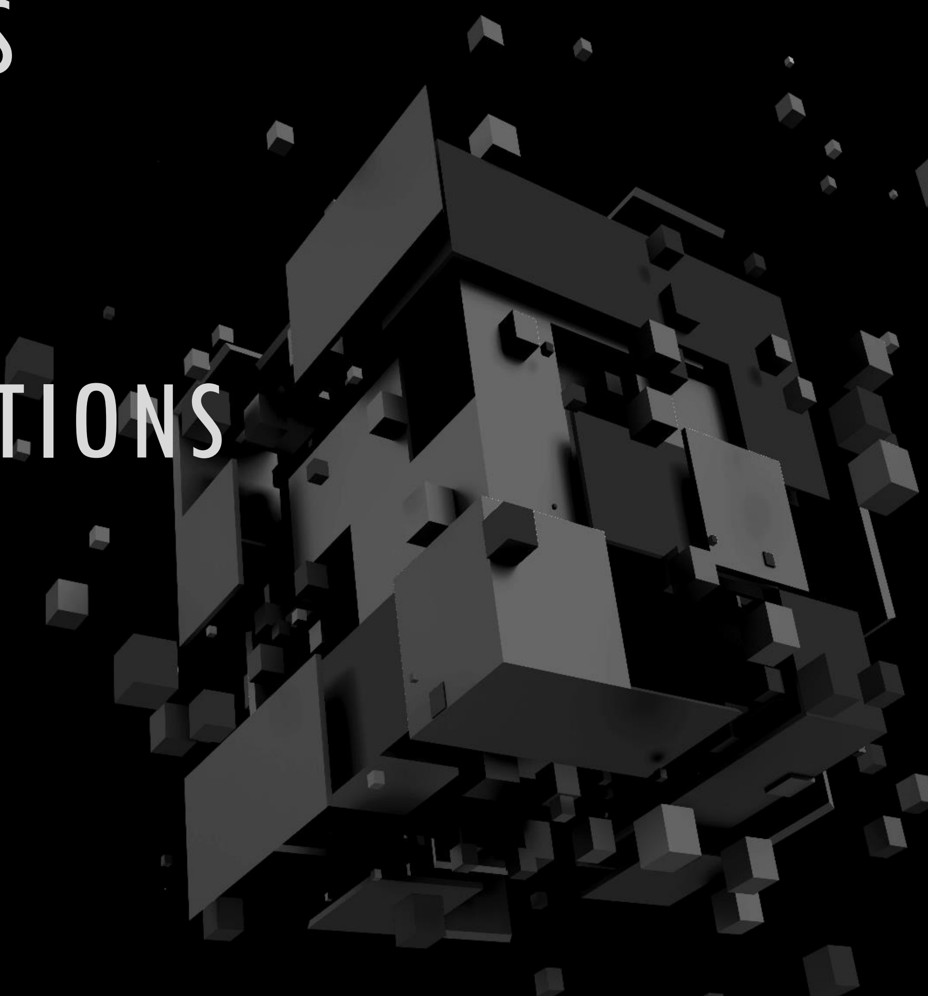
Mergers & Acquisitions



HANDBOOK FOR SAUDI COMPANIES MOVING FORWARD..

OCTOBER 2018.v2

UNITED CONSULTING GROUP

مَشُوْرَة المُتَّحِدُوْن

AT A GLANCE

The regional landscape in Saudi Arabia is changing at a rapid pace. Changing regulations and an increasingly competitive environment have placed enormous pressure on the margins of firms operating in the kingdom. M&A can be a viable solution to strengthen their competitive positioning in the market.

M&As are globally seen as a quick strategy for growth. However, studies have shown that an overwhelming majority of M&As fail to achieve their intended objectives. The principal reason identified behind the failures is the process used to undergo the M&A journey.

The report identifies the process for success based on analysis of best practices around the globe that Saudi firms need to follow when engaging in M&A. The report also sheds light on the M&A regulatory framework in Saudi Arabia that has an impact on the process highlighted.

Version 2 update

Earlier version of this handbook, incorrectly mentioned that NADEC acquired 61.25 % of Danone (P.15). This version has been corrected to reflect the accurate post-deal ownership of NADEC acquiring 100% of ASD.

EXECUTIVE SUMMARY

Saudi Companies need to engage in M&A. If successful, M&A can provide huge benefits going forward

Competitiveness: Foreign Direct Investment is a priority under Vision 2030.

With the influx of foreign capital and international firms, competition is bound to get fiercer in the Saudi market. Saudi companies must gear up to compete at higher levels through M&A with local and GCC firms or even international firms. This would aid transfer of know-how and provide added diversification to the business and its risks.

Growth & Synergies: The main objectives for companies engaging in M&As is to grow and acquire synergies.

Saudi firms should capitalize on growth opportunities in the kingdom and abroad. The cost environment in the kingdom is rising in the form of more expensive Saudized workforce, value-added tax and removal of subsidies. Thus, firms that can build synergies will gain a significant competitive advantage in the market. Companies that heavily depend on government expenditures and oil prices should seek to diversify their portfolio given the uncertainty of oil market and emphasis of Saudi government on the shift towards private sector as the economy driver.

Impact on Saudi macroeconomy

Successful M&As would help Saudi companies grow inline with the core objectives of Vision 2030, thereby leading to:

- ✓ Increase in contribution to GDP
- ✓ Increase in private sector contribution
- ✓ Increase in jobs

M&As improve shareholders return and this in turn will attract foreign investors to Saudi Arabia, thereby enhancing the capital market of the kingdom.

In order to encourage and enhance the M&A landscape in Saudi Arabia, the government needs to ease the M&A regulatory framework.

The current governmental reforms, such as reducing benefits, public spending, subsides and the implementation of VAT, should encourage M&A deals in Saudi Arabia. However, certain regulations in the framework could hinder M&A activity.

<u>Recommendations:</u>

- Have all the M&A transactions and regulations to be addressed by one governmental body
- Provide less stringent procedure for small M&A transactions
- Allow foreign investors/companies to acquire a controlling stake in Saudi companies
- Mandatory offers must be triggered automatically without the consent of the CMA
- Include a provision in the M&A regulations that addresses the Reverse Break-Up Fees, which can be no more than 1% of the value of the deal.

EXECUTIVE SUMMARY

M&As are risky and have recorded high failure rates, however, with the right approach they can provide huge benefits to a firm. Saudi companies need to particularly focus on the process to maximize the success of the deal.

Process has been identified as a key pillar for success. UCG recommends the following process:

i. STRATEGY FORMULATION & EVALUATION

1. Develop an acquisition strategy
2. Set the M&A criteria
3. Search for acquisition targets
4. Initial strategic evaluation

ii. DEAL ASSESSMENT & EXECUTION

1. Approach target company and obtain information
2. Full due diligence
3. Valuation
4. Finalize Method of Purchase
5. Negotiation
6. Deal Closing

iii. IMPLEMENTATION

Post M&A Integration

1. Set the Direction
2. Information Gathering Phase
3. Plan Development
4. Initial Evaluation of Overall Plan
5. Development of Detailed Steps
6. Approval of Detailed Steps
7. Implementation

High failure rates have been observed in M&A.

70-90%

Of M&As have failed according to a Harvard Business Report

83%

of merger deals did not boost shareholder returns according to KPMG

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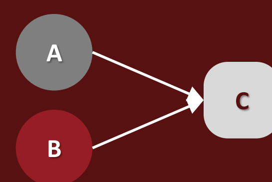
01.

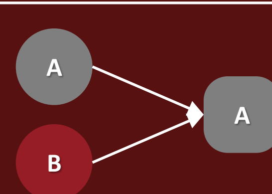
COMPONENTS OF MERGERS & ACQUISITIONS MODEL

M&As differ from each other in the legal sense:

Mergers:
A merger is when two firms combine to form a single new company rather than remain separately owned and operated.



Acquisitions:
An acquisition is when one company takes over another and becomes the new owner. The target company ceases to exist legally and the buyer absorbs the business.



By purpose: M&As are classified based on the key objective of the deal:

Unrelated M&A

1. Two unrelated companies that do not have a lot in common in order to share assets or reduce their business risk.

Horizontal Integration

2. Two companies in the same industry. They are often competitors, and the aim is to reduce costs and to gain a greater share of the market.

Market Extension

3. Two companies in the same industry but in separate markets, with the aim of creating a larger customer base.

Source: Investopedia, Johnsons Corporate, UCG analysis

Product Extension

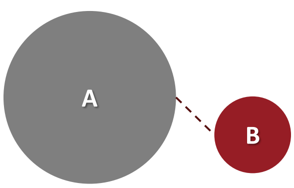
4. Two companies in the same industry but producing different products, In order to increase profits by grouping their products together to access a bigger market.

Vertical Integration

5. Two companies producing different products in the same supply chain, to increase their efficiencies.

Moreover, M&As can vary based on the degree of Integration between the entities involved:

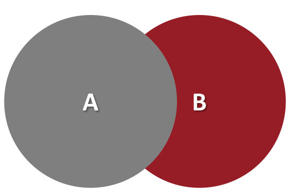
i. Low-touch Acquisition:



A low touch acquisition is when one company acquires the other in order to preserve and grow the existing company that performs very well and has an independent brand that carries significant value.

- Microsoft and LinkedIn
- Fiat and Ferrari

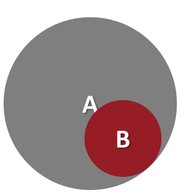
ii. Equal Merger:



A merger of equals is when both sides bring considerable assets into the merger. They both merge to form a new entity.

- Ernst and Young
- Dow Chemical and DuPont
- Exxon and Mobil

iii. Take-over Acquisition:



A Take-over acquisition is when a company acquires another company and absorbs its independent brand and identity.

- HP and Compaq
- Vodafone and Mannesmann
- Aviva Friends Life (UK)

Source: Burniegroup, UCG analysis

M&As can also vary based on the type of transaction and method of payment:

Assets Purchase

In case of purchase of assets, the buyer purchases individual assets of the target company while the seller retains possession of the legal entity. The buyer purchases assets such as equipment, leaseholds, licenses, goodwill, trade secrets, trade names, and inventory. A key distinction is that the liabilities remain with the seller.

Stocks Purchase

In case of a stock purchase, the Acquirer buys all the stocks of the target company and takes the entire corporation. All of the target corporation's assets remain subject to their its liabilities.

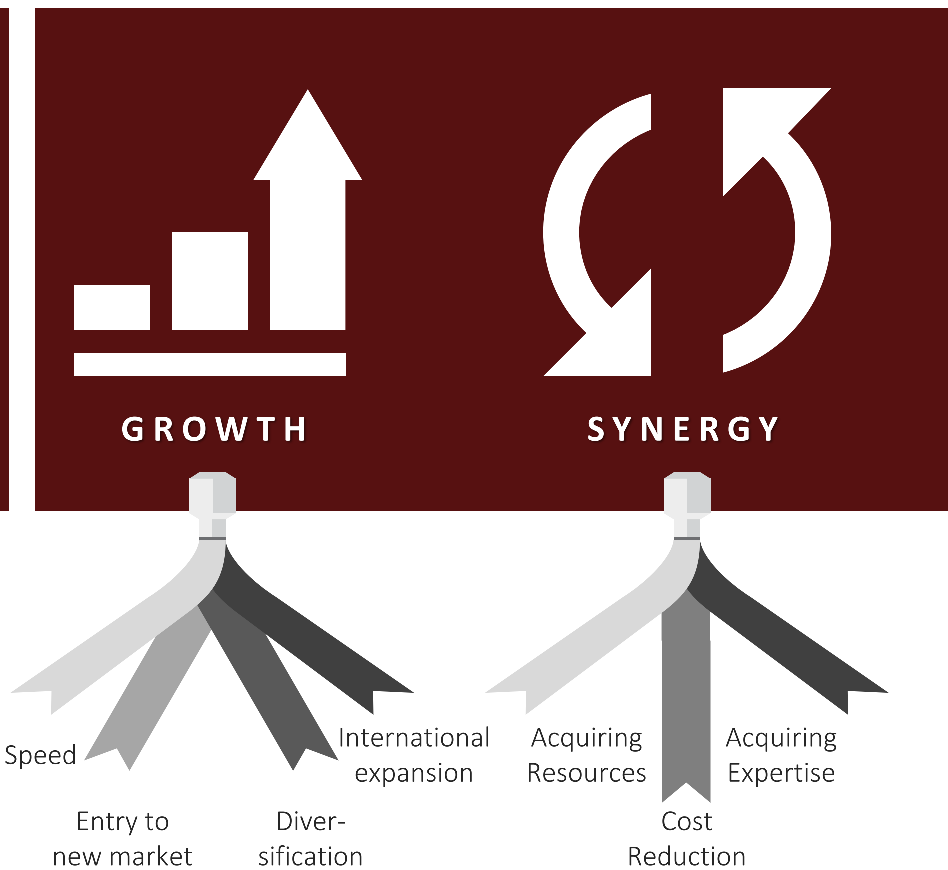
A company can be purchased using cash, stocks or a mix of the two. Stock purchases are the most common form of acquisition. The higher the confidence the management has that it will be able to realize benefits of an acquisition, the more they will want to pay for stocks in cash. The rationale is that they believe the shares will be worth more after synergies are realized from the M&A. However, likewise, the target will want to be paid in stock so that the target becomes a partial owner in the acquirer and will be able to realize the benefits of the expected synergies.

Source: Corporate Finance Institute, UCG analysis

02.

WHY MERGERS & ACQUISITIONS

Successful M&As yield high growth and valuable synergies..



Synergies Lead To Growth
&
Growth Can Result In Potential Future Synergies

Synergies can be achieved through cost reduction, leveraging on target's specialized expertise and target's resources..

Cost Reduction can be achieved through economies of scale, efficiency improvements, or vertical acquisitions.

Economies of Scale: *The more a company produces, the less the fixed cost per unit is.*

- *In 2006,* AuRico finalized a $451 million takeover of Mexgold Resources Inc., which owned the Guadalupe y Calvo gold and silver project in Mexico. *In 2011,* the company acquired Capital Gold for $408 million. Assets included El Chanate and the Orion gold projects in Mexico. In the same year, it acquired Vancouver-based Northgate Minerals in a $1.49 billion deal; to have 83% more gold resources than before. Including the takeover of Capital Gold, AuRico increased gold reserves by about 70% in less than five months. In *2015,* AuRico Gold merged with Alamos Gold in a deal worth more than US$1 billion.

Efficiency improvements: *M&A helps cut duplicate functions in the combined organization.*

- Verizon's acquisition of MCI of $8.6 billion was predicted on annual operating synergies of about $1 billion through the reduction of 7,000 jobs.
- P&G's acquisition of Gillette of $ 57 billion involved cutting 6,000 jobs, 4% of the combined workforce of 140,000. This deal led Gillette's shares to increase by 13%, while P&G's share price increased by 2.1%. Considering the fact that they both work in the consumer goods industry, this acquisition increased the market share of P&G.

Vertical acquisition: *Expanding into the supply chain (suppliers or customers) will give a company better control over the cost of its products*

- News Corporation's $6.6 billion acquisition of DirecTV, a satellite TV company used by News Corporation, acted as a medium to distribute more of its news, movies and television shows by managing the process itself.
- Chanel purchased Lambskin Tannery to have more control over the prices. This helped Chanel boost its margins by reducing its costs.

Sources: UCG analysis, Harvard Business School, BBC, Mining Global

Acquiring Expertise: *Acquiring companies for their expertise will save the acquirer valuable time.*

- McKinsey hasn't been able to help its clients with design execution, which pushed it to acquire LUNAR, a product design and development consultancy company. McKinsey can leverage on LUNAR's expertise in product designing and development instead of simply advising on developing the product.
- Adidas has acquired Textronics, a leader in the development of energy-activated fabric technology which enables "intelligent clothing" for use in fitness monitoring. This acquisition will enable Adidas to retrieve data from sensors attached to shoes or clothes, which can provide vital statistics to develop new products.
- Apple acquired P.A Semi, Chip designer, for $278 million. The acquisition was intended to add the talent of P.A Semi's engineers to Apple's workforce and help them build custom chips for the iPod, iPhone and other devices.

Acquiring Resources: *A company can leverage on the existing resources of another company to save time or get resources it otherwise cannot.*

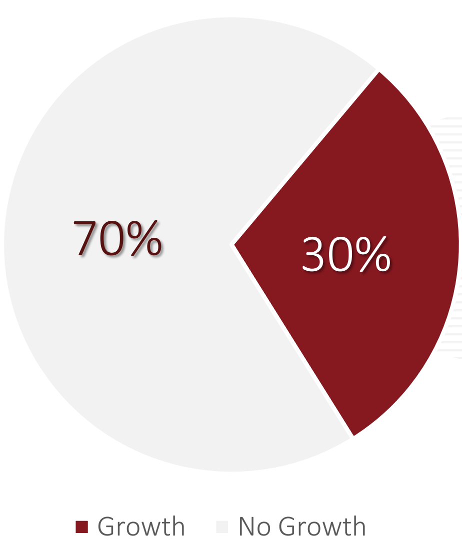
- Amazon plans to use Whole Foods' infrastructure to build itself into the real, physical lives of everyday Americans. Moreover, Whole Foods can use amazon's website and its shipping facilities to deliver their products to customers.
- In order to grow into the E-commerce industry and reach customers faster, Walmart acquired Jet for $3 billion. The acquisition will build on and complement the significant foundation already in place to serve customers across the Walmart app, sites & stores, and position the company for even faster e-commerce growth in the future by expanding customer reach.
- The acquisition of Pixar by Disney benefitted both parties. Disney benefitted by owning the world's most innovative computer animation studio, and Pixar benefitted from Disney's cushy financial safety and first-class distribution network. The deal costed Disney $7.4 Billion
- Ikea acquired its first U.S forest property that covers 25,000 acres in Lowndes County, Alabama. This acquisition is part of a broader strategy to invest in the sustainable production of resources.

Sources: UCG analysis, PR Newswire, Quora, Walmart, Quartz

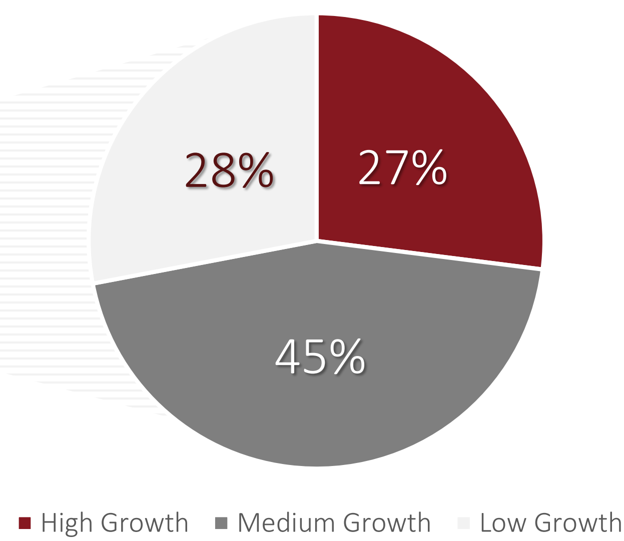
M&A helps companies achieve growth through various strategies..

- **Diversification**
  - Diversify products
  - Diversify geographic market
- **International Expansion:** Growing through acquisition or mergers in other countries
- **Market Access:** Acquiring an existing entity can often overcome formerly challenging market entry barriers while reducing risks of adverse competitive reactions.

A Deloitte study analyzed 350+ M&A deals for growth.



M&A Deals that Achieved Growth (387 deals)



Level of Growth Achieved (116 deals)

Source: Deloitte, UCG Analysis

224%

80%

115%

68%

73%

2015 REVENUE GROWTH

M&A can help companies grow in a relatively short span of time..

- **XPO Logistics:**

One of the world's largest trucking companies, XPO transports cargo in a supply chain. XPO tripled its sales in 2015 after acquiring four trucking companies.

- **Dollar Tree:**

Dollar Tree more than doubled its store count in 2015 after they acquired rival dollar-store chain Family Dollar. The sales increased by more than 80%. 90% of the increase was attributed to the acquired company.

- **AECOM** :

AECOM acquired a competitor called URS Corp for $6 billion including debt in late 2014. Since then the sales more than doubled. It was considered "the largest combination in our industry's history", according to AECOM CEO Michael Burke.

- **Kraft Heinz:**

Kraft and Heinz merged in 2015 and they together recognized a revenue growth of 68%. The company, after the merger, was valued at $50 billion making it one of the top five food and beverages companies.

- **NGL Energy Partners:**

NGL Energy Partners went on an acquisition spree acquiring companies in the oil and energy sector which boosted its revenue by 73%.

Source: UCG Analysis, fortune.com

M&A helps companies achieve growth through entry into a market, diversification & international expansion

▪ DELL:

At one point in time, Dell targeted software companies for acquisitions. The acquisitions were to diversify Dell's portfolio and build into the software sector which Dell claimed to be more profitable than the hardware sector. Dell acquired roughly 25 companies and each deal was completed for less than $1 billion. Dell's non-computer revenue eventually increased by 30%.

▪ Davis Service Group:

Davis Service Group has completed an acquisition deal with Berendsen, which is a textile services company operating in Sweden, Austria, the Netherlands, Germany, Denmark, Norway and Poland. Berendsen is considered a market leader in textile services. The acquisition benefited David Service Group in:

- Reducing operating costs
- Enhancing the management
- Improving sales and profits by saving fixed costs

▪ Indutrade:

Indutrade achieves growth by engaging in numerous acquisitions throughout the year. Indutrade has acquired more than 100 companies in the last decade. The company uses two approaches when they are going to conduct an acquisition:

- They target companies specialized in niche technology located in countries that are popular for their traditional trading. such as: Denmark, Sweden, Switzerland, Austria, UK, Finland, Norway and Benelux.
- Or, they target global niche companies that provide proprietary products.

Indutrade's objective every year is to conduct numerous amount of acquisitions and each target should have at least $3.5 M in net sales.

Source: UCG Analysis, MarketWatch.com, Indutrade.com

M&As have helped Saudi companies grow successfully

▪ Almarai and Western Bakers:

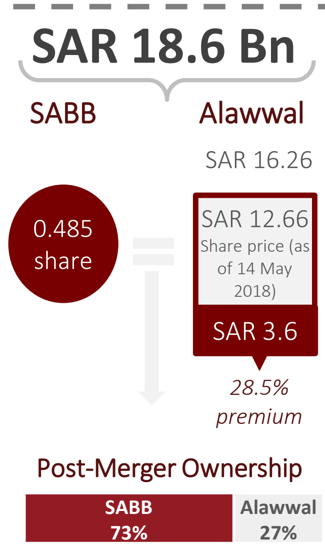
Almarai acquired 100% of Western Bakeries company in 2006. Western bakeries produced and distributed a variety of baked food products and operated under the brand name L'Usine throughout Saudi Arabia. The deal helped Almarai expand into the bakery segment. Almarai's revenue from bakery segment reached $480 K in 2017.

▪ NADEC and AlSafi Danone:

NADEC is in the process of acquiring 100% of Al Safi Danone Company via an increase in the share capital of NADEC. The acquisition will allow NADEC to better serve their customers and realize benefits not available on standalone basis. Significant synergies are expected including potential cost optimization and increased revenue opportunities from a wider distribution network and customer reach. The deal will strengthen NADEC to better compete with Almarai. Eng. Abdulaziz Al Babtain, managing director of NADEC, said in the statement: "It will create a platform for future growth and, importantly, drive significant value creation for shareholders".

▪ Saudi Aramco:

Saudi Aramco acquired Converge® polyol technology from Novomer, Inc. The deal, valued at $100M, strengthened Saudi Aramco's integrated downstream expansion strategy.



▪ SABB and Alawwal Bank

SABB's merger with Alawwal Bank marks the first major M&A deal in the kingdom's banking industry in the last 20 years.

SABB, founded in 1978, is currently the 6th largest bank in the kingdom by assets size (Q2 2018). On the other hand, Alawwal Bank, founded in 1926, is ranked 10th by its assets size. The $5 billion merger is expected to position the bank as the 3rd largest in Saudi Arabia in terms of assets, revenues and profits. Potential benefits are:

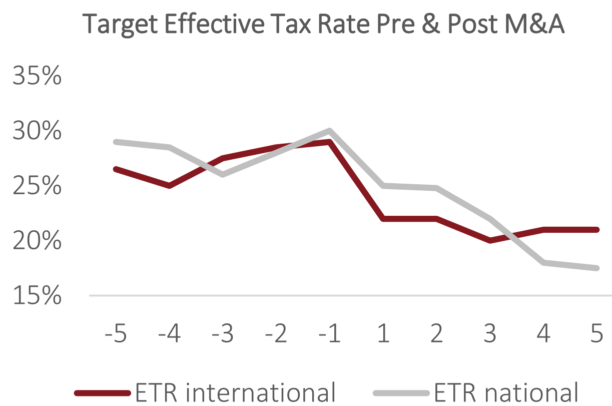
- Broader customer base
- 10-15% cost synergies
- Stronger franchise
- Revenue synergies
  - Cross-selling
  - Customer penetration
  - Diversified fundraising

Source: UCG Analysis, Almarai Press Release, Bloomberg.com

Tax savings can serve as secondary motives for companies to engage in M&As..

▪ Change legal base - Tax rates

A company in a high-corporate-tax-rate country can merge with another corporation in a low-corporate-tax-rate country. Sometimes the corporation in the low-tax environment is much smaller and normally wouldn't be a candidate for a major corporate merger. With the merger, however, the new company is legally located in the low-tax country and subsequently avoids millions and even billions in some cases in corporate taxes. The figure shows the mean Effective Tax Rate (ETR) five years pre and post M&A deals. In an international deal, the acquirer and target are resident in a different country whereas in a national deal, both are resident in the same country.



Source: Bureau van Dijk Amadeus database

Example: Pfizer and Allergan were about to merge in a $160 billion deal in 2016 only to be stopped after a U.S. treasury rule change to prevent tax avoidance deals. The merger would have allowed New York-based Pfizer to cut its tax bill by an estimated $1 billion annually by domiciling in Ireland, where tax rates are lower.

> *"Following a merger or acquisition, a target firm's effective tax rate decreases on average by 3 percentage points. This decline is as high as 8 percentage points when the acquiring firm is tax aggressive."*

▪ Losses carryover and unused tax credits

Corporations are allowed to carry back losses 3 years and carryforward losses 15 years. Companies that have a potential to be profitable in future are attractive targets as acquirers can have huge savings in tax and can buy the target at a discount. Although in most cases this is not a principal motive for M&As, it can increase the attractiveness of the deal. However, the US treasury treats M&As inspired by tax savings as tax evasion and has prohibited them.

▪ Tax savings through debt based acquisitions and higher depreciations

M&As are one way for firms to bring down their weighted average cost of capital. Moreover, if target firm has assets with high depreciation expenses, the acquirer will benefit from tax savings.

Microsoft financed $20 Bn of its $26 Bn LinkedIn acquisition with debt. It was estimated that Microsoft could potentially sidestep $9 Bn in US taxes in 2016 and more in following years.

Source: UCG analysis, Dartmouth.edu, FTC.gov, The Balance, Bloomberg

As glamourous as the benefits might seem, M&As are laborious, time-consuming and easily mismanaged. A majority of M&As have failed in the past.

83%

Of merger deals did not boost shareholder returns according to KPMG

70-90%

Of M&As have failed according to a Harvard Business Report

A survey by Roland Berger of more than 130 experienced PMI managers worldwide across 15 industries on key failure reasons shows:

Lack of synergy, management and incomplete integration	80%
Lack of compatibility between the corporate cultures	50%
Price/acquisition premium too high	30%
Management egos & organizational deficits	30%
Lack of or wrong strategic logic	10%

These failures have led to companies:

- Missing Targets
- Losing Key People
- Incurring Poor Performance In Day-to-day Business

Other Failure Reasons Include:

- Inadequate due diligence
- False sense of security
- Lack of involvement from low-level management
- Lack of understanding of the value added
- Poorly matched partner
- Hefty costs

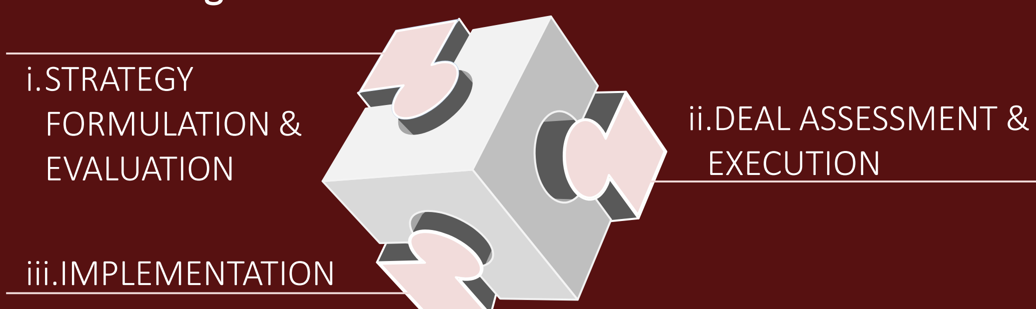
Source: UCG analysis, Roland Berger, Lakelet Capital

03.

M&A PROCESS

UCG identified a comprehensive process based on best & practical practices.

The M&A process has been identified as the single most important deciding factor for the success of an M&A. This is a potential pitfall that must be navigated with utmost care and attention.



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10. Deal Closing

iii.IMPLEMENTATION

11. Post M&A Integration

1. DEVELOP AN ACQUISITION STRATEGY

Develop a solid strategy outlining:

- Why the business should make acquisitions?
- The desired outcomes through M&A
- How the outcomes will be achieved?

Having an M&A strategy that aligns with the long term goals and vision of the company is key to a successful M&A. In interviews with 250 executives around the world by Bain, it was found that 90% of successful deals started with a deal strategy thesis, compared with only 50% of failed deals.

1. Know the relevant industries well: characteristics, main players in the market, industry cycle & future trends among others.
2. In accordance with the industry research, identify the growth and synergy pathways in line with the vision of the company.
3. Identify the appropriate M&A objectives that will help realize the growth and synergy pathways identified in step 2. Possible objectives are:

- Increase market share within same industry
- Increase market reach (geographic expansion)
- Product diversification
- Entry into a new market
- Eliminate competition
- Brand/image enhancement
- Acquire resources
- Acquire expertise

- Economies of scale
- Enhanced cost efficiency
- Vertical integration
- Make use of tax shields
- Financial investment (active & passive management)
- Reverse takeovers: Private company acquiring a public company to access public markets without IPO

The M&A team: The best outcomes are achieved when outside advisers and management work closely together to strike a balance that makes the best use of internal resources but layers on the particular experience and expertise of the outside advisers and relieves the strain on already scarce management time.

- The team must consist of **representatives of all departments** that will be affected by M&A.
- The team should demonstrate a **diverse range of expertise**.
- Given the range of internal management and external adviser involvement, it is vital to appoint an Integration Director responsible for the transaction process as a whole. One of the teams within the programme will be that of the integration planners. **It is important for that team to:**

Include a **mix of M&A experience and operational management capability**. The role of the operational team is key and can impact the ability to deliver value.

Be **full time** to enable them to give the implementation process their undivided attention.

Have **continuity** through the deal completion into the initial post-completion phase so that immediate benefits can be realised.

SET THE M&A CRITERIA

2.

Setting up an M&A criteria helps pinpoint only candidates that are a match for the strategy developed.

- M&A criteria must be set based on the M&A strategy and goals developed in the previous step
- M&As have succeeded in the past without setting an M&A criteria because the firms believed that the company they are acquiring/merging with has a competitive advantage in its market (e.g. expertise, resources, technology). However, setting up an M&A criteria will clearly define what the firm is looking for in a target.

Some of the characteristics that must be considered before conducting the search are:

INDUSTRY	GEOGRAPHIC LOCATION	COMPANY SIZE
▪ Transportation ▪ Retail ▪ Technology	▪ Asia ▪ America ▪ South Africa	▪ Multi branches ▪ Number of employees

BUDGET	FINANCIAL HEALTH	APPROXIMATED VALUE
▪ The amount of cash/shares the company is willing to pay	▪ Solvency ▪ Profitability ▪ Liquidity	▪ An estimated value of the companies to stay aligned with the budget

INDUSTRY LIFECYCLE / STAGE	COMPANY LIFECYCLE / STAGE
▪ The classification criteria of each stage must be clearly defined.	▪ The classification criteria of each stage must be clearly defined

3. SEARCH FOR ACQUISITION/MERGER TARGET

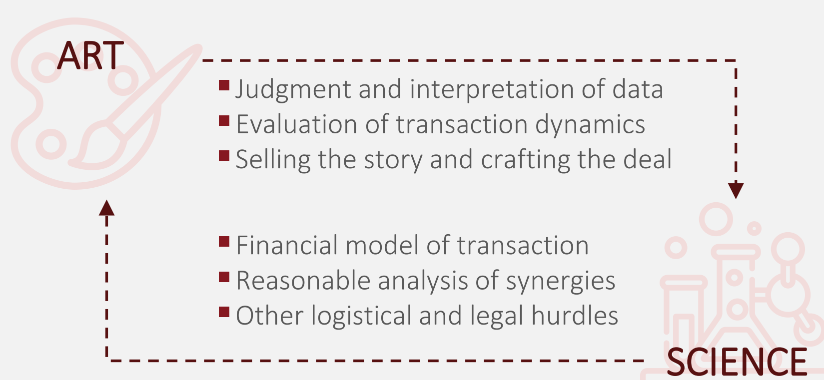
The search of a target must be based on the criteria sit to achieve the objectives and goals that was outlined in setting the M&A strategy

Based on the criteria specified, the acquirer should begin the search for eligible targets and assemble a shortlist of potential targets. The acquirer must thoroughly scan the target to identify any underlying issues that may be causing the company to be sold. If found, the issue must be investigated. If in case the issue is resulting from lack of expertise or experience required to solve the issues, and, the acquirer has the kind of expertise that can resolve the issue, it can consider acquiring the target at a discounted price to compensate for the issue.

4. INITIAL STRATEGIC EVALUATION

One of the most often overlooked, though seemingly obvious, elements of an effective M&A program is ensuring that every deal supports the corporate strategy. Many companies believe that they are following an M&A strategy even if their deals are only generally related to their strategic direction and the connections are neither specific nor quantifiable.

Strategic evaluation of a deal is a delicate combination of art and science



- After identifying companies that fit the M&A criteria, it's required to conduct initial strategic evaluation to see how they fit in the strategic objectives that have been stated in the first step.
- This step is to be done based on the available information about these companies.
- Performing strategic evaluation helps the acquirer in discussions with the management of the targeted company.
- Some information necessary to strategically evaluate may be obtained from the company after signing an NDA, in case of which, it needs to be completed after receiving information in step 6.

Questions must be asked to identify if the target company is a good strategic fit based on the M&A goal. A tree-map is often useful in this step.

GOAL	QUESTIONS *(illustrative)*	CONCLUSION	
SYNERGY	• Does the company have efficient supply chain management? • Does acquiring this company provide better economies of scale? • Does acquiring this company help extend the supply chain?	Yes	Potential Synergy after acquisition
		No	Not a good strategic fit
GROWTH	• Does the company have strong customer relationship ? • Does the company provide innovative solutions? • Does the company apply smart hiring practices? • Can the company enhance our brand image?	Yes	Potential growth after acquisition
		No	Market share will increase by the market share of the acquired company only

Strategic evaluation techniques

"Strategic evaluation provides important information about options and opportunities, but management and the board must still choose which candidates to approach, and in what order."

Focus on value creation

The buyer should analyze carefully how it can create value for the company. What revenue/cost synergies will occur? These factors can easily affect the valuation of the target and can justify why the target price is higher than the target market value. Even if the deal is considered sort of expensive for the board, it should not be refused completely before considering the value it will add to the target.

Keep an ongoing list of potential transactions

The process of strategic evaluation can take a long time. Changes in the market can affect the shortlisted firms. The attractiveness of some top candidates may decrease and others might become more attractive. Thus, the list must be constantly updated to find the best target.

Do not settle just to do a transaction

If the right candidate cannot be identified, the acquirer should not force a deal regardless with the best of the worst candidates. Often in the past, management teams have felt pressured to complete the deal when it was more appropriate to wait for the right opportunity due to the expectations set with the board. It is better to not have a deal than have a bad deal!

Typically, companies evaluate the strategic fit, by:

- Considering how each target would contribute to their M&A strategy
- Applying more subjective screens, including product fit, integration challenges, etc
- Identifying unique challenges and red flags for each target

5.

Approach Target Company and Obtain Information

Setting up an M&A criteria helps pinpoint only candidates that match the strategy developed.

- M&A criteria must be sit based on the M&A strategy and goals developed in the previous step
- Many M&A succeeded without setting an M&A criteria because they believed that the company they are acquiring/merging with has a competitive advantage in its market (e.g. expertise, resources, technology). However, setting up M&A criteria will define exactly what the acquirer is looking for in a company.

Some of the characteristics that an acquirer/merger must look into before making an acquisition/merger are:

INDUSTRY	GEOGRAPHIC LOCATION	COMPANY SIZE
▪ Transportation ▪ Retail ▪ Technology	▪ Asia ▪ America ▪ South Africa	▪ Multi branches ▪ Number of employees

APPROXIMATED VALUE	FINANCIAL HEALTH	BUDGET
▪ An estimated value of the companies to align with budget	▪ Solvency ▪ Profitability ▪ Liquidity	▪ The amount of cash/shares the company is willing to pay

INDUSTRY LIFECYCLE / STAGE	COMPANY LIFECYCLE / STAGE
▪ The characteristics of each stage, whether growth, mature or dying, differs	▪ Knowing whether if the company in the growth, mature or dying stage can outline certain characteristics

6. Full due diligence

An estimated 50% of the time, due diligence conducted before a merger fails to provide an adequate roadmap to capturing synergies and creating value. However, the danger is not that companies fail to do due diligence, but that they fail to do it well.

After receiving full information about the company, comprehensive due diligence process is conducted

The goal of this test is to

- Re-assess with the help of new information obtained and confirm that the company fits with the objective(s) of the acquisition/merger
- Size the risk associated with the deal
- Provide solutions to minimize failure rate or risk

To perform a meaningful due diligence test, the acquirer must focus due diligence on the strategic goal that made them approach the target in the first place. However, the acquirer must look into other relevant aspects of the target as well.

Based on the information retrieved from the targeted company, the acquirer must conduct a full due diligence to:

- Validate the financial statements and the legal structure of the business
- Make sure that the acquisition/merger can create value
- Ensure the value creation potential of the deal that management can deliver
- Ensure that this company can be sold for a higher value in the future if required
- Verify integrity and clear records among shareholders & board members
- Examine long and short term risks
- Outline potential growth
- Make physical visits to the company's operations facilities to ensure value drivers and to look into operations not reflected on the financial statements

7. Perform Valuation Analysis

Valuation of the deal must take into account any premiums for any resulting financial and operating synergies

Value of target firm + premiums for

→ **Operating synergy** = Value of the combined firm post transaction - Total value of individual firms

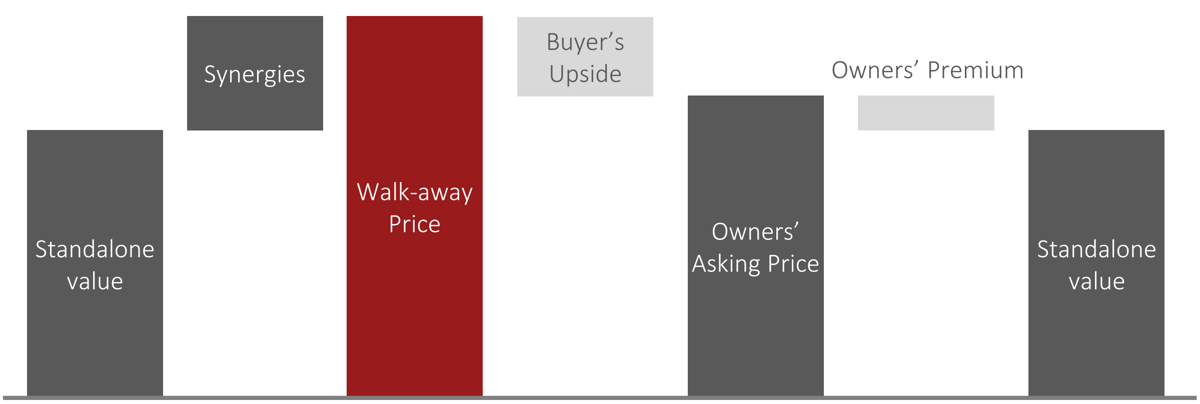
- Growth synergy
- Improved margins due to economies of scale

→ **Financial synergy**

- Tax benefits = PV of Tax benefits
- Debt capacity = Increase in value from additional debt
- Additional projects: PV of additional projects (if target cannot capitalize on available projects without M&A due to lack of funds)

→ **Active management** = Value created if the firm is run optimally by the new management

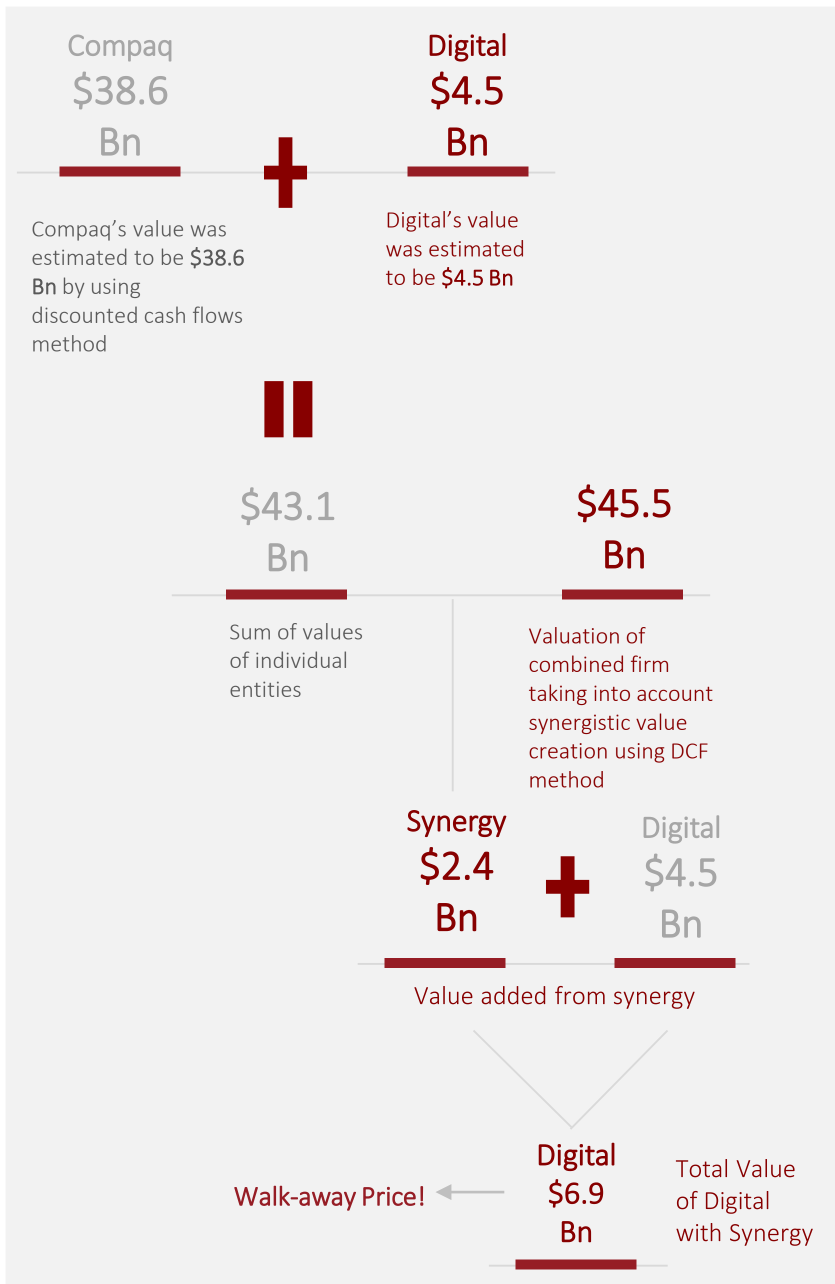
- Valuation can be performed using discounted cash flows approach or industry multiples among other methods.
- The firm should set a **walk-away price** for an acquisition based on the valuation. The firm should not pay more than the walk-away price for the acquisition.
- In case of synergies, if the target firm is indispensable to synergistic value creation, the acquirer should include the synergy premium in its walk-away price. If the acquirer is the key source of synergy and not the target, the premium should not be included in the walk-away price.



Source: UCG analysis, stern.nyu.edu

Perform Valuation Analysis: Case Study

In 1997, Compaq acquired Digital. The acquisition was motivated by the belief that the combined firm would be able to find investment opportunities and compete better than the firms individually could. The combined firm was expected to have economies of scale, allowing it to slightly increase its current after-tax operating margin.



8. Finalize Method of Purchase

4 important questions must be answered at this stage by the acquirer:

1) Is the acquirer going to acquire the assets or shares of the target?
2) Is the deal going to be financed with cash or stocks? or both?
3) If cash is going to be used, is it going to be borrowed or used from equity?
4) What is the degree of integration of the target with the acquirer?

The first 2 questions might be subject to change based on negotiations with the target in step 9.

In case of mergers:

- The parties should ascertain what percentages of ownership they will hold in the new entity.

9. Negotiations: Process and Steps for Negotiating and Signing an Acquisition Transaction

Signing the definitive acquisition agreement

1) The company counsel prepares and vets internally the definitive acquisition agreement draft.
2) The company presents definitive agreement draft to the other party.
3) Negotiation takes place on the definitive agreement.
4) The company counsel prepares and vets internally the draft exhibits to the definitive agreement (escrow agreement, registration rights, voting agreements, employment agreements, tax and corporate legal opinions, affiliate letters).
5) The target prepares disclosure schedules and possibly capitalization tables.
6) Negotiation and finalization of all agreements is done.
7) Approval of transaction in board meeting(s).
8) Target may get fairness opinion from its bankers.
9) Signing of definitive agreement and delivery of disclosure schedules.

Negotiations: Techniques

Mastering negotiation takes time, talent, homework and practice. However, there are a few key negotiating tactics and techniques that can help any buyer or seller work towards success

Concessions

- Show your target that you have given up something for the deal.
- Discover how can the target compensate you for concession. Then, demand it.
- Sometimes the targets will not offer you something in return for your concession. So, you may set conditions for them and if accepted, they will receive the concession.
- Fourth, make concessions in installments.

Sunk Costs Should not Affect Final Decisions

Do not think that there is no other choice but to complete the deal. Even though a huge amount of time has been spent for completing the deal but sometimes the best choice is to pull out.

First Candidate May be the Best Candidate

Although it is recommended to consider multiple options, first candidate in some case may be the best option.

Know Your Opposition

In order to get the other party to agree to a deal, you need to know what their interests are.

Fix the Walk-Away Price

Before entering negotiations, both parties should have a clear understanding of what's the lowest/highest bid they will offer/ask in the meeting.

Shake Hands, Then Second Guess

Even though the deal has been completed, keep researching and checking on how you can improve and modify the deal to maximize the impact.

Research

The most important tip is to never enter a negotiation meeting without doing your homework. Analyze, study and consider every small detail about the target.

Price

How much is it? The price can make or break the deal. Know how much is at stake and how much control it will grant.

Deal Closing

10.

Once the deal is formally closed and signed

- Announce the transaction publicly (press release)
- Prepare shareholder proxy statement form
- Apply for required governmental consents
- Mail proxy goes effective
- Obtain required third party consents
- Finalize all related transaction agreements and officer certificates
- Hold shareholders meeting (typically target only)
- Exchange final executed agreements, legal opinions, and officer certificates
- The deal is closed when the merger document is accepted and stamped by the respective authorities

11. Post M&A Integration

Completing an M&A deal is just the beginning of the process. Post M&A integration process is crucial to a successful M&A.

- Set the Direction
- Information Gathering
- Plan Development
- Initial Evaluation of Overall Plan
- Development of Detailed Step Lists
- Approval of Detailed Step List
- Implementation

Source: UCG analysis, Baker Mckenzie, BCG

Post M&A Integration

SET THE DIRECTION

Set the Direction

- Information Gathering
- Plan Development
- Initial Evaluation of Overall Plan
- Development of Detailed Step Lists
- Approval of Detailed Step List
- Implementation

Define the course

- Define and state clearly the objectives of the M&A deal
- Ensure the daily business remains unaffected as much as possible throughout the process
- Assemble teams based on the process and value drivers of the merger. Get the best people in the room.
- Maintain top management closely engaged and pro-active throughout the process

Post M&A Integration

INFORMATION GATHERING

- Set the Direction
- **Information Gathering**
- Plan Development
- Initial Evaluation of Overall Plan
- Development of Detailed Step Lists
- Approval of Detailed Step List
- Implementation

Most of the information might have been gathered earlier in the process as part of due diligence, however, in this step information is being revalidated and gathered for the purpose of implementation.

This step requires consultation with all relevant departments like human resources, tax, legal, compliance, business development, finance, treasury and IT. The information gathering phase needs to be carefully planned by the central project team with outside advisers.

Post M&A Integration

PLAN DEVELOPMENT

- Set the Direction
- Information Gathering
- **Plan Development**
- Initial Evaluation of Overall Plan
- Development of Detailed Step Lists
- Approval of Detailed Step List
- Implementation

Draw plan to capture values

- Clearly define and prioritize synergies
- Quantify all synergy targets
- Create a detailed plan to capture and achieve all synergy targets. Ensure the daily business remains unaffected as much as possible throughout the process

Organizational Plan

- Develop an integrated business model including tax, legal and commercial perspective.
- Draft a plan to achieve the integrated business model.
- Focus on human resources: Retain and hire top talent for the new organization
- Design and formulate a company culture to integrate workforces of both companies in a seamless manner. Allocate appropriate attention and resources to company culture integration.
- Minimize communication gaps at all levels.

Post M&A Integration

INITIAL EVALUATION OF OVERALL PLAN

- Set the Direction
- Information Gathering
- Plan Development
- Initial Evaluation of Overall Plan
- Development of Detailed Step Lists
- Approval of Detailed Step List
- Implementation

Once the high-level integration plan has been developed, it is important to have the key constituencies (for example, operations, tax, finance, legal, human resources, IT, Treasury) evaluate it and provide input on any issues the plan presents for them and any refinements that they wish to propose.

Post M&A Integration

DEVELOPMENT OF DETAILED STEP LISTS

- Set the Direction
- Information Gathering
- Plan Development
- Initial Evaluation of Overall Plan
- **Development of Detailed Step Lists**
- Approval of Detailed Step List
- Implementation

The plan should have a comprehensive steps list and timeline for executing the tasks with the responsible persons listed for each step. The detailed step list will be a critical tool for the implementation phase of the project. Interdependencies across business functions, correct sequencing of steps, and flagging aspects of the process that may be outside of the company's control must be clearly specified.

Post M&A Integration

APPROVAL OF DETAILED STEP LIST

- Set the Direction
- Information Gathering
- Plan Development
- Initial Evaluation of Overall Plan
- Development of Detailed Step Lists
- **Approval of Detailed Step List**
- Implementation

As with the overall integration plan, it is important to have the key constituencies within the business and other relevant external advisers evaluate the detailed step lists and provide their input.

Post M&A Integration

IMPLEMENTATION

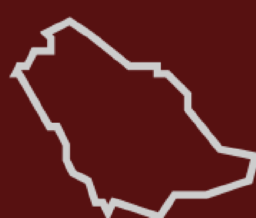
- Set the Direction
- Information Gathering
- Plan Development
- Initial Evaluation of Overall Plan
- Development of Detailed Step Lists
- Approval of Detailed Step List
- **Implementation**

Implement the business model developed
The key to success in this phase is to maintain open and clear channels of communication on the progression of implementation and the issues being faced. The plan is consistently re-tailored based on the feedback from this step.

04.

KSA REGULATORY FRAMEWORK & INTERNATIONAL PRACTICES

BENCHMARKING



SAUDI ARABIA

AUSTRALIA

USA

Acquisition Methods:

Regulations for acquisition of shares seem to be simpler among benchmarks as compared to KSA

Acquisition	of shares	▪ Mergers are not common in Saudi Arabia ▪ Buyer and seller must have the requisite authority to enter into the transaction. ▪ Transferring shares of an LLC needs the companies regulations to be waived by all the existing shareholders
	of assets	▪ The buyer acquires specified assets or liabilities of the target company ▪ The procedural aspects of the transfer of assets may need some form of third-party consent, particularly with respect to leased assets
Mergers		▪ Security Exchange Offer shall be made by the merging company ▪ Shares shall be issued in accordance with tie provisions of the capital market law, companies law and its implementing regulations

Sources: UCG analysis, CMA, MCI, Baker McKenzie

		Australia	USA
Acquisition	of shares	▪ Share transfer form is filled by the seller ▪ Share certificate needs to be provided	▪ Acquiring shares of a company means acquiring its assets ▪ 3rd party consents for important contracts is not required ▪ Target company usually retains its tax attributes, both favorable and unfavorable
	of assets	▪ The buyer acquires specified assets or liabilities of the target company ▪ More complex than share acquisition ▪ Each individual asset needs to be transferred in accordance with the formalities for a transfer that applies to that type of asset	▪ The buyer acquires specified assets or liabilities of the target company ▪ More complex than share acquisition ▪ Triggers anti-assignment clauses ▪ The buyer's tax basis in the assets may be increased to reflect the actual purchase price ▪ Favorable tax attributes of the target company will normally be lost
Mergers		▪ Companies may merge using Scheme of Arrangement ▪ This scheme is subject to the approval of a state supreme court or federal court and the targets shareholders in a general meeting	▪ Two companies can merge together solely by filling certificate of merger ▪ Requires a majority consent from the target company's stockholders for the buyer to obtain all of the target company's stock ▪ Dissenting stockholders may have the right to obtain an appraisal of their shares and recover the appraised value in lieu of the amount offered to them in the merger ▪ Transfer of assets and exchange of shares are automatic ▪ Structure of the merger will determine whether the merger is treated as an asset or stock acquisition for tax purposes

Signing and closing the deal:

Saudi Arabia has an extensive process for executing the deal

Formalities for Execution of Documents	of shares	▪ LLC and JSC share acquisition requires:
		    ▪ Purchase agreement
		    ▪ Foreign investment license from SAGIA
		    ▪ Submission of the target entity's shareholders' resolution to get MCI approval
		    ▪ Execution of the shareholders' resolution
		    ▪ Issuance of an amended commercial registration by MCI
		▪ * JSC maintains a share register

	of assets	▪ Written contracts may be required by law or to fulfil an applicable registration requirement and may require specific approval. Some examples of contracts are :
		    ▪ Contracts for the sale of land
		    ▪ Transfers of the legal title to shares
		    ▪ Transfers of intellectual property rights
		    ▪ Guarantees
		    ▪ Employment contracts

Formalities for Transferring Title	to shares	▪ Main steps of the transfer of shares
		    ▪ Submission of a ST Share Purchase Agreement to SAGIA
		    ▪ Submission of an amended provisions of the target company's articles of association
		    ▪ Submission of the target company's shareholders resolutions to MCI for its approval
		    ▪ Parties sign the amended articles of association reflecting new shareholding structure of the target company before a public notary

	to assets	▪ Title is transferred to assets when the asset is transferred to the buyer

Signing and closing the deal:
Australia has fewer requirements for transfer of shares or assets compared to US and Saudi Arabia

Formalities for Execution of Documents	of shares	▪ No legal requirement for an agreement for the sale of the legal and beneficial title to shares to be made in writing ▪ Usually the seller's lawyers prepares the first draft of the Share Purchase Agreement
	of assets	▪ Usually the seller's lawyers prepares the first draft of the Asset Purchase Agreement ▪ The agreement should clearly identify the assets (and any liabilities) to be acquired and exclude those to be retained by the seller.

Formalities for Transferring Title	to shares	▪ transfer of title to the legal and beneficial interest in shares usually involves the following three stages:
		  ▪ Entry into a written SPA for the sale and transfer of the shares;
		  ▪ Delivery by the seller to the buyer of a transfer form in respect of the shares; and
		  ▪ Approval and registration of the transfer by the issuing company.

	to assets	▪ An Asset Purchase Agreement frequently only requires signature by or on behalf of the parties ▪ However, it may also be necessary for the agreement or any ancillary documents to be executed as a deed due to a particular formality or the absence of consideration.

Signing and closing the deal:
United States

Formalities for Execution of Documents	of shares	▪ Documents must be executed by any person with authority to do so on behalf of the entity ▪ Authority is evidenced by a resolution of the board of directors or a certificate delivered by a company officer
	of assets	▪ Certain documents, such as those conveying real estate, have execution requirements under the relevant state laws such as notarization.
Formalities for Transferring Title	to shares	▪ In a purchase of shares or LLC membership interests represented by certificates, the seller will typically deliver certificates representing all of the shares or membership interests in the target corporation either endorsed to the buyer or accompanied by an executed 'stock power' authorizing the transfer of the shares or membership interests on the books of the target. ▪ Membership interests not represented by certificates will be transferred by a form of assignment
	to assets	▪ Each individual asset needs to be transferred in accordance with the formalities for a transfer applicable to that type of asset ▪ Personal property will be transferred by bill of sale, which requires no formalities ▪ Agreements and other intangibles will be transferred by a form of assignment, which may be combined with the bill of sale

Tax Transfer:

Different styles of taxation are found among benchmarks

		Saudi Arabia	Australia	USA
Acquisition	of shares	▪ Saudis are liable to pay zakat at a rate of 2.5% of the portion of their taxable wealth ▪ If the seller is not considered a Saudi resident under the Income Tax Regulation then the seller will be liable to pay capital gains tax at a rate of 20% of the tax base	▪ No share transfer duty. However, a transfer of shares may result in landholder duty ▪ Landholder duty is paid at transfer duty rates on the value of the land	▪ Many state and local jurisdictions impose sales, use or other transfer taxes on the sale of certain categories of assets, including real property ▪ Transfer taxes generally do not apply to the sale of stock where the legal title to the asset does not change. However, a few states impose a stock transfer tax, and a few states impose a real estate transfer tax on the sale of a controlling interest in a real property entity. ▪ Whether a merger is subject to transfer taxes will depend on whether the structure is treated as an asset or stock acquisition for tax purpose ▪ Using a share acquisition instead of an asset acquisition for the purpose of avoiding transfer taxes is generally less of a concern in the United States than in many other countries.
	of assets	▪ Any gain arising out of a disposal or transfer of assets is likely to be treated as normal business income and will be taxed at the normal corporate tax rate.	▪ An acquisition of assets may be subject to stamp duty ▪ The stamp duty rates and forms of dutiable property vary from jurisdiction to jurisdiction and range between 5.15% and 5.75%	
Mergers		▪ Mergers in Saudi Arabia generally do not trigger any capital gains tax ▪ No transfer tax (such as stamp duty), VAT or any other indirect tax is imposed on M&A transactions	▪ The stamp duty implications arising on a merger are dependent on whether it was done as acquisition of shares or acquisition of assets	

Saudi Arabia:
Oversight of Regulations for M&A transactions

- The Ministry of Commerce and Industry (MCI) oversees M&A transactions between unlisted companies. Limited liability companies are governed by the Saudi Companies Law. However, the Saudi Companies Law doesn’t contain any rules that govern M&A of closely held joint stock companies. Therefore, the court will apply the general principle of Islamic law to an M&A case involving a closely held joint stock company.
- The Capital Market Authority (CMA) oversees M&A transactions that occurs between two listed companies, or between two companies where at least one party is a listed company.
- However, depending on the sector of the transaction, and also on the nationality of the parties, other governmental agencies may be involved and other governmental approvals may be required. In such involvement of a foreign party, the Saudi Arabian General Investment Authority (SAGIA) will be involved.

CMA M&A regulations were first issued in 2007 based on the Capital Market Law and it was amended by resolution of the board of CMA in 2018.

The regulations discuss in details general provisions, such as the extent and scope of the regulations, general principles regarding the announcements, compliance with laws and waivers. It discusses acquisitions; the process from approaching the company to negotiation to appointing legal and financial advisors to some prohibitions and restrictions to profit forecast and asset valuations to announcements. Also, it discusses the right to withdraw acceptance, timing of the offer and the nature of payment. Lastly it discusses types of merger transactions, rules of merger transactions and the required acceptance & approvals for a merger transaction.

Saudi Arabia:

Challenges in the CMA M&A regulations were identified that might potentially hinder M&A activity in Saudi Arabia

The trigger of a mandatory offer in KSA

- Mandatory Offer: an offer to buy all of the remaining shares in a company, that must be made when a company owns more than certain threshold of the voting shares in another company
- Saudi Arabia: The CMA stated in its regulations that a mandatory offer must be made by an acquirer, if it just increased its stake to or more than 50%, to buy the remaining shares that it doesn't own from the same class of shares

Observations	▪ European Union: The European Commission (EC) Directive requires that once a controlling stake in a corporation is acquired, the offeror must make an offer to the rest of the shareholders ▪ While the mandatory offer is triggered automatically under the EC directive, the mandatory offer under the Saudi M&A Regulation lies under the CMA's discretion (the mandatory offer is not automatically triggered) ▪ The 50% threshold is more efficient threshold than 30% in Saudi Arabia because it still has an underdeveloped market and it doesn't have the same number of listed companies as in EU
Example	▪ The mandatory offer wasn't triggered during NCB's acquisition of Saudi Research and Marketing Group although 50% threshold was exceeded. On November, 2015, SRMG announced that NCB capital's funds acquired 55.21% of its shares in a private transaction. Also, on the same day, the kingdom holding company announced that it sold its 29.9% stake in SRMG in a private transaction.
Recommendation	▪ CMA's power to decide whether to require a party that acquires 50% of a target corporation to make a mandatory offer is subjective. A possible change could be to have the clause automatically triggered as is the case in the EU.

Saudi Arabia:

Challenges in the CMA M&A regulations were identified that might potentially hinder M&A activity in Saudi Arabia

Break-up and Reverse Break-up

- Break-up Fees: fees paid by the offeree for cancelling the deal
- Reverse Break-up Fees: fees paid by the offeror for cancelling the deal
- Saudi Arabia: Saudi's M&A Regulations only addresses the breakup fee (≤1% of the deal's value); it does not explicitly regulate the reverse breakup fee

Observations	▪ United Kingdom: The Takeover Code prohibits the break-up fees. However, it allows arrangements of reverse Break-up fees. ▪ The UK Takeover allows arrangements that impose obligations on the offeror such as reverse break-up fees. ▪ The Saudi M&A regulation's approach toward the reverse breakup fee is not explicitly clear.
Recommendation	▪ The Saudi Capital Market Authority should include a provision that clearly permits an arrangement that imposes an obligation on the offeror such as the reverse breakup fee. It should be the same percentage as the Break-up fees **(less than 1%)** Time Resources Cost

Saudi Arabia:

Foreign investment in publicly traded companies still face some restrictions by CMA & SAGIA regulations

The CMA stated in its regulations some foreign investment limitations such as:

- Each qualified foreign investor, may not own 10% or more of the shares of any issuer whose shares are listed or convertible debt instrument of the issuer.
- The maximum proportion of the shares of any issuer whose shares are listed or convertible debt instrument of the issuer that may be owned by all foreign investors (in all categories, whether residents or non-residents) in aggregate is 49%
- The qualified foreign investor must have assets under management or custody of SAR 1.875 billion

Challenges	▪ Although limitations have been relaxed slightly on foreign investors, it is still considered too stringent compared to countries such as USA and UAE. Limitations like obtaining a SAGIA license to acquire a stake in a Saudi company drive away investors and hinder opportunities to develop the Saudi M&A market
Solution	▪ Encourage foreign investment through laws that attract overseas investors. ▪ Provide alternatives to obtaining mandatory SAGIA license.

05.

SAUDI ARABIA: M&A CASE STUDIES

SABIC & GE Plastics

SABIC was established in 1976 by the Saudi Arabian government. The government still owns 70% of SABIC shares and the remainder is held by private investors in the Gulf region. G.E. formed its first plastics department in 1930, and it became the country's largest plastics producer. In 2006, GE plastics division had a revenue of $674 million. SABIC acquired GE plastics in the third quarter of 2007 with $11.6 billion in cash.

Acquisition Objectives: For SABIC the acquisition meant:

- A complementary addition to their core business.
- A strategic move as part of its 2020 vision.
- Opportunity for global growth and diversification in automotive, electronics, healthcare and construction sectors.

Widespread synergies result for SABIC from GE plastics

- Incremental benefit to larger volume plastics business from enhanced R&D, technical support
- Raw material cost savings
- Creation of material profits in the US to optimize possible tax credits
- Operational synergies

Source: UCG analysis, HSBC

The acquisition will reduce SABIC's risk

- Engineering polymers have demonstrated lower volatility and are influenced by a different cycle, which provides increased diversification.
- GE plastics also provides greater geographical diversification, reducing the level of dependence on production in the Middle East.

Strategic Benefits

- Portfolio synergy: It will help SABIC diversify the company into higher-value-added products.
- Continued growth: The business will be partially consolidated in 2007 and fully in 2008 which will not affect SABIC's growth even with the petrochemicals sector downturn.
- 2020 strategic target: SABIC acquired GE plastics to achieve their 2020 goal of reaching 20% revenue in specialized products.

M&A Payment method

- Cash: Saudi Basic Industries Corporation (SABIC) bought GE Plastics with cash in a deal valued at $11.6 billion.

Purchase of Assets vs Stocks

- Assets Purchase: SABIC directly acquired 100% of assets of GE Plastics

M&A by Integration Degree

- Take-over Acquisition: GE Plastics was rebranded as SABIC Innovative Plastics

SABIC sold GE Plastics later on 2016. The CEO said the business had been a profitable one for SABIC," Yousef Al-Benyan, SABIC vice chairman and CEO, said in the release. "As part of our ongoing effort to actively manage our portfolio, we concluded that this business no longer complements our core strategy.

Case Study:

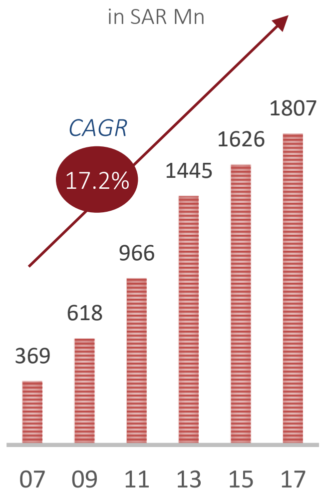
Almarai & Western Bakeries

Almarai is a publicly traded Saudi company established in 1977 focusing on dairy, juice, bakery, poultry and infant nutrition segments. Western Bakeries Company established in 1996 and based in Jeddah, sold its products under the L'usine brand (consisting of pastry, cakes, biscuits, bread, buns, waffle, maamoul and sambosa leaves) and the 7Days brand (consisting of pastry and cakes). Western Bakeries had a leading market share of 23.2%. In 2007, Almarai acquired 100% of Western Bakeries to expand its product offering.

Acquisition Objectives: For Almarai the acquisition meant:

- Increase market share within the consumer staples sector
- Strong entry into the bakery market with an established brand name "L'uisine"
- Acquire expertise of bakery products from L'uisine
- Potential synergies resulting in the form of:
    - Increased sales through Almarai's established customer network throughout MENA region
    - Economies of scale given its already large scale of operations.

Almarai's Bakery Segment Revenues Post Acquisition in SAR Mn



M&A Payment method

- Stocks: Almarai issued 9 million new shares with a par value of SAR 10 per share in exchange for Western Bakeries Company's stock.

Purchase of Assets vs Stocks

- Stocks Purchase: Almarai directly acquired 100% of stocks of Western Bakeries Company.

M&A by Integration Degree

- Low-touch Acquisition: Almarai maintained L'uisine's independent identity & brand name post acquisition. All products are marketed as L'uisine till date.

Almarai's acquisition of L'uisine can be termed as a successful one given the value added to shareholders through contribution to the company's financials and product portfolio diversification.

Source: UCG analysis, Al Bilad Capital, Almarai

Case Study:

Sipchem & Sahara

Sahara Petrochemicals is a publicly traded Saudi company established and listed on the Tadawul in 2004 with an approximated capital value of SAR 4.4 billion. Sipchem is also a publicly traded Saudi petrochemical company established in 1999 as a closely held company and listed on the Tadawul in 2006 with an approximated capital value of SAR 3.6 billion. Sipchem has nine subsidiaries in the kingdom, located in Jubail and Khobar.

Acquisition Objectives: Both companies believed that the deal is going to:

- Enhance the company's leading position in the local and international petrochemical industry
- Combined company would become a stronger platform for further growth in the long-term
- Combined business is expected to result in significant synergies related to operational efficiencies

M&A Payment method

- Stocks: Sipchem will issue 0.8356 new shares for every share held by Sahara's shareholders.

Purchase of Assets vs Stocks

- Stocks Purchase: Sipchem plans to directly acquire Sahara's stocks.

M&A by Integration Degree

- Low-touch Acquisition: Sipchem plans to maintain Sahara's independent identity & brand name post-acquisition.

The agreement

- Both companies have agreed that, in the event the proposed merger occurs, it will be implemented by way of an exchange of shares where, after the proposed merger is completed, the Company will become a subsidiary of Sipchem. Accordingly, based on the agreed exchange ratio, if the proposed merger is completed, Sipchem will increase its shares to 733,333,332.

Sources: UCG analysis, Tadawul

The updated Companies Law added rules that stated that "the decision to complete the acquisition offer by offering an exchange of securities for all the shares of the offeree Company, shall not be deemed valid unless it is issued by the votes of 75% of the shares represented in Extraordinary General Assembly" this means that a company will be able to acquire part of or the whole company if 75% of the voting shares agreed on the offer.

1st attempt at the deal in 2013

- The two companies had initially signed a non-binding MoU for a potential merger back in 2013.
- On June 4, 2013, Sahara had announced it had signed an MOU with Sipchem for it to be fully acquired by Sipchem.
- The proposed merger was expected to enhance the Company s leading position in the local and international petrochemical industry and the combined business is expected to result in significant synergies related to operational efficiencies and the combined company would become a stronger platform for further growth in the long-term.
- However, the negotiations were cancelled in June 2014, citing "inadequate regulatory framework."

Regulatory framework issue

- Sipchem wanted to acquire 100% of Sahara. However, the 1965 Companies Law stipulated that no shareholder can be forced to sell his shares without his or her consent.
- This rule resulted in difficulties for Sipchem as they needed the approval of all Sahara's shareholders
- On June 8, 2014 Sahara announced that even though Sahara and Sipchem had been in advanced stages of negotiations, they decided to postpone the deal due to difficulties encountered in consummating the transaction in the manner that the two companies wished.

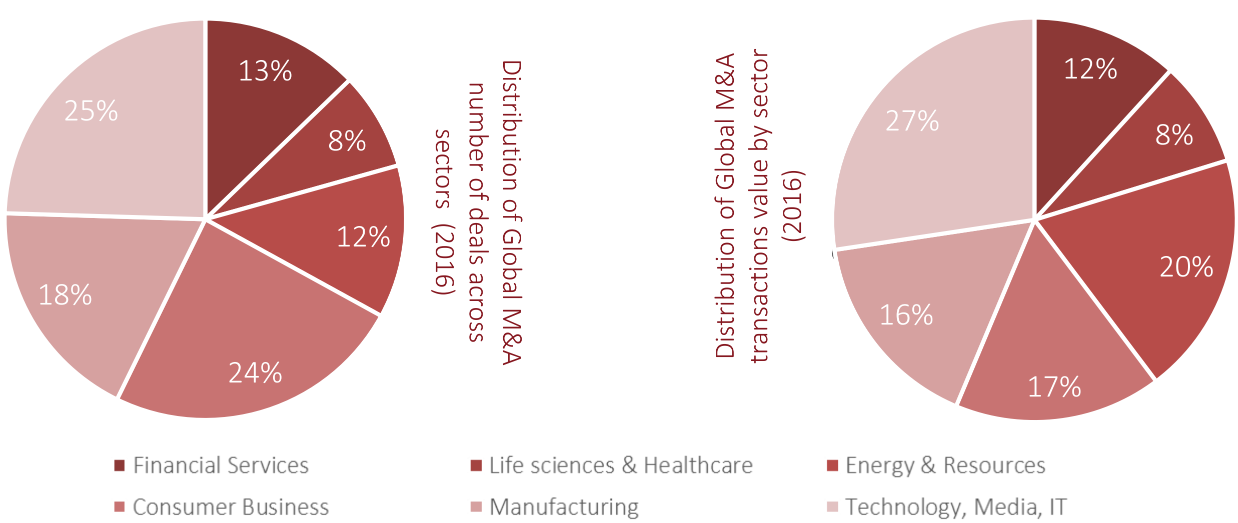
Reinitiating the deal in 2018

- In October 2018, the two companies signed an MOU again to go ahead with the deal.

06.

M&A ACTIVITY

In 2017, the M&A market recognized $3.7 trillion in transactional volume, an almost 3% drop from $3.8 trillion in 2016. North America occupied the highest percentage of deals completed at 44% followed by EMEA at 28%



Sources: UCG analysis, Jpmorgan.com

Saudi Arabia M&A Activity:

M&A landscape in Saudi Arabia is expected to have tremendous changes

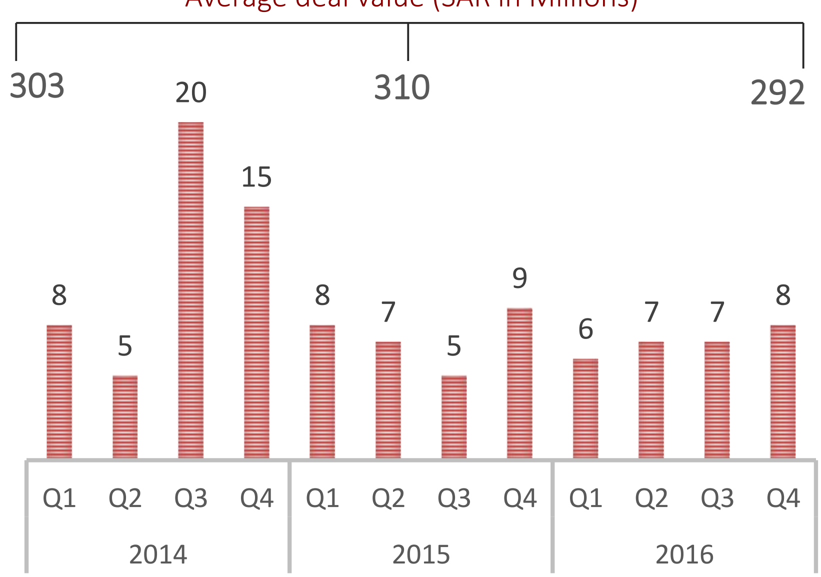
Saudi M&A transaction volumes have slowed down lately

- From an average of 12 transactions per quarter in 2014, the deals slowed down to 7 per quarter in 2015 and 2016. Deals that did close were driven by family corporate groups focusing on truly core-activities, leading to sales of those assets deemed to be non-central to key business lines.

Saudi M&A deals are expected to go up in the coming years

- Although the trend of M&A deals is downward, it is expected to boom again. This is due to the fact that the government of Saudi Arabia has taken bold fiscal reform steps targeting economic stability and revenue diversification. These reforms include reducing benefits, public spending & subsides and the implementation of VAT. Thus, corporate profitability has been impacted negatively. All of this points to a more intense competitive environment in the years to come for Saudi companies. The companies are, therefore, expected to fortify their positions in the market through all ways possible, one of which is M&A.

Average deal value (SAR in Millions)



Number of deals/quarter

Source: UCG analysis Capital IQ, MergerMarket , PWC

Saudi Arabia:
63% of completed M&A transactions were in the industrials and consumer, retailing, leisure and healthcare sectors

Key drivers

Consumer, Retail, and leisure

- Reduced foreign ownership restrictions.
- High urbanization rate, favorable demographics and expansion of retail channels (particularly online).
- Technology, while disrupting traditional routes to market, is creating new investment opportunities across the value chain.
- Favorable valuation environment in the retail sector in 2016 drove serious interest in the sector by Private Equity firms (PE) as they constituted over 60% of transactions.

Healthcare

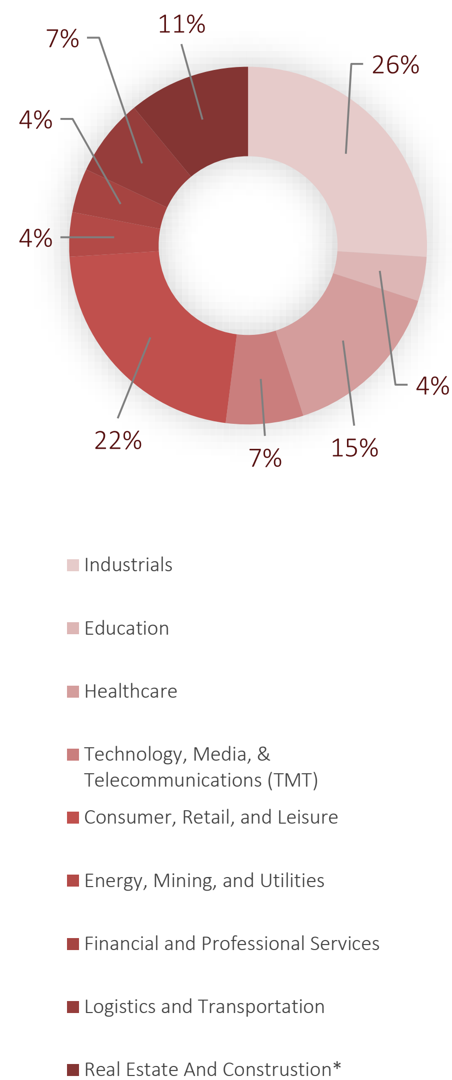
- Healthcare accessibility in the kingdom remains under-penetrated.
- Compulsory health insurance policies for private sector employees.
- The National Transformation Plan targets an increase of the private sector contribution to 35% from the current baseline of 25%

Education

- Education companies are seeking capital to expand and fulfill regulatory requirements of operating and owning proper education facilities.
- Vocational training, child-skill enhancement, and e-learning initiatives are emerging.

Other sectors

- Corporate industrial groups are increasingly seeking to dispose their non-core subsidiaries to focus on their key activities and to support their cash flow.
- Taxes on unutilized land plots are triggering conglomerates, heavy on real estate investments, to seek acquisition opportunities of real estate developers.
- Growth in transportation infrastructure (roads, railways, ports, and airports) along with an increase in local manufacturing, are creating opportunities for specialized logistics businesses.



Completed M&A transactions in the kingdom by sector

07.

A FINAL NOTE..

I. M&As can provide huge benefits to Saudi firms going forward. Resulting growth & synergies are strongly needed to survive in an increasingly competitive regional landscape.

II. M&As have shown to have high failure rates. Saudi companies need to particularly focus on the process highlighted to maximize the potential benefits from the deal.

III. M&As can help Saudi companies grow thereby increasing their contribution to GDP and creating more jobs. The authorities must encourage more activity by easing the regulatory framework and process.

Saudi sectors that can create synergistic value with M&A

Professional Services Sector

Quite a few local Saudi professional services firms have surfaced lately. These include marketing agencies, auditing firms, consulting companies and legal firms. These Saudi service providers, however, have found it very challenging to compete against the likes of strong internationally reputed firms like McKinsey, Boston Consulting Group, PWC, King & Spalding etc.

Major initiatives and consulting for key decisions are entrusted to such big firms and rightfully so given their vast & deep experience across many sectors around the globe and access to a ton of resources in the form of industry experts, key individuals and executives of major corporations. On the other hand, although Saudi firms are equipped with talented individuals with extensive experience in the Saudi market, they are relatively smaller in size and lack the large scale and diverse exposure that international firms can boast about.

Years of experience	Projects under belt	Professionals
Experts	Diversity in expertise areas	Access to resources

Thus, consolidation in industries of the Saudi professional services sector, or mergers with similar firms in GCC, where each brings vast experience along with a different range of expertise and access to resources to the table, will go a long way in terms of the reputation of these firms and perception of their capabilities in the market. Together they would pack more

Banks and Car Insurance Companies

The car insurance sector in Saudi Arabia is weak. This is a result of having many small insurance companies in the kingdom that face high risks due to lack of liquidity.

The demand of car insurances in the coming years will increase. This is due to the fact that approximately **9 million** women will be allowed to drive. Companies such as Careem are gearing up to provide almost 100K job opportunities for Saudi women. However, such small car insurance companies can't meet the enormous potential demand.

Therefore, banks acquiring small car insurance companies and providing them with financing and liquidity they require, will boost their ability to meet the potential demand while maintaining low risks. Furthermore, banks can cross-sell their insurance services to customers applying for car loans. This opens door to synergies for the bank and the insurance companies.

Potential Benefits

- Stronger car insurance sector in Saudi Arabia
- The banks could capitalize on the opportunity to invest in other sectors
- Increase in the quality and competition among car insurance companies, which will ultimately benefit the consumers

KNOW MORE ABOUT UCG

Helmy Kutby Street,
AlZahra Dist.
Jeddah, Saudi Arabia

King Abdulaziz Road,
Al Yasmin Dist.
Riyadh, Saudi Arabia

+966 12 682 9390

hello@ucg-sa.com

www.ucg-sa.com