Grant Thornton

The Evolving Capital Markets Ecosystem

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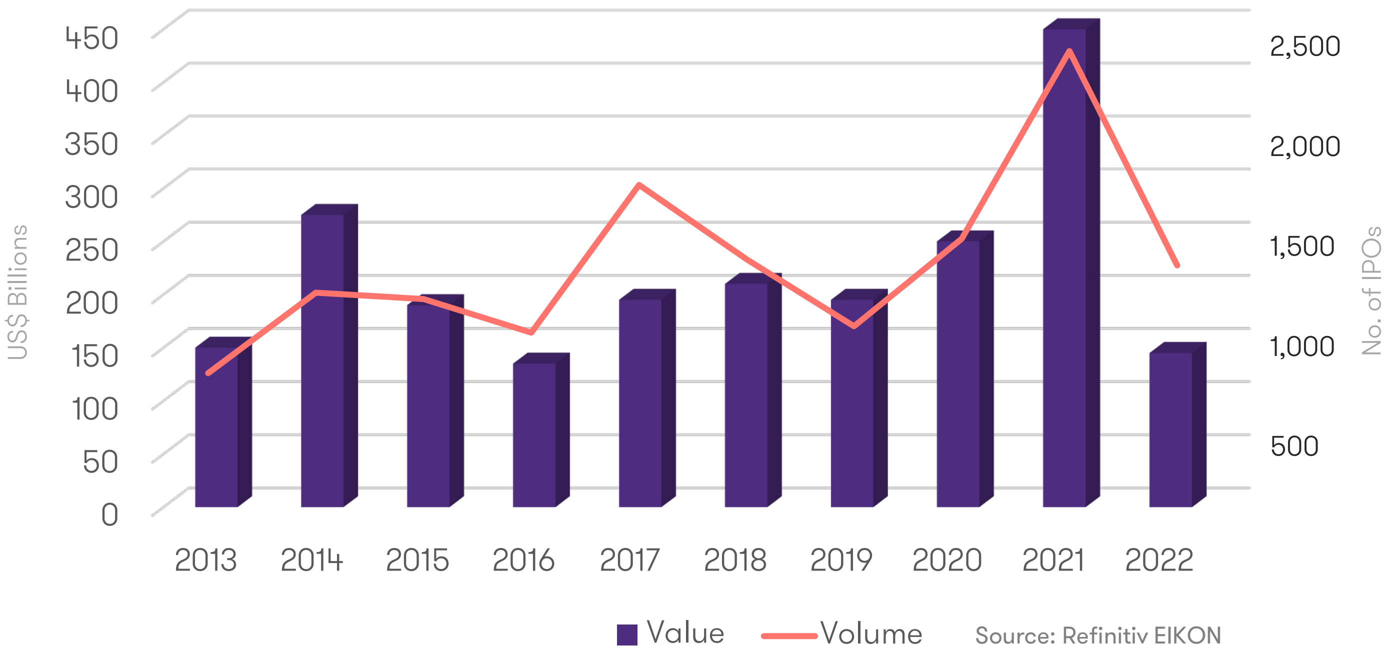
In spite of the global downturn in the capital markets, the UAE has not only resisted this trend but has even shown record levels of IPO activity. This trend is likely to continue and provide organisations and shareholders new avenues for growth.

In this document, first presented during the MENA IPO Summit Series, we analyse the global and local outlook for IPOs as well as the factors that differentiate the UAE and KSA capital markets from the rest of the world.

About Grant Thornton

Grant Thornton UAE was founded in 1966 and is one of UAE's leading assurance, advisory and tax firms dedicated to serving the needs of privately-held businesses, public interest entities and family-owned businesses. With offices in Dubai, Abu Dhabi and Sharjah, over 450 employees and considerable experience across many fields, Grant Thornton has clients in financial services, hospitality and leisure, real estate and construction, trading, insurance, banking, transportation, and manufacturing, among others.

The surge of IPOs in 2021 has been followed by record lows around the world



Source: Refinitiv EIKON

Year on Year Growth in IPO Activity

IPO Proceeds		IPO Volume	
2021	84%	2021	62%
2022	-64%	2022	-39%

- The global stock markets turned from bull to bear between 2021 and 2022.
- After a record-breaking 2021, with proceeds raised exceeding 2019 and 2020 combined, 2022 took a nosedive.
- This was a build up from the uncertainties that started to emanate towards the end of 2021.

2020

2021

2022

2023

2020

2020 was dominated by IPOs of technology and healthcare/biotech businesses (e.g. AirBnB, Snowflake and One Medical). The pandemic created significant lifestyle changes in the way we operate and consume. This sprung up huge demand for tech-enabled businesses which suddenly experienced high growth resulting in high demand and high valuations.

2020

The low interest rate environment also helped in the buoyant IPO activity.

2020

2020 also became the year of SPACs. The Covid-19 situation made this route more appealing for going public as virtual road shows were seen as less effective. Bill Ackman's Pershing Square raised $4 billion in proceeds from investors, the largest SPAC ever.

Source: Reuters

2020

2021

2022

2023

2021

In 2021, global economies started opening up. Strong global corporate earnings were being reported, the volatility factor was much lower providing a next to perfect environment for IPOs and flexible monetary policies by central banks flooded the markets with capital. Investors were keen to deploy funds and they did, helped by rock bottom interest rates.

2021

However, as the year progressed, monetary policies started tightening, the returns from the 2021 IPOs did not impress investors and supply chain issues continued.

2021

The upturn was truly global. We saw companies like Rivian Automotive in the US, tagged as Tesla's competitor, raise $13bn; Kuaishou, a live streaming and home entertainment business in Hong Kong raise $5bn; and In-Post, an e-commerce delivery business raising almost $4bn. SPACs also remained active till regulatory concerns started to creep in.

Source: Reuters, Bloomberg

2020 2021 **2022** 2023

2022

2022 brought with it a cocktail of uncertainties: interest rate hikes, inflation, the Russia/Ukraine and the US/China tensions. The impact of sanctions on the energy market started to become apparent. SPAC activity came to a halt and Bill Ackman's largest $4bn SPAC liquidated Pershing Square.

2022

Chinese companies also started to see themselves under scrutiny over the accounting practices of Chinese companies listed in the US.

2022

The NYSE and NASDAQ combined saw an 80% drop in the number of IPOs and over 90% dip in the IPO proceeds raised in 2022. The funds raised by companies listing in London plunged by more than 90% in 2022. So overall, 2022 was not a banner year for IPOs.

Source: Reuters, Refinitiv EIKON

2020 2021 2022 2023

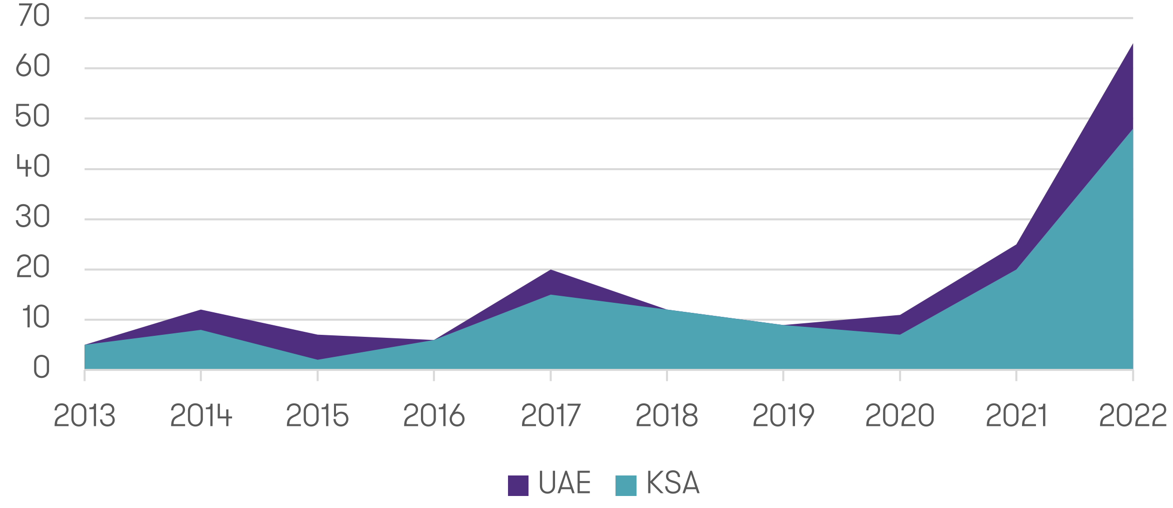
2023

Outlook:

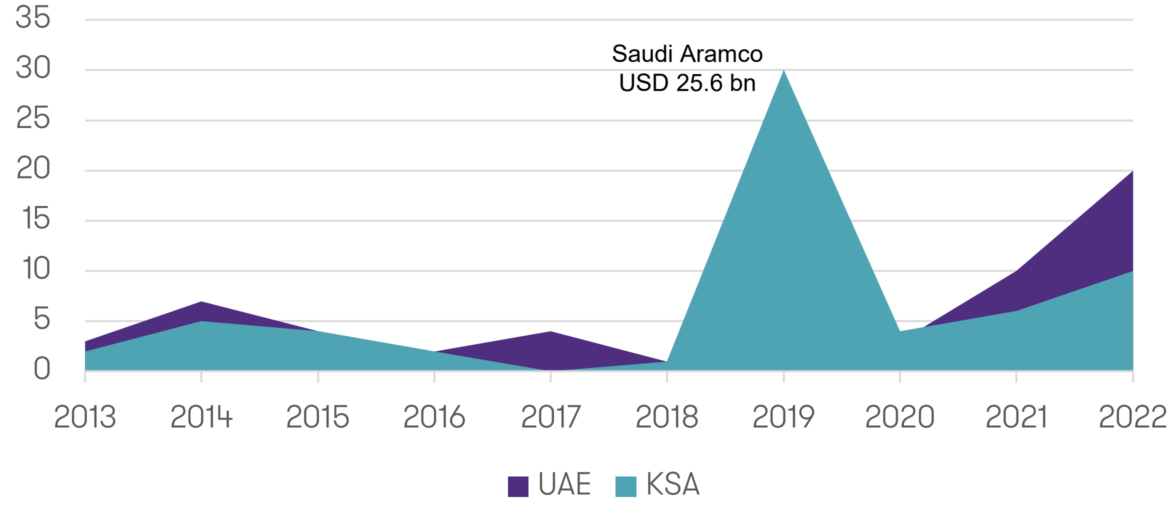
At a global level, there are hopes that the IPO market will stage some sort of a recovery in 2023 given a backlog of companies in the pipeline that plan to go public after delaying their plans in 2022. It is, however, expected that investors will favor companies that can deliver resilient profits and cashflows during tougher times over those with growth potential.

UAE and KSA have bucked the recent global IPO trend so far

IPO Volume #



IPO Proceeds (US$ Billions)



Key drivers for the growth

- Need for diversity in source funding
- Improved retail Investor participation in IPOs
- Government IPO support
- Attractive dividend yields
- Favourable macro-economic environment
- Diversification strategy

Year on Year growth in IPO Activity (KSA and UAE)

	IPO Proceeds	IPO Volume
2021	326%	260%
2022	154%	139%

Source: Refinitiv EIKON

The story of the capital markets in the UAE and Saudi Arabia was quite a contrast to the rest of the world. Why was that the case? In our view, there are a number of potential reasons for this:

Post-pandemic resilience

- UAE managed the pandemic extremely well with well-thought through policies, economic and otherwise, which enabled it to remain open for business even when a large part of the world was grasping the affects of the pandemic. This demonstrated the robustness in the country's economy.

Positive market sentiment and favorable macroeconomic situation

- The oil revenues are enabling the GCC countries to invest in other sectors as the regional economies here are taking active steps to diversify into non-hydrocarbon sectors. The dollar peg has also helped to offset forex related volatility for investors.
- Additionally, the growth in the population as well as the strong economic performance has made UAE and the region an attractive proposition for investors.

Government support

- Privatisations to catalyze the local stock markets are not a new phenomenon. European markets saw this in the 70s and the 80s and more recently China has been doing this for some years. The recent listings in the UAE supported by government privatisations has created a high degree of interest in the capital markets. The next wave of growth in the capital markets is expected to come from the private sector including family businesses, whilst privatisations are expected to continue throughout 2023.
- The government also changed the laws allowing 100% foreign ownership which is expected to encourage further foreign investment. According to the Dubai Financial Markets, in 2022, foreign investors accounted for 48.6% of the total values traded and 19.1% of the total market capitalisation, which paints an encouraging picture.
- We have seen a privatisation drive in Saudi Arabia as well. The Public Investment Fund recently offloaded 10% of Tadawul and we also saw the IPO of Saudi Aramco and ACWA Power and this is all in line with the economic reforms set out in the Vision 2030.

Source: DFM, IMF

Need for alternative sources of financing:

- The tightening restrictions for the banking sector, including the Basel III reform measures, are pressuring banks to retain additional liquid capital. There is therefore a need for alternative sources of financing and the capital markets can play an important role in this regard.

Retail investor participation and attractive dividend yields

- There is an increased level of retail investor participation in the recent IPOs with a significant level of oversubscription. The IPOs have also offered attractive dividend yields which has driven the level of interest witnessed.

Source: Central Bank UAE, Zawya

Early days but a promising heart...

Returns

We undertook an analysis of all the IPOs that took place during 2021 and 2022 and compared the share price movement from the first day of trading to the closing share prices on the last trading day of December 2022. In the UAE, the share price movement averaged at 7.1% showing some impressive returns. The comparative figures for KSA, US and Singapore were 17%, -29% and -18%, respectively.

IPO proceeds as a source of capital

The IPO proceeds raised in the UAE during 2022 as a % of GDP came to 2.2% (nil in 2019 and 2020, 0.6% in 2021). The IPO proceeds raised in the UAE as a % of global IPO proceeds was 6.4% (nil in 2019, 0.1% in 2020, 0.6% in 2021). This demonstrates the meaningful contribution the capital markets have started to make in the context of the overall economy.

Returns (2021/2022)

7.1%

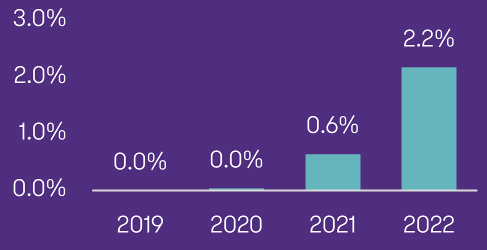
Avg. post-IPO share price movement

21/22 IPO Performance comparison:

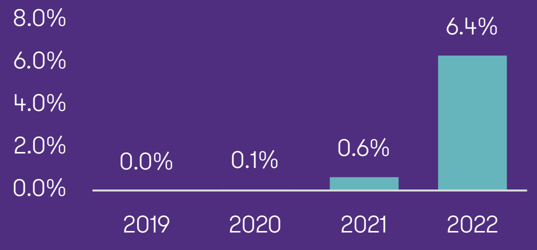
- Saudi Arabia: **17%**
- USA: **-29%**
- Singapore: **-18%**

IPO as a source of capital

UAE's IPO proceeds as a % of the GDP



UAE's IPO proceeds as a % of Global IPO proceeds



Source: Refinitiv EIKON, DFM

Liquidity

As a proxy of liquidity, we considered the average bid-ask spread for all UAE listed companies in 2022 but excluded the IPOs that took place during 2021 and 2022 in order to make a comparison of the liquidity of the stocks for companies that listed prior to 2021 and for the companies that listed during 2021 and 2022.

The results were quite clear. Companies listed prior to 2021 had an average bid-ask spread of 5.3% relative to the IPOs during 2021-22 which demonstrated an average of 1.6%. The tighter spreads of the recent listings clearly demonstrate the improved liquidity of these recent listings.

Driving towards a more liquid market

5.3%
Average bid-ask spread for UAE listed companies in 2022 (excl. 21/22 IPOs)

1.6%
Average bid-ask spread of IPO companies in 2021-22

Attraction of new investors

Looking at the Q1-Q3 2021 data and comparing it to Q1-Q3 2022 statistics demonstrates that the Dubai Financial Markets has done well to attract new investors with a growth of more than 40x in total new investors.

Overall, this shows that whilst it is early days to conclude, the UAE capital markets has had a successful year on many fronts.

Attraction of new investors

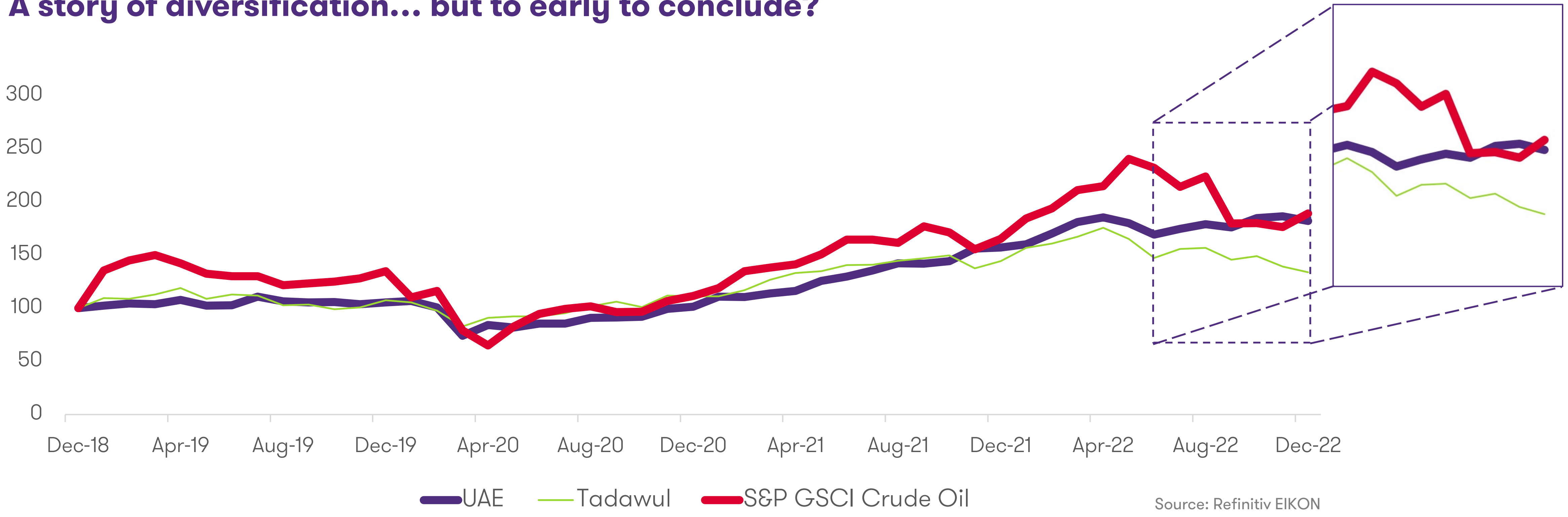
41x Growth in total investors

72% Are foreign investors

647 New institutional investors

Source: Refinitiv EIKON, DFM

A story of diversification… but to early to conclude?



Source: Refinitiv EIKON

- We tried to make an assessment of whether investors are beginning to look at UAE as less intrinsically linked to oil. To ascertain this, we compared the S&P GSCI Crude Oil index to the Tadawul index in Saudi Arabia and the combined indices of Dubai Financial Markets and Abu Dhabi Securities Exchange.
- Whilst it is evident that over the last few years both the Tadawul and the combined UAE related indices have correlated with the movement of oil price, in the last six months or so the combined UAE indices have started to diverge from this correlation.
- This may be an early sign that perhaps investors are beginning to see the UAE as a more diverse place to invest and are beginning to de-link it from the oil price movements.

How do the UAE markets compare to others?

- We considered certain metrics and compared these to the markets in Singapore, Hong Kong, Saudi Arabia and Israel based on proximity to or the relatively similar size of the GDP to the UAE (the "peer markets"). We also considered the US and UK markets, being more developed markets, for comparison purposes.

- It is clear that the number of issuers remains much lower in the UAE than some of the peer markets. There is therefore certainly a gap to be filled and private businesses and family conglomerates need to be encouraged and incentivised to list on the UAE markets.

- The bid-ask spread for the UAE markets remain significantly wider than the peer markets highlighting the historic lack of liquidity in the market. However, as discussed earlier, there has been some considerable improvement recently albeit additional steps will need to be taken to address this matter.

- Overall, during 2022, based on the combined indices performances of DFM and ADX, the UAE markets seem to have outperformed the peer markets as well as developed markets like the US and UK, which has been a positive end to the year.

Family conglomerates and private businesses – the next wave?

- There are multiple global studies available that provide evidence that listed family-owned companies have consistently outweighed the performance of non-family businesses.

- Trust is a major factor why investors have more confidence in family-owned businesses. Family-owned businesses generally tend to have a longer term horizon rather than the short termism and, particularly, in a volatile and uncertain environment, such investment opportunities are more attractive than riskier high growth but high-risk propositions.

Source: Reuter's Refinitiv, Credit Suisse

Conclusion

Our key concluding remarks are as follows:

- Increase in issuers – family and broader private businesses to play their role
  - With the government's expectations for family conglomerates to play their part towards the growth of the economy over the next few years, as set out it in the D33 objectives that were recently announced, the capital markets can play a crucial role in helping to contribute towards this agenda.
- Digitalisation and educating the retail investor
  - As retail investors get access to an increased number of investment and trading platforms, they can play an increasingly important role to help increase the liquidity of the stocks on the market. However, it is critical that retail investors are educated appropriately and their rights are appropriately protected.
- Continued development of the capital market ecosystem
  - There is an important need to improve liquidity in the after market, as highlighted earlier, and there needs to be an increased number of regulated market makers and liquidity providers to help address this issue. Additionally, access to high quality sell-side research will further assist in educating the investor community and lead to a better understanding and interest in investments and trading.
- Dual listings
  - We believe that, in addition to the importance of the participation of private businesses and family conglomerates in the capital markets ecosystem, dual listings will play an increasingly important and potentially game-changing role in the UAE.
  - We have already seen the successful dual listing of Americana recently. Similarly, Olam Group, one of the world's biggest agricultural commodity traders, is reported to be considering a listing of its $3.5 billion agricultural arm in Singapore and Saudi Arabia.
  - Almost 40% of the companies that are listed on the London Stock Exchange comprise international companies which have their primary business located outside of the U.K. We are of the view that there is nothing preventing the UAE as well from attracting international companies to list on the local bourses and this, in addition to the family businesses, is an opportunity that can prove disruptive for the growth of the regional capital markets here.

Source: Zawya, LSE

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