RESEARCH

Employee Participation In Middle East IPOs

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2006

GulfTalent

Employee Participation in Middle East IPOs

Executive Summary

The volume of initial public offerings in the Gulf has been growing exponentially over the last two years, fueled by the regional economic boom, increased maturity of the industry and highly favorable market conditions.

Many Gulf IPOs have been oversubscribed by up to several hundred times the offering, compared to typical subscriptions of just 2-3 times in developed markets. This has been driven by several factors, including an abundance of liquidity relative to available investment opportunities, very conservative IPO rules requiring below-market pricing of shares resulting in massive first-day price jumps, easy availability of leverage and bank loans for IPO investors, as well as the practice of pro-rata allocation in the IPO which encourages investors to bid several times their intended investment size.

The IPO oversubscriptions have created an opportunity for companies to reward their employees with a preferential allocation in the IPO. Under this, employees would subscribe to the shares with their own funds and at the same price as other retail investors, except that they would have a certain number of shares reserved for them. A common practice in developed markets of Europe and North America, and increasingly practiced in emerging markets such as India, IPO allocation to employees has been virtually non-existent in the Gulf so far.

GulfTalent's survey of GCC companies that have gone public or planned to do so has revealed a substantial appetite among both employees and management of companies for such preferential IPO allocations. Despite the risk that employees would incur a loss on their investment if market conditions turn sour, most company executives interviewed believed that the benefits in terms of increased employee motivation and sense of ownership outweighed the potential risk factors. IPO allocation was also seen as an easier proposition to sell to Middle Eastern shareholders as it involved zero cost to the company, relative to other means of employee share ownership which typically result in dilution of shareholders and represent a net cost.

The main barrier cited for preferential IPO allocation (and employee share participation in general) was the lack of regulatory approval or lack of clarity on the rules. Other factors mentioned were time pressure on completion of IPOs, with employee share ownership not seen as a priority and not receiving sufficient push from either management or employees.

Based on the findings of this survey, IPO allocation to employees is expected to rise significantly over the next two years, driven by (i) regulatory reform in the financial sector making such allocation easier, (ii) growing competition for talent, prompting the addition of equity-related components in management compensation packages, and (iii) the region's increasing integration with the developed markets, leading to greater acceptance by shareholders of the culture of employee equity participation.

Background on Gulf IPOs

The IPO Rush

The surge in the Gulf financial markets over the last two years has fueled a frenzy of IPO activity in the region. A trend initially started by governments privatizing state-owned monopolies, private companies have now followed suit. Several have already gone public, while many others have announced their intention to do so (see chart).

The drivers of this IPO rush have been several. While some shareholders have viewed the IPO in the current market as a highly profitable exit, others have been drawn to it as a means of raising capital for their expanding operations. Still others have been attracted by the clout and credibility associated with being a public company, and the higher level of professionalism that it can impart onto the company, its organization and its management.

This is in contrast to the trend recently observed in developed markets where, after years of growth in public listings, the new post-Enron regulatory climate has substantially raised the cost and administrative burden of being a public company. As a result, not only are fewer private companies going public, many already listed companies have been de-listed, through buyouts by private equity firms or other means.

Oversubscriptions

One distinguishing feature of the Gulf IPOs has been the exceptionally high level of subscriptions to the offerings. With the high oil prices of the last few years, the region has been awash with liquidity, resulting in too much capital chasing too few investment opportunities. Another driver has been the IPO rules stipulated by some regulators, requiring pricing at well below prevailing market prices. These have resulted in significant first-day surges in the share price and a potential windfall profit, thus attracting yet more

Gulf IPO Pipeline
Sample of planned IPOs announced

Bahrain
- Albaraka Banking Group
- Solidarity Islamic Insurance
- Tourism Holding Company

Kuwait
- Showtime Arabia
- Gulf District Cooling Company
- Touristic Enterprises

Oman
- Bank Muscat International
- Galfar Engineering & Contracting
- Sohar Power Company

Qatar
- Al Jazeera Channel
- Al Thani Holding
- Gulf Commercial Bank

Saudi Arabia
- Kingdom Holdings
- Saudi Arabian Airlines
- The National Commercial Bank (NCB)
- Saudi Int. Petrochemical Co. (SIPC)
- Saudi Arabian Mining Co. (Maaden)
- Fawaz Al Hukair & Co.
- National Air Services
- Emaar Saudi Arabia
- Al Jubail Petrochemical
- Al Rajhi Co. for Cooperative Insurance
- BUPA Arabia
- AXA Cooperative Insurance

UAE
- Air Arabia
- Nakheel
- Emirates Post
- Axiom Telecom
- Rasmala Investment
- Damas Jewellery
- Damac Services & Trading
- Dubai Financial Market
- Nasser Rashid Lootah & Sons
- Rotana Hotel Management Corp.
- Thuraya Satellite Telecommunications
- National Petroleum Construction

Source: GulfTalent research, Zawya.com, Press Reports, Jordinvest retail investors. The interest from this segment has been boosted by the relatively liberal lending practices exercised by banks in the region, which generally offer IPO subscribers loans of up to 90% of nominal value (so-called 'margin lending').

This has been further exacerbated by the common practice of allocating IPO shares on a pro-rata basis, with no maximum cap per allocation, prompting investors to bid for several times their intended investment in an effort to receive their desired final allocation.

As a result, while successful IPOs in the West have been typically 2-3 times oversubscribed, many recent Gulf IPOs have seen subscriptions of up to several hundred times the offering (see chart).

Gulf IPO Subscriptions
By number of times IPO oversubscribed

Aabar Petroleum Investments	800
Tamweel	484
Al Dar Properties	448
Abu Dhabi Nat. Energy (Taqa)	350
Sorouh Real Estate	176
Du	167
Dana Gas	140
Sahara Petrochemical	125
Aramex	80
Finance House	75
ArabTech	65
Al Salaam Bank	63
RAK Properties	57
Etihad Etisalat (Mobily)	50

Source: GulfTalent research, Press Reports, Zawya.com, Jordinvest

Employee Allocation in IPOs

As the competition for talent intensifies in the region, compensation and benefits have become a hot issue, with pay packages generally being on the rise. GulfTalent's earlier research in 2005 revealed an average 7% year-on-year increase in salaries across the GCC.

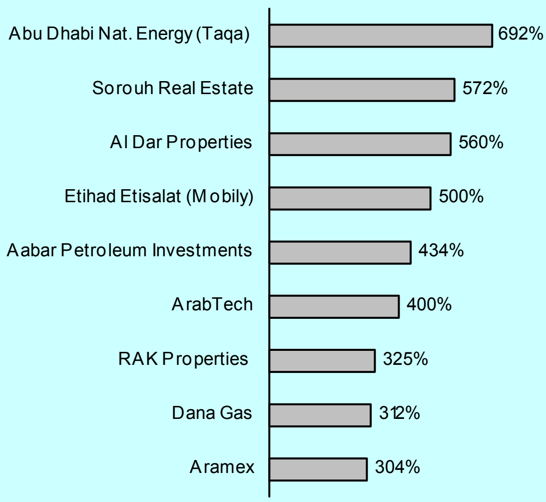
What I hear from our senior management is that, the next career move they make will have to involve equity.

Investment Banker
Leading Saudi Bank

Until recently, discussions around compensation were confined to base salary, bonus and certain allowances. Increasingly, however, offering employees some form of equity participation in the company is being discussed in corporate board rooms.

For listed companies this could be in the form of offering Employee Stock Ownership Plans (ESOPs), whereby a certain quantity of company shares are granted, subject to a minimum subsequent stay in the company (so-called 'lock-in' or 'vesting' period) as well as restrictions on when they can sell their equity stake ('holding period').

IPO First-day Price Jump
Percentage share price increase



Source: GulfTalent Analysis, Zawya.com

Private companies planning an IPO have the added option of rewarding their employees with a 'preferential allocation' in the share offering itself. In the current climate, this would mean that, while ordinary investors may receive just 1-2% of the shares they bid for, the company's own employees can potentially receive all or most of the shares they can afford to purchase. With share prices typically surging on debut (see chart on previous page), such an allocation in itself would represent a significant reward to the employees, at no cost to the company or its shareholders – since the employees will be paying the same price as any other investor in the market.

Current Practice in IPO Allocations

Developed Markets

The culture of employee share participation has a relatively long history in the West, with share ownership seen as essential in aligning the interests of top management with those of shareholders. Recent developments have simply broadened the base of employees who are permitted to participate – from just senior management, to middle management and above, and increasingly, company-wide allocation to all employees.

Most public companies in the US offer share ownership across the firm. Everyone from the MD to the tea boy can get shares... The Middle East is at least 20 years behind.

Manager,
Leading UAE Bank

According to an IPO specialist at a leading US-based investment bank interviewed by GulfTalent, currently around half of all companies going public in the US are offering their employees an allocation in their IPO – typically at least 1% of the total IPO value.

Although share options are still a common way of rewarding employees, the recent SEC ruling requiring that all employee share option grants be included in the income statement as an expense has made the cost of such share options to shareholders more transparent, slightly denting their popularity as a means of attracting and retaining employees. In contrast, IPO allocations have no such cost implication to the company and offer a cheaper way to give equity to employees.

Employee Allotment in US IPOs
By percentage of IPO allocated*

Directed Electronics	5%
Clear Channel Outdoor	5%
Refco Inc.	5%
Basic Energy Services	5%
K&F Industries	5%
Rockwood Holdings	5%
Sealy Corporation	4%
IntercontinentalExchange	4%
HealthSpring	3%

** Include allocation to directors, employees, friends and associated persons*
Source: SEC filings, GulfTalent Analysis

Emerging Markets

Many large companies in developing markets have historically been managed by members of the shareholding family, thus by default having share ownership among the management. As these markets mature, and management and ownership separate, the question of management and employee participation in equity is increasingly arising.

Indian companies have been among the most aggressive in offering IPO allocations to employees, partly due to the high prevalence of technology firms among them, but also due to the influence of the growing numbers of US-trained Indian professionals and entrepreneurs finding their way back to India and taking the equity culture with them. Several Indian companies surveyed by GulfTalent had employee allotments of 5-10% in their IPO (see chart).

Employee Allotment in Indian IPOs
By percentage of IPO allocated to employees*

Punjab National Bank	10%
Oriental Bank of Commerce	10%
aurionPro Solutions	8%
India Infoline	7%
IVRCL Infrastructures & Projects	6%
Shri Ramrupai Balaji Steels	5%
Shringar Cinemas	3%
3i Infotech	2%

** Allocations not all fully subscribed*
Source: IPO Prospectuses, GulfTalent Analysis

Middle East

With the majority of private companies in the region owned by Gulf citizens and run by largely expatriate management, the Middle East has one of the highest levels of shareholder-management separation among developing countries. However, equity participation by employees is still extremely rare in the region. In many cases, even top management have no direct or indirect equity participation in the companies they manage.

A few progressive examples of equity participation have begun to emerge in countries with relatively longer history of public equity markets. Bahrain-based Gulf Finance House and Kuwait-based Global Investment House are both known for offering share options to employees across the firm. Aramex, a courier and logistics company founded in Jordan and previously listed on Nasdaq, has long awarded shares to its middle and senior management. It also awarded employees shares in its IPO when it went public in 2005 for a second time (listing in Dubai Financial Market). Such examples, however, are exceptions rather than the norm. The current IPO boom, in particular, is concentrated primarily in the UAE and Saudi Arabia, two markets with virtually no history of employee equity participation.

Of the 20 recent or planned IPOs surveyed by GulfTalent, only one had given an employee allocation or had confirmed plans to do so. However, over half of those surveyed, mentioned that the question of allocating shares to employees had been tabled during IPO discussions.

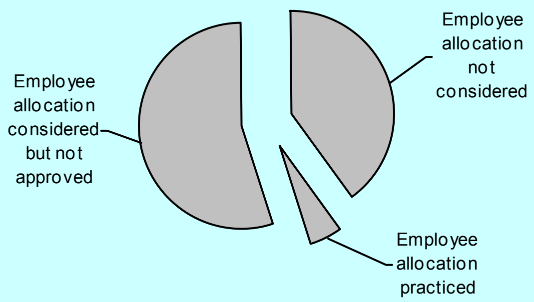
In the Middle East, capital still carries much greater weight than talent.

Manager, Private Equity Fund

In our IPO, nothing was allocated to employees. A lot of them felt they should have been part of it.

GM Human Resources
Leading Saudi Company

Gulf IPO Allocation Practices
Estimated Breakdown of Companies



Source: Interviews, GulfTalent Estimates

Barriers to Employee IPO Participation in the Gulf

In cases where the issue of IPO allocation to employees had been discussed but ruled out, the main reason cited was invariably the inability to obtain regulatory approval from capital market authorities, or the lack of sufficient clarity on the regulation pertaining to preferential allocation to employees.

Time pressure was another reason mentioned. With so much work involved in the IPO process and shareholders and their advisors fearing a possible cooling of the IPO market, adding a provision for employee allotment and getting it approved is sometimes viewed by the parties as a non-essential twist to the process they can do without.

In cases where employee allocation was not discussed at all, the reasons mentioned were lack of any push by employees for such an allocation and, in some countries, a general prohibition on IPO participation by expatriates, the segment that often forms the majority of a company's employees.

In Saudi Arabia, until recently only Saudi and other GCC nationals were permitted to own or trade in listed equities. This was opened recently to expatriates living in the Kingdom, though expats are still excluded from participation in initial public offerings.

Several companies tried it but failed. The regulator allowed it, but required such a complex structure that the management decided to abandon the idea.

Manager, Corporate Finance
Regional Investment Bank

The regulator is concerned about 'fat cat' syndrome, as well as insider trading. There is potential for abuse when employees own stock. Corporate governance in the region is not yet to international standards.

Investment Banker,
Leading Saudi Bank

We hope that the regulations for GCC markets will evolve to allow market pricing and discretionary allocation of IPOs; and allow the existence of treasury stock to facilitate employee stock option plans.

Managing Director,
Leading Regional Investment Bank

Finally, a notable factor observed in most IPOs surveyed by GulfTalent was the relative absence of the company's HR managers and representatives, from the IPO process. This may have contributed to more limited coverage of the employee allocation issue in management discussions.

Assessment of IPO Allocation to Employees

Potential Risks

As employees become shareholders, their attention is inevitably drawn to the share price, a factor that changes on a daily, sometimes hourly, basis. This elevated attention to company's prospects at the high level may sometimes come at the expense of focusing on the actual operations which is where the employee can add value.

Furthermore, if the share price experiences a substantial fall, it can lead to concern and insecurity. In particular, if the share price falls below the initial listing price, the investing employees would stand to lose a portion of their savings. Lastminute.com, a UK-based internet company that went public in March 2000, days before the dot-com crash, reserved up to £5,000 of shares in its IPO for each employee. With the IPO heavily over-subscribed, the allocation allowed employees to purchase significant numbers of shares. After an initial rise, the share price collapsed a few days later, making the employees with their higher allocations the biggest losers among retail investors.

> ***When the share price was going up, employees were happy. When it went down, they were asking why this is happening... People expect the price to go up all the time. We had to run special sessions to explain to them how the markets work.***
>
> *Chief Financial Officer*
> *Recently Listed Egyptian Company*

Benefits

Equity participation is generally recognized as a significant contributor to employee motivation. At the top management level, the benefit is obvious – as management become co-owners in the business, their incentives are better aligned with the shareholders, making them more driven and more likely to make decisions that maximize value for shareholders.

> ***Share allocations will give a sense of ownership and help build morale and team spirit within the company. The employees will pay for it in the IPO and will be part of it. It is a win-win situation.***
>
> *GM Human Resources*
> *Leading Saudi Company*

Even for employees who do not have direct individual impact on corporate strategy or results, some token equity ownership is generally viewed as creating a sense of common purpose and belonging, and a deeper interest in the company's prospects that ultimately translate to better morale, higher productivity and greater loyalty.

IPO allocations have the added advantage of being practically cost-free to the company. While an Employee Stock Ownership Plan (ESOP) generally dilutes the existing shareholders and therefore has a net cost, in an IPO allocation, employees pay for the full price of the shares and their reward comes from share price appreciation post-listing.

Furthermore, the fact that the employees and management of a company are willing to invest their own money in buying its shares should send a strong positive signal about the company's prospects to outside investors and this could only be good for the success of the IPO.

In summary, although there are risks and downsides in allocating shares to employees, they should be weighed against the potential benefits of involving employees, particularly those at mid-level and above, in the ownership of the firm.

Future Outlook

IPO allocation to employees, although virtually non-existent in the Middle East at present, is expected to become much more common over the next two years – particularly for middle and senior management. The key drivers of this trend are likely to be:

(i) *Regulatory Reform:* With lack of regulatory approval and lack of clarity on the IPO rules currently cited as the main obstacle for many companies planning to offer an allocation to employees, a change on this front is likely to pave the way for a significant wave of employee allocations in forthcoming IPOs.

(ii) *Competition for talent:* As the economic boom in the Gulf continues, more and more companies are competing for a limited pool of regional talent, particularly at the senior management level. As a result, equity participation is increasingly being offered to entice managers to switch allegiances or to retain existing management teams.

(iii) *Integration with developed markets:* The growing participation of multinational companies in the region, increasing presence of regional companies in international markets, membership of several GCC countries in the WTO, as well as the return of many Western-trained Arab expatriates to the region are all helping to bring best-practice to regional companies – including a greater understanding and appreciation of the equity culture.

With over 100 of the region's most prominent companies planning to go public in the near future, the trend towards greater employee participation in IPOs could have wide-reaching implications for management, shareholders and regulators.

More broadly, as the regional markets develop and there is a gradual shift from capital-based to knowledge-based economies, employee equity participation in its various forms will become a critical factor, particularly for publicly traded companies.

Appendix – List of Gulf IPOs

The following is a list of recent IPOs (completed between Jan 2004-April 2006) and the expected IPO pipeline (current and announced offerings as of April 2006).

Bahrain

Recent
- Al Khaleej Development Company
- Al Salam Bank
- Banader Hotels Company
- Ithmaar Bank
- Nass Corporation

Pipeline
- Albaraka Banking Group
- Al Masref
- Jawad International Fashion
- Solidarity Islamic Insurance
- Tourism Holding Company
- Unicorn Investment Bank
- United International Bank
- United Islamic Bank

Kuwait

Recent
- Al Qurain Petrochemicals Industries
- Al Sour Fuel Marketing Company
- Boubyan Bank
- First Domestic Fuel Marketing
- Jazeera Airways
- Kuwaiti Chinese Investment Company
- Kuwait National Airlines Company

Pipeline
- Capital City Real Estate
- Gulf District Cooling Company
- Kuwait Airways
- Kuwait Ports Authority
- Showtime Arabia
- Touristic Enterprises

UAE

Recent
- Aabar Petroleum Investments
- Abu Dhabi Nat. Energy Company (Taqa)
- Amlak Finance
- Al Dar Properties
- Arab International Logistics (Aramex)
- Arab Technical Construction (ArabTech)
- Dana Gas
- Emirates Foodstuff and Mineral Water
- Emirates Integrated Telecoms Co. (Du)
- Finance House (FH)
- RAK Properties
- Sorouh Real Estate Company
- Tamweel

Pipeline
- Abu Dhabi National Industrial Projects
- Abu Dhabi Tourism Authority
- Air Arabia
- Arkan Building Materials Co.
- Axiom Telecom
- CERT
- Damac Services & Trading
- Damas Jewellery
- Dubai Financial Market
- Dubai Investments - Subsidiary
- Emirates Building Materials
- Emirates Finance House
- Emirates Post
- Emirates Ship Investment Co.
- General Holding Company (GHC)
- Habtoor Hospitality
- International Petroleum Investment Co.
- Kampac Oil Middle East
- Nakheel
- Nasser Rashid Lootah and Sons
- National Petroleum Construction
- Palm District Cooling
- Rasmala Investment
- Rotana Hotel Management Corp.
- Thuraya Satellite Telecommunications Co.

Oman

Recent
- AES Barka
- Al Kamil Power Company
- Al Maha Petroleum Products Marketing Co.
- Dhofar Power Company
- Oman Telecommunications Company
- Taageer Finance Company

Pipeline
- Bank Muscat International
- Galfar Engineering and Contracting
- Omani Qatari Telecommunication
- Sohar Power Company

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Appendix – List of Gulf IPOs *(continued)*

Qatar

Recent
- Al Rayan Bank
- Barwa Real Estate Company
- Dlala Brokerage and Investment Holding
- Gulf Cement Company
- Qatar Gas Transport Company

Pipeline
- Al Jazeera Channel
- Al Thani Holding
- First Finance Company
- Gulf Commercial Bank
- Qatar Clay Bricks Company
- Qatar Insurance Company

Saudi Arabia

Recent
- Aldrees Petroleum and Transport Services
- Al Marai Company
- Bank Al Bilad
- Etihad Etisalat Company (Mobily)
- Kingdom Hotel Investments
- National Petrochemicals Co. (Yansab)
- NCCI
- Sahara Petrochemical Company
- Saudi Research and Marketing Group
- Saudia Dairy and Foodstuff Company

Pipeline
- Abdelkhalek Saeed Perfumes
- Afia International Co.
- Ajlan & Brothers
- Al Abdullatif Industrial Investment Co.
- Al Alamiya
- Al Akhawain
- Al Babtain Power & Telecom
- Al Bassami Int'l Group
- Al Issa Agriculture
- Al Jouf Cement Company
- Al Jubail Petrochemical
- Al Khaleej Training and Education
- Al Khorayef Group
- Al Khozama Management Co.
- Al Kifah Construction Equipment Co.
- Al Madina Printing and Publishing Co.
- Al Othaim Mall
- Al Rabie Saudi Foods Company
- Al Rajhi Co. for Cooperative Insurance
- Al Sawani
- Al Tayyar Travel Group
- Arabian Industrial Fibers (Ibn Rushd)
- Arabian Shield Insurance
- AXA Cooperative Insurance
- BUPA Arabia
- Buruj
- Dallah Healthcare Holding Co.
- Dar Al Arkan Real Estate Development Co.
- Egyptian Saudi National Mutual Insurance
- Elaj Group
- Emaar Saudi Arabia
- Emar Al Watan Co.
- Fawaz Al Hukair & Co.
- Gulf Advanced Chemical Industries
- Gulf Cement – Saudi Arabia
- Gulf Real Estate Construction Company
- Gulf Stevedoring Cont. Co. (GSCCO)
- Huta Group
- Inmaa Bank
- Int'l Islamic Org. for Trade Finance
- Jabal Omar Development
- Jeraisy Group
- Kayan Petrochemicals
- King Faisal Foundation
- Kingdom Holding Co.
- Lazurde Jewelry Company
- Makkah Medical Centre
- Malaz Insurance and Reinsurance
- Mediterranean & Gulf Ins. & Reinsurance
- Middle East Specialized Cable Co.
- National Air Services
- National Industrialization

(Continued on next page)

Appendix – List of Gulf IPOs *(continued)*

Saudi Arabia

Pipeline (continued)

- National Petrochemical Transport
- National Petrochemical Co. (NatPet)
- Obeikan Industrial Investment
- Power & Water Utility Co. Jubail & Yanbu
- Rabigh Refining and Petrochemical Co.
- Red Sea Housing Services
- Riyadh Cement
- Rotana Holding Saudi Arabian Airlines
- Saudi Arabian Mining Co. (Maaden)
- Saudi Arabian Oil Co.
- Saudi Aramco Lubricating Oil Refining Co.
- Saudi Formaldehyde Chemical Co.
- Saudi Health Investment Company
- Saudi Indian Insurance
- Saudi Int'l Petrochemical Co. (SIPC)
- Saudi National Insurance
- Saudi ORIX Leasing Co.
- Saudi Paper Manufacturing Co.
- Saudi Steel Company
- Saudi United Cooperative Insurance
- Saudi White Cement
- Shuaiba Water and Electricity
- Tabuk Investment and Tourism Company
- Taif Investment & Tourism
- The National Commercial Bank (NCB)
- Tokio Marine & Nichido
- United Cooperative Assurance
- Usul Company

Source: GulfTalent research, Press Reports, Zawya.com, EFG-Hermes, Jordinvest

Methodology

This report was based on GulfTalent's research, including interviews with a representative sample of HR Managers, CFOs, investment banking professionals and regulatory authorities, a review of the relevant press literature and company filings, and analysis of publicly available market data. The survey was conducted during March/April 2006.

About GulfTalent

GulfTalent is the Middle East's leading internet recruitment portal for mid-level and senior professionals, serving an active client base across Saudi Arabia, Kuwait, Qatar, Bahrain and the UAE. Headquartered in Dubai Knowledge Village and used by leading employers and recruiters in the region, GulfTalent specializes in matching top candidates with attractive career opportunities through its internet site.
In addition to its core recruiting service, GulfTalent provides HR professionals, executives, senior decision makers and government bodies with original research and analysis on the key employment and human resource issues in the Middle East – including compensation, talent sourcing, attraction and retention.

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