

PRIVATE ACQUISITIONS IN THE UNITED ARAB EMIRATES: MARKET ANALYSIS OVERVIEW

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Legal Briefings - By **Zubair Mir, Chris Walters and Shazi Askarpour**

The Q&A gives a high level overview of key issues including current major trends, private M&A activity, structuring and documentation in transactions, governing law and arbitration, and reform and future market trends.

MARKET OVERVIEW

1. WHAT ARE THE CURRENT MAJOR TRENDS IN THE PRIVATE M&A MARKET?

Since the beginning of 2019, M&A activity in the UAE has largely been driven by business consolidations. There have been significant deals in the banking and finance sector, including:

A USD115 billion three-way merger between Abu Dhabi Commercial Bank, Union National Bank and Al Hilal Bank, in May 2019.

Dubai Islamic Bank's acquisition of Noor Bank in January 2020, creating an entity with more than USD75 billion in assets.

Sharjah's Government's acquisition of a USD300 million majority stake in Invest Bank in April 2019, with reports indicating that it is also considering merging Invest Bank, Bank of Sharjah and United Arab Bank.

The merger of Abu Dhabi Financial Group with Shuaa Capital in August 2019, creating a combined entity with USD12.8 billion in assets under management.

The energy sector has also seen significant activity with:

The acquisition by Kohlberg Kravis Roberts and Blackrock of a 40% stake in Abu Dhabi National Oil Company for USD4 billion.

Eni's acquisition of a 20% stake in Abu Dhabi Oil Refining Company for USD3.1 billion.

The acquisition by Abu Dhabi National Energy Company PJSC (Taqa) of most of Abu Dhabi Power Corporation's utility assets.

Uber's acquisition of ride-hailing app Careem for USD3.1 billion in March 2019 was another major consolidation deal in the transportation, delivery and technology sectors.

The UAE private equity market has been adversely affected by the collapse of Abraaj, and the prolonged impact that this has had on investor confidence in the region. Private equity investments involving firms in the Gulf Cooperation Council reached a ten-year low of USD6 billion in August 2019. The private equity market in the UAE has also been affected by exit barriers, including an unattractive IPO market and secondary sale market.

According to information obtained from Mergermarket, in 2019 there were a total of nine private equity deals involving UAE-based target companies, with a total disclosed value of about USD9.7 billion. Only two of these deals involved secondary buyouts, including CVC Capital Partners' acquisition of a 30% stake in GEMS Education for an undisclosed amount from a Fajr Capital-led consortium.

2. WHAT HAS BEEN THE LEVEL OF PRIVATE M&A ACTIVITY IN THE PREVIOUS YEAR?

According to information obtained from Mergermarket, 2019 saw a decline in the number of private M&A deals compared to the previous year, although overall deal value increased. In 2019, there were 50 announced private M&A deals involving UAE-based target companies, with a total disclosed value of approximately USD20 billion. This is compared to 67 deals, with a total disclosed value of approximately USD13 billion, in 2018.

This trend seems to have continued into 2020 with only nine announced private M&A deals involving UAE-based target companies in Q1, with a total disclosed value of approximately USD690 million.

DEAL STRUCTURES

3. WHAT ARE THE CURRENT TRENDS IN THE STRUCTURING OF PRIVATE M&A TRANSACTIONS?

In the authors' experience, a majority of transactions are conducted as share sales, rather than asset sales. From a seller's perspective, this is the preferred approach as it allows a clean break; generally none of the debts or liabilities of the target are left behind. Although buyers often prefer an asset sale, which allows them to cherry pick assets and ignore liabilities, this is more difficult to implement from a regulatory perspective. For example, a business transfer in the UAE is generally regulated by Articles 39 to 48 of the UAE Federal Law No. 18 of 1993 Concerning Commercial Transactions (Commercial Code). Under the Commercial Code, a transfer of ownership of business assets must be documented in a notarised business transfer agreement and a summary of key terms must be published in two local Arabic newspapers for one week to enable creditors to submit any objection that they may have to the transfer. Publishing the key transaction terms and providing creditors with an opportunity to object is often undesirable to parties to a transaction.

Therefore, a typical transaction involves a share sale for cash consideration paid on completion. Where shares are used as consideration, there is often also an element of cash consideration. Price adjustment mechanisms are generally used in determining the consideration to be paid, with completion accounts and locked box the most frequently used mechanisms. The authors anticipate that price adjustment mechanisms will become more frequently used as parties try to account for the potential consequences of the 2019 novel coronavirus disease (COVID-19) pandemic, particularly in ongoing transactions where initial valuations and non-binding offers have been based on pre-COVID-19 activity levels.

4. WHAT ARE THE CURRENT TRENDS IN THE TERMS AND DOCUMENTATION OF PRIVATE M&A TRANSACTIONS?

De minimis provisions and basket caps are market standard, with the latter either being expressed as a percentage (often 1% to 2% of the total consideration) or a fixed monetary amount.

The use of warranty and indemnity insurance is not as common as it is in other jurisdictions, as the market is less mature than for example Europe. However, the authors are seeing greater interest from sellers in this regard, particularly in the context of auction sales and from private equity sellers.

Share purchase agreements often contain restrictive covenants, with the most common seller restrictions relating to the solicitation of employees and customers and the conducting of a similar business. Material adverse change is not always defined. However, this is likely to change and more precise definitions of material adverse change will be used, as parties seek to include/exclude consequences stemming from the COVID-19 pandemic.

5. WHAT ARE THE CURRENT TRENDS IN HOW PRIVATE M&A TRANSACTIONS ARE CONDUCTED?

In the authors' experience, a number of transactions that were underway before the restrictions imposed as a result of the COVID-19 pandemic are continuing. However, parties are taking their time to revisit previous assumptions as to valuation and pre-closing conditions, and assess the possible trading impacts and capital expenditure requirements going forward. In particular, buyers are adapting their acquisition strategy and investment criteria to better suit the current market conditions. The authors expect that a key trend for M&A in 2020 will be that deals will take longer to complete as a result of a greater emphasis being placed on valuation and due diligence, and many may fail. A number of transactions will have failed or will have been postponed as a result of a failure by the parties to bridge any valuation gap or uncertainty relating to transaction execution and integration.

Large corporates are continuing to dispose of non-core business lines and other non-core assets to generate liquidity and satisfy leverage concerns. There is also significant opportunity for well-funded financial buyers and sovereign wealth funds to generate value for their investors by acquiring distressed assets and undervalued companies.

In the UAE, sovereign wealth funds and significant family offices emerge as key participants in M&A activity. The UAE is heavily dependent on imports in critical industries such as health care, pharmaceuticals, energy, and food production. A number of sovereign wealth funds and family offices pursue targets in these sectors in support of the UAE Government's localisation efforts.

Based on market observations and the authors' experience, the majority of transactions are conducted as negotiated sales rather than auction sales (with some auction sales, in the authors' experience, quickly becoming bilateral deals).

The combination of legal, financial and commercial/technical due diligence is becoming increasingly common in lower mid-market transactions and above. Owing to costs involved, red flag rather than full narrative diligence reports are typically commissioned by buyers when undertaking transactions at the lower end of the market. Bespoke tax due diligence is also becoming more common due to the recent introduction of VAT in the majority of GCC countries and as a result of many UAE-headquartered enterprises having significant foreign holdings.

It is market standard for a virtual data room to be prepared by the seller, with the review of legal, financial and commercial documents conducted via an online portal. This is more efficient, in relation to both cost and time, than using a physical data room. However, the authors note that physical data rooms and clean team agreements are still being used in transactions that are being negotiated between competitors, but physical data rooms may be increasingly replaced by clean team only sections of virtual data rooms.

The current situation with regards to COVID-19 gives rise to questions surrounding the management of practical requirements of a transaction. For example, if there are any restrictions in place for entry into or out of individual Emirates, or the UAE, parties will need to handle such restrictions effectively so as to minimise disruption to transaction execution, particularly if there is any intention to hold in person management meetings or undertake site visits.

CROSS-BORDER LITIGATION AND ARBITRATION

6. IS IT COMMON MARKET PRACTICE FOR A SHARE PURCHASE AGREEMENT TO PROVIDE FOR A FOREIGN GOVERNING LAW AND/OR JURISDICTION? IF SO, IN WHAT CIRCUMSTANCES DOES THIS OCCUR AND WHICH GOVERNING LAW AND/OR JURISDICTION ARE COMMON CHOICES?

It is common market practice in the UAE for share purchase agreements to provide for a foreign governing law. Generally, choice of law provisions are valid under UAE law. In the authors' experience, the law of England and Wales is the most common choice of foreign governing law. However, where a party to the contract is a state-owned entity, it is more difficult to agree a foreign governing law without first assessing the status of the parties to the transaction. This is because Federal Law No. 5 of 1985 regarding Civil Transactions provides that contracts entered into with UAE government bodies must be governed by local law. Dubai also has a specific law that prohibits the Dubai Government or its departments, institutions, bodies or authorities from entering into foreign law-governed agreements. If UAE law applies, the forum for resolving disputes must also be in Dubai. For this reason, it is not uncommon to see local law, such as the federal law of the UAE, as the governing law of agreements entered into with state entities.

7. IS IT MARKET PRACTICE FOR AN ARBITRATION PROVISION TO BE INCLUDED IN PRIVATE M&A DOCUMENTS? ARE ARBITRATION CLAUSES ENFORCEABLE IN YOUR JURISDICTION? DO LOCAL COURTS RESPECT THE CHOICE OF JURISDICTION IN AN ARBITRATION CLAUSE?

It is common market practice in the UAE for arbitration provisions to be included in private M&A documents. The UAE has been a signatory to the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (New York Convention) since 2006 and is generally considered an arbitration-friendly jurisdiction, especially since the enactment of the new arbitration law in 2018 (Federal Law No. 6 of 2018).

Arbitration clauses in commercial agreements are generally enforceable under UAE law, including arbitration agreements that provide for international arbitration (that is, arbitration agreements that specify a seat outside the UAE). However, when contracting with a UAE government entity, the commercial counterparty should ensure that the requisite approvals have been granted before entering into the arbitration agreement. Under UAE federal law, government departments cannot enter into arbitration agreements unless the agreement has been approved by the Ministry of Justice before the contract is executed. In addition, Dubai has specific laws requiring government departments, institutions, bodies and authorities to obtain approval from the Ruler of Dubai before entering into arbitration clauses that specify a seat outside Dubai. Without such approval, the arbitration clause will be null and void.

RECENT DEVELOPMENTS AND PROPOSALS FOR REFORM

8. HAVE THERE BEEN ANY SIGNIFICANT RECENT OR PROPOSED LEGAL DEVELOPMENTS AFFECTING THE MARKET THAT COULD IMPACT ON TRANSACTIONS?

Foreign investment

In September 2018, the UAE issued Federal Law No. 19 of 2018 on Foreign Direct Investment (FDI Law). The FDI Law provides a framework under which foreign investors can own up to 100% of the shares in companies incorporated onshore in the UAE. Typically, companies incorporated onshore in the UAE must be at least 51% owned by UAE nationals or an entity wholly owned by UAE nationals (*Federal Law No. 2 of 2015 on Commercial Companies*). The FDI Law therefore provides for a relaxation of these restrictions.

In March 2020, the UAE Cabinet issued Cabinet Resolution No. 16 of 2020, which sets out a list of 122 economic activities in which 100% foreign ownership is permitted (Positive List), subject to certain requirements such as a minimum capital investment and a minimum percentage of Emirati employees. The Positive List includes certain activities in sectors such as:

Agriculture.

Manufacturing.

Various services industries (including health care, construction, education, hospitality and entertainment).

Article 7 of the FDI Law sets out a list of 13 sectors in which more than 49% foreign ownership is not permitted (Negative List). The Negative List includes sectors such as:

Oil exploration.

Banking and finance.

Insurance.

Water and electricity services.

Postal services.

Telecommunications.

Printing and publishing.

Commercial agents' services.

Land and air transport.

With the introduction of the FDI Law and the Positive List, the UAE may begin to see an increase in foreign direct investment from investors who had previously been deterred by the foreign ownership restrictions.

Bankruptcy law

The UAE also introduced a new bankruptcy law in 2016, Federal Law No. 9 of 2016 concerning Bankruptcy (Bankruptcy Law), which will need to be considered in the context of distressed M&A deals. The Bankruptcy Law provides that certain transactions (such as security granted for existing debt or disposals at an undervalue) may be invalid and unwound where they have been entered into by a company during the two years prior to it entering into bankruptcy proceedings. Bankruptcy proceedings can be initiated by creditors with an aggregate debt of least AED100,000 in cases where the company has failed to pay its debts for more than 30 consecutive working days. Buyers will therefore need to consider this when purchasing companies with significant losses or debts if there is a risk that the target or seller may become insolvent following completion.

9. WHAT WILL BE THE MAIN FACTORS AFFECTING THE MARKET NEXT YEAR, AND HOW DO YOU EXPECT THE MARKET TO DEVELOP?

The COVID-19 pandemic is likely to be the most significant factor affecting the UAE M&A market over the next year. The pandemic has already had an impact on the practicalities of completing M&A deals in the UAE, as most transactions require documents that need to be signed before a UAE notary public. While this has initially delayed completion of transactions, parties and local authorities have had to adapt. For example, there has been an increase in the use of electronic signatures rather than a physical exchange of documents. The Dubai Notary Public has also launched an online notarisation service for certain documents, such as powers of attorney. The notary will verify the identity of authorised signatories by way of a video call. A similar approach has also been taken by the Notary Public in Abu Dhabi. The economic departments in certain Emirates and free zone authorities are also processing share transfer applications online. If the use of these electronic processes proves to be efficient from a time and cost perspective, they may remain in place and be used more frequently by parties in the future.

The parties to ongoing and new transactions will need to consider the impact of COVID-19 on target businesses and agree risk allocation between the buyer and seller. As part of their due diligence, they will need to determine the degree of contractual counterparty risk, supplier disruption, customer slowdown and employment issues, each of which may have an impact on the valuation of the target. In terms of transaction documents, the parties will need to consider any conduct of business and pre-closing covenants relating to the implementation of COVID-19 measures, including additional warranties and disclosures, material adverse change and termination provisions, and deferred payment of consideration as a result of the uncertainty created by the pandemic. On leveraged deals, it will also be important to identify if the lending banks have any ability to pull the financing, and parties may need to find other solutions where there are new financing gaps. For example, some sellers may need to consider offering vendor financing to buyers to ensure that deals can be completed.

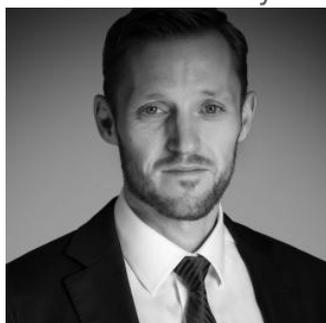
Expo 2020 was expected to cause an increase in activity in the facilities management industry. According to reports at the end of 2019, Emrill Services, a Dubai-based facilities management company, had been in discussions with a number of specialist services companies in the Middle East regarding one or more acquisitions. Emaar Properties was also reportedly in talks with potential buyers for the sale of its district cooling business. Now that Expo 2020 has been postponed to 2021, these types of deals may be pushed back to next year.

While many buyers may choose to postpone their potential acquisitions until there is greater certainty in the market, the impact of COVID-19 on many businesses in the UAE may potentially provide buyers with greater opportunities in stressed and distressed M&A deals. There may also be increased activity in certain sectors such as e-commerce and technology, as traditional businesses seek to adapt to the significant changes to consumer trends brought about by COVID-19. Sellers may also seek to accelerate anticipated disposals of non-core or underperforming businesses to raise cash.

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