



The Saudi Parallel Market (Nomu)

Summary

- Although Saudi Arabia is the first country in the Gulf region to launch a parallel market, such markets have existed since the 1970's in many mature economies. Perhaps the best examples are the US NASDAQ and the UK's FTSE AIM.
- Replicating the success of some of the more established parallel markets will not be easy. The example of the Neuer Markt in Germany illustrates how the perception of weak regulatory oversight combined with inherently riskier and volatile nature of parallel markets can be detrimental.
- That said, the Capital Markets Authority (CMA) has published very detailed and concise provisions related to Nomu. Although these regulations are looser than TASI requirements, they are stricter than international equivalents, and underline the CMA's approach in giving priority to sound regulation ahead of hurried implementation.
- Although Nomu is open to all types of companies, we do, nevertheless, expect the number of SME listings to rise in-line with the government initiatives to drive up SMEs contribution to the Kingdom's GDP. The Musharakah program is one example of an initiative that aims to boost the growth of SMEs, especially at the start-up level.
- Looking at both the Musharakah and Nomu together, we can see the strategic direction behind government policy in trying to develop a path for SMEs that allows them to progress from a small-scale start-up to a listed entity.

Overview

The evolution of the Saudi Arabian Stock Exchange continues apace, with one of the latest developments being the launch of a parallel equity market called Nomu (meaning growth in Arabic). The Nomu is designed to be an alternative stock exchange that serves as a platform for companies to go public. Parallel markets, in general, are seen as a vehicle for facilitating the listing of small and medium sized companies (SMEs). In theory, once a company is listed it should be able to attract capital and expand its operation. That said, whilst Nomu aims to increase listed companies access to capital, it is open to all types of companies and not just SMEs.

The recent establishment of Real Estate Investment Traded Funds (REITs), and now Nomu, have resulted in greatly diversifying the investment offering available within the Kingdom. On a macro-level, the launching of a parallel market conforms with the broader goals of the National Transformation Program (NTP) and Saudi Vision 2030. In line with this, some significant initiatives have recently been launched to drive up SMEs contribution to the Kingdom's GDP and, at the same time, their capacity to create jobs. The launch of Nomu should therefore also be seen in this wider context.

For comments and queries please contact:

Fahad M. Alturki
Chief Economist and Head of Research
falturki@jadwa.com

Asad Khan
Senior Economist
rkhan@jadwa.com

Head office:

Phone +966 11 279-1111
Fax +966 11 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

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The Capital Markets Authority (CMA) and Tadawul officially launched Nomu on 26th February 2017.

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...although an authorized person must be appointed to act as a point of contact between any issuer and the CMA.

Nomu regulatory framework

The Capital Markets Authority (CMA) and Tadawul officially launched Nomu on 26th February 2017. Whilst the regulatory set-up is tighter than global parallel markets, it is looser than TASI. Table 1 highlights the key similarities and differences of Nomu with the UK's parallel market, the FTSE Alternative Investment Market (AIM), and TASI. The main regulations related to Nomu are as follows:

- **Saudi and Gulf** companies majority owned by nationals are eligible for listing.
- Only qualified investors are permitted to invest in listed shares:
 - 1) **Corporates**, government-owned companies, GCC funds and companies, investment funds and discretionary portfolio managers.
 - 2) **Natural persons**: i) someone conducted 10 transactions per quarter over the past 12 months with a minimum amount of SR40 million on TASI, or ii) portfolio size exceeds SR10 million in last year or iii) holds relevant CMA-recognized certificates.
 - 3) **Qualified Foreign Investors (QFIs)** are able to participate, as per previous guidelines laid down by the CMA (please see our report [Recent CMA announcements related to Tadawul](#)).
- A minimum of **SR10 million** market capitalization with no less than **20 percent of total shares** listed.
- If market value of shares is **greater (less) than SR40 million** there should be a minimum of **50 (35)** shareholders.
- Company to be listed must have been carrying out main activity for **at least one financial year**.
- Saudi Organization for Certified Public Accountants (SOCPA) audited financial statements for previous **one year needed**.

In addition, an authorized person (AP) must be appointed to act as a point of contact between any issuer and the CMA. The AP is responsible for carrying out due diligence and has to confirm to the CMA that all relevant conditions have been met prior to any listing.

Table 1. Comparing Nomu to FTSE AIM

Overview		FTSE AIM	Nomu	TASI
Minimum Market Cap.		none	SR 10 million	SR 100 million
Free Float		15 percent	20 percent	30 percent
Advisory Requirements		Nominated advisor (referred to as the 'Nomad')	Nominated advisor (referred to as the 'Authorized Persons')	Nominated advisor (referred to as the 'Authorized Persons')
Operational Listing Requirements		none	Operating for at least one year	Operating for at least three years
Disclosure requirements	Quarterly	On a voluntary basis	Within 45 business days from the end of the period	Within 30 business days from the end of the period
	Annually	Within 120 days from the end of the period	Within 90 business days from the end of the period	Within 90 business days from the end of the period
Ownership Listing Restrictions		none	Majority owned by Saudi or Gulf	Majority owned by Saudi or Gulf
Daily Price Fluctuation		none	20 percent	10 percent



Nomu and Saudi capital markets

Parallel markets have existed since the 1970's in many mature economies...

...with one of the best examples of a parallel market being the US NASDAQ.

One obvious advantage of parallel markets, from an issuer's perspective, is that a higher level of transparency,...

...through the disclosure of financial accounts, can help attract credit to fund investment for expansion.

Another benefit of Nomu is related to the relatively lower cost of listing vis-a-vis the main market.

Although Saudi Arabia is the first country in the Gulf region to launch a parallel market, such markets have existed since the 1970's in many mature economies. Perhaps the best example of a parallel market is the US NASDAQ, which was set-up in the early 1970's. During the mid to late 1990's, many European exchanges also went about launching their own versions of a parallel market, including AIM (UK), Neuer Markt (Germany) and the Nouveau Marché (France). By in large, such markets have been a relative success, helping spawn a number of prosperous companies, which have ultimately sought full listing in the main market. If the success of US and some European parallel markets is replicated by Nomu, then we would expect not only to see deeper and more diverse capital markets, but also a more favorable business environment that fosters entrepreneurship, sustains productivity, and creates higher skilled jobs.

There is a significant amount of empirical data showing parallel market's positive contribution to the development of overall capital markets. One of the obvious advantages, from an issuer's perspective, is that a higher level of transparency, through the disclosure of financial accounts, can help attract credit to fund investment for expansion. This is especially important for Saudi Arabia, since one of the main sources of financing for private companies, bank credit, has begun to slow recently. Data on bank claims shows that growth in bank credit to the private sector has been slowing, in line with subdued private sector activity. Year-on-year growth in credit to the private sector stood at 1.4 percent in January 2017, compared to an average of 14.9 percent during 2013 (Figure 1). Listing on the parallel market should help enhance investor confidence in such companies and thereby open up another avenue for raising finance rather than relying overwhelmingly on domestic banks.

Another benefit of Nomu is related to the relatively lower cost of listing vis-a-vis the main market. The higher cost in listing on the TASI is partially due to regulatory burden of full and timely disclosure and the hiring of both APs and legal representatives. For Nomu, in addition to lengthier timelines in submitting financial statements, the

Figure 1: Nomu an alternative for private sector financing, since bank credit has slowed recently

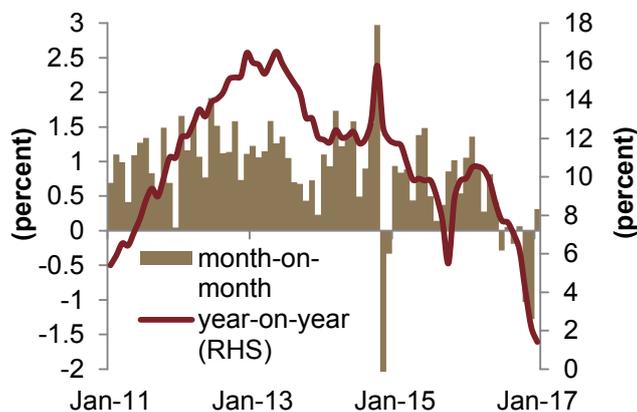
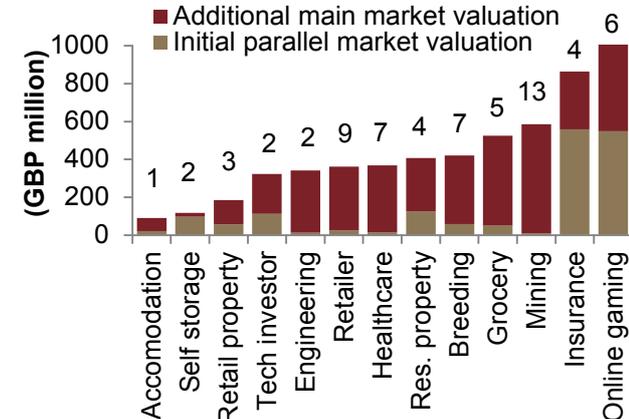


Figure 2: 13 of the largest transitions from FTSE AIM to main market (and no. of years taken to transit)





Nomu also presents the possibility for companies to transition into the main market...

...with the transition from parallel to the main market being quite common in global parallel markets.

Establishing successful parallel markets is not guaranteed.

Whilst strong returns are possible (although not guaranteed) they can also be more volatile...

level of disclosure is less strict when compared to TASI. For example, there is no requirement for a working capital statement or a management discussion and analysis, both of which are required in a main market listing. Also, whilst APs are mandatory for Nomu, a legal representative is not.

Lastly, as Tadawul states, Nomu presents the possibility for companies to transition into the main market. As a Nomu company increases in size, a move to the main market could result in an accompanying increase in its profile as well as increased equity analyst coverage, both of which may help ensure higher demand for the company's securities. The transition from parallel to the main market is quite common in global parallel markets. Using AIM data between the period from 1995 to 2009, we can see that the largest 13 companies to transit from AIM to the main market (FTSE 100), saw their combined total valuation rise by GBP3.9 billion in the process. We can also see that these 13 companies came from a variety of sectors, such as technology investment, on-line gaming and animal breeding, and, on average, took five years to transition from the parallel to the main market (Figure 2).

Assessing parallel markets

Whilst the US NASDAQ and AIM are both examples of successful parallel markets, replicating their success is not guaranteed. The example of the Neuer Markt in Germany illustrates how a perception of weak regulatory oversight combined with the inherently riskier and volatile nature of parallel markets can be detrimental.

Higher risk, higher return?

When comparing the UK's AIM parallel market to the main FTSE 100 index, we can see that there are sizable differences in total return between them in the last five years. The FTSE 100 total returns are significantly higher than AIM's (Figure 3). Investing in higher growth, smaller, and less proven companies is inherently riskier than backing larger, more established ones. As a result, the AIM has seen a large divergence in performance on a sectorial level, with even larger divergence in performance on a company level (Figure 4). This highlights that whilst strong returns are possible (although not guaranteed) in parallel markets, they can also be more volatile.

Figure 3: Total return: FTSE 100 vs. FTSE AIM (Mar 2012-17, percent)

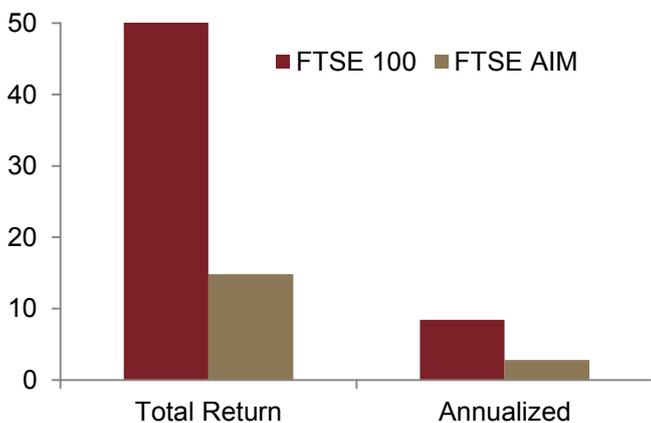
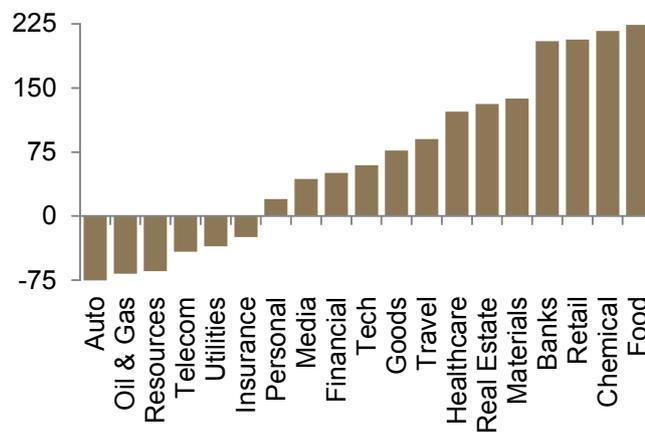


Figure 4: Significant divergence in total return between FTSE AIM sectors (Mar 2012-17, percent)





...which is why in our opinion, retail investors, who add to volatility levels, have been excluded from Nomu.

Speculative behavior linked to the dot com bubble was not the only reason for the failure of the German parallel market...

...but also the perception of a lack of sufficient supervision and scrutiny of business deals.

The CMA's cautious approach is defined by sound regulation ahead of hurried implementation.

When looking at retail investors' behavior in TASI, their generally larger risk appetites and shorter investment horizons has, through speculative activity, added to volatility levels. This, in our view, is one of the reasons why the CMA has only allowed qualified investors to participate in Nomu, whilst excluding retail investors (*for more on this please see our report [Saudi Stock Market](#) published August 2014*).

Parallel casualties:

The German parallel market, or Neuer markt, was set up in 1997 following the success of the technology led US NASDAQ index. It was designed for technology shares and other high-growth stocks. As a result of the huge speculative bubble related to the internet sector (dot com bubble), the index rose from 1,000 points at the end of 1997, to a historical peak of 9,666 points in March 2000, then plunged back to 1,000 points by 2002, as the internet bubble deflated. The index was formally closed in 2003 after a number of bankruptcies and a dearth of IPOs. It is important to note that speculative behavior linked to the dot com bubble was not the only reason for the failure of the Neuer Markt, there were also a number of corporate scandals that made headlines. These incidents gave the impression that there was a lack of sufficient supervision and scrutiny of business deals related to listed companies, all of which diminished investor confidence in the market.

In the case of Nomu, besides excluding retail investors, who add to speculative activity, the CMA has published very detailed and concise provisions related to disclosure requirements, reporting deadlines for audited financial statements and operational disclosures. Although these regulations are looser than TASI requirements, they are stricter than international equivalents (Table 1). This underlines the CMA's cautious approach where priority is given to sound regulation ahead of a hurried implementation. This is consistent with the approach seen in other areas too, such as the rules related to opening up to QFIs (*again, please see our report [Saudi Stock Market](#) published August 2014*).

Figure 5: Not all current Nomu constituents are SMEs based on SMEA revenue classifications

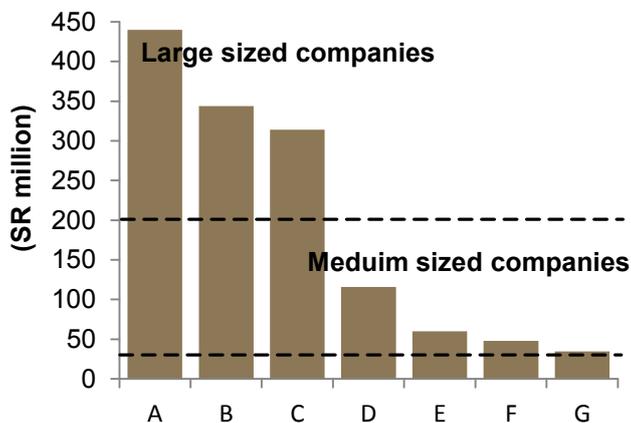
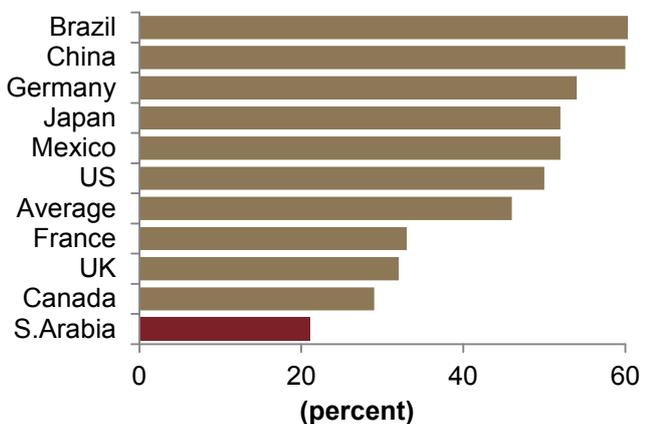


Figure 6: SMEs contribution to Saudi non-oil GDP vs. global peers





Is Nomu only for SMEs?

Using SMEA's classifications, we can see that three out of the seven current constituents of Nomu are 'large' companies...

...proving that Nomu is not restricted to SMEs.

Despite Nomu being open to all types of firms, we do expect the number of SME listings to rise significantly...

...especially as government implements initiatives to help support the development of such companies.

The Musharakah program can be seen as directly facilitating the growth of SMEs...

...and aims to increase funding from venture capital, debt, mezzanine, and private equity

Europe's parallel markets were created to provide SMEs, which meet international standards of transparency, with access to the investment community. Nomu, on the other hand, does not explicitly aim to attract SMEs, with the Tadawul stating that Nomu is open to all types of companies. Using the revenue classifications outlined by the Small and Medium Enterprise Authority (SMEA) (Table 2), we can see that three out of the seven current constituents of Nomu are 'large' companies, with the rest being 'medium', and none being 'small' (Figure 5). Therefore, evidence from the currently listed companies proves that Nomu is indeed not restricted to SMEs and, as a result, is quite different to the parallel markets seen in the rest of the world.

Table 2. SMEA's company classification

Classification	Employees (full time)	Revenue (SR million)
Small	1 to 49	0 to 40
Medium	50 to 249	41 to 200
Large	250+	200+

SMEs, Nomu and the Saudi economy

Despite Nomu being open to all types of firms, we do expect the number of SME listings to rise significantly, especially as the government implements initiatives to help support the development of such companies.

In the past, with policy objectives centered around building up larger companies that could compete internationally, the SME sector was overlooked. As a result, according to the SMEA, SMEs contribution to the Kingdom's non-oil GDP is around 21 percent, which is lower than the average of 46 percent amongst the 15 largest global economies (Figure 6). This lower contribution to GDP is also mirrored in Saudi exports, with SMEs contributing 5 percent to total exports and 15 percent to total non-oil exports, again, lower than global peers. In terms of employment opportunities, whilst SMEs create over 50 percent of all jobs within the private sector, these jobs are mainly low value adding in nature and require cheap, and invariably imported labor.

According to the SMEA, bringing Saudi SMEs economic contribution in line with global peers could add a further SR1.1 trillion to GDP. The benefits of nurturing an environment where SMEs can grow is therefore quite obvious. The NTP has also pinpointed three strategic areas through which SMEs can help the Saudi economy. These include (1) increasing the culture of entrepreneurship (2) raising the contribution of SMEs to the GDP and (3) contributing to the creation of employment opportunities. As a result, a number of initiatives have recently been launched that aim to boost SME growth. In particular, one recently launched program, Musharakah, can be seen as directly facilitating the growth of SMEs, especially at a start-up level. The Musharakah program, which is part of a larger



sources.

Looking at the Musharakah program and Nomu together, we can see the strategic thinking behind government policy...

...which is trying to develop a path for SMEs that allows them to progress from a small scale start-up to a listed entity.

government-backed SR4 billion fund, aims to develop a system where the required types of capital for all stages of an SMEs lifecycle are made available on a Shariah compliant basis. The key attraction, from an investor’s point of view, is that Musharakah will exactly match an investor’s loan, with the investor retaining the profits on the whole (investor plus Musharakah) loan amount. The program specifically aims to facilitate funding from venture capital, debt, mezzanine and private equity funds.

Looking at the Musharakah program and Nomu together, we can see the strategic thinking behind government policy in trying to develop a path for SMEs that allows them to progress from a small scale start-up to a listed entity. Although both the Musharakah program and Nomu are in the early stages of development, over time they could greatly increase the number of SMEs, which, in turn, will ultimately help boost economic growth and provide more highly skilled jobs for locally sourced labor (Table 3).

Table 3. The path of an SME from start-up to Nomu listing



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