In the Public Spotlight

The UAE's IPO market is dominated by large, multimillion-dollar firms. With the government's renewed focus on the advancement of SMEs, the question around the potential of SMEs going public has been doing the rounds in the industry.

By Sidra Tariq, Dubai

NASDAQ Dubai, which is regulated by Dubai Financial Services Authority (DFSA), also set up an advisory group early last year to discuss potential developments and regulatory frameworks that would encourage SMEs to get publicly listed.

While the 'S' part of the SME equation doesn't fit the IPO picture, the benefits for medium-sized businesses going public can be attractive. "By raising capital in the IPO market, [SMEs] can get access to a vast shareholder base and can use that to raise even more capital to fund their future activities to acquire new strategic interests that are aligned with their long term growth," says Alexandar Williams, director of the strategy and policy division at Dubai SME, an agency of Dubai's Department of Economic Development mandated to develop the SME sector.

"It also gives you a certain branding premium. The market will know this SME is a Nasdaq Dubai or Dubai Financial Market (DFM) company; therefore, its branding value increases in terms of reputation. Once you are in the league, a lot of investors and institutions will want to make deals and be associated with you."

Lukewarm response

However, the uptake within the UAE's SME market has not been tremendous yet, say experts. Speaking about the companies in the Dubai SME 100 ranking, which is a list of the best performing SMEs in the emirate, Williams says, "There is a lot of interest in the whole intellectual and practical discussions regarding an IPO for SMEs. But while many of our SME 100 companies are

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financially-savvy, that leap forward to an IPO is still an unchartered territory."

Hisham Farouk, managing director of accounting and consulting firm Grant Thornton UAE, says approximately five to ten of the firm's clients are 'considering' listing in the capital markets, out of which only two to three can be classified as SMEs. Under the Dubai SME definition, a typical SME can be defined as a company that has less than 250 employees and an annual turnover of less than AED250 million.

According to experts, there currently don't appear to be any SMEs listed in the UAE's capital markets. Last year, there was news of Abu Dhabi-based restaurant chain Just Falalel planning for an IPO, which would have made it the first publicized SME IPO in the country. The company had reportedly hired an advisor to help it prepare for a listing on Nasdaq Dubai. However, over the past few months, it has been continuing its aggressive global expansion plans, largely driven by franchise agreements, and the IPO matter has gone quiet. Just Falafel has declined to comment on the IPO at this stage.

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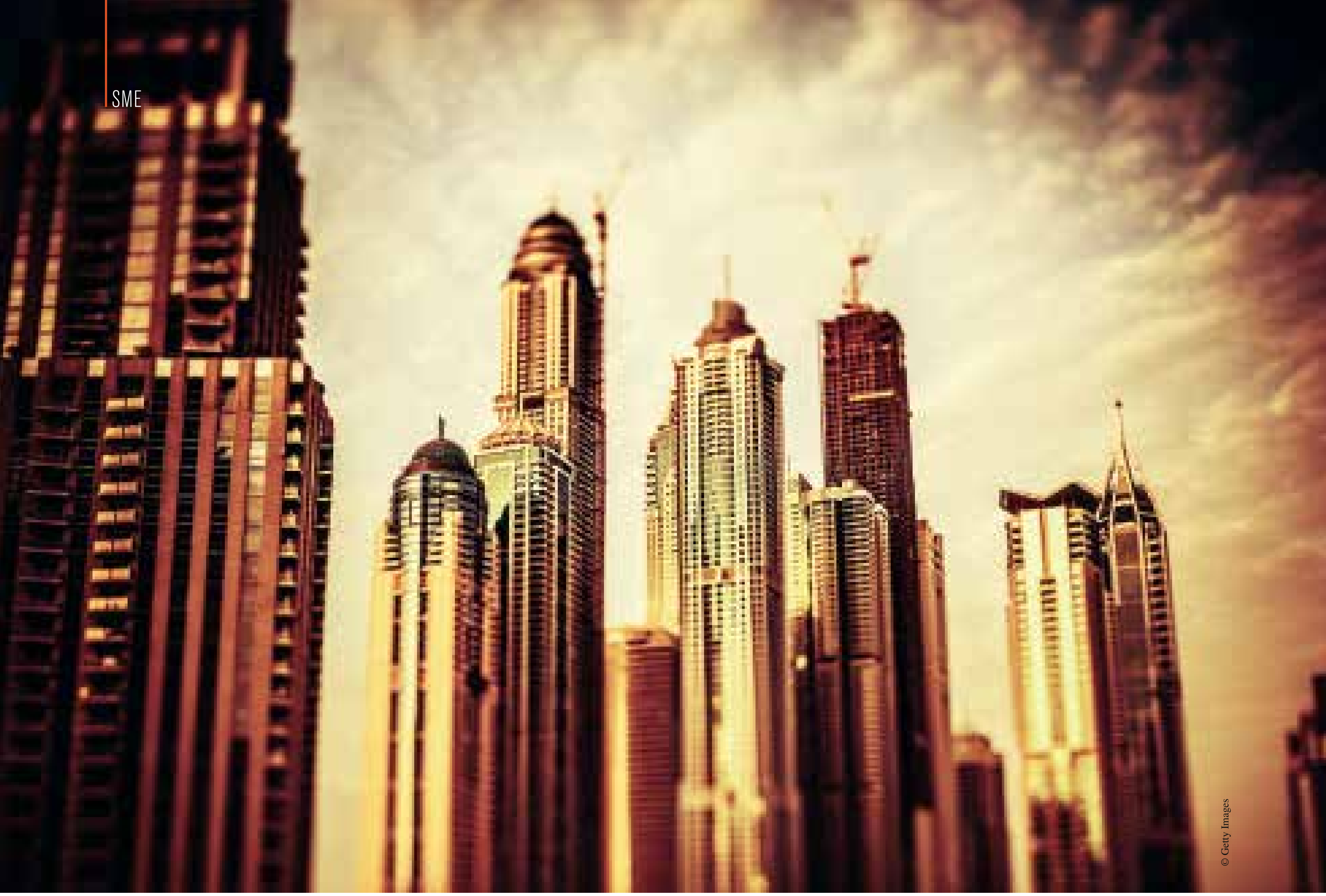
"It could be that they were consolidating," Farouk speculates. "Their model is driven by giving franchises and it takes time for these outlets to open up and generate income. It could be that they are on the right track, have a lot of contracts signed for the franchises, but it is just the physical time it will take for these to open up and generate the income so that their financials look a little bit more positive."

Meanwhile, Prathit Harish, partner at auditing firm PwC in the Middle East, which advises Nasdaq Dubai and is also part of the advisory group, says, "Just Falafel has been going through its expansion streak and has had multiple rounds of funding, [which have] been through venture capitalists (VCs) as well as private equity (PE) players. The moment you have VCs, PEs and others funding the business, it removes you from the need to invest time and effort in an IPO. They have massive expansion plans in the region and perhaps they are able to now manage those investment plans through large chunks of PE funding. The management may feel that getting into an IPO is probably not a good time for them."

He adds that, "the main source of funding for medium-sized enterprises still continues to be banks."

According to a 2010 report by the Union of Arab Banks and The World Bank, entitled: 'The Status of Bank Lending to SMEs in the MENA Region', only four per cent of banking lending in the UAE goes to SMEs, when compared to approximately 14 per cent in non-GCC markets. ▶



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Over the years, however, there has been an improvement, Harish says. "There is a high degree of liquidity available within banks and they are now spreading that to SMEs. There is easier funding available. But it is still fairly expensive. A good, well-run SME still ends up paying anywhere between eight to 11 per cent in interest, per annum."

Barriers to entry

Filing for an IPO involves a massive amount of due diligence and preparation, which may prove to be challenging for an SME. To go public, a company must have a solid corporate governance structure, strong management team and culture, at least two to three years of audited financials, a sustainable turnover and a strategic long-term plan for the business and how the funds will be allocated, among other factors. Nasdaq Dubai, for instance, requires three years' audited financial statements as part of its application criteria.

The process also involves appointing legal, financial and due diligence advisors that need to assess the company's track record and structure and ensure that it meets the regulator's requirements in terms of documentation and infrastructure – which requires time, funds and resources.

The bulk of the time for the IPO process is spent in the preparation phase. According to Williams, it takes approximately one-and-a-half to two years to prepare a company to be listed. Harish adds, "We have worked with some of the very large and medium-sized corporates in the region. In some cases, the preparation time takes four or six months, and for some, it has taken a couple of years."

The IPO route can also be quite expensive for SMEs, which tend to have limited resources. "The whole process can cost between AED 1–2 million," says Farouk.

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"If that cost is five to six per cent of how much you are going to raise, then it is better just to go to a bank," says Farouk. When it comes to Nasdaq, some of the basic costs include an application fee of US$5,000 (AED18,365), admission fee starting from US$75,000 (AED275,475) depending on the number of shares admitted and an annual fee of more than US$20,000 (AED73,460).

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"For any company to be an attractive listing, it needs to be making above $30m to $50m a year. Less than that, there is a concern."

According to Williams, the cost of going for an IPO in general "is high and the same for bigger companies as the rules/regulatory compliance is the same for all, irrespective of size. The bigger companies would, by default, be better endowed with resources (talent and budgets) to undertake the complex and detailed tasks to an IPO and [its] aftermath."

Capital markets also often require firms to have a large ticket size. According to DFM's Guide to Going Public, the initial capital requirement for a limited liability company is at least AED10m. As per Nasdaq Dubai's requirements, a company must have a market capitalization of at least US $10m (AED36.7m) – which was revised from US$50m in 2012 – as well as normally list at least 25 per cent of its shares.

Farouk adds that SMEs should also have sizeable revenue before considering an IPO: "Any company that must be attractive to go listing, needs to be making anywhere above US$30m to US$50m a year. Less than that, there is a concern."

These are some of the reasons going for an IPO is neither an option, nor feasible for start-ups and early stage SMEs. For a start-up it will take "no less" than five years of growth to be able to reach a point where they can go for an IPO and be able to attract retail and institutional investors, Farouk estimates.

SMEs that are considering an IPO also need to be mentally prepared for the public scrutiny that is part and parcel of going public. They will need to have a higher degree of transparency and a framework for investor relations as new shareholders will come on board, says Williams. "Professional execution of a strategy, in light of what the shareholder requirements are and a proper check and balance in the form of compliance, internal audit and other activities should be in place," adds Harish, saying that the nature of ownership "dramatically changes" post-IPO.

The other way out

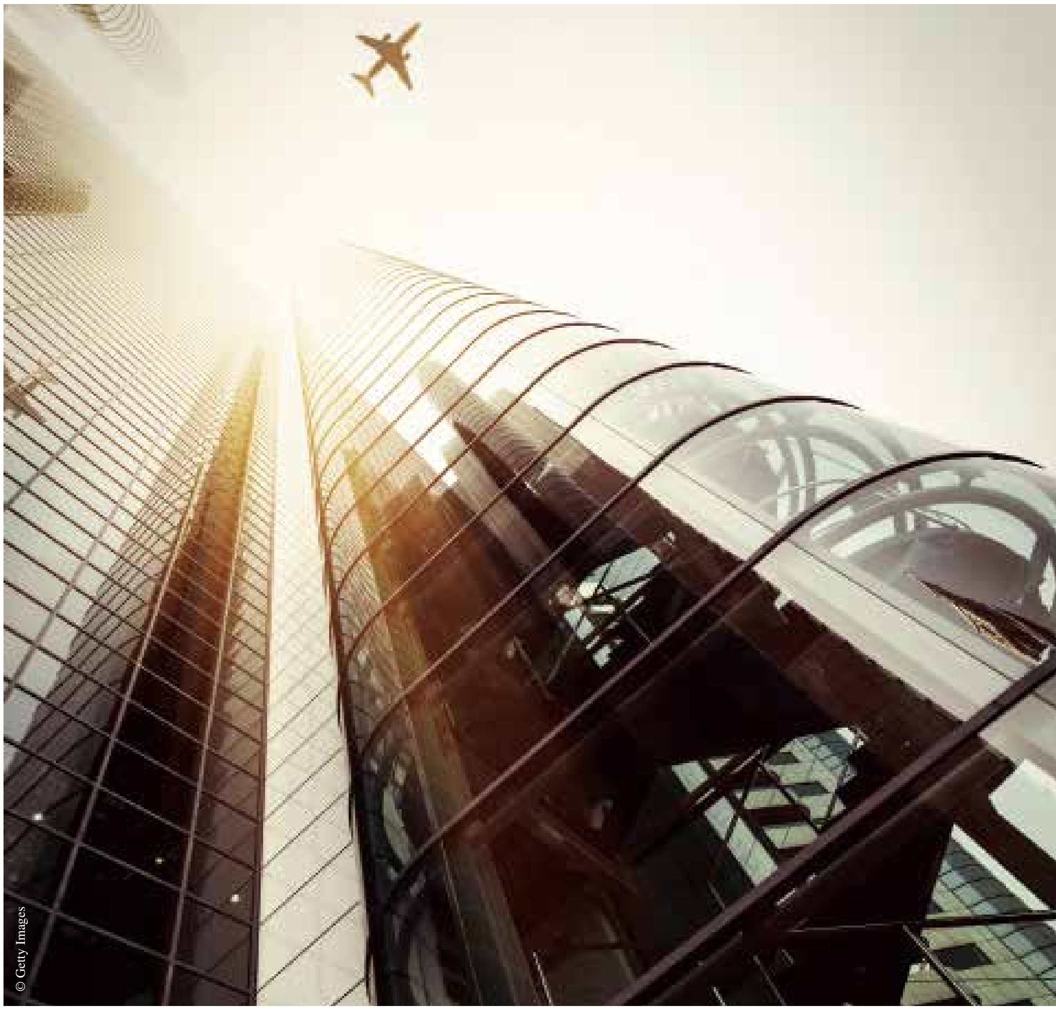
Williams advises SMEs to first "raise funds through PEs to get used to the whole idea of an external shareholder or equity investor in the company and how to manage that relationship, before thinking about listing publicly. PE is a good intermediate way to get SMEs to experience some form of external control…and together work on a plan to IPO, if that is the vision."

Another funding concept that is slowly picking up in the region is crowd-investing. May 2013 saw serial entrepreneur Chris Thomas and investment banker Sam Quawasmi, launch Eureeca.com – a platform for SMEs to post funding proposals on its website to attract investment from as little as $100 from 'the crowd,' in return for an equity stake in the businesses.

The crowd-investing concept may have a potential as a less expensive option for SMEs to acquire funds from a large group of shareholders, but it is not suitable for large-ticket sizes, according to Williams. "Crowd funding may be better suited for younger SMEs with scalability potential."

While an avid supporter of crowd-investing, Farouk reiterates the limitations around the ticket size: "Sometimes [companies] raise $1m to $2m. But you are not going to raise $50m or $100m through the crowd – not yet."

An IPO would be more suitable for MEs looking to raise a very large amount of capital.



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The way forward

When asked how SMEs in the UAE can be encouraged to file for an IPO, Farouk proposes the establishment of a dedicated index or capital market for SMEs, such as NILEX in Egypt and AIM in the UK: "On that dedicated platform, the requirements for listing should be slightly different to allow for these SMEs to build up. Once these requirements are defined, then obviously the cost to list will also be defined to a lesser point, because the professionals that you'll need to work with and the size of the investments from the institutions will be different."

The type of investors the index would attract will be those that have a larger appetite for risk, the ticket size would be smaller and SMEs should ideally be making approximately AED500m in sales to be considered a sustainable company to list, he suggests.

According to Williams, "the capital markets should continue to engage the SMEs; they should go to the ground and meet as many founder/CEOs as possible to understand their business conditions as well as growth and expansion requirements. They should continue to get feedback from the SMEs on their needs, readiness, and offer training/awareness sessions to prepare them. [For instance], Dubai SME is focused on helping SMEs be corporate-governance ready."

He says the UAE is closer to the concept of SMEs going public than two years ago and expects the uptake to grow "in the next two to three years, because it takes time for the listing of an SME."

Both he and Harish agree that once a successful SME IPO story emerges, the momentum will pick up from there.