

DISCUSSING THE TRENDS

Q&A with Andrew Macklin & Christopher Lester

The M&A Outlook in the Middle East: A Look Back at 2014 and Beyond

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The Megatrends in Mergers & Acquisitions conference held in October 2014 focused on the evolving M&A landscape, promoting inbound and outbound M&A in the Middle East, and general industry trends. Among the speakers at the event were Latham & Watkins partner Andrew Macklin, who moderated the global M&A outlook panel, and Latham counsel Christopher Lester, who moderated the value optimization panel.

In this lw.com interview, Macklin and Lester offer key takeaways from the conference, including how market trends in the Middle East compare to the global M&A outlook and how changes in regulatory regimes may impact the future of the market.

Are the trends in the Middle East consistent with the broadly positive global M&A outlook?

Macklin: At a macro level it is fair to say that a combination of improving consumer confidence, favorable demographics, pent up demand, availability of credit and maturing capital markets are all having a positive impact on deal-making in the Middle East region, a trend which is consistent with what we are seeing in the global markets. Volume and value of deals are both markedly up in the Middle East in 2014, but there have also been a large number of failed deals. Why? The valuation gap has not narrowed as much in the region as perhaps elsewhere, and investment appetite is still cautious — in a relatively small market investors don't want to be seen to be over-paying for assets, which has resulted in heightened levels of due diligence and purchasers looking for enhanced post-closing protection.

Regional private M&A has been dominated by family businesses looking to divest core assets and private equity looking for growth. With the exception of the sovereign wealth funds, there hasn't been a huge amount of outbound activity mostly because strategics and private equity see better growth prospects in-region. To a degree this sentiment has been picked-up by global private equity players who, with dry powder to deploy and the availability of credit, are certainly paying more attention to the region. As well as the need for infrastructure development, the burgeoning capital markets (and loosening of foreign ownership restrictions) are also encouraging inbound investment.

In contrast to the US and Europe, public M&A has been relatively quiet principally because applicable regulations are largely untested and regulators are keen to maintain sector depth on their exchanges. Despite this, commentators expect that we will see more public M&A in 2015.

Lester: One of the key global M&A trends in 2014 has been the return of strategic acquirers, with many large corporates in the US and the UK doing ground-breaking deals that they've been thinking about for a long time. This seems to have been driven by a return of CEO and board confidence, positive equity market reactions to M&A, low interest rates and low organic growth opportunities. Although we have seen a few large strategic acquisitions in the Middle East in 2014, the markets are very different to Europe and the US and there probably needs to be real regulatory reform in the Middle East before we see a significant amount of strategic M&A here.

Are you seeing a disproportionate amount of M&A activity in heavily regulated sectors — with increasing regulatory oversight favoring scale — as seems to be the case on the global scene?

Macklin: To a large degree sectoral behavior in the Middle East is consistent with the global marketplace. Boards are considering M&A in a host of sectors, including in the more regulated technology and telecoms, healthcare, and pharma and financial services spaces. Saying that, on a regional level activity is also being driven by the huge levels of infrastructure investment and the synergies and growth prospects available in the soft infrastructure and energy sectors. Demographics and the need to diversify away from energy-focused economies mean that the regulatory

regime is, to observers at least, not as influential in M&A decision-making as in more developed markets. Agriculture and the need for food security is an example of a driver more specific to the Middle East than perhaps is the case elsewhere.

Lester: It's interesting to note that there has not been significant activity in 2014 in financial services M&A outside the Middle East, probably because of increasing regulation and many of the players needing to get their houses in order. In the Middle East, there continues to be significant financial services M&A taking place, particularly in the UAE, Egypt and Bahrain. This activity is being driven by international banks exiting the region as many lack sufficient scale to be successful, and many are finding it very challenging to comply with international anti-money laundering and sanctions obligations. In addition, while many of the regional banks are doing ok, they have limited potential for organic growth because the market is over-banked, so there should be more consolidation among regional banks in the future.

What other trends are you seeing in the Middle East that will impact on M&A in the next few years?

Lester: Middle East regulatory regimes are becoming more sophisticated, which will make M&A transactions more complex and interesting. The UAE has recently introduced a new merger control law for example, and Middle East tax regimes outside the UAE and Bahrain have been developing rapidly, particularly in Egypt. Regional buyers, sellers and M&A service providers are also becoming more sophisticated. Products like warranty and indemnity insurance, which have been gaining more traction in Europe and Australia, but which have not really been seen before in the Middle East, have appeared on a few recent deals.

As with the rest of the world, players in Middle East M&A transactions have been increasingly focused on bribery and corruption due diligence owing to the potential these issues have to destroy value and kill deals and I expect this to continue. Continued political instability in the region has also resulted in investors being more interested in bilateral investment treaty protection than ever before.

CONTACTS

Andrew Macklin
Doha
T + 974.4406.7717
andrew.macklin@lw.com

Christopher Lester
Abu Dhabi
T + 971.2.813.4825
chris.lester@lw.com

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