Saudi IPO Market:
The Saudi IPO market is showing signs of recovery after a few slow years post 2009. Historically, deal count peaked in 2006 and 2007, mostly due to the increase in insurance IPOs. Deal count and value are expected to pick up again in the second half of 2014 and the next two years. It is worth noting that in the examined period (2003 – 2014) companies from 14 different sectors have filed for IPO amounting to a total of 91 companies and total offer size of more than SAR107Bn.

Key Findings:
- 2014 is expected to be one of the highest years in terms of total IPO Deal Value.
- Saudi IPOs average returns are relatively higher than other regional and international markets.
- Insurance companies exhibit the highest average returns in all examined time frames followed by petrochemical companies.
- The Insurance sector had the highest number of IPOs followed by the retail sector.
- Issuance in the examined period was broad, covering 9 sectors.
- SAR 107.7Bn was raised in IPOs in the examined period, averaging SAR 1.17Bn per IPO.
- A smaller offer size\(^1\) was correlated with higher median returns in almost all examined time frames, as smaller companies typically experience higher volatility and higher price swings.
- There is an apparent corporate age gap between the companies filing for IPO. The majority being either exempt from the regulatory requirement or being relatively old in terms of years since inception.
- Changes in regulations limiting daily price change have altered post IPO price swings causing more stable increase overtime rather than radical short term price hikes.
- Limited risks and opportunity costs makes maximum exposure to IPOs along with accumulation prior to historical peaks and a short to medium term exit scheme a general investment strategy tailored for Saudi IPOs.

\(^1\) Proceeds raised from the IPO.
Investment Approach Based on Market data and Findings:

The dynamics of the Saudi IPO market are quite unique. The returns, risks, available opportunities, price movement pattern, and market participants are all factors that differentiate Saudi IPOs. Taking these dynamics into account in making the investment decision is crucial for a return maximizing approach to IPO investment.

Before the price movement cap, investing in Saudi IPOs almost guaranteed high returns in the first few days. Many companies experienced moonshots in the years 2006 to 2009. Some of which were large companies, including names like YANSAB, AL Bilad Bank, and Emaar Economic City. During that time period, high returns in IPOs were mostly made by flipping stocks in a mostly speculative manner. This is similar to the behavior exhibited in the dot-com era in the US market.

The norm in IPOs however has changed since. It is worth noting that IPOs in Saudi Arabia still provide high returns to investors, beating market returns in the short and medium run in every recent IPO. The change in regulation setting a 10% cap on movement sets the daily price change in IPOs in par with the maximum market movement. This cap on movement limits both the risks and rewards involved in investment in IPOs compared to an investment in the market. This also has the effect of limiting the opportunity cost involved in investing in an IPO as opposed to investing in the market. This unique case of risk and reward in the Saudi market as well as the limited number of IPOs per quarter triggers a surge in liquidity towards the stock making almost every IPO worthwhile as an investment option.

The allotment of an IPO to investors is another variable to consider in an IPO investment decision. In most occasions the allotment per retail investor is low, which affects potential returns, even in the case when the stock experiences a 100% jump in price in the first few weeks, the investment might still be deemed not worthy for the individual investor. Note, however, that retail investors in Saudi IPOs get higher allotments on average than most developed markets\(^2\). On the other hand, institutional investors get a larger allotment, usually with a lockup period set and mentioned in the prospectus. For institutional investors, the investment is attractive in terms of possible returns given the high average returns exhibited in Saudi IPOs and the limited risks and low opportunity cost compared to IPOs in other markets.

From an entry point perspective, retail investors can maximize exposure by going for full retail subscription and adding exposure through funds investing in the targeted IPO. Accumulating post IPO is rarely possible in the first two weeks in the Saudi market due to high demand, yet IPOs can still be profitable prior to the first month of trading which makes it a reasonable yet riskier accumulation point with lower potential return.

Developed markets usually experience a dip in the price of the company post IPO, ruling out the issuance price as the lowest price available in the short and medium run. This is not the case in Saudi IPOs, less than 7% of the time do companies dip in price to levels below issuance price. This makes investing at issuance the lowest price point in the short and medium run and that is one of the reasons why maximum exposure to IPOs in Saudi is recommended as an entry point approach.

From an investment exit standpoint, it is difficult to back an exit strategy without further data. The limitation of data is simply due to the fact that the change in regulation took place mid-2013, making the long term view out of sight. Limitation of data also applies to the small sample of IPOs along with the narrow sector exposure after the regulation took place (6 companies, 5 sectors). However, from the available data we notice gradual price increase moving towards the three months point, which might gradually emerge as the point where price peaks as more data becomes available.

It is worth noting that IPOs are displaying similar behavior in terms of price movement, the limitations imposed by the regulator only makes price movement slightly predictable compared to an open market. Overall, given the available data, investors should take a less cautious approach to IPOs in Saudi Arabia compared to developed markets. Maximum exposure is recommended along with a short to medium term exit strategy.

\(^2\) Term used for IPOs that double in price during the first trading day.
Insurance IPOs top the list as the most IPOs in the past decade, most of which were between 2006 and 2008. Retail and building & construction companies fell second and third at ten and nine IPOs respectively. Issuance across sectors vary, a main factor affecting issuance is government support. Certain companies in petrochemicals, cement, and real estate have filed for IPOs before being fully operational; these are mostly projects and efforts supported by government entities in an overall step to accelerate targeted economic goals.

The telecom sector raised the highest amount since STC’s IPO with a total of around SAR 24Bn followed by petrochemicals with a figure just shy of SAR 20Bn. An additional SAR 18Bn is expected to be added to the market by the end of 2014, having at least two more IPOs in the pipeline. It is worth noting that the regulatory framework allows for confidential submissions, taking that into account, it is not out of reach for the market to add more than the estimated value above.

The next few years are expected to hold the momentum of 2014 in terms of proceeds lifting the Saudi IPO market from its post 2009 slump. The figure below illustrates a breakdown of proceeds raised by each sector covering the major sectors.

**Figure 2: Issuance and Issuance Announcement VS Market Index (2005 - 1H 2014):**

Insurance IPOs top the list as the most IPOs in the past decade, most of which were between 2006 and 2008. Retail and building & construction companies fell second and third at ten and nine IPOs respectively. Issuance across sectors vary, a main factor affecting issuance is government support. Certain companies in petrochemicals, cement, and real estate have filed for IPOs before being fully operational; these are mostly projects and efforts supported by government entities in an overall step to accelerate targeted economic goals.

The telecom sector raised the highest amount since STC’s IPO with a total of around SAR 24Bn followed by petrochemicals with a figure just shy of SAR 20Bn. An additional SAR 18Bn is expected to be added to the market by the end of 2014, having at least two more IPOs in the pipeline. It is worth noting that the regulatory framework allows for confidential submissions, taking that into account, it is not out of reach for the market to add more than the estimated value above.

The next few years are expected to hold the momentum of 2014 in terms of proceeds lifting the Saudi IPO market from its post 2009 slump. The figure below illustrates a breakdown of proceeds raised by each sector covering the major sectors.

**Figure 3: Total Offer Size per Sector (2003 – 1H2014) (mn):**

Insurance IPOs top the list as the most IPOs in the past decade, most of which were between 2006 and 2008. Retail and building & construction companies fell second and third at ten and nine IPOs respectively. Issuance across sectors vary, a main factor affecting issuance is government support. Certain companies in petrochemicals, cement, and real estate have filed for IPOs before being fully operational; these are mostly projects and efforts supported by government entities in an overall step to accelerate targeted economic goals.

The telecom sector raised the highest amount since STC’s IPO with a total of around SAR 24Bn followed by petrochemicals with a figure just shy of SAR 20Bn. An additional SAR 18Bn is expected to be added to the market by the end of 2014, having at least two more IPOs in the pipeline. It is worth noting that the regulatory framework allows for confidential submissions, taking that into account, it is not out of reach for the market to add more than the estimated value above.

The next few years are expected to hold the momentum of 2014 in terms of proceeds lifting the Saudi IPO market from its post 2009 slump. The figure below illustrates a breakdown of proceeds raised by each sector covering the major sectors.
Profitability of IPOs in Saudi Arabia

Strategy Report

September 2014

Please read Disclaimer on the back

A drop in total offer size per year, expected recovery:

Proceeds from IPOs dropped dramatically from its last high in 2009. Total proceeds raised in the years 2003 to 1H-2014 reached SAR 107Bn with an average per IPO of SAR 1.18Bn.

2008 had the highest total proceeds raised at SAR 35.9Bn having Zain, Al Inma Bank, and Petro Rabigh’s IPOs all in the first half of the year. On the other hand, 2011 had the lowest total at SAR 1.56Bn.

Table: Offer Size per year (SAR mn).

<table>
<thead>
<tr>
<th>Year</th>
<th>Average</th>
<th>Median</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>1436.5</td>
<td>1467.5</td>
<td>5746</td>
</tr>
<tr>
<td>2006</td>
<td>1214.7</td>
<td>1104</td>
<td>10932.2</td>
</tr>
<tr>
<td>2007</td>
<td>868.8</td>
<td>171.2</td>
<td>19033.2</td>
</tr>
<tr>
<td>2008</td>
<td>2767.45</td>
<td>723.6</td>
<td>35976.91</td>
</tr>
<tr>
<td>2009</td>
<td>414.4</td>
<td>80</td>
<td>3730</td>
</tr>
<tr>
<td>2010</td>
<td>360.4</td>
<td>243</td>
<td>3964.6</td>
</tr>
<tr>
<td>2011</td>
<td>391.75</td>
<td>373</td>
<td>1567</td>
</tr>
<tr>
<td>2012</td>
<td>685.7</td>
<td>694.8</td>
<td>5486</td>
</tr>
<tr>
<td>2013</td>
<td>437.73</td>
<td>270</td>
<td>1750.95</td>
</tr>
<tr>
<td>1H 2014</td>
<td>500</td>
<td>452.5</td>
<td>2000</td>
</tr>
</tbody>
</table>

High Average Returns:

Generally, IPOs are underpriced at issue\(^3\). However, the swings in the first few days after the issue date vary in different markets as well as in different sectors. The Saudi market exhibits high returns in the first few days of trading compared to other markets. Saudi IPOs rarely contract in price in the first few days of trading, less than 7% of Saudi IPOs contract in the first day compared to 22% in 2013 alone in the US market and contraction in price being the norm in recent Japanese IPOs.

It is also worth noting that other markets exhibited similar high swings in the first few days of trading. These markets share certain attributes; they are mostly frontier or emerging markets, enjoy a level of protection, mostly young compared to developed markets, and experience consistent over subscription in the IPO market.

Figure 4: Sector IPOs per Year:

Source: Bloomberg, Reuters, Aljazira Capital Research.

Figure 5: Average 3 Day Returns in Different Markets:

Source: Bloomberg, Reuters, Aljazira Capital Research.

\(^3\) Underpricing is a general approach to IPOs in an effort to make the investment attractive and allow for a price hike post listing.
Saudi IPO returns peaked on average after one month of trading, recording returns above 200%^4. Returns start a declining pattern after six months of trading. A closer look at Saudi IPO returns reveals that Saudi returns excluding insurance companies would provide a more realistic portrait of IPO returns. Average returns are substantially lower after excluding insurance returns.

**Figure 6: Average Returns vs. Average Returns Excluding Insurance Sector:**

![Graph showing average returns vs. average returns excluding insurance sector](source)

**Sector Returns:**

A full breakdown of sector returns show that other than the abnormal insurance sector returns, petrochemical returns were high in the first few days till the end of the first month. Examining these issues reveal that most of these IPOs were exempted from the regulator three years of operation and audit financials requirement as well as being backed and supported by government entities. Real estate companies show a similar pattern. This pattern of having high returns and government support usually comes with previous build up prior to the IPO. Cement companies showed consistency over time, mostly given regular IPO underpricing practiced in Cement IPOs. Building and Construction lagged behind other sectors in the long term.

**Figure 7: Average Return per Sector:**

![Graph showing average return per sector](source)

---

^4 Sample includes 89 companies in the period from 2003 to 1H 2014.
Market and economic conditions during the IPO’s first trading days, i.e. IPO timing, play a role in early price swings. IPOs in 2007 had the highest average three day returns, followed by 2009. Insurance IPOs and bullish market sentiments both had a role in marking the years with the highest average three day returns. Bearish markets and economic condition could partially account for relatively low returns in 2008. Evidence indicates that IPOs in bearish periods performed below average in the Saudi market and in developed markets. The chart illustrates the average return per year for companies that started trading in that specific year.

Figure 8: Average Return per Year:

Different Market, Different Returns:

Frontier and emerging markets experience higher post IPO returns compared to developed markets. This is also evident in financially conservative markets where investors are “protected” from foreign investors. A comparison of average one year returns for IPOs in the United States, UK, and Saudi Arabia show a large difference in returns for the first year of trading. Saudi companies return on average 177.8% compared to the United Kingdom’s 36.2% and the United States at 24.1%. A full comparison of returns over time is shown in the graph below.

Average returns over different time frames show the difference between Saudi IPO returns and other developed markets. Saudi IPO returns are somewhat similar to other less developed markets showing abnormally high returns compared to developed markets. This pattern is expected to change overtime given both new regulation controlling one day returns at 10% and an increase in the number of IPOs in the long run.

Figure 9: IPO Average Returns in Different Markets:

5 Sample covers 89 IPOs (2003 - 1H 2014)
6 Sample covers 328 IPOs (2003 - 1H 2014)
7 Sample cover 483 IPOs (2002 – H1 2014)
Long-Term Performance:

Data from developed markets indicate that on average, IPOs tend to underperform the market in the period between three and five years after the IPO. The Saudi IPO market shows a different pattern; companies outperform the market on average in the medium and long run. IPO returns outperformed the annual 18.3% market return. A comparison with different developed markets highlights the substantial difference in long run performance based on one, two, and three year average returns. The only market experiencing steady growth in return in the long run was the US market; other markets suffered declines while the UK and Japanese IPOs turned to negative returns.

Figure 10: IPO Long Run Performance across Markets:

Source: Bloomberg, Reuters, Aljazira Capital Research.

Issue price and Age of companies filing for IPO:

Generally, there seems to be a level of price sensitivity in the Saudi IPO market. This is evident in the subscription behavior exhibited by individual investors in the market, which is reflected in the price behavior in the first few days of trading. Data shows that IPOs with a lower issue price exhibit a higher price in the first few days of trading regardless of the offer size. Generally, all else equal, IPOs priced below market midpoint display higher average returns. Median issue price is at SAR 20 and average price is at SAR 36.1.

Saudi companies filing for IPO have an average corporate age of 11.6 years. There is an apparent age gap in the market where companies over twenty five years and companies below three years form the majority while companies in the prime IPO age of three to ten years form 14.4% of companies filing for IPO. This is not the case in developed markets. Factors weighing in on this pattern include the exemption from certain IPO requirements for semi government companies, government supported and economic projects, and exemption for certain sectors based on market and economic needs (Insurance and Cement).

Figure 11: Age Bracket Breakdown

Source: Bloomberg, Reuters, Aljazira Capital Research.
Limiting Daily Price Movement:

It is important to take into consideration the changes in IPO regulatory framework made by the Capital Market Authority (CMA) in Saudi Arabia to limit daily price movement at 10%. The change was made in two steps, years apart. The first being in 2006 where the change limited daily price oscillation in all trading stocks to 10%, excluding the first day of trading post IPO. The second step took effect mid 2013 where the first day post IPO trading was capped at 10% price oscillation. The cap set by the CMA changed the dynamics of IPO returns. Returns take longer to peak compared to previous IPOs as well as eliminating moonshots, this also implies that prices will take longer to adjust and touch fair value after peaking. The change in regulation is expected to stabilize post IPO price movement and returns overtime. It is worth noting that the cap has not been in effect for more than a year so far which makes it difficult to examine long term effects of this policy.

IPO Market Outlook:

2014 promises to be one of the most active IPO years in terms of gross proceeds. Four companies have filed for IPO and started trading during H1 2014 with total value raised at SAR 2B. At least two more IPOs are expected to trade before the end of the year adding more than SAR 18 Billion in proceeds, mostly from NCB’s (National Commercial Bank) upcoming IPO. Ending the year with total raised proceeds above SAR 20 billion, potentially marking 2014 as one of the highest years in proceeds raised.

The next few years are expected to hold 2014’s IPO momentum and drive up the number of deals providing a level of consistency in the number of issues. The value raised on the other hand is expected to be lower per year. Positive growth opportunities in the kingdom along with both government support in the form of large projects and privatization efforts are the main drivers of the IPO market in the kingdom. The success of recent IPOs in terms of returns would have a positive effect on market sentiment towards upcoming IPOs going forward.
Aljazira Capital, the investment arm of Bank Aljazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. Aljazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. Aljazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, Aljazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated “Overweight” will typically provide an upside potential of over 10% from the current price levels over next twelve months.

2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated “Underweight” would typically decline by over 10% from the current price levels over next twelve months.

3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated “Neutral” is expected to stagnate within +/- 10% range from the current price levels over next twelve months.

4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further investigation in the security or any other assets. Some stocks or securities maybe, by nature, of low volume/trades or may become like that unexpectedly in special circumstances and this might increase the risk on the investor. Some fees might be levied on some investments in securities. This report has been produced by professional employees in Aljazira Capital, and they undertake that neither them, nor their wives or children hold positions in any listed shares or securities contained in this document during the time of publication of this report, however, The authors and/or their wives/children of this document may own securities in funds open to the public that invest in the securities mentioned in this document as part of a diversified portfolio over which they have no discretion. This report has been produced independently and separately by the Research Division at Aljazira Capital and no party (in-house or outside) who might have interest whether direct or indirect have seen the contents of this report before its publishing, except for those whom corporate positions allow them to do so, and/or third-party persons/institutions who signed a non-disclosure agreement with Aljazira Capital. Funds managed by Aljazira Capital and its subsidiaries for third parties may own the securities that are the subject of this document. Aljazira Capital or its subsidiaries may own securities in one or more of the aforementioned companies, and/or indirectly through funds managed by third parties. The Investment Banking division of Aljazira Capital maybe in the process of soliciting or executing fee earning mandates for companies that is either the subject of this document or is mentioned in this document. One or more of Aljazira Capital board members or executive managers could be also a board member or member of the executive management at the company or companies mentioned in this report, or their associated companies.

Disclaimer

The purpose of producing this report is to present a general view on the company/economic sector/economic subject under research, and not to recommend a buy/sell/hold for any security or any other assets. Based on that, this report does not take into consideration the specific financial position of every investor and/or his/her risk appetite in relation to investing in the security or any other assets, and hence, may not be suitable for all clients depending on their financial position and their ability and willingness to undertake risks. It is advised that every potential investor seek professional advice from several sources concerning investment decision and should study the impact of such decisions on his/her financial/legal/tax position and other concerns before getting into such investments or liquidate them partially or fully. The market of stocks, bonds, macroeconomic or microeconomic variables are of a volatile nature and could witness sudden changes without any prior warning, therefore, the investor in securities or other assets might face some unexpected risks and fluctuations. All the information, views and expectations and fair values or target prices contained in this report have been compiled or arrived at by Aljazira Capital from sources believed to be reliable, but Aljazira Capital has not independently verified the contents obtained from these sources and such information may be condensed or incomplete. Accordingly, no representation or warranty, express or implied, is made as to, and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this report. Aljazira Capital shall not be liable for any loss as may arise from the use of this report or its contents or otherwise arising in connection therewith. The past performance of any investment is not an indicator of future performance. Any financial projections, fair value estimates or price targets and statements regarding future prospects contained in this document may not be realized. The value of the security or any other assets or the return from them might increase or decrease. Any change in currency rates may have a positive or negative impact on the value/return on the stock or securities mentioned in the report. The investor might get an amount less than the amount invested in some cases. Some stocks or securities maybe, by nature, of low volume/trades or may become like that unexpectedly in special circumstances and this might increase the risk on the investor. Some fees might be levied on some investments in securities. This report has been produced by professional employees in Aljazira Capital, and they undertake that neither them, nor their wives or children hold positions in any listed shares or securities contained in this document during the time of publication of this report, however, The authors and/or their wives/children of this document may own securities in funds open to the public that invest in the securities mentioned in this document as part of a diversified portfolio over which they have no discretion. This report has been produced independently and separately by the Research Division at Aljazira Capital and no party (in-house or outside) who might have interest whether direct or indirect have seen the contents of this report before its publishing, except for those whom corporate positions allow them to do so, and/or third-party persons/institutions who signed a non-disclosure agreement with Aljazira Capital. Funds managed by Aljazira Capital and its subsidiaries for third parties may own the securities that are the subject of this document. Aljazira Capital or its subsidiaries may own securities in one or more of the aforementioned companies, and/or indirectly through funds managed by third parties. The Investment Banking division of Aljazira Capital maybe in the process of soliciting or executing fee earning mandates for companies that is either the subject of this document or is mentioned in this document. One or more of Aljazira Capital board members or executive managers could be also a board member or member of the executive management at the company or companies mentioned in this report, or their associated companies.

Asset Management | Brokerage | Corporate Finance | Custody | Advisory

Head Office: Madinah Road, Mosadia, P.O. Box: 6277, Jeddah 21442, Saudi Arabia, Tel: 02 6692669 - Fax: 02 669 7761