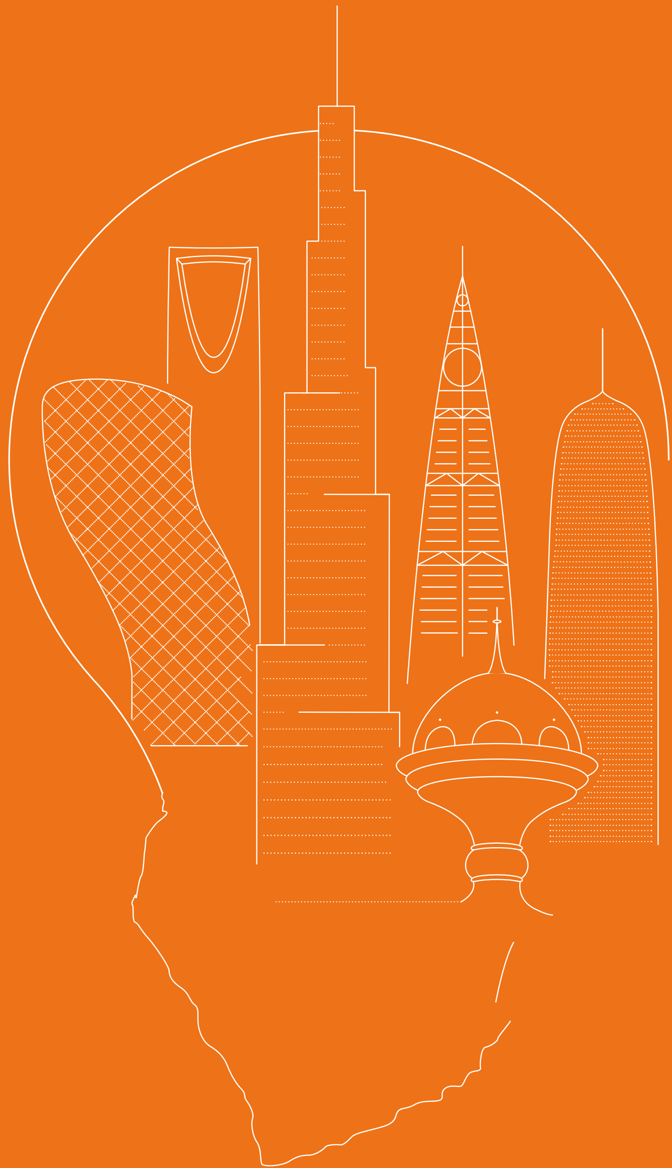
Middle East Deal Study 2019

Clyde & Co

Trends in M&A and Joint Ventures

Analysis & Insight



30 YEARS IN THE MIDDLE EAST

Introduction

Now in its fourth edition, the Clyde & Co Middle East Deal Study is a one of a kind report. By analysing data from the deals Clyde & Co has advised on in the region it gives an unparalleled insight into attitudes to risk and the current market practice for M&A and JVs. Since inception, 329 transactions have been reviewed, with an aggregate deal value of USD 17.55 billion.

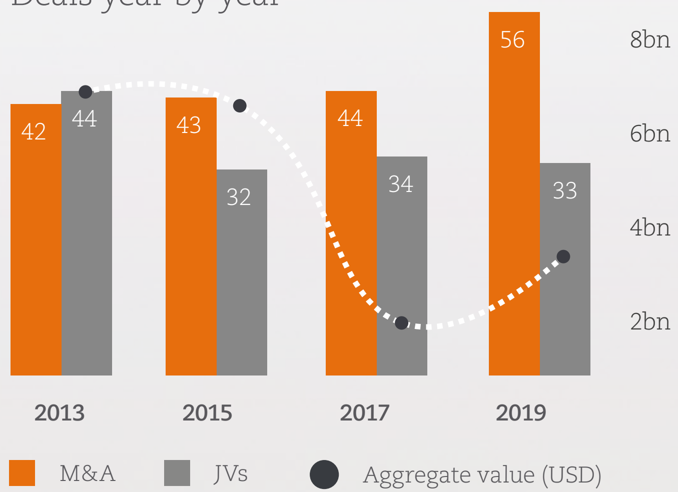
Today's shifting – and at times contradictory – dynamics are shaping deal-making in the Middle East. Sentiment is cautious but positive and appetite for the right deals at the right price is strong. In such a context, market data and expert insight are a vital tool for anyone executing M&A or JV transactions in the region.

Despite relatively tough market conditions, both deal volumes and aggregate values have increased since our previous study in 2017, suggesting there is good reason to be optimistic about the outlook ahead.

Our aim in this report is to use our proprietary deal data and our expert insight to help regional and international businesses and their in-house counsel, as well as advisers and intermediaries, navigate market practice so that they can adequately allocate risk and capitalise on the opportunities that exist.

Should you require any further information on the issues raised in this report, please do not hesitate to contact us.

Deals year-by-year



Since inception of the Middle East Deal Study:

329 deals Analysed | **USD 17.55bn** Analysed

Top trends

1. Healthcare gets pulses racing

Healthcare tops our table of deals-by-volume as population growth and rapid technological change spur innovation. Meanwhile oil & gas market turbulence in recent years has created opportunities for strategic acquisitions and collaboration in energy.

2. M&A on the rise as JVs decline

Growing confidence in the legal environment and moves to open up foreign ownership may explain why the proportion of JVs versus M&A deals is down. JVs were also more likely to be true partnerships rather than "structures of convenience".

3. M&A: a buyer-friendly, but cautious market

The market now appears to be becoming more favourable for buyers with more extensive warranties and walk away rights for buyers. Caution remains, however, particularly in relation to pricing structures with completion accounts gaining ground over locked box.

4. Value and volume up

Both aggregate deal value (up 57% to USD 3.15 billion) and deal volume (up 14% to 89 deals) have increased since our 2017 report.

5. Challenges persist in closing deals

Regulatory hurdles remain high. While important, these can often delay deals and create extra layers of complexity. This can affect the ability to close deals quickly and make business asset transfers complex.

6. Improved dispute resolution options

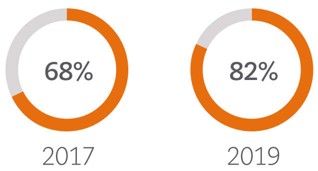
Overall, deal makers now have a growing number of reliable dispute resolution options. DIFC-LCIA arbitration is now the go-to forum to hear disputes. English law (and increasingly DIFC law) is the dominant governing law.

Key findings

M&A buyers gain upper hand

There are clear signs that the M&A market is becoming more "buyer-friendly". In all our previous Deal Studies, sellers have generally had greater leverage to negotiate favourable terms, but now as market conditions harden, the tide may be turning. As proof of this, our data shows more extensive seller warranties, fewer limitations on seller liability and an increase in indemnities and walk away rights for buyers.

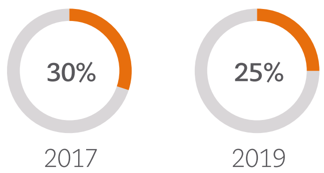
Deals that included walk away rights for buyers



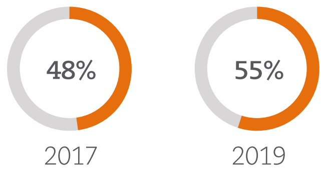
Cautious approach to pricing structures

Though pockets of opportunities exist in the market, a more cautious approach is being adopted when it comes to agreeing purchase price structures. Suggesting a reduced appetite for risk from buyers, the use of completion accounts has increased in popularity (deployed in over half of deals) compared to the locked box mechanism (used in just a quarter), reversing the trend we saw in our 2017 Deal Study.

Deals using a locked-box mechanism



Deals using completion accounts



2019 highlights

In the past 2 years:

- **M&A: 56 deals** with aggregate value of **USD 3.15bn**
- **JVs: 33 deals**

57% increase

In deal aggregate value and 14% in deal volume – 2019 compared to 2017

USD 17.55bn value

We have now analysed **329 deals** across all 4 Deal Studies spanning 8 years

New M&A buyer protections

Buyers are looking to sellers to provide additional warranty cover, amid rising risks from an increasingly complex regulatory environment.

Our 2019 data reveals the following new trends:

- 41% of deals included data protection warranties
- 56% of deals included anti-bribery/corruption warranties
- 58% of deals included tax warranties

JVs: BFFs become even closer

In the JV space, the traditional model whereby both partners agree to a long-term, exclusive commitment remains the norm. If anything, the ties that bind them are becoming tighter, as JV partners become more insistent on share transfer restrictions, pre-emption rights and lock-in provisions.

Cash is still king

Cash remains top choice in Middle East M&A deals, used in almost all transactions. While there may not currently be much in the way of appetite for alternative solutions, procedural and/or legal difficulties that buyers can face in issuing shares in local companies for non-cash consideration are a hurdle that must be overcome.

Gaps still remain

In terms of tax/VAT warranties, the gap in coverage for buyers that we reported in our 2017 Deal Study is beginning to close, however, significant areas for improvement remain. Most notably, our 2019 data reveals a poor take-up of warranty and indemnity insurance, lower than expected levels of security against buyer claims and lack of the use of separate tax deeds or covenants. This may become more of a concern now that the new VAT rules have started to bed down.

Business asset transfers remain tricky

Regulatory hurdles mean share transfers are heavily favoured over asset transfers. This precludes buyers from easily cherry picking assets or excluding unwanted liabilities.

Governing law: DIFC Law popularity increases

There was an increase in the choice of DIFC law to almost a fifth of deals, suggesting that some parties like a regional way of dealing with disputes and the sophistication of DIFC law.

English law remained dominant, but saw a significant decrease, being used in just over half of deals last year, compared to almost three-quarters at the time of our previous Deal Study in 2017.

Challenges in getting the deal done

The majority of share transfers in the Middle East require regulatory approval, hence the large majority of deals (78%) involve split signings and completions. Indeed, less than a third of deals managed to complete within a month of signing.

Delays inevitably cause more issues and complexity. Debates relating to actions pending completion, walk away rights and escrow arrangements are common, while issues such as warranties being repeated at completion and updated disclosure letters also frequently need to be addressed.

Dispute resolution: arbitration gains ground

Arbitration has gained ground with DIFC-LCIA rules being the most popular form of dispute resolution for both M&A and JVs.

Overall deal makers will gain comfort from the continued popularity of DIFC and English courts, as well as DIFC-LCIA Arbitration, given that these dispute resolution forums are typically among the most predictable and reliable for resolving disputes.

Market insight: Sector spotlight

Healthcare

Healthcare topped both our M&A and JV tables, accounting for more than one sixth of deals by volume. As the population increases and more facilities are required – the sector is forecast to expand by over 60% between 2016 and 2021 to become worth over USD 100 billion – the rationale from industry players to build scale and upgrade capabilities through strategic acquisitions and partnerships is clear.

Market activity in the GCC is centered in the UAE and Saudi Arabia in particular. Here, we are seeing the emergence of specialist facilities like IVF clinics, long-term home care, and Public Private Partnerships (PPP) to deliver purpose-built hospitals for specific treatments such as cancer care. Such facilities should help spur the "medical tourism" that these economies are keen to promote.

Energy

Market volatility often creates opportunities for M&A. The oil & gas sector is a case in point and we have seen a significant rebound in activity in energy M&A (up from 3% of deals by volume in 2017) and JV deals (6% in 2017) this time around. Creating efficiencies and driving innovation should help to maintain a solid energy/oil & gas market, which is likely to remain central to economic success in the years ahead.

As the region's population grows, energy and utility requirements are also increasing. So, too, is the desire of several Middle Eastern countries to add value to their energy capabilities, for example by increasing power plant capacity. The latter are likely to take the form of JVs requiring a mix of international and regional players to deliver projects.

Education

The market is increasing in sophistication, seeing a number of new entrants, together with different types of operators and deal structures coming to the fore. For example, not long ago, a typical deal would involve an individual international school licensing their brand to local investors in return for operating the school in accordance with their standards. Now (often private equity-backed) commercial operators are targeting acquisitions, taking M&A activity from near-zero four years ago to 11% today.

Elsewhere in the Middle East we are seeing activity in Oman and the Kingdom of Saudi Arabia (KSA). In particular we expect rapid growth in the Kingdom as it goes through the process of updating a suite of regulations, from easing foreign ownership restrictions to relaxing rules on the type of curriculum that can be taught.

Infrastructure

Interestingly, while infrastructure JVs remained popular, M&A activity in the sector slowed considerably, accounting for just a small fraction of M&A deals in this Deal Study (3%) from a sizeable chunk (12%) only two years ago and 15% in 2015.

Given the tough market conditions dampening construction activity, a sense of caution over acquiring new assets and a shift towards a lower-cost partnership model, this is understandable.

Sectors to watch

Digital/Tech

Technology is a major driver of growth across the region, forming a significant plank of several Smart City initiatives and national development plans. The Middle East's fast-growing, young population lends itself to early adoption, giving these markets attractive potential for tech companies to expand.

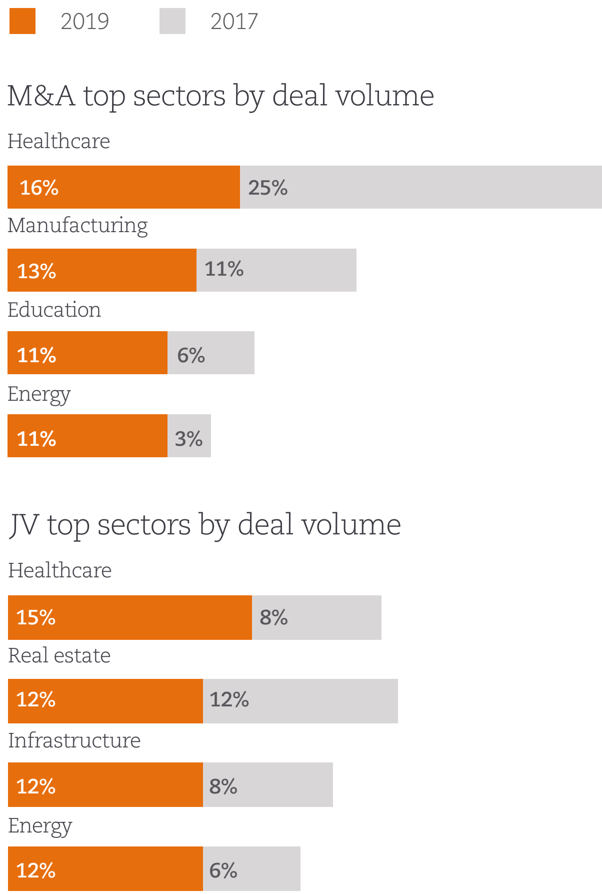
Our data suggests that JVs are currently the preferred option in this space (9% of JVs and 6% of M&A deals were in tech). For start-ups trying out new ideas and larger players looking to identify "the next big thing", the JV model may seem more suitable.

Insurance

Insurance M&A activity across the Middle East is increasing, fuelled by a number of factors:

Changes to insurers' and intermediaries' solvency capital requirements in several jurisdictions – jumping up to five-fold in the case of the KSA – is creating fertile ground for high-value mergers between major insurers (as balance sheets come under growing pressure).

We are also seeing an element of M&A activity in the DIFC as a number of international reinsurance vehicles there look to exit the market. As the cost of capital deployed in the region becomes increasingly hard for them to justify in terms of profitability, regional buyers are sensing an opportunity to buy up assets on the basis that they can settle liabilities more cost-effectively. This is a trend we expect to see continue.



Market insight: Regional spotlight

Here, we outline some of the key features in markets across the region.

UAE

As in other Middle Eastern countries, **consolidation is a major driver behind UAE deals**, as businesses seek to eliminate competition and strengthen market position.

While mega deals such as Uber's planned takeover of Careem garner headlines it is important not to overlook the mid market where there are pockets doing extremely well.

For example, **healthcare and education have been a major focus of activity in the UAE** in recent years. Now that the market has matured, it's likely that major providers will increasingly start looking elsewhere in the region for new market penetration and growth opportunities.

We are also seeing a trend for corporates moving towards conducting more focussed deal due diligence and using professional advisors to carry out "red flag reviews" – cutting costs but effectively **taking on more risk around transactions**.

Finally its not unusual for a substantial portion of transactional work to involve **regional implementation of global multi-million M&A deals**, as these are rolled out around the world.

KSA

In the Saudi market, opportunities exist across most sectors, but some of the **most active areas are currently: energy/utilities, healthcare, education and e-commerce**. Recognising that the latter is a huge growth area, new e-commerce laws are being introduced.

Notably, interest is growing from **private equity houses looking to acquire businesses in the Kingdom** with scope for value-add via efficiency gains or restructuring. Particularly for foreign companies new to the Saudi market, it pays to spend time and effort to really get to understand the landscape early on, to ensure a robust pre-planning and decision-making process.

For example, given that a relative lack of public records about private companies means that it can be hard to get information on M&A targets (or JV partners), buyers are often reliant on sellers for information.

Helpfully, in recent years the Saudi Arabian General Investment Authority (SAGIA) has become much more efficient in processing approvals, and is also willing to assist investors in dealings with other regulatory authorities.

Oman

Oman's traditionally stable economy has continued to see gradual growth and several factors could mean that opportunities for deal-making increase as we look ahead.

Most large business groups in Oman are still family-owned, and many are now seeing that the **time is ripe to restructure**, for instance to improve efficiency, divest non-performing assets or prepare themselves for **external investment, e.g. via an IPO**. As this happens, more acquisition opportunities for foreign investors should come to market. At the same time, some companies in specific sectors such as power and water are gearing up for IPOs as a condition of their Power Purchase Agreements.

In addition, the **government has been focussing efforts on increasing investment in Oman**. As it opens up areas such as tourism, healthcare, aquaculture, fisheries and food security, there is significant scope for M&A and JVs between Omani, regional and international players to deliver specific projects.

As elsewhere in the region, the drive **towards consolidation in the banking sector** is likely to heighten opportunities for M&A activity involving Omani banks.

Qatar

The 2030 Vision includes ambitious goals to develop **healthcare, education and infrastructure (via construction)** in particular, and these sectors are key areas of focus for deal-making.

With many government tenders in the market already and an even more fluid pipeline expected later this year, we are **likely to see more JVs**, especially in infrastructure. Moreover, as the recent changes to foreign ownership rules are written into legislation (and as interest grows in the new Qatar Freezone), **M&A could come to the fore too**.

Market to watch: Africa

While sectors like mining are obvious areas of focus, **opportunities exist across a wide range of industries, from breweries and cement production to telecoms and fintech**. The latter are happening as innovative providers leapfrog existing technologies to develop improved mobile networks and come up with new ideas to connect companies and consumers digitally.

Investors should be prepared for challenges. For instance, it is normal for due diligence processes to highlight numerous red flags, which in another market might de-rail a deal. A robust approach to risk, including considering purchase price retention mechanisms, warranties or indemnities, is essential. Tax authorities can be relatively aggressive, so full tax indemnities should be obtained where possible.

Also, the regulatory regime means that **deals typically take 2-4 months to complete**.

Summary and outlook

As we approach a new decade, the outlook for deal-making in the Middle East appears relatively positive. With governments in the region broadening their economies, rising populations spurring growth in sectors such as healthcare, energy and education, and investment in technology delivering new opportunities for innovation, there is significant potential to be harnessed.

The rapidly changing regulatory environment too, is expected to generate greater M&A activity, while JVs seem set to become more project-specific than has been the case in the past. Buy-outs of JV partners as these relationships are unwound could well be a feature of the landscape as we look ahead.

Identifying pan-regional trends is helpful, especially as Middle Eastern economies open up and competition to attract foreign investment increases. However, knowledge and insight into specific local markets, with their individual nuances and drivers, is just as vital, to provide a well-rounded and accurate portrait of the realities on the ground before significant investments are made.

Our aim with this report is to provide both that "big picture" and the "fine detail", to help international and regional businesses with their decision-making, transactional approach and implementation processes. By sharing our expertise gleaned from 30 years advising on deals right across the region spanning a wide range of industry sectors and transaction types, we have the breadth and depth of experience to add real value to clients as they navigate their options and structure deals for success.

Click here to request a full copy of the report

Middle East Corporate team

Abdulaziz Al-Bosaily
Partner, Riyadh
+966 11 253 2110
abdulaziz.albosaily@clydeco.com

Ross Barfoot
Partner, Abu Dhabi
+971 2 494 3598
ross.barfoot@clydeco.com

Naji Hawayek
Partner, Dubai
+971 4 384 4619
naji.hawayek@clydeco.com

Glenn Lovell
Partner, Riyadh
+966 11 253 2155
glenn.lovell@clydeco.com

Taimur Malik
Partner, Dubai
+971 4 384 4616
taimur.malik@clydeco.com

Stephen McKenna
Partner, Abu Dhabi
+971 2 494 3592
stephen.mckenna@clydeco.com

Paul Sheridan
Partner, Muscat
+968 22 506 514
paul.sheridan@clydeco.com

Jonathan Silver
Partner, Dubai
+971 4 384 4000
jonathan.silver@clydeco.com

Benjamin Smith
Partner, Dubai
+971 4 384 4512
ben.smith@clydeco.com

Peter Hodgins
Partner, Dubai
+971 4 384 4111
peter.hodgins@clydeco.comaaa

Abhi Jalan
Partner, Dubai
+971 4 384 4537
abhimanyu.jalan@clydeco.com

Lee Keane
Partner, Doha
+974 4 494 1012
lee.keane@clydeco.com

Philip O'Riordan
Partner, Dubai
+971 4 384 4580
philip.oriordan@clydeco.com

Niall O'Toole
Partner, Abu Dhabi/Dubai
+971 2 494 3504
niall.otoole@clydeco.coma

Alain Sfeir
Partner, Riyadh
+966 11 253 2112
alain.sfeir@clydeco.com

Marla Valdez
Partner, Muscat
+968 22 506 515
marla.valdez@clydeco.com

Avril Cole
Legal Director, Dubai
+971 4 384 4566
avril.cole@clydeco.com

Rizwan Osman
Legal Director, Riyadh
+966 11 253 2100
rizwan.osman@clydeco.com

440

Partners

1,800

Lawyers

4,000

Total staff

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