, the DIFC is introducing a real-time dollar and euro settlement facility, called RAPID, to support local markets and liquidity.

In closing, Saidi suggested a further regional initiative to help development: a GCC/regional development bank to bring together disparate financing bodies.

The panels that followed Saidi's fascinating and stimulating address focused on specific corporate experiences in the region, bringing together treasurers, CFOs and other finance professionals to do so.

CORPORATE FINANCE. The first panel, on corporate finance options, highlighted a number of business funding issues from a capital perspective. In the past two years, the banks' share of capital provisioning in the GCC has fallen by half or more, although it has been partially replaced by debt capital issuance in the bond and sukuk markets. However, these markets are generally only available to better names/credits (such as those from Abu Dhabi and Qatar, and banks and other financial services institutions). But the discussion was not all bad news, with some commenting that some banks are willing to work with customers in supporting development although tenors have shortened and credit analysis increased.

Delegates were urged to consider the view that the bank market should not be the sole source of finance for the various stages of business development. There was widespread agreement that regional banks especially vary in skills and capacity, and have a cyclical interest in types of funding. On the plus side, regional banks understand the need to manage relationships. International banks were taken to task for their inconsistent approach to credit provision and long-term commitment to relationships in the region. Some international banks are returning to regional markets, especially in energy, and carbon prices will support credit availability, although this is expected to be selective and covenanted.

When looking at bank lending in detail, a case was made to move away from bilateral arrangements to syndicated facilities. Use of syndicated lending can be cost-effective and efficient but it was noted that markets have been more problematic in the past year requiring club-type deals and leverage of ancillary business depos, advisory services, treasury transactions and the need to offer assets as security or financial covenants. One further comment on lending was that tenors had been capped at a maximum of five years and margins increased by between four and eight times.

The panel also considered the options available in the Islamic finance markets, especially the sukuk bond markets. On balance, the value of investor and balance sheet diversity needs to offset by the additional complexity in structuring the bonds, although pricing is not the same problem as in 2006 and 2007. Novice issuers would be wise to use just one bank as lead to reduce structuring.

The panel also touched on ratings, which can be a positive, but there was a minor complaint that bond pricing doesn't really differentiate between credits, although ratings help to improve liquidity. However, businesses need to be relatively mature to gain full value from a rating.

The panel also looked at various other opportunities for corporates to source financing. Equity capital markets may be useful in accessing different investors but an issue needs careful implementation and better understanding of local markets. It was suggested that Western bankers sometimes applied Western market pricing as standard, and local treasurers were urged to challenge pricing perceptions.

Other suggestions that could be useful in certain industries (capital or infrastructure goods or services) were to look at Western government export credit agencies or regional funding bodies (such as Kuwait's Arab Fund), which provide subsidised interest rates and soft loans for

capital goods. Lastly, supply chain financing techniques (some of which pre-date modern international trade) were also thought worthy of consideration.

RATINGS. The discussion on funding options was neatly followed by a ratings panel, which included a presentation by credit rating agency S&P about the ratings process and its regional application. S&P provides a GCC comparative analysis and ratings scale which allows GCC factors to be considered above global basis for ratings (the service is also available for Asia).

In general during the recent crisis, all GCC public sovereign ratings have remained stable. There has been some pressure on financial institutions and clearly more impact on corporate ratings in certain sectors, particularly real estate.

The panel looked at the pros and cons of ratings and although delegates expressed some concern about disclosure of sensitive information to ratings analysts, there was reassurance that agencies do not disclose such information. There was broad agreement that ratings – at any level – add pricing and liquidity value to investor decisions, which in turn adds to overall market development. More to the point is whether regional corporates have adequate systems internally to support the information needs of ratings agencies. However, as more corporates move towards IFRS reporting, this deficiency should be addressed over time.

TRADE AND WORKING CAPITAL. The panel on trade and working capital was able to draw on a depth of knowledge and experience in trade credit and credit insurance that was greatly appreciated by delegates. The context for the discussion was that there has been a strong rise in corporate insolvencies in GCC economies, even the stronger ones. A number of factors have contributed to this, but late payment practices in particular are having a crippling effect on corporate liquidity management.

There was an explanation from a banking perspective as to why there are now more stringent criteria for lending. This may mark a welcome return (at least for bankers) to more sensible credit processes from the lax lending in the mid-2000s which produced a 50% concentration of lending in real estate facilities (property, materials). Lending can still be based on more traditional practices (30-40% of bank assets are still "name" lending in the UAE), but there is greater bank focus on corporate credit management and risk management across the whole of a company's activities, not solely financial risk.

From an operations perspective, there remains a reliance on open account trading. These receivables are now being turned into an asset class for corporates, with credit insurance to "secure" receivables (on non-recourse basis) giving lenders more confidence in cashflows. This also applies to letter of credit business where rather than the letter of credit being bank-confirmed, the credit insurance offers a similar "confirm" but up to 50% cheaper than bank cost. The use of factoring has also increased but there is still progress to be made in more sophisticated automated supply chain financing processes.

LIQUIDITY AND INVESTMENT. The final panel of the day focused on how corporates can improve their working capital practices and what they can do in the happy situation of having surpluses to invest.

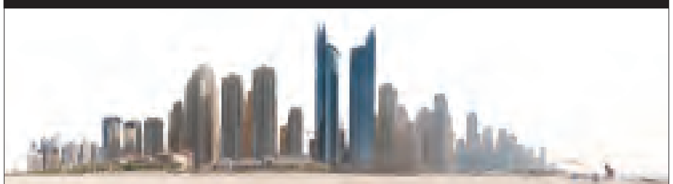
The key message was that even in good times cash is critical in business success. While corporates tend to focus elsewhere in good times, hard times can be an opportunity for treasurers to demonstrate their true worth in their businesses. The critical point is that everyone in a business must see and appreciate the value of cash – whether in receivables outstanding, capex, investment or payments management. The panel's view was that cashflow forecasting, whether 100% accurate or not, is at least useful as a discipline and at its best a metric that can be clearly understood and communicated both internally and externally to stakeholders, investors, lenders and credit analysts.

In any focus on cash investment, the principles of security, liquidity and yield (SLY) seem universal in their application and never more so when the return of capital is more important than the return on it.

Overall the day's debates were very well received and a sure sign that the treasury profession is maturing and growing in confidence and in its ability to influence business development in the Middle East. ACTME's network has been instrumental in fostering this progress but there remains much exciting and interesting work to do to raise the profile and importance of treasury management in the region.

Peter Matza is head of publishing at the ACT.
pmatza@treasurers.org

Box 1: The panels



The panellists at *talkingtreasury* Dubai offered treasurers attending the event a wealth of experience and insights. The experts included:

- **Corporate finance panel.** Raphael de Ricaud, head of Islamic finance at Rothschild (facilitator); Mohamed Al Neaimi, CEO of Mawarid Finance; Neeraj Agarwal, CFO at Crescent Petroleum; Robby Zahr, group treasurer of Al Jaber; and VP Nagarajan, executive director of ETA.
- **Ratings panel.** Jan Plantagie, regional head Middle East at Standard and Poor's (facilitator); Matthew Hurn, executive director group treasury at Mubadala Development Company; Farouk Soussa, head of sovereign ratings Middle East at S&P; and Michael Killian, managing director consulting services group at Kroll.
- **Trade and working capital panel.** Anil Berry, CEO of GCC (facilitator) and Euler Hermes Credit Insurance; CBV Reddy, vice president group control at Emirates NBD; Muhammad Naeem, senior treasury operations manager at Majid Al Futtaim Retail; and HC Barke, CEO and president at Prudence Insurance Brokers.
- **Liquidity and investment panel.** Ajay Sehgal, deputy treasurer at Emirates NBD (facilitator); Rob Farrow, corporate treasurer at Alghanim Industries; Peter Matza, head of publishing at ACT: Ravi Narayanan, general manager treasury at Omantel; and Daniele Vecchi, group treasurer at MAF Group.