

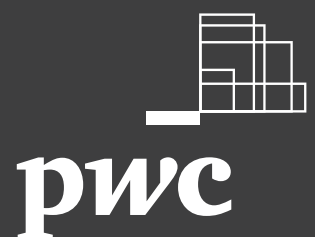


TransAct Middle East

What's shaping M&A in the Middle East?

June 2019

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Foreword

TransAct Middle East is our annual Deals publication which gives you insights into the Middle East deals market, what is driving deal activity and the emerging trends.

Given the macro economic challenges, deal activity has remained subdued but there are some interesting trends emerging which should be key to both buyers and sellers. We are also seeing a change in the M&A landscape as well as the priorities of the players who constitute this market.

Consolidation activity across the financial services sector has continued with strong momentum and it won't be surprising to see further consolidation activity gathering pace across some other sectors which are also battling with demand/supply imbalance.

As organic growth continues to slow across a number of sectors, the incentive to drive EBITDA growth through an inorganic route or through achieving operational efficiencies (including digitisation) is likely to stimulate future M&A activity. Transformational reforms (including privatisation initiatives) taking place across the region are expected to continue to provide interesting opportunities, particularly for international inbound investors.

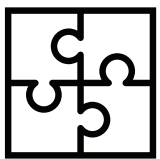
We have seen some landmark deals in the recent period, including Uber's acquisition of Careem, Saudi Aramco's bond sale, and Network International's IPO on the London Stock Exchange etc. which further reinforce our view that the market will continue to offer interesting deal opportunities with a particular focus on technology and digital transformation.



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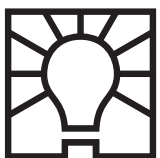
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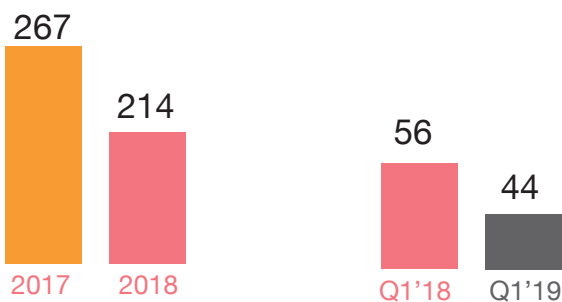
Consolidation drives deals as caution prevails

The evidence from our second TransAct Middle East report indicates a marked decline in M&A activity since 2017. Macro-economic headwinds and geo-political concerns continue to foster a cautious approach to dealmaking among both buyers and sellers, as they focus on operational efficiencies amid slow growth in many sectors.

The total volume of deals in the region fell from 267 in 2017 to 214 in 2018, led by a slowdown in the region's largest markets, notably in Egypt and Saudi Arabia. Overall M&A activity continues to remain slow in the current year, with 44 deals reported in Q1'19 (vs. 56 deals in Q1'18) and only 1 IPO reported in Q1'19 (vs. 4 IPOs in Q1'18).

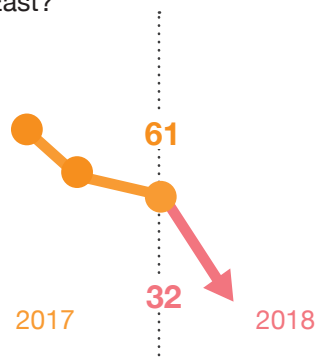
These figures reflect the generally bearish sentiments of Middle East business leaders as shown in our latest Global CEO survey, where only 28% of the region's CEOs said they were "very confident" about their company's revenue growth prospects over the next 12 months, compared with 35% among their global peers.

The total volume of deals in the region



All numbers within this report are based on deal information reported in Mergermarket or Thomson Reuters for the given year.

What's driving the decline in Deals across the Middle East?



By sector, **retail and consumer goods** drove the overall decline, including a steep fall in food and beverage activity



Yet beneath the headline results, our 2019 TransAct Middle East report reveals a varied landscape across markets and sectors, with several prominent themes emerging:

- Consolidation** continues to be a major driver of M&A activity in 2019 across the MENA region, especially in the banking and financial sector, where the region has seen a series of national and cross-border mergers, and also in retail and consumer goods, where online and traditional retailers continue to seek efficiencies to build scale.

2 Private equity (PE) activity saw a decline from 26% to 21% of all deals in 2018. Abraaj going into liquidation dampened the private equity sentiment in the region (at least temporarily) and has also had ramifications for regional players looking to raise new funds. In addition, exit opportunities continue to remain challenging given the muted activity in Capital Markets and limited demand for secondary sales (except for a few instances including the sale of The Entertainer to GFH and Middlesex University to Amanat Holdings by the Abraaj Group). This has driven the need for value creation, as private equity investors focused on deals offering a secure exit strategy on a three-to-five year horizon.

3 Despite the decline in the number of **inbound deals** from 74 in 2017 to 53 in 2018, international interest in the region continues to remain strong. Governments have continued to make efforts with greater diplomacy to attract international inflows and also acquire interest in international strategic assets. In addition to the opportunities in KSA and the UAE, we expect the upcoming privatisation programme in Oman to generate a lot of interest from international investors.

4 Corporate dealmakers remain open to new strategic alliances and joint ventures, in line with the Middle East findings of our Global CEO survey. In total, corporate acquirers increased their share of deals from 54% in 2017 to 60% in 2018, with energy, financial services and healthcare among the most active sectors. Key drivers of corporate activity was the need for efficiencies, new technologies, and expansion of the value chain.

5 Valuation multiples appear to have corrected themselves given the overall sentiment of the market, the geopolitical headwinds and regulatory risks across the region. Average PE multiples for both UAE and KSA indices, have decreased from highs in 2016 (see below).

	2016	Dec 18	Mar 19
DFM	14.47x	10.14x	11.49x
ADX	16.75x	13.62x	15.07x
Tadawul	18.02x	17.71x	20.1x

On the transaction side, whilst a valuation gap exists, we have noticed some sign of change in the market whereby buyers are financing transactions through vendor loans and also building in earn out mechanisms to bridge the valuation gaps (given the challenges for buyers in forming a view on earnings trajectory in the current environment).

Despite macro-economic challenges and a slowdown in the 2018 deal market, international interest in the region is seeing positive signs with some iconic deals already taking place in 2019:

\$3.1 Billion



In March 2019, **Uber** agreed to acquire the Middle East ride-hailing service **Careem** for \$3.1 billion, in a deal the two companies billed as the largest-ever technology industry transaction in the region.

\$12 Billion



In April 2019, this year, **Saudi Aramco's** first bond sale (of \$12 billion) was significantly oversubscribed, with orders exceeding \$100 billion.

\$1.4 Billion



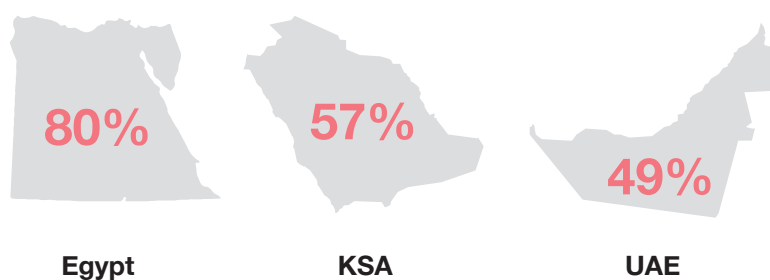
In April 2019, Dubai-based payments company **Network International** raised \$1.4 billion in an IPO on the London Stock Exchange.



M&A landscape: sectors and countries in focus

MENA-based investors continue to dominate activity throughout the region, with domestic deals accounting for 80% of all transactions in Egypt, 57% in KSA and 49% in UAE, the three largest markets. These figures are consistent with the regional results from our latest Global CEO survey, which show that a smaller proportion of Middle East business leaders are focused on organic growth and launching new products than their peers worldwide. M&A offers an opportunity to companies struggling for organic growth amid an uncertain global economy.

Volume of domestic deal transactions in key markets



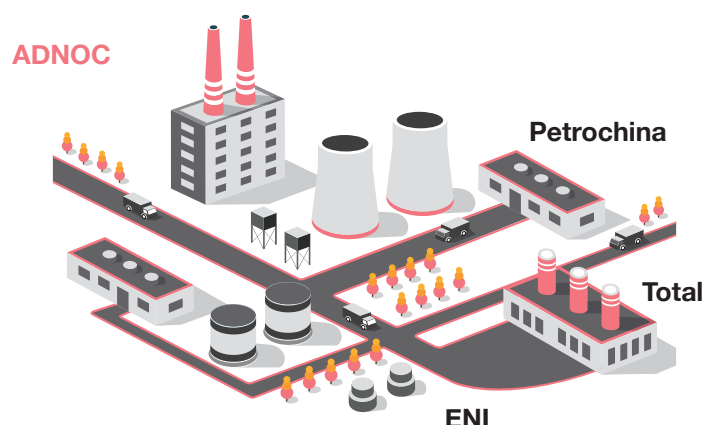
Sectors in focus

Against this background, the current deal-making landscape includes four notable sector trends:

1. Oil and gas: acceleration of petrochemical deals

The energy sector has witnessed a modest pick-up in activity, although a significant portion of deals came from asset disposals to foreign companies. One outstanding example was the sale of three concessions by the Abu Dhabi National Oil Company (ADNOC) to European and Chinese acquirers, including Petrochina, Total and Italy's ENI as well as a stake in its refinery and pipeline assets to international investors.

Increasingly, national oil companies (NOCs) in the region are focusing on expanding their output and developing their downstream operations to reduce the risks associated with rising competition from US shale and slowing global demand for oil. This strategy also reflects these companies' declared commitment to increasing domestic value creation and reducing national reliance on crude export revenue and the wider energy sector.



Many NOCs are emphasising petrochemicals – in particular, olefins (alkenes) and aromatics – as key areas for increasing long-term demand for crude oil.

As a result, there has been an acceleration of deal-making activity along the petrochemical value chain, including Saudi Aramco's planned acquisitions of a 70% stake in the state-controlled petrochemical group Saudi Basic Industries Corp and potential acquisition of a minority stake in the refining business of Reliance Industries Limited (India).

2. Financial services: the drive to consolidate

In total, financial services accounted for 23% of all deals in 2018, approximately the same proportion as in 2017. Beneath the headline numbers, the results in this year's TransAct Middle East report underscore the consolidation theme across the financial services sector, principally in banking.

In recent years, a sustained period of lower oil prices has reduced government budgets and thus bank deposits, creating an overbanked regional market which needs to consolidate to remain competitive. Recent national and international mergers have reinforced the drive by major banks in the region to build scale to remain competitive and diversify their asset base.

Abu Dhabi

A three way merger of Abu Dhabi Commercial Bank, Union National Bank and Al Hilal Bank.

Kuwait

Kuwait Finance House is considering a share - swap deal to acquire a **35%** stake in Bahrain's Ahli United Bank. ¹

Dubai

Dubai Islamic Bank and Noor Bank have been widely reported in the press to be weighing up a potential merger. ²

KSA

National Commercial Bank and Riyadh Bank potential merger plans are also under discussion. ³

1: <https://www.bloomberg.com/news/articles/22-01-2019/kuwait-finance-ahli-united-to-consider-merger-reports-this-week>

2: <https://www.arabianbusiness.com/banking-finance/-421783dubai-islamic-bank-approves-plan-to-acquire-noor-bank>

3: <https://www.reuters.com/article/ncb-bank-riyad-bank/update-1-saudi-arabias-biggest-bank-ncb-in-merger-talks-with-rival-riyad-idUSL8N1YT1SE>

3. Digital and technology: acquiring the disruptors

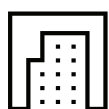
In 2018, the fintech deal count surpassed e-commerce to account for 12% of all start up acquisitions in the Middle East. Unsurprisingly, banks were the principal dealmakers, given the disruption caused to their business models by fintechs and the opportunities created by artificial intelligence (AI) applications and other emerging technologies. A striking illustration came in November 2018, when the partnership between Abu Dhabi's Al Hilal Bank and the fintech Jibrel allowed Al Hilal to settle a \$500 million Sukuk transaction (financial certificates similar to bonds which comply with Shariah law) on the secondary market, using blockchain technology.

Beyond the financial services sector, large companies across the region are looking for acquisitions and partnerships with digital/tech businesses to provide additional services to their existing customers, as well as protecting their market share from start-up challengers.

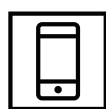


In October 2018, for example, the regional retail group Majid Al Futtaim (MAF) invested \$30 million in the Saudi e-grocery provider – Wadi.com. In November 2018, MAF bought the UAE operations of the mobile payments platform Beam in order to strengthen the retailer's multi-channel payment offering.

Other examples of recent regional digital and tech transactions include:



The acquisition of Property Finder by General Atlantic and their recent acquisition of Bahrain Property World



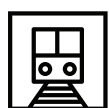
The acquisition of Dubizzle by Nasper



The acquisition of The Entertainer by GFH



An increased stake in Namshi by Emaar Group



Delivery Hero's acquisition of Zomato's food delivery business in UAE



\$30m of A series fund raising by Awok Group from Stone Pine Ace Partners

4. Health and education: maintaining momentum

Both the healthcare and education sectors continued to attract interest from investors, with a combined total of 24 deals in 2018, only a slight fall from 2017 (27).



An increased interest was noted in longer-term **Healthcare** strategic assets, with PE investors focusing on value-building deals that potentially offer exit strategies after five years. In addition, a growing number of investors are seeking to create regional value-for-money healthcare businesses aimed at a wider population. Lastly, deal-making opportunities are shifting from the competitive UAE to KSA, where the healthcare market remains largely untapped and there are upcoming opportunities as the Government seeks to privatise a number of healthcare assets.



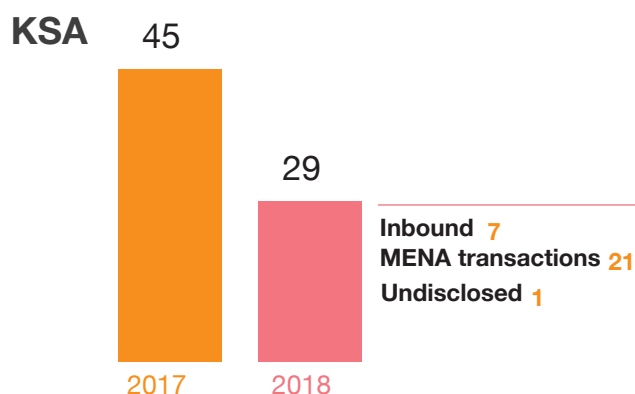
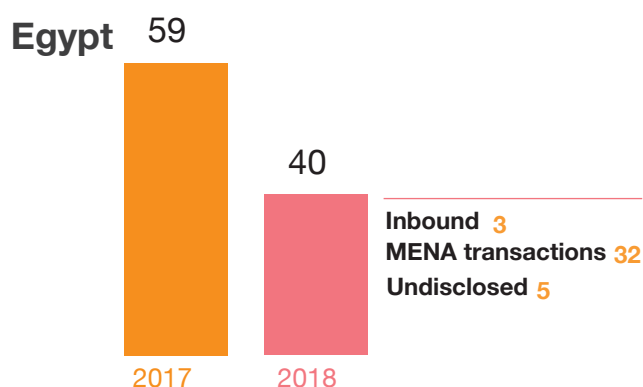
Education continues to attract private equity investors seeking to grow their schools and university portfolios and build Pan-GCC portfolios. There are increased deal making opportunities in the KSA education space because of the need to consolidate a fragmented market and the government's drive to improve the quality of education with the help of private investment.

Countries in focus

We are seeing both regional and international investors getting excited about the opportunities in Egypt. With a relatively stable political landscape and currency situation, strong underlying fundamentals and relatively healthy forecast GDP growth, Egypt is back on the radar and presents attractive opportunities for investors in search of the most attractive opportunities across the emerging markets. We currently see all consumer facing sectors in Egypt, particularly food manufacturing, getting a lot of attention with investors also considering the export opportunities from Egypt. In addition, we believe opportunities also exist in the energy, infrastructure and non-bank financial institution space. The Government's long awaited IPO programme, which would involve 20-25 public sector companies getting listed, seems to be gaining momentum - this should also provide interesting opportunities for investors looking into Egypt.

The National Transformation Plan continues to offer investment opportunities across a number of sectors (e.g. healthcare, education, energy, agriculture and others) and market entrants are therefore considering joint ventures or affiliations with local partners. We also expect the privatisation agenda to gather more momentum over the nearer term.

In addition, domestic private sector led M&A activity which started recovering during the last 6-9 months is showing further signs of resurgence and we are seeing a number of businesses gearing up for potential merger or IPO in the next year or so.



What tax, legal and accounting changes should deal makers consider?

Tax changes to think about:

Dealmakers need to be aware of the following tax developments when thinking about their next deal:

- **January, 2019** - After the introduction of VAT in the UAE and KSA in 2018, Bahrain followed. Oman and Qatar also plan to introduce VAT in the near future.
- **February, 2019** - the new transfer pricing regulations came into force, requiring KSA companies to have transfer pricing documentation to support the pricing of related party transactions.
- **March, 2019** - UAE and Oman were added to the EU's European Union's ("EU") list of non-cooperative jurisdictions for tax purposes.



Legal changes to think about:

There have been some key legal developments across the GCC to strengthen the corporate sector, support ease of doing business and attract foreign investment. These initiatives could influence the deal market and stimulate M&A and restructuring activity.

In the UAE

- UAE Foreign Direct Investment Law (FDIL) creates a pathway towards 100% foreign ownership of UAE companies (whereas a maximum of 49% is allowed to date) in certain sectors. However, 100% ownership will not be applicable in certain protected sectors, including exploration and production of petroleum products, transport services, banking and utilities services. The full list of sectors which the FDIL does and doesn't apply to is expected to be published in 2019.
- Significant changes have been made to the DIFC Companies Law in November 2018 to include a new merger and compromise regime and schemes of arrangement (which allow DIFC companies the use of a new compromise or arrangement process to agree solvent or insolvent restructurings with creditors or shareholders).

In KSA

- A new bankruptcy regime is now applicable in KSA which can be used by both individuals and companies (foreign or local) with assets in the KSA to modernise bankruptcy and reorganisation procedures.
- Special Economic Zones (SEZs) are now being established across KSA with the first zone being set up at King Khalid International Airport in Riyadh. SEZs are another effort to attract foreign investment, in line with the Kingdom of Saudi Arabia's Vision 2030 objectives.
- SAGIA has launched foreign investment e-licences which aim to simplify the process for set up and renewal of investment licenses. There is now an option to obtain a 5-year license (whereas only 1 year licenses have been available to date).

Accounting changes to think about

From 1 January 2019, the new IFRS 16 leases standard became effective for many IFRS reporting groups in the region. Middle East dealmakers should note:

- For lessees, balance sheet leverage and EBITDA will increase in the year of the adoption, while net profit will decrease.
- Certain industries which are “lease-heavy” will be particularly impacted: for example, large retailers, airlines, professional services and transport companies.

Other accounting changes, such as implementation of IFRS15 (Revenue) and IFRS 9 (Financial Instruments) may also have an impact on results; although the impact is likely to vary by industry (e.g. IFRS 9 is likely to have a significant impact on provisions in the banking sector).

All of the above will need to be considered when assessing the underlining profitability.





Looking ahead: where do the opportunities lie?

We expect the following trends to have the biggest impact on deal making activity in the region's main markets over the next 12 to 24 months:



Consolidation will continue to drive M&A activity in the financial services sector. In addition, it may not be surprising to see consolidation happening in other sectors where organic growth has slowed (e.g. retail).



Technology will remain a key driver of deals across all sectors. In retail, for example, traditional regional companies are seeking to develop or complete their e-commerce strategies through acquisitions.



Long term value will be increasingly emphasised by dealmakers, in line with the findings of PwC's 2018 report "Creating value beyond the deal". In particular, private equity investors in sectors such as healthcare are looking for long-term, substantial returns rather than a quick turnaround and exit.



Inbound and outbound activity will pick up, driven by the need across the Middle East to attract foreign investment and international expansion by Middle East companies, especially in fast-growing Asian markets. International investors are closely following the upcoming privatisation opportunities, particularly in the energy and infrastructure sector.



Capital Markets We expect some rebound in the level of GCC IPO activity since a number of companies have announced their plans to list in the next 12-18 months and some have already started preparatory work.

Contact us

If you are thinking about doing a deal and would like more information on the Middle East deal market, you can speak to us:



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