Investment Outlook 2019

Economic trends and corporate transactions in the GCC
Contents

Introduction 4
Challenges and opportunities for foreign investment 6
Utilizing equity markets in the Middle East 12
The progression of privatization 14
PPP starts to move 16
Dubai – the African business hub 18
M&A boosted by restructuring pressures 20
The Gulf tech boom 22
Debt capital markets driven by loans 24
Prospects for 2019 26
Introduction

On the surface, 2018 looked like a good year for the Gulf region. The oil price averaged over US$70/barrel for the year, compared to an average of US$50 for the previous three years.

Combined with increased production, that allowed for increased spending while governments continued to improve the fiscal environment.

Under the surface, however, the reality for investors and the private sector has been more mixed. M&A picked up as corporates restructured, sovereign wealth funds moved aggressively into global technology ventures and loans drove growth in debt markets, but in key areas such as privatization sales, foreign investment and IPOs progress was minimal, despite continued reform.

Three factors slowed commercial transactions in 2018 – and these will continue to shape Gulf markets in 2019:

1. **GDP growth has not translated into a better environment for the private sector.**

   The private sector has been hit by rising costs, cautious consumer demand and lower government demand. Larger Gulf companies are looking outside their home markets to diversify revenues and are investing heavily in technology to boost their global competitiveness. But many smaller family companies – especially in Saudi Arabia – are struggling to wean themselves off cheap expatriate labor, protectionist regulations and local government spending.

2. **The low-hanging fruit has gone.**

   The UAE, long the focus of investor interest as a hub, is no longer a growth story. Private sector jobs are declining as companies restructure and cut costs. Expats are squeezed by rising taxes and stagnant wages, so consumer demand is down. The government too has kept spending low. In Saudi Arabia, the growth potential is huge, the reform drive is continuing and government spending has grown in a few key areas. But actual transactions are hampered by a difficult business environment, and local worries about the impact of opening up to outside influence. Qatar is opening itself to investment, but regional logistical links have disappeared, making operations difficult. Oman and Bahrain are no longer in crisis, and Kuwait remains stable, but progress in all three is slow.

3. **The global and regional framework has become more challenging.**

   The oil price is highly volatile and will remain so – which helps to focus minds on the need for private sector development and foreign investment, but makes it more difficult to guarantee stability while opening up. Gulf countries are making more resolute efforts to develop ties in new markets, but growing protectionism at home and abroad increases the tension between jobs and the pressure to produce locally, on the one hand, and opening to foreign investment on the other.
Key developments we expect to see in 2019:

• In Saudi Arabia, a number of privatization deals, currently in the pipeline, are likely to be completed in 2019.

• Saudi Aramco is likely to move ahead with the acquisition of a 70% stake in SABIC, financed by debt markets and banks.

• An increased number of public-private partnership (PPP) projects will get off the ground around the region, with a growing focus on renewables, transportation, education and healthcare.

• The impact of key market regulations will become clearer as they are approved and implemented: PPP law in Saudi Arabia and possibly Oman; Foreign Investment Law in UAE and Qatar.

• Emirati investors will continue to expand out of their slowing home market and take advantage of growth potential in Saudi Arabia, as well as increasing ties in Africa, China, India, Russia and Latin America.

• Sovereign wealth funds like Mubadala and Saudi’s Public Investment Fund (PIF) will expand their investment in global ventures, increasingly financed by loans. They could start investing more actively into their home economies to make up for a lack of foreign investment and struggling private sectors.

In this year’s report, alongside trends for capital markets, privatization and PPPs, we take a close look at the prospects for foreign direct investment (FDI), growing trade and investment ties with Africa and China, and the Gulf region’s emergence as Silicon Valley’s leading venture investor.

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Challenges and opportunities for foreign investors

The macroeconomic picture improved significantly across the GCC in 2018. Increased oil production and the more benign fiscal environment translated into improved GDP growth.

With government spending up 25%, Saudi Arabia saw a return to growth of more than 2%, while in the UAE, GDP growth approached 3%. Both the UAE and Qatar returned to fiscal surpluses in 2018, and Saudi Arabia brought its budget deficit below 3% of GDP. Oman’s deficit narrowed very sharply, while Bahrain pulled back from crisis, after receiving support from Saudi Arabia, the UAE and Kuwait.

<table>
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<th>GCC fiscal balance (% GDP)</th>
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Source: IMF WEO (October 2018)  Note: includes IMF estimates for SWF income (outside budgets)
Saudi Arabia is the clear focus of investor attention in the region, due to a combination of underdeveloped markets, far-reaching reforms, renewed government spending and a determination to have the private sector play a key role in infrastructure development. A privatization plan for 2018-20 was approved in April, with a view to unlock state-owned assets for investment; several PPP projects are on the way; and, whilst there have been some delays, a pipeline of IPOs are to come. The political will to open the market to foreign investment is strong. Reforms and restructuring continued apace to create a private sector that can employ young Saudis who make up 70% of the 12.9% unemployed – and still rising. But preparing state-owned enterprises for privatization takes time, the local private sector is struggling to adapt to the new environment, and foreign investors are not yet ready to pour money into Saudi Arabia. Foreign direct investment flows did double in the first three quarters of 2018, compared to the same period in 2017 – but they remain well below 2014-16 levels and are a tiny fraction of pre-2012 inflows. Since the surplus on the capital account and debt capital are invested abroad, net direct investment flows remain solidly negative. “The market is large and there are big growth opportunities, but the changes made don’t add up to making it attractive yet,” says Sorana Parvulescu, who heads the geopolitical risk analysis team for the Middle East and North Africa at Control Risks.

As the pieces of the investment framework gradually come into place, deals should start to flow. In early 2019, geopolitics will continue to dominate discussion around Saudi Arabia, but as the year goes on, the Saudi government is expected to get into fifth gear in terms of Vision 2030, completing a number of privatization sales and PPP projects by the end of the year. If large-scale foreign and private sector investment fail to materialize, however, there is a chance that the government will opt to redirect sovereign wealth fund resources back home to tackle the need for job creation, rather than – as planned – investing the surplus abroad to diversify and mitigate oil shocks. That would be suboptimal and crowd out the private sector, but it would help to tackle the urgent issue of unemployment that the government has promised to reduce in 2019.
In the UAE, the big challenge for investors is the slowdown in growth and the uncertain future after Expo 2020. Budget spending remained tight in 2018; the private sector is cutting costs and laying off people, while investing in IT infrastructure to raise productivity. A number of multinationals have moved out of Abu Dhabi and Dubai, citing high costs and difficulties accessing the local market. The expat population is spending less, with job growth declining, wages stagnating, costs rising through a combination of VAT and high fees for health and education.

Consumer demand is no longer a driver of growth in the UAE. Private consumption made up 50% of GDP in 2010 but its share had dropped to just 30% in 2017 and has slumped further with the introduction of VAT. Sectors that developed to serve a fast-growing population – real estate, retail, restaurants and private education – are now struggling. Schools are operating below capacity and facing a cap on school fees in a leveraged model that requires high prices and high capacity. Mall operators are under pressure to offer rent reductions to retailers who are forced to offer discounts in an increasingly competitive environment. Property developers, bullish even at the start of 2018, have now abandoned plans to buy land as rents fall. This is not a crisis on the scale of 2009 – and Abu Dhabi is arguably more impacted than Dubai. It reflects a maturing market that needs to move into a new gear. Increased government spending, planned in 2019, plus the build-up to Dubai Expo 2020, will pump money into infrastructure and create positive sentiment. But the knock-on impact is expected to be limited and there are worries that the flurry of activity around the Expo could be hiding a situation that is worse than it seems.

The government knows it has to restructure the way business works – cutting costs and fees, granting visas that would allow expats to stay and opening up the domestic market to foreign investors who do not feel comfortable being forced to take a minority stake in joint ventures. But it needs to do this without reducing government revenues or damaging local businesses.

The U.S. investor perspective

Aaron Cutler, Partner, Washington, D.C.

Saudi Arabia is certainly the hottest market in the region, but US investors have some concerns. Right now, the investing community is seeing assets overpriced and they are worried about a potential global slowdown coming. They are sitting on large capital reserves and building up a cash pile, so they can withstand it. That means they will have cash for buying opportunities, but only when pricing is lower.

Will the UAE open up its market?

Imtiaz Shah, Partner, Dubai

The UAE’s new Foreign Direct Investment Law and 10-year visa regulation reflect the government’s recognition that they must compete with other Gulf states to attract both foreign investors and expat talent. At present, the ambition remains limited as the UAE tries to accelerate diversification without introducing changes that reduce government revenues or affect locals. Nevertheless, these changes have the potential to open the market up – it’s hard to open a gate partially. If the UAE introduced a strong foreign investment law and the right to stay, that would dramatically change the game.
That was the motivation behind the Foreign Direct Investment Law and 10-year visa regime announced in broad outline in 2018. In early 2019, an FDI Committee will clarify in which sectors and under which conditions companies can operate onshore with 100% or at least majority ownership. The aim is to open the doors to specific investors in sectors such as technology and pharmaceuticals or in particular areas of the country. There are likely to be minimum investment levels and local job creation guarantees for varying levels of ownership. “They are testing things out to start with, choosing a few companies in target sectors, so the process can be managed more closely”, says Khatija Haque, Head of MENA Research at Emirates NBD. “But it is not impossible to imagine that you could, in future, introduce a small corporate tax on this group of 100% owned companies, diversifying the revenue stream without additional cost to consumers.”

Qatar has also made several efforts to open its market to foreign investment, after largely shrugging off the impact of the boycott, imposed in June 2017. In May 2018, the government announced a draft allowing 100% foreign ownership in most sectors, up from 49%. The law is expected to go into effect in 2019. Stock market data shows that there were US$1.8 billion of net foreign inflows into the Qatar Exchange in May-Oct 2018, after remaining flat since the start of the boycott.

New ties with China

**Jun Wei, Partner, Beijing**

China’s relations with the Gulf have undergone a transformation over the past year. Trade and investment ties have been tiny compared with Asia, Latin America or Central Asia – but speculative real estate investments have grown strongly. Latest data released by the Dubai Land Department reveals that 7,013 Chinese investors made 9,640 real estate transactions worth a total of US$4 billion between July 2002 and July 2018. Chinese regulations have now clamped down on any transactions where real estate is not the core business, effectively stopping the flow of capital into property over the past 18 months.

In its place, following President Xi’s visit to the UAE in 2018, trade and investment relations are becoming more strategic. The Gulf region is becoming a key connection point for all parts of China’s Belt and Road initiative. China has pledged lending of US$20 billion to the region, signing over a dozen deals in financial services and hydrocarbons, while focusing investment on key areas from tech, retail, artificial intelligence and robotics and medical services.

The impact of Brexit

**Peter Watts, Partner, UK**

Brexit has certainly caused Middle East financial markets to suffer. While there were initial gains when the referendum result was announced in 2016, markets declined, with stocks and commodities such as oil particularly hit.

However, as economies become less reliant on oil and successfully branch out into other sectors, it could be argued that Brexit may offer opportunities for growth and development for Middle East businesses. GCC governments should be able to agree mutually beneficial trade deals directly with the UK, whilst utilizing the uncertainty in Britain to secure quick and favorable agreements.
Utilizing equity markets in the Middle East

Gulf countries are continuing to make slow progress in opening up, regulating and using their equity markets.

Saudi Arabia’s Tadawul lifted the foreign ownership cap to 49% in January 2018 and issued new price stabilization rules to limit large movements after IPOs.

MSCI upgraded Saudi Arabia to emerging market status in June. The Tadawul will be included in stages, starting with the May 2019 Semi-Annual Index. The impact will unfold over several years but has already encouraged higher trading volumes and new reforms. Tadawul announced, for example, that it would launch exchange-traded derivatives, such as futures, in 2019 based on an index developed jointly with MSCI.

The Gulf IPO market did not grow as expected in 2018. There were 18 IPOs in 2018, totaling US$2.7 billion, compared to 26 totaling US$3.7 billion in 2017. Most were small-scale Real Estate Investment Trusts (REITs) in Saudi Arabia and UAE, with only one large deal – the privatization of Qamco in Qatar, raising around US$750 million, a quarter of the total.

There is still reluctance from family firms to raise finance through equity markets rather than through banks and debt financing, but a few mid-sized companies did list locally in 2018, including Saudi's Leejam Sports and Kuwait's Integrated Holding, which each raised over US$200 million. Dubai's Shell Drilling listed in Norway.
The large IPOs that had been expected in 2018 in UAE and Saudi Arabia were delayed, for multiple company-specific reasons, despite generally strong and liquid markets. In the UAE, GEMS Education had planned a US$1.5 billion IPO in London in July, but postponed it after Dubai froze tuition fees. Careem postponed listing because of a possible acquisition by Uber. Emirates Global Aluminium delayed a US$3 billion IPO due to market conditions. In Saudi Arabia, ACWA Power delayed its listing, partly due to problems with a large plant in Turkey.

Some of these delayed IPOs could materialize in 2019, and others are expected too – but there is unlikely to be an IPO boom in 2019, with global market conditions remaining volatile, driven by high valuations in places, monetary tightening, and worries about the US-China trade war and Chinese debt.

In Saudi Arabia, Gulf Steel Works is expected to list, having received regulatory approval in September. Amlak International for Real Estate Finance and Nayifat Finance, which loans to SMEs, are both considering IPOs. Flynas, a budget airline, is planning to list by 2020. In Kuwait, planning is underway for Boura Kuwait to list in 2019 and there is likely to be an IPO as part of the Shamal Azzour power plant PPP. In the UAE, several companies including Emirates Global Aluminium are waiting for the right market conditions.

Prospects positive for Tadawul

Dr. Najem Alzaid, Partner, Riyadh

Joining the MSCI Emerging Market index is a major step for the Tadawul. Saudi capital market has now joined an important club and we are already seeing regulators loosening restrictions, introducing more financial products and allowing foreign investors to be more active. By 2020, we expect to see more foreign investment on the exchange.
The progression of privatization

Vision 2030 puts the creation of a vibrant private sector and the streamlining of government activities at the heart of Saudi Arabia’s economic transformation program.

The main instrument to realize these goals is the privatization of existing state assets in everything from energy and water to sports clubs and flour mills, alongside an ambitious PPP program that leverages the private sector to build and operate infrastructure across the spectrum from schools and hospitals to desalination plants.

2018 was initially proposed to be the year when the first few key assets would come to market, however 2019 will see the process move into a new gear. The rhetoric may be less grand but the focus now is on prioritizing the sales of the most advanced companies and attracting greenfield investment through PPPs, while continuing the long process of readying other companies for privatization.

In July, a proposal emerged for Aramco to buy a 70% stake in SABIC from the sovereign Public Investment Fund. That would help Aramco to realize its long-term strategy of shifting from crude oil to chemicals exports, provide PIF with a similar supply of cash as the IPO would have done, and avoid the need for significantly greater disclosure that listing on a foreign exchange would require.

The process of planning for privatization has been helpful in defining Aramco’s future as a business. It has also allowed the company to partner more easily as it expands internationally, with US$60 billion in investments agreements announced in 2018. On a smaller scale, it is this kind of transformation that the preparation for privatization is aimed to bring to the more than 100 state-owned enterprises identified for sale.

On the other hand, the authorities have worked to prioritize sales that will be able to take place in 2019-20. The National Center for Privatization & PPP (NCP), set up in 2017 in order to improve implementation, issued a revised plan of sales to 2020, with the aim of raising around US$10 billion. The water sector looks set to be the pioneer in 2019, with the sale of Ras al-Khair desalination plant already well advanced and others on the way. Four flour mills are also likely to be sold within the year, as well as the national football clubs.
Saudi private sector takes shape

*Saad Alrashed, Partner, Saudi Arabia*

The transformation is based on developing the role of the private sector in the Saudi economy and all initiatives are aimed at doing that. The rise in expat fees, introduction of VAT and the loss of buying consumers as more than one million expats left the country over the past two years, has impacted local businesses, who are adapting to a new environment. While this adjustment takes place, the reforms will continue since they are key to creating jobs. There are signs that demand from the private sector is picking up. With PPPs and privatization coming through in 2019, we expect to see a major shift in the private sector.
PPP starts to move

Much of the inertia blocking privatization comes from a fear of having to lay-off nationals when existing assets are sold.

That makes greenfield PPPs – potentially creating thousands of jobs – an easier alternative and there has been significantly more progress across the entire Gulf region in 2018. We expect the PPP market to be vibrant in 2019.

Saudi Arabia published a draft PPP law in July 2018 for public consultation which should codify practices and address questions around payment guarantees. The first few large-scale PPP projects are already taking place. The first utility-scale solar project under the King Salman Renewable Energy Initiative, Sakaka PV, was closed financially in November, with the participation of ACWA Power, a Saudi energy company. A contract was signed on the world’s largest independent water desalination plant at Rabigh in December, also with ACWA Power.

PPP payment guarantees

Sohail Barkatali, Partner, Dubai

The PPP market is fairly vibrant across the GCC, but the key focus is on Saudi Arabia, where we expect to see more deals in renewables, education, transportation and health. One of the big questions for international investors is whether these projects will have a guarantee from the Ministry of Finance, underpinning payment obligations. These used to be standard in power and water deals, but more recent infrastructure projects have used different models, including a government support letter and support from government-related entities. The challenge is that government entities can have an obligation to pay, but the finance ministry controls their budget. International developers and financiers are looking at ways to be more creative around mitigating the risks associated with non-payment. Ultimately, these long-term PPP deals are about taking a view of the sovereign state and the entity heading the project.
The NCP is planning to award 14 PPP projects by 2020, worth around US$7 billion, in areas such as parking, recycling, renewable energy, education and health. The lack of clear payment guarantees in these sectors will benefit regional players, such as Saudi and Emirati companies, that are able to understand and manage sovereign risk more easily. In the education sector, for example, UAE-based GEMS Education is lining up to build new private schools under a PPP program announced in January 2018, while Mediclinic, a South African company that merged in 2017 with an Abu Dhabi company, is focusing on investing in clinics and hospitals through new PPP programs.

Elsewhere in the region, PPP is moving ahead. Kuwait, one of the first countries to pass a PPP law, finally saw two strategic and badly needed projects in wastewater treatment and waste-to-energy approved for completion after several years of delay. Another project planned at the same time has been retendered, while others were dropped, largely because they no longer met requirements. Once these deals are closed, there will be renewed interest in PPP projects in the Kuwaiti market, which offers a lot, but takes inordinate patience. For 2019, the government has signaled interest in launching education PPPs.

Oman did not pass expected PPP legislation in 2018, amid a challenging period with two sovereign downgrades and a lack of clarity around succession to the Sultan. Nevertheless, its history of successful independent power and water projects, starting in 1999, mean the government has a strong record of consistent behavior and there is still considerable interest from international lenders. One ambitious PPP project closed in 2018, the Sharqiyah desalination project, developed in conjunction with a dedicated solar facility. The PPP law is expected to be introduced in 2019 and more projects are expected in the renewable energy space. Oman is also looking to move into infrastructure projects in the coming years.

In the UAE, the first project to be completed under Dubai’s PPP law is underway, building a court and smart parking. Abu Dhabi Electricity and Water Authority has also been active with a number of large-scale solar and desalination projects working towards completion.

"Taking PPPs forward

Turki Alsheikh, Partner, Riyadh

Saudi Arabia is the dominant economy in the MENA region, and will likely maintain high growth levels for the foreseeable future, as its infrastructure and ultrastructure catches up with its population growth in its peripheral cities and towns across its vast landmass. Logistics, transportation and utility services are the main ‘engine throttles’. The PPP law is finally taking things forward by clarifying the “dos and don’ts” in this field. Most likely 2019 and 2020, as economic confidence returns to the 2012 levels through a calmer and steadier period. The prospect seems cautiously optimistic for the next 36 months."
Dubai has managed to take this status away from old hubs such as Johannesburg for a number of reasons. First and foremost is convenience. Flight connections and communications links are good, international companies can trade in dollars and move currency in and out, while housing, taxation and amenities are attractive. Traders use Dubai’s efficient ports, freight terminals and logistical infrastructure to serve small and fragmented Africa markets. But the UAE is also a capital surplus region looking to invest its money and Emirati companies such as Emaar, DP World and Emirates are seeking new markets.

As Dubai’s role expanded, so did the hype around Africa’s potential, but with the slowing market in 2018, the relationship between Africa and Dubai has showed signs of changing. A number of high-profile corporate failures, such as Etisalat’s withdrawal from Nigeria, have shaken confidence in Africa’s business potential.

“Reliance on local partners and the interdependent nature with technical expertise from overseas investors are where disappointments often arise” says Sanjeev Gupta, Executive Director of Africa Finance Corporation. “They blame Africa, but it is really ill-conceived strategies or irrational expectations that cause these problems”.

Alongside slow growth and balance sheet problems at home, many Dubai-based companies are rethinking rapid expansion. Phoenix Group is one company that has recalibrated its strategy. It is currently importing rice into Africa from India. It had planned to grow rice in Africa, with the hope that farming would pick up strongly, but it has narrowed its ambition to thinking about import substitution. “There is not less interest in Africa as a market but it can’t be the bread basket of the world,” says Sanjay Sethi, Director of Sustainability at Phoenix. “The population is big and growing fast and there is pressure for import substitution, so there is demand.”
Some people wonder whether Dubai is losing its status as a trading hub for Africa since trade can be done from anywhere. But DP World points to the continued need for transshipment for containers. “The model still works – there are 15 million containers arriving every year in Dubai,” says Redwan Ahmed, Director of Investor Relations at DP World. “We also offer sea-to-air cargo services – a product African companies often use so they can export to Europe more easily.”

DP World has been one of Dubai’s success stories in Africa and is expanding now from ports to providing inland cargo routes in countries such as Rwanda and DRC. “Even where there are challenges, we are looking at long-term potential,” Ahmed says. “As a company, our DNA is going to difficult markets and building infrastructure and relationships that helps us make a good return.”

Dubai-based Agility Africa is also thriving on helping other companies to maneuver in difficult markets. It is building a network of warehouse parks that create an international standard, user-friendly platform that is a simple and low-capital way to enter the African market. Agility’s first warehouse was in Ghana and it is now opening in Cote d’Ivoire, Nigeria and Mozambique. “Many Gulf companies have realized that if they want growth in the next decade, they would have to go to Africa, but the risk perception is so high and execution is very difficult,” says CEO Geoffrey White. “If you can manage the real risks and understand the market and the true drivers of growth – and you wish to build a sustainable business – then Africa is a very significant opportunity.”

An investment gateway to Africa
Andrew Skipper, Head of Africa Practice

As African economies continue to expand and develop, businesses and investors from around the globe are increasingly recognizing the benefits of using Dubai as a base to access the continent’s myriad growth opportunities. It serves as a strategic hub along the ‘New Silk Road’, which will link resource-rich Africa with capital-rich regions such as the GCC and Asia, and provide foreign businesses with easy access to fast-growing markets in the continent.

The Dubai Chamber of Commerce has invested US$27 million on raising awareness of trade and investment opportunities in Africa, and we are starting to see a pattern of multinational companies transferring their Africa focused teams to Dubai. Dubai is committed to contribute towards Africa’s future growth – and businesses can see the opportunities.
M&A boosted by restructuring pressures

M&A has picked up in 2018, as companies respond to growing cost pressures, sector disruption, increased competition and the need to expand globally.

With a more enabling business environment coming into place, M&A deals that had foundered on insufficient regulation are also being revived.

The financial sector remained among the most active, with tighter margins spurring consolidation and governments pushing for larger and stronger banks in what remains a heavily overbanked region. In Saudi Arabia, Saudi British Bank (SABB), backed by HSBC, acquired Alawwal Bank for US$5 billion in October, creating the country’s third largest bank, pending regulatory approval. In December, Saudi Arabia’s largest bank NCB started merger discussions with Riyad Bank, giving it a clear lead over its rivals. PIF has sizeable stakes in both banks.

In Abu Dhabi, talks began in September for a three-way tie-up between Abu Dhabi Commercial Bank, Union National Bank and Al Hilal Bank. That would create a regional powerhouse with assets of about US$110 billion. The trio share the same majority owner in Mubadala. There is also talk of merger between three Sharjah-based banks: Bank of Sharjah, Invest Bank and United Arab Bank. And merger talks have started in Oman between Oman Arab Bank and Alizz Islamic Bank.

Kuwait Finance House and Bahrain’s Ahli United Bank also revived talks, dating back to 2016, for a US$93 billion merger that could create the GCC’s second largest Islamic bank. Cross-border deals are also taking place outside the region. Emirates NBD acquired Turkey’s Denizbank for around US$3 billion, pending what could be difficult regulatory approvals.

Rethinking finance

Rahail Ali, Partner, Dubai

The region is over-banked, so institutional mergers reflect market need and that’s likely to continue. The embryonic fintech sector has every potential to shake up the market further, M&A finance activity is bound to follow.
Gulf financial companies have also started to acquire innovative fintech start-ups. In May, Bahrain’s GFH Financial Group acquired a majority stake in The Entertainer, a Dubai-based incentives app.

This trend will pick up in 2019, with the likelihood of significant tech M&A deals too. Uber is expected to acquire Careem, or merge their Middle East units, supported by GCC SWF investments in both companies.

Real estate companies, struggling in the slowing UAE market, have also been merging assets. Aldar Properties, Abu Dhabi’s biggest-listed developer, reached an agreement with Tourism Development & Investment Company in May to acquire real estate assets worth around US$1 billion.

The oil and gas/petrochemicals sector has seen a spate of international and regional M&A deals as it restructures. Abu Dhabi’s ADNOC sold a series of assets in 2018 to finance its integration with downstream; Saudi Aramco acquired a petrochemicals refinery in China as part of its long-term strategy. Kuwait Energy was bought by United Energy of Hong Kong for US$651 million in September, after a merger with SOCO of the UK fell through. M&A activity in this sector will continue in 2019 with the likely execution of Aramco’s acquisition of 70% of SABIC from PIF, worth about US$70 billion, mainly debt-financed. Two Saudi petrochemicals companies, Sipchem and Sahara, have also resumed merger talks, taking advantage of improved regulations.

Looking further afield

*Charles Fuller, Partner, Dubai*

The need to cut costs and expand outside of home markets is building up to a great deal of restructuring work. Many mergers are taking place and more are under discussion – especially in the financial sector, but also in energy, tech, retail and elsewhere. It is something like what happened after the crisis in 2010, although it is not that bad.
The Gulf tech boom

Gulf sovereign wealth funds have emerged as the most active venture investors in Silicon Valley in 2018, at the front of the queue for any tech company looking for funding.

In 2019, we expect even greater volumes of investment as fiscal surpluses in the region bring in new capital inflows and other SWFs consider investing more actively.

Saudi Arabia’s PIF had already made a splash in 2017, taking a US$3.5 billion stake in Uber and making a US$45 billion investment in the Softbank Vision Fund. Its activity picked up pace in 2018, with dozens of investments, both above and below the radar.

Through the Vision Fund, PIF invested US$2.3 billion in GM Cruise, the automaker’s self-driving division, US$1.9 billion in Manbang, a Chinese truck-hailing firm and US$0.6 billion in German used-car broker Auto1, among others. On its own, it also invested US$2 billion in Tesla and US$1 billion in its US rival Lucid in 2018.
The UAE’s Mubadala, now a US$250 billion sovereign wealth fund following two mergers in 2017 and 2018, has emerged as an equally active player. It established an office in San Francisco in 2018 to manage its participation in the Softbank Vision Fund, a US$400 million Venture Fund I targeting early stage US tech companies, as well as a US$200 million fund to invest in other funds. Mubadala led funding rounds for a number of early stage ventures, including Turvo, a real-time collaborative logistics platform, and C2FO, a non-bank working capital provider.

Mubadala aims to invest US$1 billion in tech ventures by 2021. In 2019, it plans to launch a US$400 million fund to invest in European tech firms and – crucially for the region – to set up a fund and support platform for tech ventures in the UAE. In addition to financial returns, Mubadala specifically aims to create synergies between its investment partners that feed into tech ventures in the UAE.

Forging links between global and regional tech ventures is likely to provide another boost in 2019 to the UAE’s fast-growing tech sector. Tech start-ups are flourishing in areas such as online retailing and digitization. Behind the few big names such as Souq and Careem that have attracted global attention, and Noon, founded by Mohamed Alabbar, there is a wave of tech start-ups, mostly based in Dubai and founded after the recession, that are now reaching critical mass and attracting serious venture capital investment.

In 2019, we expect even greater volumes of investment as fiscal surpluses in the region bring in new capital inflows. Mubadala and PIF will remain the most active investors in 2019, but others could join them. Although currently not active in the tech sector, Qatar Investment Authority’s strategy may shift under the new and younger leadership team that took over toward the end of 2018.

“Diversification drives investment
Babak Nikravesh, Partner, Silicon Valley

Gulf SWFs have become major investors in tech ventures over the past year. This is new for many of them, and the relatively small cheque sizes accompanying earlier stage investments contrasts with the typically large cheque sizes demanded by SWFs in other deals. Venture investments are a major focus for players like PIF and Mubadala, which have established (or are looking to establish) offices in Silicon Valley to focus on technology. While other sovereigns have retrenched recently due to market conditions globally, we have seen no retrenchment from Gulf investors. Whether the focus is high returns or building local or regional synergies with innovative partners, the need for diversification continues to drive investment into tech.”
Debt capital markets driven by loans

Debt capital markets had another strong year in 2018, ending the year above 2017 levels.

Sovereign issues continued, but at a lower level, reflecting higher oil prices and rising interest rates, as well as growing regional uncertainty. Loans drove growth in 2018, coming from sovereign wealth funds, other government-related entities and banks and corporates.

Sovereign bonds and sukuks totaled US$34 billion, compared with US$50 billion in 2017 and US$36 billion in 2016. Saudi Arabia’s bond issues fell in 2018 to a total of US$13 billion, but a sovereign loan added US$16 billion to the coffers in March. Starting in April, Saudi Arabia listed some of its local bonds on the Tadawul. A UAE public debt law was passed in October permitting the Ministry of Finance to issue bonds and support banking liquidity through a debt-management office.

Both Qatar and Oman tapped the markets heavily, taking advantage of strong demand early in the year. Rising yields and lower demand saw Bahrain pull a planned issue, while other rumored issues never came to market.

Source: Bloomberg

Sovereign international bonds/sukuk (US$bn)
The region’s most active sovereign wealth funds, Saudi Arabia’s PIF and the UAE’s Mubadala, both tapped the debt market in 2018. PIF took out an US$11 billion debut loan in September, the biggest of the year, enjoying sovereign rates. Mubadala took out an US$800 million five-year loan in November. Other government-related entities, predominantly in the energy sector, were active in the debt markets as they restructured portfolios and expanded. Saudi Aramco, for example, took out US$6 billion in loans in January, while Saudi Electricity took out US$2.2 billion in November. In Abu Dhabi, ADNOC took out US$3 billion, while Bahrain’s BAPCO is finalizing a US$4 billion financing for Sitra refinery, backed by the Export Credit Agency. Dubai’s DEWA took out a US$1.5 billion loan for a solar park in April.

Credit defaults swap rates generally improved across the region, barring spikes in Bahrain and Saudi Arabia. Credit ratings were cut in Bahrain (Fitch cut two notches to BB- in March, Moody’s cut one to B2 negative in August) and Oman (Moody’s cut to Baa3 negative in March), Qatar was restored to stable by Moody’s and Fitch (though not yet S&P) Qatar’s CDS was just 6 basis points higher than Abu Dhabi in early November, the lowest in years.

In 2019, sovereign issuances are expected to fall as public finances improve. Nevertheless, Saudi Arabia’s 2019 spending plans show a continued budget deficit that will be met partly by tapping into debt capital markets. The UAE federal government may issue bonds under its new law, and Oman and Bahrain are likely to require financing of their deficits. As in 2018, sukukus will remain strong, but we expect to see more innovative structures, such as covered sukukus, coming into play in 2019.

Sovereign wealth funds and government-related entities are expected to remain active, primarily boosting the loan market. Aramco could borrow up to US$50 billion to finance its SABIC acquisition, mostly through loans. Private issuances are likely to be bolstered as banks boost capital post IFRS9.

JP Morgan will add GCC sovereign and quasi-sovereign issuers to its benchmark emerging market bond index between February and September 2019, phased in monthly. Oman is already in the Index. Overall, the GCC could represent over 12% of the index with about US$150 billion in bonds. Passive demand should push down yields.

Islamic loans

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Debt capital markets, both conventional and Islamic, will continue to be the mainstay for sovereign and GRO related funding. Saudi, in particular, will build on its success of tapping the domestic and international capital markets during the past few years. Corporate issuers may need to include an insurance overlay or "covered" component to their deals to achieve competitive pricing when looking for DCM investors.
Prospects for 2019

2018 was, in some ways, a year of uncertainty as economic reform in Saudi Arabia took place, business in the UAE slowed noticeably and the tensions in the Middle East worried both governments and investors, despite huge pockets of opportunity and potential.

In 2019, overall market trends will continue – while the global marketplace is impacted by issues such as Brexit – but we expect to see real progress in PPPs, privatization and the environment for foreign investment and global talent in the GCC. The extent of the progress will shed more light on the Gulf states ability to open up their economies, while protecting the interests of their own citizens and businesses – and redefining their place in a world that is changing fast.
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