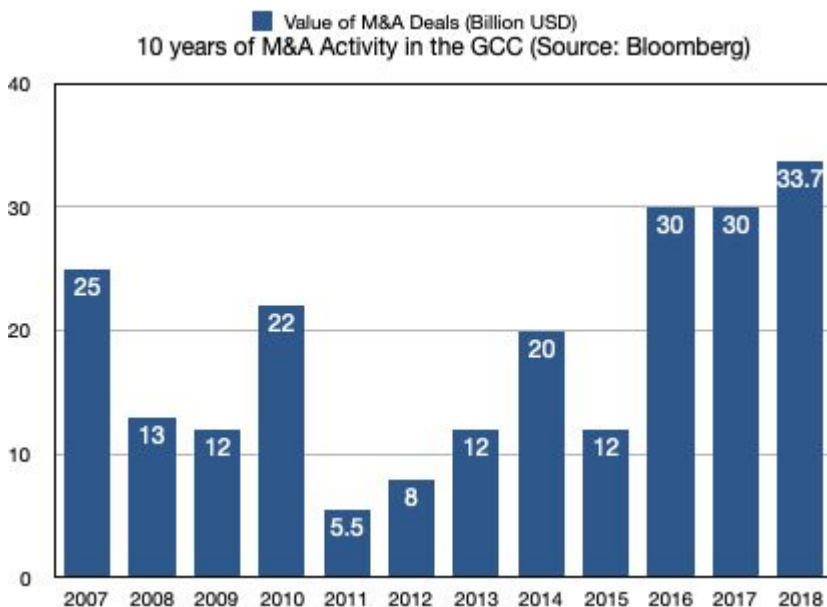


Why is the GCC undergoing extensive banking consolidation

Since the drop in oil prices in 2014, GCC countries are undergoing extensive consolidation with the rate of Mergers and Acquisitions (M&A) increasing in value over the last few years. Representing 79% of deal values and 73% of deal volumes for the MENA region in 2018, the six GCC countries represent a formidable opportunity for overseas investors and are far from solely being outbound dealmakers.

GCC M&A in general:



(Source Bloomberg)

The year 2018 saw as much as 92 deals (inbound and outbound) worth \$33.7 billion, all sectors included. Although deal volumes in the region have followed decreasing global trends, the value of such deals has continued to increase. There were at least 10 deals in the region that surpassed the \$1 billion threshold. An even more positive development has been the growth of cross-regional M&A deals, increasing by 20% to reach \$11.3 billion in 2018, compared to the previous year. This means that the GCC is increasingly becoming an integrated economic region and that local investors and regulators are increasingly successful in working together.

Nonetheless, the MENA remains an active acquirer of foreign companies and this trend continues to increase as outbound deals grew by 53% in 2018 to reach a value of \$17.5 billion. Out of this amount,

the GCC represents the major chunk of acquisitions as the region is endowed with many successful institutional investors and companies. With the diversification programmes in progress, particularly in Saudi Arabia, GCC companies are likely to increase their scope and the speed of their foreign acquisitions. For instance, Aramco's purchase of Arlanxeo (a Dutch chemical company) for \$1.6 billion shows that Vision 2030 pushes major Saudi companies to gain foreign expertise and even buy potential foreign competitors, as Aramco is set to buy SABIC, the country's leading chemicals company.

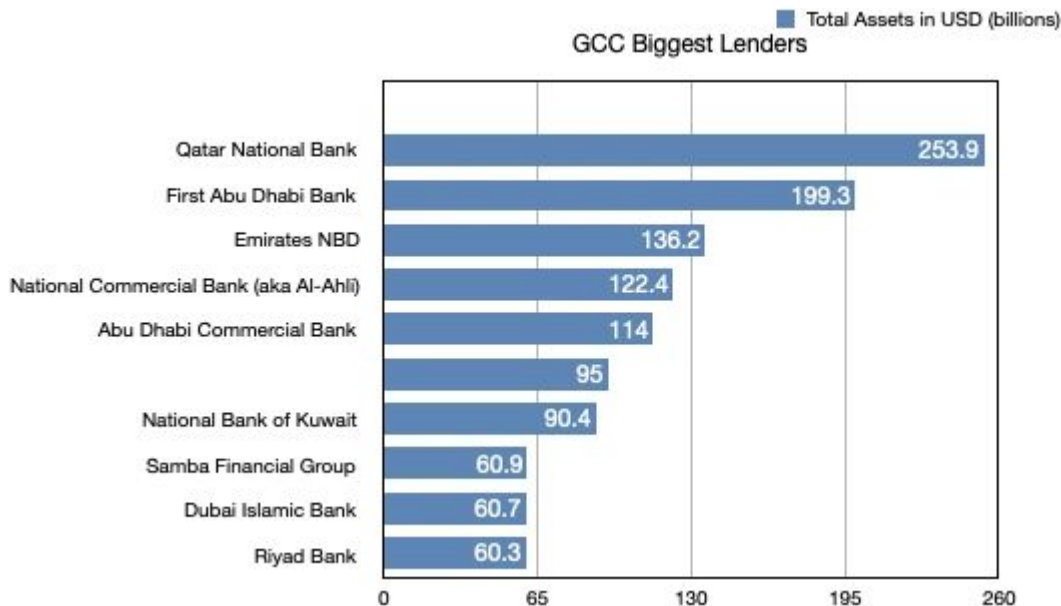
M&A in the energy sector:

Being smaller in value by only \$1.3 billion, inbound deals are on a very sound path to surpass outbound deals in the future. As this article will later show, GCC countries' diversification imperatives push them to domestically pursue economies of scale, cost cutting and synergies through mergers. Unsurprisingly, last year's most popular sectors for M&A deals were the energy and power sectors. Being energy and power hubs thanks to their generous natural resources endowments, Gulf countries are known to have many energy companies competing against each other, but in an inefficient way.

This is why states in the GCC seem to bolster the position of their domestic market leader, as it is clear in the case of Aramco for Saudi Arabia. The idea is for hand-picked winners to streamline the regional market by acquiring competitors and therefore becoming genuinely global companies able to compete on international markets. The petrochemicals sector is likely to undergo such consolidation, particularly in Saudi Arabia where there are 16 petrochemicals listed on the Tadawul. Already, Saudi International Petrochemical Company agreed to acquire Sahara Petrochemical Company in an all-share deal valued around \$2 billion. In 2017, Qatar proceeded with the merger of Qatar Vinyl Company and Qatar Petrochemical Company. This merger was pushed through by Qatar Petroleum, the state-owned petroleum company of Qatar.

Indeed, a key characteristic of M&A deals in the GCC is the need and cruciality of political backing. Being highly involved in economies, this in spite of their calls for privatisation, GCC states have extensive shares in companies key to their economies. Often, the two merging companies have the same major shareholder in the state, which is a boon to dealmaking as it smoothenes and shakes up the process. Yet, this does not mean that deals in the region are more transparent or happen quicker than elsewhere. Quite the contrary, analysts continue to believe that deals in the GCC take at least 2 years to materialise and another 3 years for integration to be fully achieved.

Banking M&A in the UAE:



(Source: Bloomberg)

Another sector undergoing growing consolidation is the banking sector, as the same imperatives for economies of scale, cost cutting and synergies apply. Last week, Abu Dhabi Commercial Bank (ADCB) agreed to merge with Union National Bank and to buy Al Hilal Bank, to be used as the new entity's separate Islamic bank. Already a regional leader in M&A deals as the country boasted 65% of all GCC deals last year, the UAE has particularly consolidated its banking sector and has by far been the GCC's most attractive destination for overseas investors until now.

With three banks comprising 53% of the federation's total banking sector, it was imperative for ADCB to consolidate its position and ensure it would maintain its third lender's place for the future. Now, smaller lenders such as Invest Bank, United Arab Bank and Bank of Sharjah are expected to proceed with another three-way merger. This merger is likely to be politically backed by the government of Sharjah, just like ADCB's merger was backed by the government of Abu Dhabi through Mubadala, which is the bank's major owner and will own 60.2% of the new entity.

Overall, ADCB now controls 15% of the UAE's total banking assets, 21% of federation's the retail loans, 16% of deposits and services close to 1 million customers. The merger is expected to create cost synergies of around \$167.4 million on an annual basis, which equates to 13% of the three

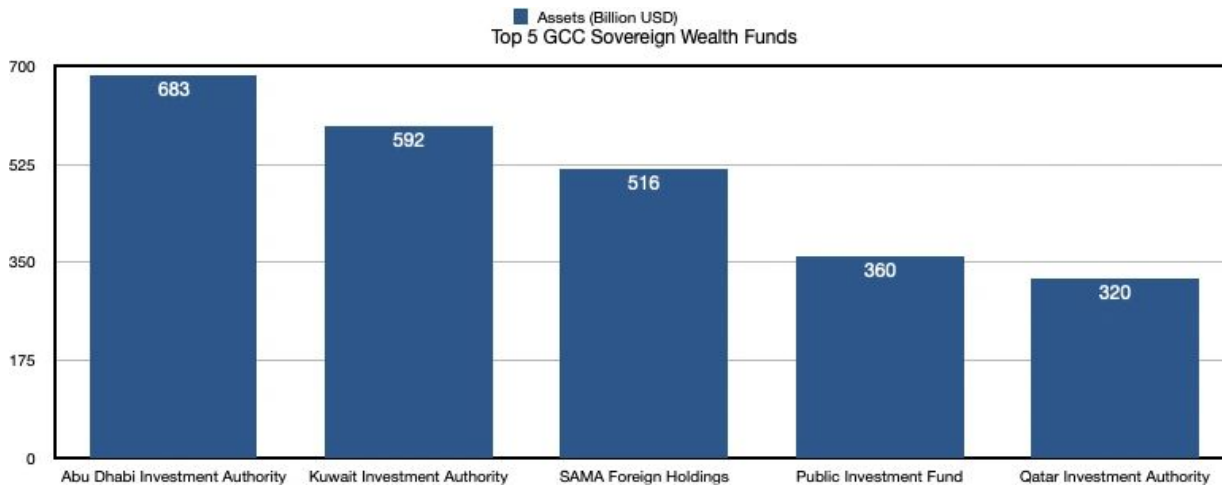
merged banks' combined cost base, way above the global benchmark sitting at 10% for similar domestic transactions. For this deal to go through, foreign advisors such as Barclays, J.P. Morgan, Allen & Overy, Clifford Chase, KPMG and EY were needed, thus showing that much of the legal and technical assistance in dealmaking in the GCC still comes from abroad.

Mergers

Banks involved	Combined Assets (Billion USD)	Value of deal (Billion USD)	Country	Date	Entity Created
National Bank of Abu Dhabi + First Gulf Bank	182.7	15	UAE	2017	First Abu Dhabi Bank
National Bank of Dubai + Emirates Bank International	129.8	Unknown	UAE	2007	Emirates NBD
Abu Dhabi Commercial Bank + Union National Bank + Al Hilal Bank	114	Possibly 4 in addition to Al Hilal bought for \$272 million	UAE	2019	ADCB
Alawwal + Saudi British Bank	71	5	Saudi Arabia	2018	SABB-Alawwal
Emirates NBD PJSC + Denizbank AS	42.8	3.2	UAE-Turkey	2018-19	Emirates NBD
Dubai Bank + Emirates Islamic Bank	16.2	Unknown	UAE	2012	Emirates Islamic Bank

(Source: Bloomberg)

In 2018, the UAE continued to lead the way with acquisitions, accounting for more than half of the region's outbound deals. A major actor behind such purchases are Sovereign Wealth Funds (SWF), which are themselves undergoing important consolidation. Being powerful institutional investors, SWFs are used throughout the region to direct the diversification programme and boost economies. Out of the world top 80 SWFs, 12 are from the GCC and the UAE has the region's richest one: Abu Dhabi Investment Authority. But it is Mubadala that has particularly been busy in M&A deals. In 2017, the SWF merged with International Petroleum Investment Company and in 2018 it combined with the Abu Dhabi Investment Council to reach \$230 billion of total assets. With 6% of the world's oil reserves, Abu Dhabi can in fact push forward its policy of amassing wealth through a few massive funds to pursue agendas like Vision 2021 and Vision 2071.



(Source: SWF Institute)

Saudi Arabia is the GCC's next M&A Hotspot:

The UAE are by far the GCC's leader in terms of inbound and outbound deals, particularly in the banking sector. It will take time for any other regional country to surpass the federation. Nonetheless, dealmaking in the UAE is likely to slow down and return to normal levels while M&A activity in Saudi Arabia is set to rise as a result of higher oil production and the strengthening of the country's non-oil sector. Last year, 12 M&A deals were made in Saudi Arabia.

One of those deals was the merger between HSBC's subsidiary SABB and Royal Bank of Scotland's subsidiary Alawwal. This deal was the first banking merger in the Kingdom for the last 20 years and promises to become the third biggest lender of the country. With HSBC, the Olayan Saudi Investment Company, Natwest Markets, Banco Santander and GOSI as shareholders, the new bank is to aim for a privileged marketplace in offering personal savings schemes, home ownership solutions and wealth management. In addition to setting new standards for career development in training, it is believed that the merger will not cause any lay-offs, contrary to the expected 1000 jobs to be lost as a result of the recent Emirati merger.

Potential Mergers/Buy Stake in Finance

Banks involved	Combined Assets (Billion USD)	Country	Timeline	Note
Saudi National Commercial Bank and Riyadh Bank	182	Saudi Arabia	Possibly 2019-2020	Could become Saudi Arabia's third lender but the merger talks were denied in early 2019
Kuwait Finance House KSCP + Bahrain Ahli United Bank BSC	92.6	Kuwait-Bahrain	Possibly 2019	N.A.
Barwa Bank + International Bank Qatar	22	Qatar	Possibly 2019	N.A.
Bank Dhofar SAOG + National Bank of Oman	20	Oman	Possibly 2019	N.A.
Invest Bank + United Arab Bank + Bank of Sharjah	18	UAE	Possibly 2019	Government of Sharjah acquired >50% of Invest Bank and has all shares in all banks
National Bank of Bahrain + Bahrain Islamic Bank	11.5	Bahrain	Possibly 2019	N.A.
Oman Arab Bank SAOC + Alizz Islamic Bank	7	Oman	Possibly 2019	N.A.

(Source: Bloomberg)

The fact that no employee risk being laid off might show that the Saudi market is more reluctant in cutting costs by decreasing personnel. This reluctance might in turn be caused by the more severe unemployment level and Saudisation programme going on in the Kingdom. Additionally, cross synergies in Saudi Arabia are believed to be at least 10 percentage points smaller than in the neighbouring UAE, meaning that merging Saudi firms are not as successful as their Emirati peers in cutting costs, creating synergies and economies of scale.

In spite of these weaknesses, it is highly likely that the attention of overseas investors will gradually

pivot toward Saudi Arabia, as the Kingdom is the region's largest economy and the most populated country in the GCC. Such investors are guaranteed to find a domestic market in mutation and dire need of consolidation. Particularly, insurance is to be added to the list of sectors prone to M&A, alongside petrochemicals. There are about 30 listed insurance firms on the Tadawul and Al Ahlia Cooperative Insurance has already agreed to merge with Gulf Union Cooperative insurance. In fact, many important business sectors like petrochemicals and the insurance sector must find solutions as they are increasingly less likely to be supported by capital-strapped states through subsidies in liquidity, feedstock or energy.

Why Gulf banks seek to consolidate?

As aforementioned, GCC firms are likely to continue their M&A activity to stay competitive in an era of low oil prices. Beforehand, when the oil price was high and states' coffers were plentiful, government deposits greatly benefited GCC banks. Now, with lesser revenues and increasing debt, states are not willing to support their domestic financial markets as much as they did before 2014. This has indeed become a major problem for Gulf companies, financial or non-financial institutions, as they have had to become more resilient through mergers.

In fact, Gulf firms are becoming more mature and cost conscious. Instead of expecting abnormal gains, they are looking to sustain moderate growth by cutting on costs. Through mergers, they are allowed to do exactly this. By cutting redundancy, inefficient competition and increasing efficiency in operations through synergies, merging companies are able to create value not only for their investors and customers, but also for their employees and surrounding communities (as long as mergers do not lead to significant lay-offs).

This exercise in cost-cutting is particularly crucial now at a time when stringent new regulations push costs higher. In fact, the introduction of the value-added tax, new accounting standards, Anti-Money Laundering and Counter Financing of Terrorism laws as well as the imperative to adopt technologies such as Fintech are important costs to take into account and to tamper with synergies.

Another idiosyncratic problem of financial markets in the Gulf is that the region is over-banked, with 236 registered banks catering for 51 million people, when the UK's market of 65 million people only has a dozen commercial banks. International organisations such as the Institute of International Finance and the International Monetary Fund have for long called for consolidations throughout the

GCC in order to enable cost savings and economies of scale.

An Over-banked Region

Country	Population (million)	Number of Commercial Banks	Breakdown (local and foreign banks)	Ratio (Bank per Million people)
UAE	8.2	51	23 local and 28 foreign	5.6
Saudi	33.6	26	10 local and 16 foreign	0.7
Qatar	2.7	18	11 local and 7 foreign	6.6
Oman	4.4	20	11 local and 9 foreign	4.5
Kuwait	4.2	23	11 local and 12 foreign	4.4
Bahrain	1.3	98	44 local and 54 foreign	75.3
Sources: Bloomberg and GCC Central Banks (CBUAE, SAMA, QCB, CBO, CBK and CBB)				

(Source: Bloomberg and Central Banks in the GCC)

By creating bigger banks, countries in the GCC are exactly doing this. Scale is key for success and preeminence brings more market access, not only domestically through a larger customer base but internationally also as larger banks get unrivalled access to the global banking network. Through their new positions, bigger banks can also support the diversification process entailed in national agendas such as Vision 2030 by attracting investment flows and trade into the GCC.

Outlook onto 2019:

Undoubtedly, 2019 is not going to be as crisp as 2018 due to the expected global economic downturn. Global M&A transactions' value is expected to drop by \$200 billion compared to last year in 2019, and to reach \$2.3 trillion in 2020. Yet, the law firm Baker McKenzie is "cautiously optimistic" that 2019 will

continue to be a prolific M&A year in the GCC, in spite of deals' value dropping to \$22 billion. This remains however a large figure, as the region's average annual deal value over the last decade has been \$19.2 billion.

GCC firms are likely to continue their cost cutting and higher efficiency objectives this year, especially in Saudi Arabia which is undergoing significant legal reforms to welcome overseas investors and has a domestic market ripe for fruitful mergers. Sectors to look for are insurance, petrochemicals, banking and aviation, the latter seeing many cross-regional code share agreements meant to rationalise flight networks and align schedules. Indeed, FlyDubai and AirJordan have both entered such agreements with Emirates.

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