# MERGERS & ACQUISITIONS

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SQUIRE SANDERS

# SAUDI ARABIA

Kevin Connor, Squire Sanders

**How would you describe M&A activity in Saudi Arabia over the last 12-18 months? What factors are driving deals in the current market? Are certain sectors more active than others?**

M&A activity has picked up significantly in the past year, especially in Saudi Arabia, the UAE, and Kuwait. Other markets in the MENA region continue to be sluggish given the Arab Spring events and the transitions and reforms taking place in many countries in the region. The UAE and Saudi M&A markets have been robust, primarily as a result of political stability, the UAE beginning to shrug off the economic downturn, and the sheer size and potential of the Saudi market. Significantly, cash rich MENA players continue to look at and acquire assets outside the region with reasonably priced valuations. On the inbound side of regional MENA M&A, a principal driver remains consolidation, and particularly with construction, industrial and consumer products, and in the insurance and financial services sectors.

**How would you characterise the appetite of strategic and financial buyers for M&A? Broadly speaking, what fundamental aspects of a business are they looking for when identifying a prospective target?**

Strategic investor buyers are attracted by low valuations, sellers looking to exit fast, and access to new markets. In the Middle East, and especially the Gulf, the market turmoil related to the Arab Spring events has not led to a dampening of enthusiasm. The main appetite of both strategic and financial buyers is in Saudi Arabia, the UAE, Kuwait and Oman. Bahrain and Yemen continue to work through political issues and investors in North Africa seem to be taking a 'wait and see' approach. Overall, I have seen more activity from strategic buyers, the principal driver being to access the growing MENA markets. In many cases this includes developing further manufacturing capacity, and/or shifting production to newly acquired assets. There has been somewhat less interest from financial buyers; though, based on reports from private equity players and industry pundits, that should be set to change in the near term as markets get comfortable with the dramatic changes in the MENA region.

**What steps should a buyer take to minimise transactional risk in a deal? Is thorough due diligence an indispensable part of the process?**

Thorough due diligence is indispensible. However, this does not always mean just due diligence on the asset or opportunity. Many inward bound investors fail to focus sufficient resources in reviewing ancillary issues such as political risk, currency risk, availability of skilled labour, infrastructure risk, regulatory, and other country specific cultural issues. There are investors who are comfortable with all of these risks and, as a result, may not spend as much due diligence on the asset as they know the market so well, know the business of the target, and are generally confident that they can 'fix' whatever issue may be out there. This can lead to certain advantages, the main one being to close quickly and to get a good price. Obviously the risk level may go up, but sophisticated investors who do their homework know how to evaluate those risks.

**Have you seen an improvement in the banking and finance environment to support M&A deals in Saudi Arabia? What is your advice to acquirers on designing and negotiating the optimal capital structure?**

The banking and finance environments have improved significantly in those countries perceived as most stable in the MENA region. In Saudi Arabia, the last year saw a tremendous influx of additional capacity as new financial institutions entered the market, providing an overall stimulus to activity as competition has increased. Also, many corporate finance advisories which were unable to perform at a high level have been under serious pressure, with many simply ceasing operations or being acquired for their contacts and relationships. In designing any capital structure in the MENA region, careful attention needs to be paid to the capital requirements under any applicable foreign investment legislation. Potential acquirers need to confirm whether a certain percentage of the capital structure must be reserved for companies or individuals resident in the relevant jurisdiction. Consideration should also be given to potential incentive packages reducing the overall cost to the investment, or access to any local development fund

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monies at favourable borrowing rates on the debt side. Finally, there is no substitute for having a very developed terms sheet agreed in advance such that all parties are on the 'same page'. Naturally, this means having dedicated financing in place.

**How important is local market knowledge when it comes to closing deals in a tough economic environment?**

The political, economic, and legal landscape continues to evolve and progress. If an investor does not understand these local dynamics, a heavy price can be paid. Knowing the local market has advantages at many levels, one of them being a potential game changer on a tough deal. Most experts agree that early integration planning is vital to delivering the benefits of a merger. The two most common obstacles are cultural awareness and expectation management. I have seen, many times, a complete lack of basic understanding of cultural issues, or worse, a sense by a buyer in an emerging market of 'cultural superiority'. This is simply toxic. Companies should be aware of this and have this as part of a fully developed integration plan. The second problem, expectation management, is just that. Most people will accept change, bad news, and so on. If there will be a closure of one business line and the loss or transfer of employees, it should be dealt with openly. People will adjust and adapt if they are being told the truth.

**Could you outline any recent developments in M&A regulations that will affect transactions in Saudi Arabia going forward?**

One recent development worth noting is the enhanced role the Saudi Arabian Monetary Agency (SAMA) will play in supervising the financial sector as the country considers whether to open fully to direct foreign investment. SAMA and the Saudi Capital Markets Authority (CMA) recently signed a cooperation agreement to better align oversight, the issuing of regulations, assessing risk management, the IPO and Sukuk markets, and overall to work together to improve market stability. Importantly, at present only CMA approval is needed for mergers and capital increases. While it is not clear how the recent agreement between SAMA and CMA will be implemented, investors should be aware that these changes are underway.

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Kevin Connor is the coordinating partner for Squire Sanders' Middle East and North Africa (MENA) practice. He is resident in Riyadh, Saudi Arabia, where he works in the offices of Squire Sanders' independent network firm, EK Partners & Al-Enezee Legal Counsel (EKP), and also spends a portion of his time in EKP's Beirut, Lebanon office. After having spent 18 years providing legal support and guidance on numerous projects throughout emerging Central Europe, Kevin brings significant experience to the region. He has advised companies and investors on various aspects of international business law, particularly in acquisition-related matters, energy, infrastructure projects, commercial disputes and finance.

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