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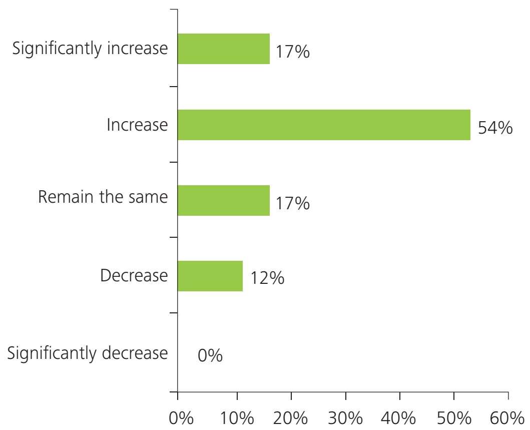
GCC Equity Capital Markets confidence survey
From a trot to a canter?

Eighty seven years in the Middle East

Contents

Macro-economic

Expectation around volume of local IPOs in next 12 months



Recent regional unrest in Egypt and Syria has led to a positive external shock for the GCC countries, especially the UAE, benefitting from the flight of capital out of unstable regional countries providing liquidity to these markets

Volumes of IPO

- Over 70% of the respondents expect the volume of IPOs in the GCC region to increase in the next 12 months. The lack of any significant recent listings seems to have created a pent up supply of issuers looking to come to market, to access relatively cheaper equity capital and as a way for private equity investors to exist some of their investments.
- The same respondents also believed that issuers would consider international markets as a listing destination, if the regional markets were unable to attract them.

High growth sectors

- The sectors expected to drive growth in the GCC include infrastructure, retail, oil and gas, and manufacturing which are likely to see potential issuers in the foreseeable future.
- Industry favorites such as retail and the oil and gas support sector have been the recent focus of private equity investments and are expected to result in exits in the future, possibly by way of IPOs.
- We have already seen businesses (NMC and Al Noor Medical) in the defensive healthcare sector realising value through London listings. These have set a precedent for successful outbound listings and other aspirants are expected to follow suit.

Effective regional policy

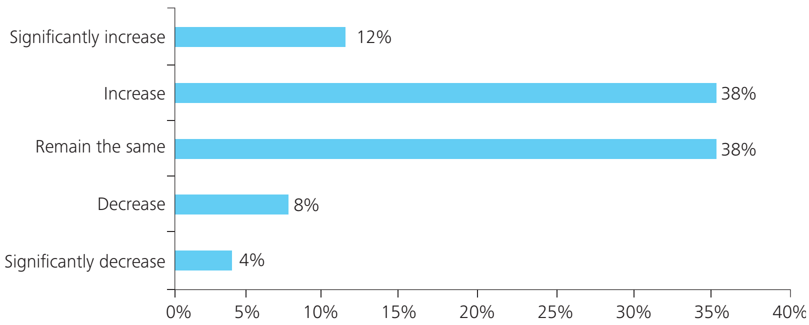
- A fine balance needs to be maintained between encouraging issuers to list (supply side) and the protection of investors (demand side), in particular retail investors, through transparency and disclosure requirements.
- In general, demand side policies such as relaxation of foreign ownership are thought to be effective tools available to regional governments to stimulate equity capital markets.
- Concerns were voiced by respondents regarding:
  - the lack of harmonisation of corporate regulations and capital market regulations; and
  - where principle-based regulations exist, inconsistency in their interpretation and implementation.

Capital market confidence

- Middle East investors are traditionally invested in Europe and emerging markets. Uncertainty and weakness in those markets over the last 12-18 months has adversely impacted sentiment and liquidity in regional capital markets.
- Recent regional unrest in Egypt and Syria has led to a positive external shock for the GCC countries, especially the UAE, benefitting from the flight of capital out of unstable regional countries providing liquidity to GCC markets. However, the jury is out on whether this capital is here to stay.
- A majority of the respondents noted their involvement in a healthy number of active IPO mandates, which they expect to see list over the coming 24 months.

Equity valuations

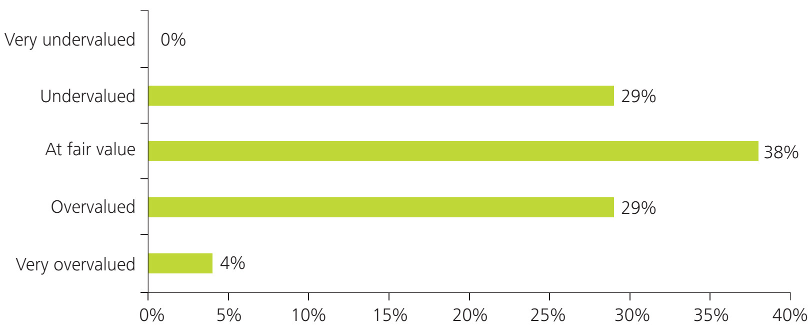
Outlook for equity values across the global market



Equity valuation

- Over half of the respondents believe that global equity values will increase in the next 12 months. The main catalyst for this perception is:
  - Increased confidence in the health of the global economy after addressing the Eurozone crisis;
  - Expectation of a US recovery, initial signs of which are already being seen;
  - If the quantitative easing programmes slows down in Western economies, bond issuances and debt will become relatively more expensive for issuers; and
  - Growth in the emerging markets in Asia and MENA.

Current view on equity valuations in the GCC



Outlook for GCC equity valuations

- The announcement by the MSCI to upgrade the UAE and Qatar exchanges to emerging market status, effective from May 2014, has gone some way to explain the uplift in valuations.
- Recent increases in trading volumes on the DFM exchange are seen in large part to come from foreign investors, seeking a safe haven from socio-political turmoil, bringing money flows to the GCC region, which is positively affecting real estate and stock values, especially in Dubai.
- There were differing views expressed by the respondents on the different GCC exchanges and their relative valuation, thus resulting in a broad distribution of responses when combined. However the following general observations apply:
  - Widely held perception that petro-dollars are artificially keeping valuations buoyant compared to other emerging markets, hence multiples are likely to be overvalued;
  - Structural deficiency in the form of a lack of long term institutional investor base which results in investors discounting valuations; and
  - Short term view taken by the current regional investor pool, hot money flows and speculators, brings volatility to the market, discouraging investors.
- Those supporting the undervalued position believe that available liquidity will seek equities for the arbitrage opportunity presented, vis-à-vis real estate and bonds.
- Real estate is currently the preferred asset class attracting investment, while more sophisticated investors might consider the bond and private equity route.

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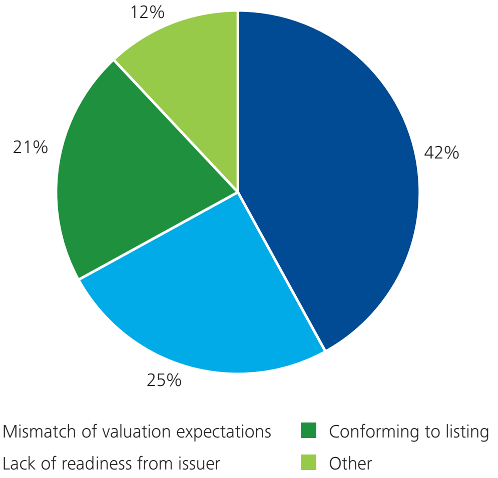
The IPO process

Top three challenges experienced on IPO processes



Challenges experienced on IPO process

- The most significant challenge experienced by respondents in relation to the IPO process is the mismatch of valuation expectation, which has led to aborted processes and continues to have a dampening effect on issuers' desire to list.
- The reluctance by regulators to permit innovative structures for IPOs that enable valuations to be more comparable to those achieved in more developed markets was the main reason identified by respondents for the dearth of IPOs in the recent past.

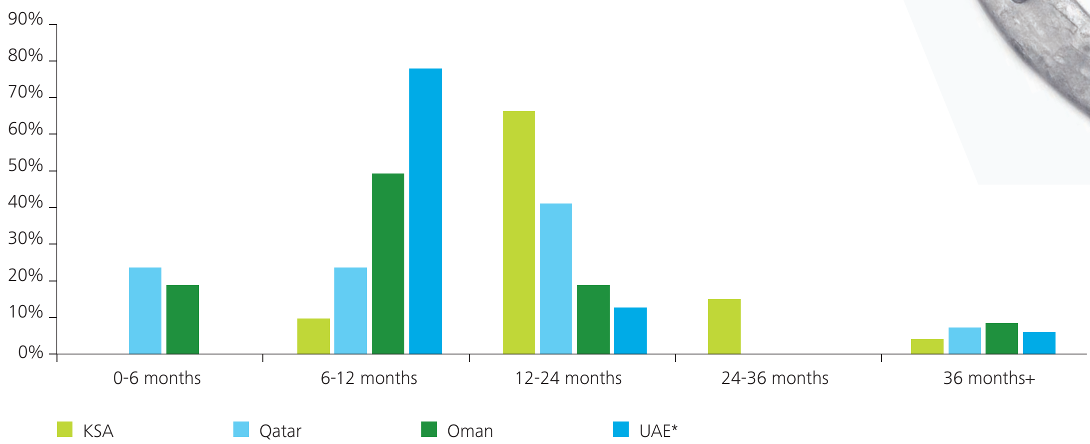
Conforming to listing requirements is seen as a major challenge for most issuers who struggle to meet the reporting, structure, disclosure and transparency requirements associated with listing – a mindset change for private companies moving to a public environment

- Lack of readiness on the part of issuers to deal with the IPO process on any public exchange was the second challenge highlighted by respondents which stemmed from the issuer's lack of appreciation of the pressures of a listing process, the internal resourcing and preparation required, as well as the time and cost of listing.
- Conforming to listing requirements also ranked highly by most respondents, with a large number of issuers struggling to meet the reporting, structure, disclosure and transparency requirements associated with listing – a mindset change for private companies moving to a public environment.
- The latter two challenges lead to unrealistic timetables being pursued by issuers, while a lack of investors' understanding (especially regional investors) of the equity story and lack of liquidity were also issues which respondents have experienced with the regional IPO process.

IPO risk management

- Whilst regional issuers have historically (pre-2008) always used lawyers and accountants on IPOs, there has been limited use of:
  - Specialist reporting accountants to address specific financial reporting and governance matters; and
  - Investor relations and PR specialists.
- There was general consensus from most respondents that historically the transaction risk was carried by the board of directors of the issuers and the sponsor bank(s). However, with GCC regulators becoming more interested in establishing a rigorous criteria for issuers and more international listings being considered, there is an increasing trend where specialist advisors are being brought on board to facilitate a more efficient process and provide a risk management framework to the issuer and sponsor.
- Respondents are increasingly encouraging prospective issuers to give consideration to engaging specialists earlier in the IPO process to identify any red flags and therefore minimise unforeseen delays and costs.

Length of IPO process



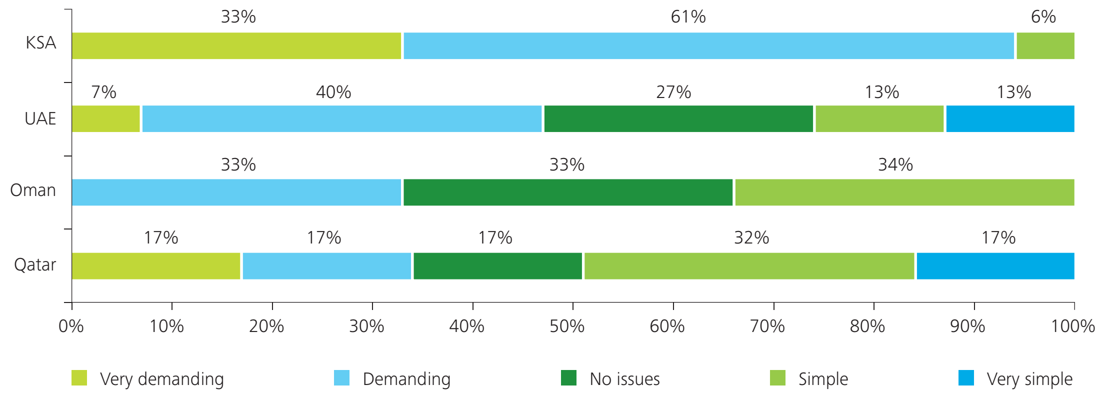
*Based on respondents' experience of listings on the ESCA regulated on-shore exchanges

Timeframe for an IPO process

- Whilst each IPO process varies in its duration depending on a multitude of factors specific to the issuer and the listing exchange in question, there is a general trend for each exchange which is highlighted in the results.
- Based on the respondents' experiences:
  - KSA IPOs on average took longer to go through the listing process, with almost 90% of respondents experiencing a typical process in excess of 12 months (23% of respondents experiencing 24+ months).
  - The length of the process was attributed to the Saudi Capital Market Authority's proactive approach, over the last 3 years, in undertaking an in-depth level of scrutiny on prospective issuers which has added to the listing timeframe for almost all, except for the few issuers who are fully prepared for listing;
  - The Qatar Financial Market (QFM) process for 50% of the respondents took less than 12 months; and
  - UAE and Oman took the shortest amount of time with 79% of issuers achieving listing within 12 months on the UAE exchanges, both the Abu Dhabi Securities Exchange (ADX) and DFM, and 70% for Oman.
- Half of the respondents were of the view that by being IPO ready, issuers could have saved at least 3-6 months on the IPO process from the date of appointment of a sponsor to the listing date. The majority of challenges revolved around inefficient planning of internal resources to support the IPO process, lack of financial and operational house keeping and lack of initial consideration of the listing requirements, all of which led to delays in the listing date and higher advisors' fees.

Regulation

Ranking of listing requirements



Listing requirements

- 94% of the respondents rated the listing requirement in KSA as demanding or very demanding, as the general sentiment is that the CMA has taken a hands on role, with detailed oversight on the work of sponsors.
- 47% of respondents regard the UAE listing requirements as demanding or very demanding due to the lack of clarity of rules and their interpretation. Hard underwriting requirements and lack of a tested book building framework for the UAE onshore exchanges were seen as a general disincentive to list by respondents.
- Overall the lack of established market practice, due to insufficient IPOs across these equity markets, presented issuers and sponsors with a high level of uncertainty and the challenge of understanding and interpreting the listing rules and regulations.
- Issuers generally struggled to meet disclosure and reporting requirements and achieve timely compliance in particular around related parties, corporate structure, and historical track record to support the equity story.

Post listing requirements

- The post listing (ongoing) obligations were rated as being most onerous in KSA, followed by UAE, Oman and Qatar. There is an increasing focus by regulators to assess the issuer's ability to continue meeting the reporting obligations that comes with a listing.
- 52% of respondents expect more listing regulations and disclosure requirements in the next 12 months, as regimes with lower requirements move towards a higher level of disclosure and reporting, to be comparable to their peers and generate investor confidence.
- A lack of awareness and resource constraints on the part of issuer was highlighted as the main cause of such listed companies not being able to meet their obligations, resulting in loss of investor confidence and valuation, fines and in certain cases, suspension from trading.

- The change in the senior leadership at the CMA is being seen as a positive sign with expectations of enhanced engagement and more visibility being offered by the CMA.
- Many expect that further clarifications will be issued by the CMA as many banks are asking questions and lobbying on various points.

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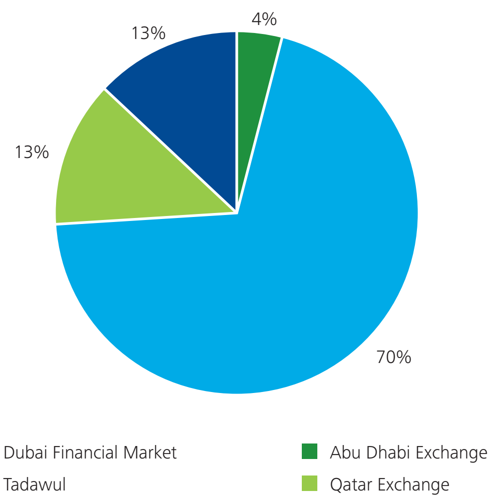
IPO activity

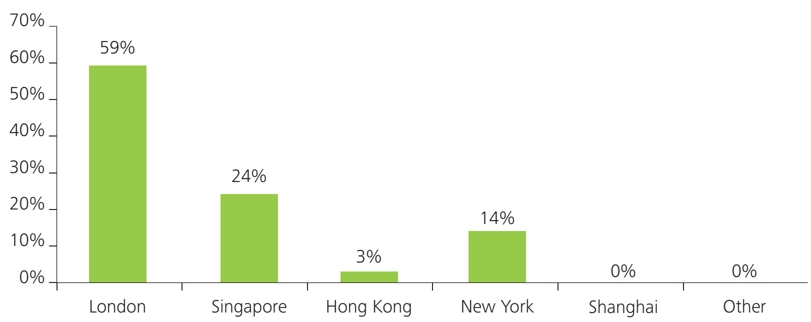
Expectations for IPO activity on GCC exchanges



Regional exchanges

- On the outlook for the next 12 months, the Tadawul was ranked as the most active GCC market in terms of IPO activity, with 70% of respondents ranking this in first position, followed by the Dubai Financial Market, Qatar Exchange and the Abu Dhabi Exchange.
- The small number of recent IPOs across the GCC exchanges tends to suggest the ongoing structural challenges that respondents believe are holding back listings and need to be addressed to help in the evolution of these high potential markets.
- Despite the recent change in leadership in Qatar, respondents were cautiously optimistic about the prospects for IPO volumes and trading to increase, with a pipeline of IPOs looking to target the liquidity in the market.

Popular international exchanges



International exchanges

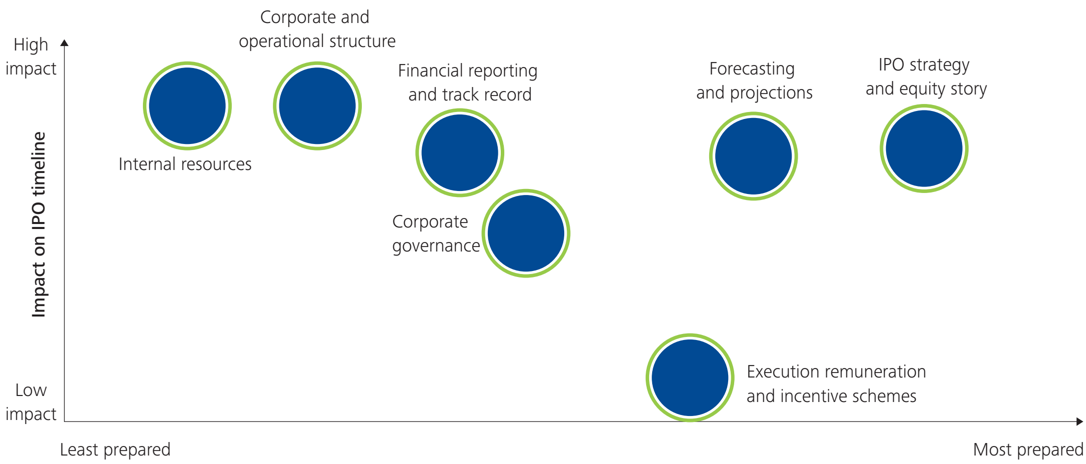
- London was rated as the most popular international exchange attracting regional issuers' attention, with 59% of respondents ranking this on the top spot, followed by Singapore with 24%.
- The primary reasons for London's preferred ranking amongst banks and issuers relate to:
  - Reputation of being the pre-eminent centre for raising capital, with a long track record, liquidity and established market practice;
  - Openness to consider complex transaction structures designed to accommodate regional issuers (as evidenced on the recent NMC and Al Noor listings) and an appreciation of regional risks and opportunities;
  - Middle Eastern issuers' familiarity with London as a holiday destination, its relative accessibility and time difference with the region makes it a likely preference; and
  - A pool of comparable sector peers and a strong analyst community that are likely to lead to better valuations.
- The current challenge for GCC markets appears to be one of winning the confidence of market participants and providing transparency over the IPO process. A number of respondents felt that a handful of good, confidence building IPOs coming out in the market may get the ball rolling on establishing a trend, in what are highly liquid economies.

Alternative intermediate funding sources

- Respondents also highlighted that where issuers have not been successfully able to pursue an IPO in the short term, or delayed listing due to market conditions, they are seeing such issuers turning to private equity or mezzanine finance options to bridge any medium term funding gaps pre-IPO.

Readiness

IPO readiness



Respondents felt that issuers were least prepared from an internal resourcing perspective for the demands of an IPO process, with 25% of respondents highlighting this as the biggest challenge.

The most onerous issue around resourcing involved the business suffering adversely as a substantial part of management's time is taken up by the IPO process, potentially undermining an otherwise attractive equity story.

Consideration of an appropriate corporate and operational structure for the listing group was also ranked highly, with 18% of respondents raising this. Related party transactions and the opaque nature of key business relationships are timeline impacting issues typically not considered by issuers.

Linked to the structure were issues around lack of a financial track record to support the equity story and financial forecasts. Carve out and proforma financial information for pre-IPO divestitures and acquisitions respectively, arose during the listing process leading to delays.

Robust corporate governance and an effective system of financial reporting and controls was highlighted as a key challenge for issuers, especially in fulfilling post-listing obligations to the exchange and the market. A significantly higher level of attention has been given to this issue by regulators recently and it will continue to feature high up on the list of regulators and sponsors.

Whilst some of the respondents saw issuers proactively engage with advisors at an early, pre-IPO stage to address such issues, these were generally limited to private equity portfolio companies and multi-national corporates, especially those looking at international listings.

The expectations exist that as the equity markets evolve, issuers will progressively look to invest in IPO preparedness to maximise opportunity and stakeholder value.