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Spotlight: M&A Trends In The Middle East


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Law360, New York (July 14, 2010) -- The first two quarters of 2010 have seen moderate M&A activity in the Middle East. However, there are demonstrated signs that M&A activity in the Middle East could be set to pick up once again.

The lagging global economic recovery appears to be turning the focus of Middle East money inwards and primarily containing it within closer borders. Many of the announced or completed deals in 2010 have been made by regional buyers and sellers. There have been a few notable inbound transactions in regulated industries, and a scattering of outbound activity; however, the resurgence is being driven largely by regional players.

While the volume and overall value of deals remain relatively moderate, the increased activity is a healthy sign that regional M&A activity is on the rebound. Conditions are becoming more positive for deal-making across a variety of industry sectors, including health care, energy & renewables, consumer goods and telecommunications.

A number of factors are set to underlie the positive trend of Middle East M&A for the remainder of 2010 and into 2011. These factors include: (a) an increase in the activity of regional sovereign wealth funds and government-backed investment entities; (b) the continuing consolidation efforts in certain strategic sectors; (c) a partial easing of access to credit; and (d) a continuing emphasis on reduced deal sizing, together with a pick-up in sell-side M&A.

Sovereign Wealth Funds and Government-Backed Investment Entities

After a somewhat cautious 2009, sovereign wealth funds and government backed investment entities are expected to deploy greater amounts of capital to grow their existing asset portfolios and to make investments with strategic or opportunistic value. Such capital is expected to be deployed mostly within the Middle East and in other emerging markets.

However, the slower pace of recovery in Europe and the United States could encourage regional sovereign wealth funds and government-backed investment entities to seek more targets in those markets, as the window on attractive valuations remains open.

Sovereign wealth funds will benefit from a slight softening of the protectionist reaction they experienced during the recent boom in the Middle East, including as a result of the adoption of the Santiago Principles.

Although such concern no longer dominates news headlines as it did a few years ago, an essential factor of any high-profile overseas investment remains: Middle Eastern sovereign wealth funds and government-backed investment entities must have a well-prepared plan for navigating the political issues that come with their activity.

Overall, while uncertainty still exists in the markets, we expect that Middle Eastern sovereign wealth funds and government-backed investment entities will become more active through the remainder of 2010 and into 2011. While they are likely to have a general preference for smaller and medium-sized deals, attractive valuations could lead to one or more high-profile investments being made before the end of 2010.

Key Sector Consolidation

Over the past two years, there have been visible consolidation efforts in several key sectors in the Middle East, including the all-important real estate sector. Most of the news in this area has revolved around large government-owned or sponsored corporations. We expect that this trend will continue in the short-to-medium term, as stakeholder governments push merger activity in fragmented sectors that they consider key to the overall recovery of their economies.

Interestingly, the economic downturn has not triggered a much-anticipated wave of consolidation in the Middle Eastern banking sector, including in the Gulf Cooperation Council region where the banking sector remains largely fragmented. This trend stems from a number of local and regional factors, including the lack of a clear legal framework for takeovers, sizeable government ownership and, in many cases, a lack of appetite to engage in risk assessment of current asset portfolios.

Better Access to Credit

M&A activity in the Middle East will continue to benefit from a partial relaxation of the credit markets. Improved access to credit is allowing buyers to include a greater element of cash consideration in deals, making those deals easier to close with potential sellers who, in the Middle East, have historically disfavored non-cash payment such as stock consideration.

In exchange, the market is likely to continue to favor buyers, who will demand intensive due diligence access and stronger deal-protections (including broad walk-away rights, post-closing price protections, strong representations and longer indemnification periods).

In addition to improving access to acquisition financing, regional lenders are also engaging in principal finance by investing in or acquiring assets from their clients in return for capital required for growth and balance sheet restructuring. This type of activity is expected to continue as clients seek to access credit and re-negotiate the terms of their facilities.

Even though there has been some relaxation of the credit markets, the fact that there is still only partial accessibility remains one of the main elements slowing the recovery of regional deal-making.

Continued Deal-Size Reduction

Partial accessibility to credit means that the prevalence of small-to-medium sized M&A deals is likely to continue for the remainder of 2010 and into 2011. Many strategic and private equity players who in the past could make larger deals with a high degree of leverage no longer have this option.

Even larger players, who will have access to credit or might not need it, are likely to continue their preference for a greater number of small-to-medium sized deals. This trend reflects the continued uncertainty in the markets, and the desire to spread risk across deals.

Overall, there seems to be a consensus that M&A in the Middle East will maintain its measured activity for the rest of 2010. Although there is uncertainty as to what impact a slow U.S. and European recovery, the European public debt crisis and regional geopolitical developments will have on business sentiment and M&A activity, there is reason to be optimistic.

With the opportunity for initial public offerings in the Middle East at present still fairly limited, the process of restructuring by regional players still ongoing and buyers' valuations starting to look more reasonable for prospective sellers, the gap in value perception between sellers and buyers is likely to narrow, and more deals are likely to be made.

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