Transformation of the Middle East

Market Insight

By Yousif Al-Shamali
ABS Investment Analyst
June 10, 2022

In a world where geopolitical tensions are rising, first with China and now with Russia, it has never been more important for investors to assess risk/reward in different markets and even more so in Emerging Markets. Although the Middle East has its own history of geopolitical turmoil, relations with the West have steadily improved as they have opened their societies and markets. The region stands out within emerging markets for its continued reforms and relative stability.

Yousif Al-Shamali, a Kuwaiti native and one of our Emerging Markets analysts, travels regularly to the Middle East. His most recent month-long trips were in December 2021 and May 2022 and spanned the United Arab Emirates (UAE), Kuwait, Qatar, and Saudi Arabia. During his trips, he had numerous interactions with our local partners on the ground as well as family offices, entrepreneurs, and industry leaders. Throughout his travels, he was particularly struck by the changes happening within private entrepreneurship, and their growing impact on public equity markets.

THE NEED FOR CHANGE: ECONOMIC DIVERSIFICATION

For decades, the Middle East has preserved its position as the largest oil producer in the world, supplying one third of the oil consumed globally[1]. Although oil riches have generated great wealth, economic growth and income distribution have been uneven. Gulf states have also become concerned about the sustainability of their commodity-based economies given the global shift towards renewable energy and potential decline of oil and gas reserves. This situation is further exacerbated by the low productivity of their labor force. Therefore, the need for economic diversification has gained a greater importance in countries in the region.

In recent years, countries in the region initiated programs to diversify their economies away from commodity exports. In 2016, Saudi Arabia unveiled an ambitious economic and social reform plan entitled Saudi Vision 2030. The program was designed to reduce the country's dependence on oil by facilitating the emergence of a robust private sector. The key goals are to (1) develop a diversified economy focused on trade, (2) encourage social liberalization, (3) enhance public service sectors such as health and education, and (4) promote a business-friendly environment to attract foreign direct investment and entrepreneurs[2]. The plan includes campaigns to diversify into tourism and high-tech industries. Other similar programs have been replicated across the region including Abu Dhabi Vision 2030, Egypt Vision 2030, Qatar Vision 2030, and Kuwait Vision 2035. The purpose of these programs is to grow the private sector's contribution to their economies via capital market reform and by supporting small and midsize enterprises (SMEs) and startups.

While these transformations are long term in nature and may take years to yield material results, the region is changing and a deep understanding of this transformation from the ground will be crucial to continued investment success.

THE DEVELOPMENT OF A VENTURE CAPITAL ECOSYSTEM

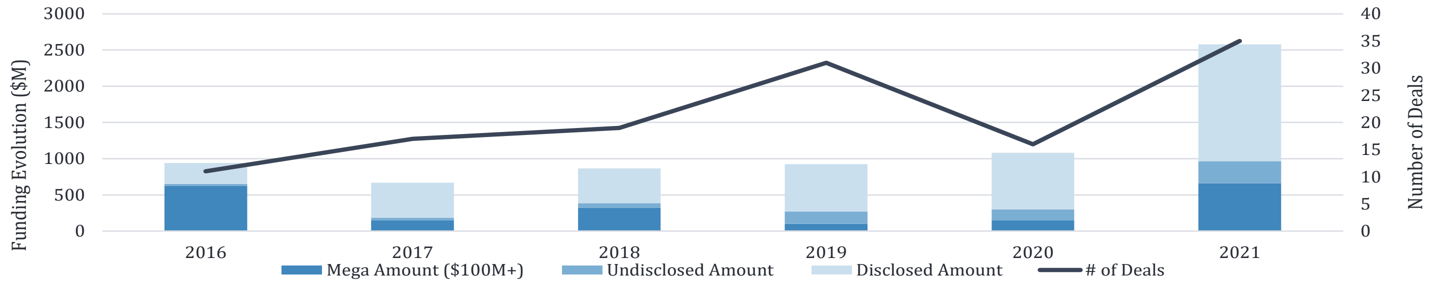
In a push to increase economic diversification, regional governments have invested billions of dollars to support SMEs and start-ups. Private and non-government affiliated investors have followed these regional governments, increasing their participation in the venture capital ecosystem, and further supporting the growth of SMEs. With fintech attracting most of the funding, it has spurred growth within tech-enabled sectors like ecommerce, transport and logistics, and enterprise software[3].

Local Government Support

In Saudi Arabia, the government established multiple venture capital funds to help support these businesses. The Saudi Venture Capital Company, for example, was created in 2018 with the goal of committing $750 million to support regional startups and venture investors. Similarly, the PIF, the country's sovereign wealth fund spearheaded a fund of funds program called Jada to invest in Saudi private equity and venture firms. This influx of capital in Saudi helped make 2021 a record year for venture capital funding, with $550 million raised across 139 deals[4]. Elsewhere in the region, Abu Dhabi launched Hub 71 and DisruptAD, both venture capital incubators tasked with fostering up to 1,000 local startups by 2025 and funding them from a pool of $2.5 billion[5].

This funding growth is happening across the MENA region (Middle East and North Africa), which helped make 2021 a record year for venture capital in terms of funding ($2.6B), and number of deals (590) and exits (35)[6].

Middle East & North Africa Yearly Funding Evolution: 2016-2021



Source: Magnitt.. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision

Global Investors

With the recent uptick in activity by local investors, venture capital markets in the Middle East have increasingly caught the attention of foreigners. Indeed, prominent foreign investors including Global Founders (Germany) and 500 Global (Silicon Valley) were among MENA's top 10 active investors in 2021[6]. The region has also attracted mega investors like Sequoia and Softbank, who made their first investments in 2021. We expect foreign interest to continue its rise, in-line with the explosion of local funding and government support for startups.

With increased funding from both local and international investors, more "unicorns" (private companies valued more than $1B), are being created. The region has had at least five unicorns so far, all of which emerged in the past three years.

Interest from global tech giants in local companies that operate outside the commodity industry have further fueled excitement for these "new economy" businesses. Some mega acquisitions by global tech giants in the region include Amazon's acquisition of Souq ($580 million, ecommerce) and Uber's acquisition of Careem ($3.1 billion, ride-hailing)[7].

> "2021 was a banner year for Saudi Arabia's venture capital investment landscape with significant headlines, including the first venture capital-backed IPO, the region's largest ever Series-A capital raise, and the local debut of venture capital debt-funds. These and other key developments are a testament to the rapid evolution in the venture capital investment cycle."
>
> *- Venture Capital manager we met in Saudi Arabia*

THE IPO BOOM

Over the past few years, the region has experienced a meaningful surge in initial public offerings (IPOs). Greater company listings typically also imply growing equity market capitalization, improving liquidity, and eventually, declining funding costs for businesses. Initially the increased IPO activity was driven largely by governments bringing some of their prized assets to the public market. While the listing of these state-owned entities may have been the initial spark, IPOs have since become increasingly diversified. 2021 was particularly lively, with 20 GCC ("Gulf Cooperation Council") companies listing, up from 7 in 2020[8]. Saudi led the region with 15 listings in 2021 and 50 since 2017[8]. Crucially, 95% of Saudi IPOs since 2017 have been private companies outside of the banking and materials sectors[9]. Many are consumer-oriented, capturing emerging global and regional sectors, including renewable energy, digital transformation, tech, and IT solutions. These listings should reshape the local benchmarks.

Saudi Arabia continues to lead the region in terms of listings and their exchange is now considering IPO applications from around 100 companies[10]. However, other markets such as Dubai are taking steps to keep up with the competition. For example, Dubai has announced it will list 10 state-owned assets and increase its market capitalization from $100 billion in 2021 to $800 billion[11].

> "A climate of economic optimism was also attributed to a flurry of IPOs listing on the exchange, nine in the main market and three in the Nomu-parallel market, the highest since 2007, bringing the Saudi market capitalization to approximately SAR 10 trillion for the first time. Tadawul reached its highest level in 15 years."
>
> *-Insight from a MENA equity manager*

FOREIGN INVESTORS WELCOME

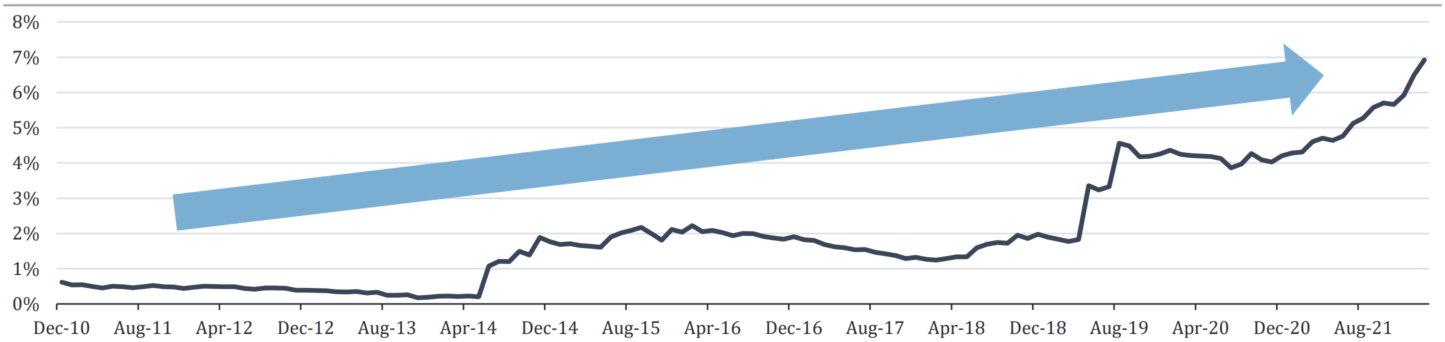
Historically, foreign ownership limits have been a hurdle for access to these markets, but there has been a common trend across the region to ease and, in some cases, eliminate these constraints. In the past five years, Kuwait has removed foreign ownership limits for listed banks. In 2019, Saudi removed the limit on foreign ownership of listed Saudi companies. In 2021 Qatari ministers approved allowing foreign investors to own up to 100% of capital listed on the Doha Stock Exchange. The UAE continues to reduce limitations, starting with strategic assets such as telecommunications companies and banks. With these changes, the region is welcoming foreign investors and hoping to attract foreign active and passive equity flows.

WHAT DOES THIS TRANSFORMATION MEAN FOR PUBLIC EQUITY MARKETS AND ITS INVESTORS?

As the shape of economies across the Middle East change, public equity markets are expected to expand and continue to undergo changes of their own. Some of the most relevant implications of these transformations on public equity markets include:

- **Growth**: The most obvious impact of the transformation in the Middle East is an expansion of its markets. In 2011, there were only 40 MENA stocks in the MSCI EM IMI index. Today the number of companies in the index has expanded to 168[12]. The pipeline of potential IPOs in markets like Saudi are at historical peak levels.
- **Diversity**: Although Middle Eastern equity markets are still heavily dominated by "old economy" sectors like financials and materials, consumer-facing and "new economy" companies are growing in weight and importance. For example, in Saudi, 95% of company listings since 2017 have been outside the banking or material sectors.
- **Relevance**: At the end of 2016, Middle Eastern countries represented less than 2% of the MSCI Emerging Markets index, and included the UAE, Qatar, and Egypt. As of April 2022, the region's weighting in the MSCI Emerging Markets index has risen more than four times to 8% after the inclusion of Saudi Arabia and Kuwait. The region's relevance should continue to grow as more companies list and enter the MSCI EM index.

Growing Importance: Weight of MENA within the MSCI Emerging Markets Index



Source: Bloomberg. Graphs are presented for illustration purposes only and should not be relied on to make an investment decision

As the universe of stocks in the region has expanded and become more diversified, the opportunity set for active stock-pickers has and will continue to improve. We believe that this development benefits local specialists based in the region. While it may be difficult to capture the nuances of the changes these markets are undergoing from afar, we believe our local partners on the ground are best situated to understand not only these transformations, but how they vary across countries and industries, which stages they are in and their likelihood of success. These local specialists are on the ground building relationships with companies and their management, even before they become public. Those who are first-hand witnesses and in some cases part of these changes, will be considerably advanced in their ability to take advantage (i.e., capture alpha) in this market.

> "The economy is transitioning towards a more digital ecosystem, and the companies that are leading the charge in digitizing the corporates as well as the government entities are key beneficiaries. These include the likes of STC Solutions, Elm, and Moammar Information Services."
>
> *-Insight from a MENA equity manager*

YOUSIF AL SHAMALI

Yousif Al Shamali is a qualitative investment analyst at ABS, based in Greenwich, Connecticut. He is responsible for sourcing and monitoring Emerging Markets equity strategies. He joined the team full time in October 2019 after a summer internship at ABS. His previous work experience includes interning for Wafra's alternative investments division. Yousif holds a BA in Mathematics and Economics from New York University and is a CAIA charterholder. He is a Kuwaiti national.

DISCLOSURES

This presentation includes the opinions of ABS Investment Management LLC, shall not constitute investment advice and should not be relied upon for any investment decisions. This shall not constitute an offer to sell or the solicitation of any offer to buy which may only be made at the time a qualified investor receives a final confidential private offering memorandum (the "Fund Documents") describing an opportunity to invest with ABS (a "Fund"). In the event of any inconsistency between this presentation and the Fund Documents, the Fund Documents will govern. This presentation being provided to a prospective investor does not guarantee an investor's qualification for an investment in the Fund or the Fund's capacity for its investment. Such criteria may only be determined upon completion of the Subscription Material for the Fund. Investments in any Fund will be suitable only for certain financially sophisticated investors who have no need for immediate liquidity in their investment and can bear the risk of an investment in the Funds for an extended period of time. There is no secondary market for interests or shares in the Funds and none is expected to develop. There are also restrictions on transferring interests or shares and withdrawing or redeeming interests or shares from the Funds. The information herein is not intended to provide, and should not be relied upon for, accounting, legal or tax advice or investment recommendations. You should make an independent investigation of the investment described herein, including consulting your tax, legal, accounting, or other advisors about the matters discussed herein. Information pertaining to our processes is subject to change at any time without notice.

Past returns are not a guarantee of future results. Investors should be aware that it is not possible to invest directly in an index. The MSCI information may only be used for your internal use, may not be reproduced or redisseminated in any form and may not be used as a basis for or a component of any financial instruments or products or indices. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied upon as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as if" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each other person involved in or related to compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties (including, without limitation, any warranties of originality, accuracy, completeness, timeliness, non-infringement, merchantability and fitness for a particular purpose) with respect to this information. Without limiting any of the foregoing, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including, without limitation, lost profits) or any other damages. (www.msci.com). The information herein is not intended to provide, and should not be relied upon for, accounting, legal or tax advice or investment recommendations. You should make an independent investigation of the investment described herein, including consulting your tax, legal, accounting, or other advisors about the matters discussed herein. Although data used in this presentation has been gathered using public and private sources and data we believe to be reliable, data points have not been independently verified and we make no representations as to their accuracy or completeness.

For more information, please contact the ABS Relationship Management Team at ir@absinv.com or 203-618-3700

---

[1] Investopedia. https://www.investopedia.com/articles/investing/101515/biggest-oil-producers-middle-east.asp#:~:text=The%20Middle%20East%20includes%20five,about%2027%25%20of%20world%20production.
[2] Vision 2030. https://www.vision2030.gov.sa/media/rc0b5oy1/saudi_vision203.pdf
[3] Magnitt State of Startup Funding – 2022 Emerging Venture Markets Report. https://magnitt.com/research/state-of-startup-funding-2022-50796
[4] Magnitt, 2021 Saudi Arabia Venture Capital Report. https://magnitt.com/research/2021-saudi-arabia-venture-capital-report-en-50794
[5] Wired. https://wired.me/business/startups/abu-dhabi-to-support-1000-startups-in-bid-to-boost-tech-ecosystem/. Haaretz. https://www.haaretz.com/israel-news/.premium-israeli-startups-thought-the-uae-was-paved-with-gold-but-there-s-a-twist-1.10415060
[6] Magnitt. State of Startup Funding – 2022 Emerging Venture Markets Report. https://magnitt.com/research/state-of-startup-funding-2022-50796
[7] Pitchbook, Magnitt, Yahoo Finance.
[8] Kamco Invest. https://www.kamcoinvest.com/sites/default/files/research/pdf/GCC%20IPOs%20-%202021%20-%20The%20Year%20That%20Was....pdf
[9] Saudi Exchange Tadawul. https://www.saudiexchange.sa/wps/portal/tadawul/markets/listings/ipo?locale=en
[10] Arab News. https://www.arabnews.com/node/2046371/business-economy
[11] The National News. https://www.thenationalnews.com/business/markets/2021/11/01/dubai-to-launch-dh2bn-market-maker-fund-to-encourage-listings/. https://www.tradinghours.com/markets/dfm
[12] MSCI EM IMI Index Constituents on Bloomberg as of 5/26/2022