An Introduction to the Principal Stock Exchanges of the UAE, Saudi Arabia, Kuwait and Bahrain

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1. Overview of MENA IPO activity since 2004[i]

There were ten initial public offerings (IPOs) in the Middle East and North Africa (MENA) region in 2004, which raised a total of $1 billion. There then followed a period of rapid growth both in terms of the number of MENA based IPOs and in the amount of equity raised – in the four years from 2005 to 2008 there were 376 IPOs which raised a total of $51 billion.

However, the financial crisis hit the MENA region hard, in a way many had not foreseen. During the last quarter of 2008 and throughout 2009, Gulf Cooperation Council (GCC) and wider Middle East IPO activity decreased significantly in response to falling stock markets, a decrease in oil prices, tighter external financing, the exodus of institutional investor money and overheated property markets. In 2009 only $2 billion was raised in the MENA region, a fall of 86 percent from that raised in 2008.

The decrease in IPO activity was, in part, a result of the global economic climate, but in the GCC it was also a reflection of investor insecurity. Investors headed for more mature markets, such as the New York or London Stock Exchanges, and MENA issuers postponed IPO plans. Whilst the appetite for risk during the boom drove investment in emerging markets, that was no longer the case. Incidents of insider trading, market abuse and concern over how the region's regulatory framework was implemented contributed to the slowdown in MENA IPO activity. In fact, the GCC IPO frenzy was replaced by a near stand-still.

Exchanges within the GCC responded and over the last couple of years have taken measures to increase regulation and strengthen corporate governance requirements in anticipation of, and as an impetus to, the re-emergence of the GCC and wider MENA region as a hub of IPO activity in the aftermath of the global economic crisis.

Growth in MENA IPO activity has slowly returned, but not to the levels of the boom days. The first half of 2010 saw four more IPOs completed (26 vs. 22) and $1 billion more equity raised ($3 billion vs. $2 billion) than in the whole of 2009. Ernst & Young's Global IPO Trends Report 2010 opines that MENA IPOs should see increased growth in the second half of 2010, as over 100 IPOs have been announced. However, the report concludes that this is fewer than expected, possibly due to the MENA IPO market still being affected by global economic uncertainty, which has dampened investor confidence.

The MENA region and its markets remain significant – indeed, the exchanges reviewed here have over 500 listed companies (plus bonds and sukuks) with a combined market capitalization of over $500 billion. This article provides a summary of recent trends, as well as an overview of the key listing requirements in the UAE, Saudi Arabia, Kuwait and Bahrain.

2. Stock Exchanges in the UAE

Over the past decade the UAE has emerged as a hub for international business for a number of industries including construction, banking and finance. The UAE has three principal stock markets: (i) the Abu Dhabi Securities Exchange (ADX) (ii) the Dubai Financial Market (DFM) and (iii) Nasdaq Dubai. On July 11, 2010, Nasdaq Dubai outsourced its trading, settlement, clearing and custody functions to the DFM's systems. This is seen as a possible precursor to further consolidation in the UAE. Currently, however, each of the three exchanges has different listing requirements, the key aspects of which are as set out in the Table on page 2.

2.1 ADX and DFM

The DFM was established in March 2000; shortly afterwards, it became a Public Joint Stock Company (PJSC) with 20 percent of its shares offered for public subscription. The ADX is based

[i] Figures are as reported in *Ernst & Young's Global IPO Trends Report 2010*

in Abu Dhabi and was established in November 2000. Both the DFM and the ADX are on-shore UAE exchanges. Trading takes place in UAE Dirhams, and access by foreign investors to both the DFM and the ADX is restricted to 49 percent of the relevant company, as outlined in the Table below.

Before listing on the DFM or the ADX, the issuer (domestic or foreign) must have been approved by the Emirates Securities and Commodities Authority (ESCA). Securities that may be listed include: shares in PJSCs incorporated in the UAE, shares of foreign companies, bonds, debt instruments and other securities, in each case as have been approved by ESCA.

ESCA imposes supplementary requirements for the listing of securities of foreign companies, including compliance by the issuer with the laws of its country of incorporation, that it is in the form of a PJSC or equivalent and that it is listed on its domestic market. The DFM also requires that: the issuer provides evidence of its financial position, that its accounts comply with IFRS or US GAAP and that its information memorandum and other financial information (as required by the ESCA) are available in both English and Arabic. Issuers listed on the DFM and the ADX are subject to continuing obligations including the disclosure of price-sensitive information, details of dealings by directors in their own shares and details of any shareholdings exceeding 5 percent. On both

Table: Overview of Listing Requirements on the Principal GCC Stock Exchanges

Requirement	DFM / ADX	NASDAQ Dubai	Tadawul – Saudi Stock Exchange	KSE -Official Market & Parallel (Secondary) Market	BSE
Foreign ownership restrictions	Foreign ownership of UAE Public Joint Stock Company (PJSC) limited to 49% (possibly higher). GCC ownership of a PJSC, may in some instances be 100%.	None. However, if the DIFC holding entity owns UAE on-shore companies and applicable consents have been obtained, foreign ownership may be limited to 49%.	No foreign ownership permitted. Other GCC nationals may own or deal in securities in certain circumstances (on a case-by-case basis). Since August 2008, foreigners can invest through certain 'swap' derivatives transactions with a licensed broker.	Foreign ownership of banks limited to 49% (with any stake of 5% or more in a bank requiring Central Bank approval). No general limits in relation to other industries.	Generally 49% maximum cap on foreign ownership for non GCC nationals. 2 companies require 100% Bahraini ownership and 12 companies allow 100% foreign ownership.
Minimum Free Float	55% for PJSCs (UAE company law requirement)	25%	30%	30%	As prescribed by the CBB
Minimum number of shareholders	100 (in case of foreign issuer only for ADX)	No minimum (currently)	200	OM - No minimum PM - 50	100
Paid-up share capital	ADX: AED 20m (approx $5.4m) for domestic issuer and AED 40,000,000 (approx $10.9m) for foreign issuer DFM: AED 25m (approx $6.8m) for domestic issuer (rules allow down to AED 20m if that represents 35% of shareholder equity) and AED 40m (approx $10.9m) for foreign issuer.	None. The issuer, however, must have an expected market capitalization of at least $50m.	SR 2m (approx $530,000). Where shares are being offered to the general public this is increased to SR 10,000,000 (approx $2.7m).	OM - KD 10m (or equivalent in a foreign currency, approx $35m) PM - KD 3m (or equivalent in a foreign currency, approx $10.5m).	Paid-up capital must be at least BD 500,000 (approx $1.3m), and the number of issued shares must be at least 500,000. At least 50% of the issued shares must be paid up. Any foreign issuer's paid-up capital must be at least $10m.
Minimum shareholder equity (i.e. net assets)	No less than paid-up capital for a domestic issuer and 120% of paid up capital for a foreign issuer.	None	SR 100,000 (approx $26,695) in the case of share listings and SR50,000 (approx $13,350) in the case of bond listings and other securities	OM - KD 11.5m or equivalent (approx $40.2m) PM - No less than the issuer's paid-up capital.	In the case of domestic issuers, net assets must exceed paid-up capital by at least 20%.
Net profits	ADX: 5% of paid up capital for each of 2 years prior to listing DFM: Domestic issuer: just audited accounts for the 2 years prior to listing. Foreign issuer: 5% of paid up capital for each of 2 years prior to listing	Not required. The issuer, however, must have published audited accounts covering at least 3 years in accordance with IFRS or other acceptable accounting standards	No specific requirement.	OM - 7.5% of paid-up capital or KD7.5m (approx $26.2m) for each of the 2 years preceding the listing application PM - as above, but reduced to 5%.	A domestic issuer must have recorded net profits for each of the 2 years preceding the listing application. This is increased to 3 years for a foreign issuer.
Regulator	ESCA	DFSA	CMA	CMA (as of Sept 2010)	Central Bank of Bahrain / Capital Markets Supervision Directorate.
Total Market Cap - Primary listings (approx Oct 10) *(Zawya)*	ADX: $68.3 billion DFM: $36.2 billion	$27.4 billion	$336.1 billion	$113.5 billion (aggregate for OM and PM)	$17.4 billion
No. of Listed Stocks *(Zawya)*	ADX: 64 DFM: 64	24	145	224 (with 14 listed on the PM).	49

the DFM and the ADX, the issuer must provide audited financial statements and other financial information as required by ESCA. In relation to the offering price for an IPO, ESCA does not generally permit book-building, instead the valuation is agreed with it.

The DFM and the ADX have not historically been known for their transparency and compliance with corporate governance international best practices, however this may change. The mandatory Corporate Governance Code for Joint-Stock Companies and Institutional Discipline Criteria (focusing on the issuer's board and its committees) came into force on April 30, 2010 and it is reported that the minimum free float requirement may reduce to 30 percent (through a change in UAE company law). These changes can only help make the UAE on-shore exchanges more attractive to local and foreign investors.

2.2 NASDAQ Dubai

Nasdaq Dubai (formerly the Dubai International Financial Exchange or DIFX), was established in 2004 and is regulated by the Dubai Financial Services Authority (DFSA). In December 2009, Nasdaq Dubai was acquired by DFM and in July 2010 many of its back office functions were merged with the DFM. Securities are now encouraged to be listed in UAE Dirhams and the exchange's opening hours have been changed to align with the DFM's. As noted above, this may signal the start of a consolidation process although the listing requirements and identity of the regulator remain different.

Nasdaq Dubai accepts foreign issuers and a wide range of equities, sukuk, debt and structured products. The DFSA requires that both the issuer and the securities satisfy certain conditions. In determining the suitability of an issuer, the DFSA considers several factors, including the issuer's published audited accounts and constitutional documents. Nasdaq Dubai also requires an adequate and open market in the issuer's securities – in practice, a minimum free float of 25 percent. Valuation is typically determined following a book-building process.

The securities must meet certain requirements: the listing must relate to a whole class of securities, the class must carry the same rights, and any restrictions on transferability must be pre-approved by Nasdaq Dubai. In addition, once the issuer has obtained a listing, it must comply with a series of "continuing obligations" similar to those imposed by other exchanges worldwide.

There also plans to reform the existing regulatory framework following consultation over the last year. The proposals include increasing the shareholder minimum to 300 (with each shareholder holding a minimum of 100 shares), requiring an issuer to make all materials referred to in its prospectus available for public inspection and introducing new obligations for the lead manager.

2.3 Tadawul –Saudi Stock Exchange

The principal stock exchange of Saudi Arabia is the Tadawul. It is also arguably the leading stock exchange in the MENA region, outperforming the other GCC exchanges in recent times. The position of the Tadawul is, in part, a result of the size of the economy of Saudi Arabia, but also a reflection of the regulatory, political and economic developments that have taken place within Saudi Arabia.

Saudi Arabia implemented the Capital Markets Law of 2003, followed by the establishment of the Capital Markets Authority (CMA) in 2004. The Capital Markets Law and the CMA ensure that listing rules, continuing disclosure obligations and market conduct standards are introduced and applied in a manner similar to those in other international exchanges.

The implementation of the regulatory framework, however, has not always been consistent and transparent. As a result, there have been recurring allegations of insider trading and market manipulation, which has led many investors to view the Tadawul as a risky (albeit potentially highly lucrative) option.

The manner in which the existing regulatory framework has been put into place has also raised investor concern. The CMA and its board possess a great deal of discretion in implementing rules and regulations, leading to an arbitrary application of the regulations, depending on the issuer and the securities to be listed.

The Tadawul started the process of opening up to foreign investment in July 2008 by allowing derivative products such as swap agreements (although counter-party risk remains and the foreign investor enjoys no voting rights). However, the significant restrictions on foreign ownership are still a barrier to the development of the Tadawul as a leading global exchange. Nonetheless, the liberalization push continues in Saudi Arabia, and certain new products became available in 2010. For example, the first Saudi exchange traded fund open to foreign investors was established in March 2010, however, after its launch it became clear that an investor needs a Saudi bank account, which may limit its appeal.

2.4 Kuwait Stock Exchange (KSE)

The KSE has been in operation since 1961. Historically, speculative trading and a failure to comply with official exchange listing requirements have had an adverse impact on the KSE, as evidenced by the market collapses of 1976 and 1982. Since then, the Kuwaiti government has undertaken a series of reforms to increase the efficiency of the KSE and the overall marketplace, which have continued throughout 2010 with the formation of a new Capital Markets Authority (CMA) as noted below.

In addition, the growth and development of the KSE have been constrained by additional factors including a lack of market makers, foreign ownership restrictions (particularly for non-GCC nationals), significant government intervention, a prohibition on short selling, a lack of alternatives for securities lending and borrowing and lax information and disclosure requirements. The allegations of insider trading and market manipulation in recent years dealt a further blow to the KSE, which have led to SEC investigations in the United States and high-profile media coverage such as of the hoax takeover offer for Harman International in July 2009.

The KSE responded by implementing new Ministerial Decisions for 2009 including reforms to: (i) the manner in which listed companies can buy and sell their own equities on the KSE, (ii) the procedures where a sale of 5 percent or more of a listed company's capital stock is at issue, (iii) the selling fees on the KSE, and (iv) the settlement procedures for trading on the KSE. These Ministerial Decisions aimed to increase transparency and place a greater onus on brokers to ensure that they know their customers and are able to confirm both the ownership of traded securities and their clients' ability to pay for (or guarantee the value of) the securities being traded.

In 2010, the Kuwait Parliament enacted laws to set up the CMA as an independent regulatory body to oversee the KSE and ensure transparency. This is seen as a significant step forward. The new laws also introduced a Capital Markets Tribunal with jurisdiction over stock market offences including fraud and insider trading. On September 8, 2010 the CMA was appointed and a process is underway to establish a new regulatory regime. Once in place, this should provide some much needed stability to the KSE.

2.5 Bahrain Stock Exchange (BSE)

The BSE commenced operations in June 1989. The BSE has implemented a relatively sophisticated regulatory framework, together with appropriate clearing and other operational support systems, which historically has given the market credibility vis-à-vis potential investors (both local and foreign).

The Central Bank of Bahrain (CBB) regulates the BSE and in doing so exercises a large degree of discretion. A new Corporate Governance Code was issued in early 2010, forming part of the CBB's rulebook which applies to all Bahraini PJSCs on a 'comply or explain' basis. The provisions require the separation of the chairman and CEO roles and that at least half of the board of the issuer consists of non-executive directors. In addition, in the summer of 2010, the CBB updated the regulatory regime relating to disciplinary actions and the resolution of disputes. These measures should further help restore confidence in the BSE, which was badly hit by the financial crisis when the aggregate market capitalization of the issuers on the exchange more than halved.

3. Conclusions

The GCC has real potential to emerge as a significant player in the global IPO arena. However, the region needs to overcome market instability and poor company valuations before investors return to the GCC's capital markets as a source of funding in the way they did in the period 2005 to 2008. Nonetheless, some commentators have predicted that as soon as market pricing improves, revised fundamentals, massive financial reserves and a robust IPO pipeline will bode well for a revival of IPO activity in the GCC and, in particular, Saudi Arabia. Secondary listing of MENA based companies' securities on overseas exchanges may also prove popular for a variety of reasons, including easing access to foreign capital and addressing any regional regulatory or reputational concerns.

Challenging corporate governance and regulatory issues remain high on the agenda. Recent developments and overhauls of regulatory regimes are a step in the right direction. The GCC exchanges must show that they are reliable and robust, while GCC issuers need to recruit qualified independent board members, enhance internal controls, form qualified audit committees, implement board meeting and reporting processes, create management compensation structures and resolve related party transaction issues. If these issues can be successfully addressed, the GCC may well position itself as one of the significant players in the global IPO arena.

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