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# Gulf Cooperation Council (GCC) Investment Outlook 2014



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# Methodology

In the third quarter of 2014, Mergermarket interviewed 75 corporate executives from the GCC region to gain perspective on the business community's outlook for investment activity in the region over the next 12 to 24 months. Respondents provide insight into the specific investment trends emerging in the region and offer detailed forecasts of future activity. All respondents are anonymous and results are presented in aggregate.

# Bridging the Gulf

## Foreword

**Welcome to the *Gulf Cooperation Council (GCC) Investment Outlook 2014*, published by Mergermarket, in conjunction with Dr. Saud Al-Ammari Law Firm in association with Blake, Cassels & Graydon LLP. Many changes have occurred in the global economy since this report was last published in 2010, and the GCC now stands out in the emerging markets category with a robust growth forecast and an abundance of opportunities for foreign and direct investment in the various sectors of the GCC countries, comprised of Bahrain, Kuwait, Saudi Arabia, Oman, the UAE and Qatar.**

The report reveals attitudes and opinions of key dealmakers and executives in the Gulf region on vital matters such as regulation, the impact of the opening up of the Tadawul (Saudi Arabia's Stock Exchange) and the reduced dependency on oil & gas.

All of the six economies remain heavily reliant on revenue derived from hydrocarbons, but diversification efforts are increasingly bearing fruit, to varied degrees, across the GCC. Forty-five percent of survey respondents believe that the opening of stock markets to foreign direct investment will be one of the main drivers for regional growth, while 36% consider increased demand for infrastructure funding to result in increased investment activity.

The Gulf nations are seeking to leverage their strengths in areas such as sourcing capital and functioning as a springboard into the growing consumer markets of the Middle East. Vying to present themselves as ideal start-up locations for new businesses and expansion targets for European and Asian retailers, the UAE, Bahrain and Saudi Arabia have made great strides in improving corporate governance while also tackling economic reforms and labour challenges.

Having weathered the global economic downturn, these markets contain growing consumer classes and are equipped with robust legal infrastructure – both of which should entice North American, European and Asian investors looking to start up or expand businesses.

In addition, survey respondents anticipate an increasing number of international joint ventures as well-capitalized publicly listed national companies in sectors such as transportation, telecommunications, and real estate are expected to develop their presence both regionally and internationally. Over the next 12 to 24 months, 73% of respondents expect publicly listed companies to be the most active investors in the GCC region.

Meanwhile, 62% of respondents said that public-private partnerships are best suited to fund large industrial and infrastructure projects as governments are aiming to match capital with foreign expertise and

technology. Notably, respondents believe that scheduled mega projects such as Saudi Arabia's US\$1.1 trillion projects, underway or planned, or the Dubai Expo 2020 and the FIFA World Cup in Qatar in 2022 will underpin regional growth not only in the infrastructure sector but also in sectors as diverse as real estate and tourism and present plenty of joint venture opportunities. Fifty-one percent of respondents think real estate will be among the top sectors to target for diversification away from hydrocarbon-related industries.

The majority of survey respondents in the GCC region also believe that closer integration between the six countries will be vital to the growth of the region as a whole. Projects, such as the regional high-speed rail link and a new causeway between Bahrain and Saudi Arabia announced in September, are expected to enhance the flow of goods and labour. Additionally, further economic reforms in the individual countries are sure to spark investor interest.

In terms of M&A activity, it is perhaps unsurprising that survey respondents expect most dealmaking over the next 12 to 24 months to take place in the oil & gas sector. However, real estate, financial services, infrastructure and retail sectors also figure highly as dynamic sectors in the M&A market.

Oil & gas revenue still constitutes the majority of GDP in the GCC. But, as governments step up their efforts in their perennial quest to diversify their economies and channel funds to jumpstart other sectors, the rewards are solid growth projections and the promise of foreign direct investment in the region. Developing a competitive advantage in one or more industries remain a serious challenge for every GCC country.

We hope you enjoy this report and the in-depth analysis on the above findings and other specific facets of GCC investment activity, including deal structures, drivers of M&A activity and financing trends. We think you'll find this survey both useful and informative, and as always, we welcome your feedback.

# Integration brings investment

As the six countries of the GCC aim for sustainable growth through the diversification of their still heavily oil-reliant economies, attracting foreign investment remains of key importance. The region's future will also largely depend on the GCC's ability to maximize regional cooperation in the areas of transportation, electricity and oil & gas pipelines, tackling labour challenges and implementing efficient policies to encourage private-sector activity.

At 40%, more than one-third of respondents believe the level of economic integration in the GCC will determine future growth. Expectations are in place for a full customs union in 2015 that would enhance the flow of capital, goods and labour and give the GCC a distinct competitive advantage as a trading block. Closer integration of the Gulf markets will also assist diversification of the economy and support the growth of non-oil industries, which 40% of respondents considered as important as economic integration.

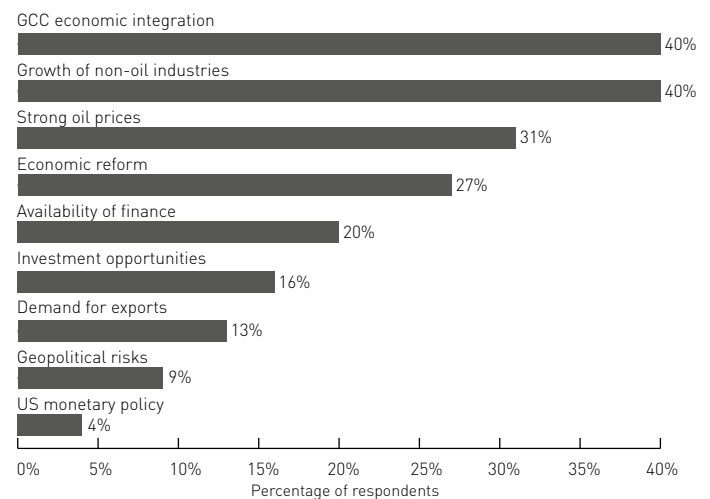
One respondent states that: "Diversification and the growth of non-oil industries will help shape a better economic environment for the GCC region."

GCC's non-oil sectors, specifically the construction and retail-related segments, will continue to buoy economic activity, the International Monetary Fund (IMF) said. Private-sector credit and significant spending on infrastructure are the drivers. On the other hand, the IMF warned that non-oil revenues, in terms of the overall numbers, are still limited and recommended looking at alternate sources including corporate income or value-added taxes. In fact, asset management firm Alkhabeer Capital recently said that the spending on the annual budgets of GCC countries is still mostly derived from revenue that is based on the export of hydrocarbons even though non-hydrocarbon industries' contribution to the region's overall GDP has already risen considerably. For instance, Alkhabeer said Qatar's and the UAE's non-hydrocarbon revenues have reached over 40% of the countries total revenue. This is much higher than Saudi Arabia at 10%. As a comparison, the firm also brought up other resource-rich economies such as Norway where oil-related income comprised roughly 30% of the government's revenues.

Hence, 31% believed that strong global oil prices remain an important factor as it determines government spending, and 27% said domestic economic reform played a vital role for enabling growth. Only 9% saw geopolitical risk as a determining factor — given the tensions in the wider Middle East region, this is a particularly optimistic finding and highlights the growing stability in the GCC.

Respondents estimated a growth rate of between 4% and 9%, with the majority projecting an average of 5% to 6% growth. This is slightly above the IMF's estimate of an average of 4.2% GDP growth for the GCC in 2014. This forecast compares very favourably with a number of other emerging markets. According to data from Bloomberg, the GDP growth figure of 4.2% is higher than powerhouses such as Brazil (2.6%), Mexico (3.7%), Russia (2.5%) and South Africa (3.05%).

## Which of the following factors will be most important to determining future economic growth in the Gulf Cooperation Council (GCC)? (Select top two)



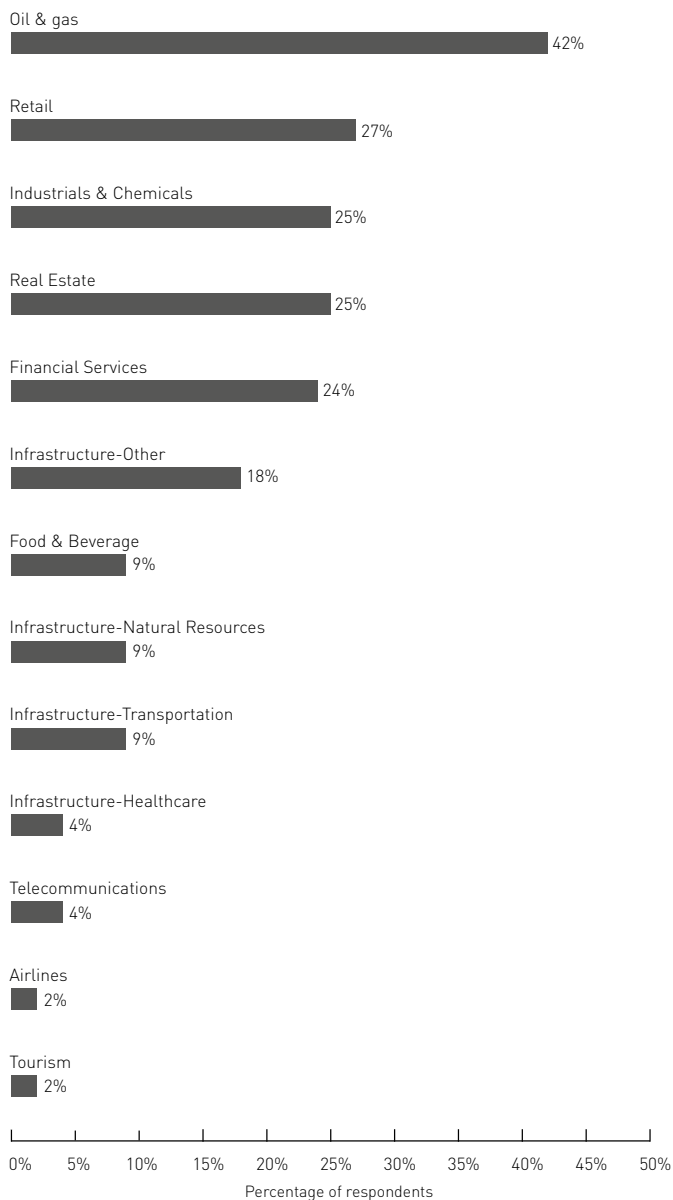
**"There is no doubt that economic integration will bring significant benefits to the GCC and the region as a whole. It now seems only a matter of time as the peoples of the GCC really want economic integration to happen sooner rather than later."**

**Scott Burrell, Managing Partner, Blake, Cassels & Graydon LLP**

In addition to the factors stated above, it is also worth noting the fast-growing and youthful demographic within the region. According to recent research from the Economist Intelligence Unit (EIU), the GCC has one of the fastest-growing populations in the world. It is estimated that by 2020, the population is set to increase by one-third to 53 million people. More than 45% of these will be between 15 to 64 years of age.

At a time when many developed economies are struggling to cope with an aging population, these demographics present serious opportunities for corporates in a variety of sectors, particularly the technology and consumer industries.

## In the GCC region overall, which of the following sectors do you think will see the most rapid future growth? (Select top two)



Despite efforts to minimize exposure of the Gulf economies to changing global energy demand patterns and volatile oil prices, 42% of respondents said the oil & gas sector would still see the most rapid future growth. Respondents were also confident about the growth of the retail sector (27%), industrials & chemicals sector (25%) and the real estate (25%) and financial services (24%) sectors.

Diversification efforts over the past decade are starting to bear fruit in some GCC countries, where the total contribution of oil & gas towards the national GDP is slowly making room for rising revenue from non-oil-related industries. For instance, in Kuwait, real non-oil GDP growth is expected to reach 3.9% in 2014 versus 2.7% in 2013, according to an IMF report on GCC economies released in June. This increase was mainly due to government investment in both infrastructure and refineries.

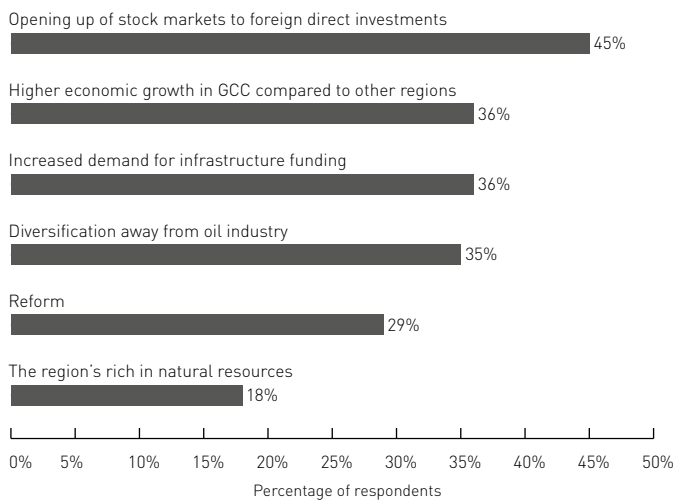
Despite the findings, many respondents in the survey acknowledged that, anecdotally, both the telecom and infrastructure sectors are also seeing rapid growth. One executive stated: "Infrastructure in healthcare is a sector into which the GCC is diversifying to reduce the dependency on oil and natural resources output."

Meanwhile another respondent felt that: "The telecom sector is growing with the entry of telecoms businesses from Europe. And, infrastructure demand is also on the rise, mainly because of the expansion of businesses who feel they have lesser scope in domestic areas."

Foreshadowing the infrastructure boom that is expected to take place before the arrival of the World Expo in 2020 in Dubai and the FIFA World Cup 2022 in Qatar, 18% of respondents said infrastructure will see the most rapid growth. Some respondents also expected preparation for these events to act as a catalyst for other sectors, with growth spilling over into higher demand for labour and materials.

"The industrials & chemicals sector will mainly grow alongside the subsectors of building materials and fixtures, considering the need for new infrastructure. The real estate sector is also expanding with commercial construction as the need for domestic housing increases," one respondent said.

## What are the main drivers of investment in the GCC region overall? (Select top two)



Overall, 36% of respondents think that the increased demand for infrastructure funding will be one of the main drivers for investment in the region. An equal number thinks that higher economic growth in the GCC, compared to other regions where recovery following the downturn is slower to emerge, will be a main catalyst for overall investment in the region.

“The food and beverage and retail industry will grow in the GCC region based on consumer demand, and European firms who are in need of speedy growth will approach GCC countries as there is ease in developing a startup,” one respondent commented.

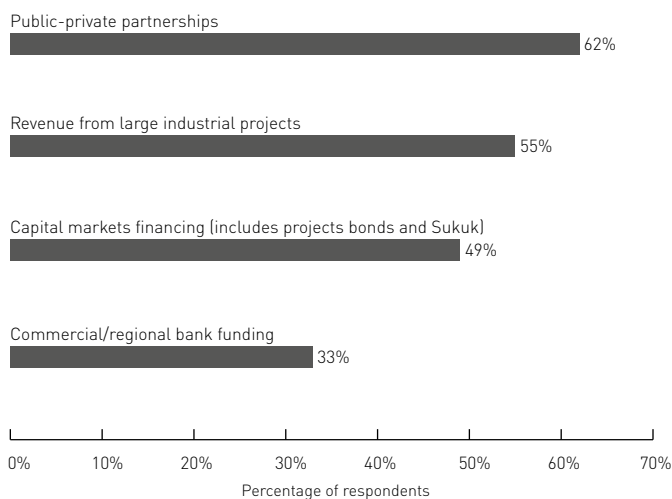
However, the opening up of stock markets to foreign direct investment is rated even higher, with 45% of respondents considering this as the main driver for investment. Here the expectation is that, in 2015, foreign investors will inject fresh cash into the economy by being allowed to participate in Saudi Arabia’s Stock Exchange, Tadawul, which is worth approximately US\$530 billion.

“This development may be the catalyst for consolidating the various regional stock exchanges in the GCC and allows the Tadawul to become the driver of the GCC and broader regional capital markets as it alone has the breadth of issuers and potential liquidity to do so among the regional exchanges.”

**Tim Sunar, Partner, Blake, Cassels & Graydon LLP**

# Investment focus

**Infrastructure spending is bound to increase in the GCC due partly to utility demand and Dubai's sponsorship of the World Expo 2020. Which of the following funding sources will be used the most to back these initiatives? (Select top two)**



Diversification away from oil also remains a key driver for 35% of respondents. The Gulf economies are seeking to draw out private sector involvement, in particular to support large infrastructure spending, for example, for special economic zones and transportation hubs such as Khalifa Port in Abu Dhabi and the Port of Duqm in Oman, which bring more relevance to public-private partnerships (PPPs) in the GCC.

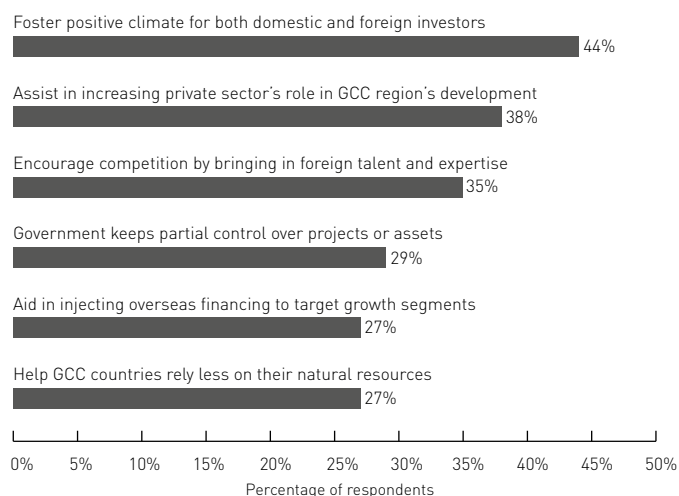
"PPPs are an efficient financing tool; as they gather investments from foreign investors leading to an increase in capital availability. I think this is the most important factor for the GCC region, which is looking forward to developing the other sectors," one respondent said. Another respondent commented: "PPPs will be widely used as a funding source based on resource utility, accountability and value-generation possibilities."

Sixty-two percent of respondents believe that PPPs are best suited to finance projects especially when taking into account that 90% or more of PPP projects finish on time and on budget. Meanwhile, 55% said revenue from large industrial projects would be a source of funding, and 49% pointed to capital markets as a source for financing.

**"The combination of regional population growth with the strategic direction to diversify GCC economies speaks to the need for a long-term focus for infrastructure planning and investment. The PPP model offers regional governments an opportunity to deliver high-quality infrastructure investments that put the risk of long-term asset performance with the private sector."**

**Graham McLeod, Partner, Blake, Cassels & Graydon LLP**

### What is the primary advantage of public-private partnerships (PPPs) as a financing tool in the GCC region? (Select top two)

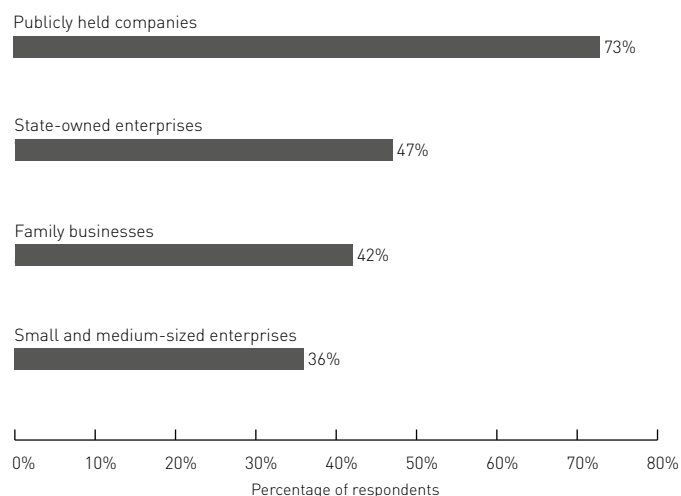


Forty-four percent of respondents consider PPPs as a financing tool conducive to creating a positive climate for both domestic and foreign investors, and 38% said PPPs assist in increasing the private sector's role in the region's development.

**“ Borne of certain fiscal realities in western economies, the emphasis has shifted in ‘next generation’ PPP jurisdictions such as Canada: what started as an economic necessity is now viewed as a more effective investment vehicle to maximize the public’s return on infrastructure investment through shifting the burden of on-time, on-budget delivery of projects to the private sector.”**

**Graham McLeod, Partner, Blake, Cassels & Graydon LLP**

### Which of the following will be the most active investors in the GCC region over the next 12 to 24 months? (Select top two)

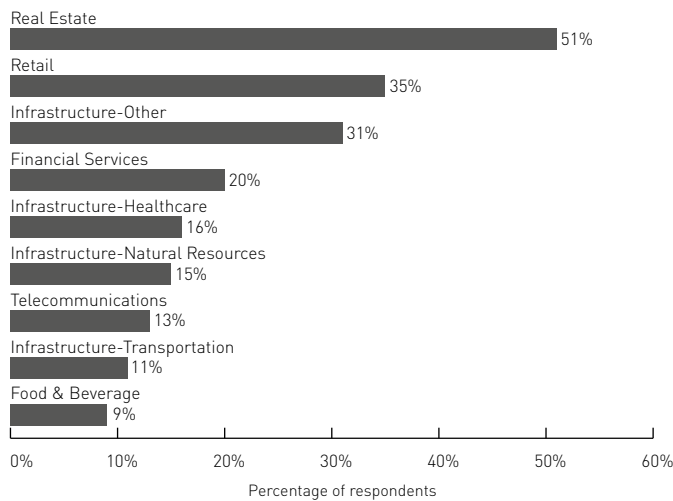


The majority of respondents (73%) said publicly held companies would be the most active investors over the next 12 to 24 months, as government support has traditionally underlined the take-off of many of the successful regional heavyweight public players in transportation, industrials & chemicals such as the continued expansion of Saudi Arabia's Jubail industrial complex by SABIC, TMT and real estate. In comparison, 47% believe state-owned enterprises will be most active. Saudi Arabia is planning to implement projects worth US\$1.1 trillion, and aims to attract investment in airport upgrades, manufacturing, power generation and offshore oil, gas as well as value-added downstream processing to meet growing consumer demand. The Saudi Arabian General Investment Authority (SAGIA) estimates more than US\$100 billion in investment opportunities in sea ports, air transport, rail, road and logistics infrastructure over the next decade.

Notably, inbound tourism has also increased, partly as a result of new infrastructure in support of the pilgrimages to Mecca, resulting in an approximately 80% increase in the volume of spending over the past four years to an estimated US\$27 billion in 2014.



**In which of the following industries are the GCC countries diversifying into as they reduce their reliance on oil and their natural resources?**



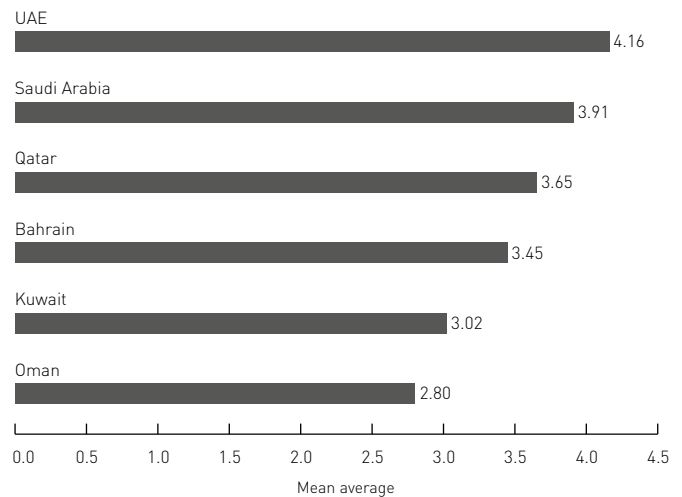
Overall, 51% of respondents considered real estate as the most popular target for diversification. The Bahraini government, for example, is targeting major funds toward transport, utilities and housing projects, with more than 5,000 units to be completed over the next three years.

Meanwhile, 35% said the GCC region was diversifying into the retail sector in order to reduce reliance on oil & gas.

One respondent noted: "The real estate and telecommunications sectors are seeing an increase in demand as market needs are increasing as expats settle down to start new business ventures or take on existing businesses." Another respondent added: "Businesses in the GCC region will focus on diversification into the retail and real estate sectors, and established companies will try to connect with businesses in the European region for ventures to make improvements."

**"The spike in non-hydrocarbon revenues has resulted from the GCC countries' diversification efforts. Governments have made sizeable infrastructure investments, particularly in the real estate and telecommunication sectors, that have driven economic growth and private sector involvement."**  
**Michael Quigley, Partner, Blake, Cassels & Graydon LLP**

**Which of the following GCC countries will rely the least on oil-based revenue in the next 12 to 24 months? (Rank where 1=most reliant and 6=least reliant)**



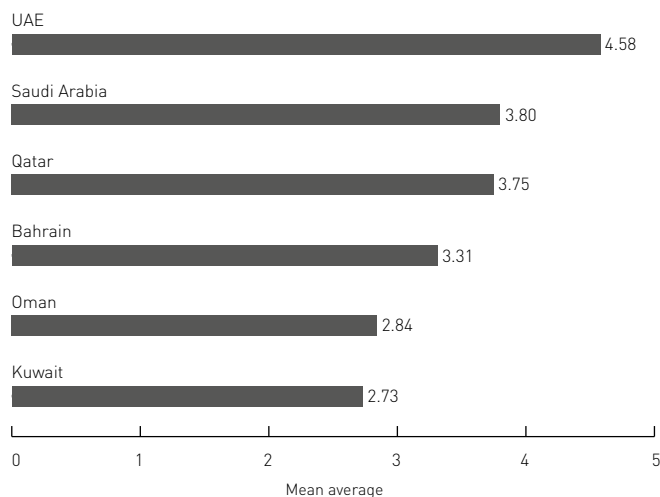
The UAE and Saudi Arabia were deemed by respondents as the economies that will be least reliant on their oil revenues over the next 12 to 24 months, as both countries have actively invested in other sectors such as financial services, real estate, telecom and consumer goods, in addition to offering taxation benefits to investors and businesses located in these countries.

Specifically in Saudi Arabia, SAGIA has said that the government's priority sectors emphasize investments that encourage job creation and facilitate the aim to transfer both technology and knowledge. As an example, the country's information and communications technology sector is considered the biggest in the Middle East because of the liberalization of the market as well as public spending on projects that support the sector.

In September, Virgin Mobile Middle East and Africa introduced its services in the Kingdom as the Saudi telecom regulatory authority has introduced new measures to foster competitiveness in the sector.

# Investment activity

Which of the following GCC countries have seen the biggest impact from economic reform on investment activity? (Rank where 1=least impact and 6=most impact)

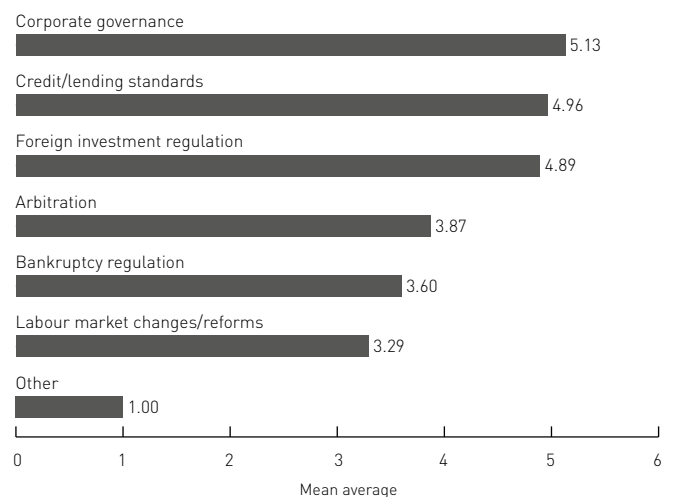


Respondents also credited economic reforms in the UAE as having increased its attractiveness as a strategic location to start up businesses and act as a gateway for expansion into the wider GCC region, which includes the availability of local talent. "UAE has seen a revolution in the past few years where a variety of businesses have set up a base, driven demand and created value for invested capital and policies have been put in place and followed which are making activities easier," one respondent said.

Within the GCC region, according to 36.4% of respondents, Kuwait and Oman have been least impacted by economic reform on investment activities, while the UAE has experienced the most, followed by Saudi Arabia. One respondent pointed out that: "Saudi Arabia has seen the biggest impact from economic reform on investment activity; as the country has been receiving extensive investments from foreign institutional investors and private equity. This market has become one of the fastest growing in the global economy."

According to the IMF, real growth in Saudi Arabia is predicted to stay above 4% in 2014 and 2015. The IMF attributed this healthy growth rate to both government spending and the private sector's increased role in Saudi Arabia. The government has been heavily involved in funding infrastructure projects. Middle East business news provider MEED figures showed that the announced 2014 pipeline of projects in Saudi Arabia's energy and utilities, transportation and real estate sectors is worth US\$240 billion, the lion's share of which is government funded. It has also been actively spending on education as well as promoting labour law reform to increase Saudi Arabian citizens' involvement in the private sector. Saudi Arabia is

Please rate the following areas in terms of which have experienced the most reform: (Rank where 1=least reform and 7=most reform)

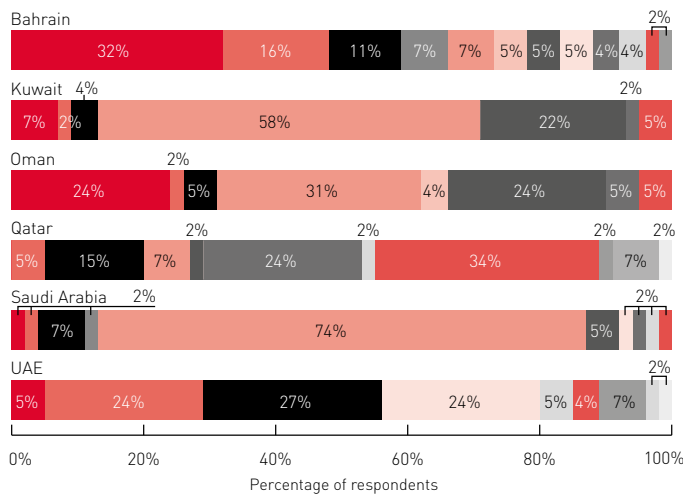


one of the world's top spenders in education — the government has not only allocated US\$56 billion in its 2014 budget to the education ministry, but King Abdullah in May approved a five-year plan worth US\$21 billion to further develop the country's education sector. The government's Nitaqat Law for Saudization, which helps Saudi nationals be hired for private-sector jobs before expatriates, has also helped the government limit its social spending and helped in its diversification efforts.

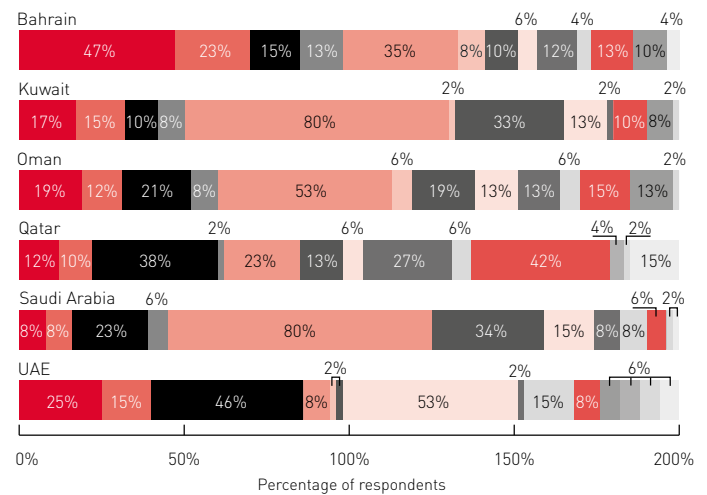
The government has also made notable efforts to stimulate investments through initiatives that bolster the small and medium-sized enterprise (SME) sector. These efforts include the creation of the Saudi Industrial Development Fund (SIDF) as a way to encourage commercial bank lending to SMEs. As a result, SME investment in the country is expected to grow to over US\$70 billion by the end of 2015. Another government strategy to increase investments into the country is to enact measures that make it easier for foreign companies to invest in Saudi Arabia including amending existing laws that hinder investor interest.

Respondents named corporate governance as the area that has undergone the most reform, closely followed by credit standards. "Foreign investment regulation has experienced the most reform; as the governments have liberalised their restrictions and freed the business transactional flow; GCC regions had high regulations and barriers to inbound investments in the past which have now been reformed and abolished," one respondent said.

**Which sector will banks be most willing to lend to over the next 12 to 24 months? (Select one per country)**



**Which sectors will see the most M&A activity for each GCC country over the next 12 to 24 months?**



Key for above two charts:

- Financial Services
- Industrials & Chemicals
- Real Estate
- Mining and Metals
- Oil & Gas
- Infrastructure-Healthcare
- Infrastructure-Natural Resources
- Infrastructure-Transportation
- Retail
- Telecommunications
- Infrastructure-Other
- Food & Beverage
- Tourism
- Education
- Airlines

According to respondents, the focus of lending activity still remains on oil & gas across most of the region, especially in Saudi Arabia (74%) and Kuwait (58%). Saudi Arabia is the main focus for oil & gas investment opportunities with around 9.6m barrels per day in the first five months of 2014, although the country is emphasizing support for manufacturing and downstream projects, which led to a 5.5% growth of the non-hydrocarbons economy in 2013, according to the National Commercial Bank, Al Ahli. Among other significant petrochemicals projects are the US\$20 billion joint venture between Dow Chemicals and Saudi Aramco and the US\$12 billion Yanbu export refinery, a joint venture between Saudi Aramco and Chinese company Sinopec, both are expected to contribute to higher export revenues by adding value from domestic hydrocarbons processing and provide significant employment and training opportunities.

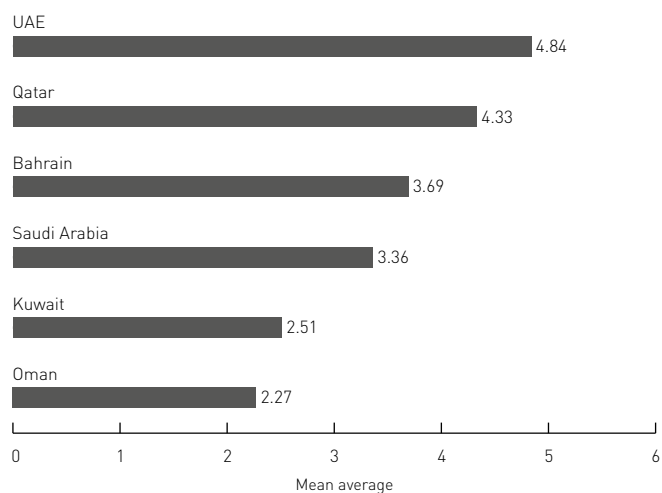
In Kuwait bank lending in the oil & gas sector is thought to provide favourable investment opportunities as more advanced technology is required to extract the country's heavy oil & sour gas. However, Kuwait is also considering mega-infrastructure projects such as the US\$10 billion National Railroad and the US\$7 billion Kuwait City Metro, which are currently undergoing feasibility studies.

Meanwhile in Bahrain, respondents thought banks would be most favourable toward the financial services sector (32%) as Bahrain has long focused on diversifying the economy away from its declining natural resources stock into presenting itself as a hub for Islamic finance and a gateway for businesses into Saudi Arabia and the wider Gulf region.

“Bahrain has been growing in the sectors of training, pharmaceuticals and financial services and the market will respond well to start-ups based on the systematic rules laid down by the government,” one survey respondent noted. Another said: “Bahrain is a location which offers a great amount of support to businesses to set up regional offices and distribution centers in most sectors.”

In the UAE, banks would be most willing to lend to the real estate sector (27%), particularly as Dubai prepares for the World Expo. In addition, respondents said the industrials & chemicals sector could attract credit (24%) as current projects such as the development of the ChemaWEyaat chemicals complex in Abu Dhabi's Western Region is set to spark growth in the sector, while respondents were equally confident (24%) about lending for the retail sector which is expanding in step with a growing consumer market in the Emirates. The increase of the UAE's retail sector also comes amid a number of foreign brands trying to enter the GCC markets, as the emirate is planning to build another mall – the world's largest.

**Which of the following countries will see the most foreign investment activity over the next 12 to 24 months? (Rank where 1=least activity and 6=most activity)**

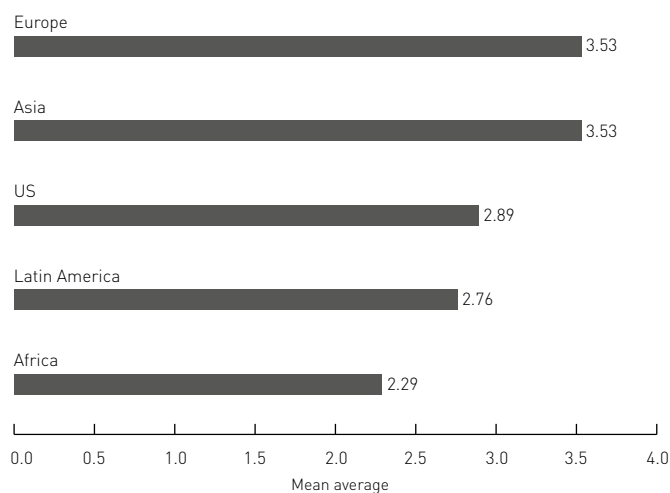


Respondents expect the UAE to receive the most attention from foreign investors over the coming year. For the GCC region as a whole, respondents project the largest inflow of investment to come from Europe and Asia. Respondents noted that trade policies and good inter-governmental relations with Asia will fuel these investments. “Asian companies will tie up with the large corporates in the GCC region; as the regulatory gates have been opened up and impact of taxation on the imports and exports have been reduced,” one respondent said. The UAE is Asia’s leading trade partner in the GCC, reaching a value of US\$75 billion in 2013.

“The retail sector is growing with European and other Asian businesses trying to float their products and tap the huge potential the GCC consumer market can offer to them,” another respondent said.

One respondent thought Saudi Arabian markets are among the fastest growing markets in the world: “...so the companies that are underperforming in Europe and US will seek solace in these markets and will try to acquire and invest more.”

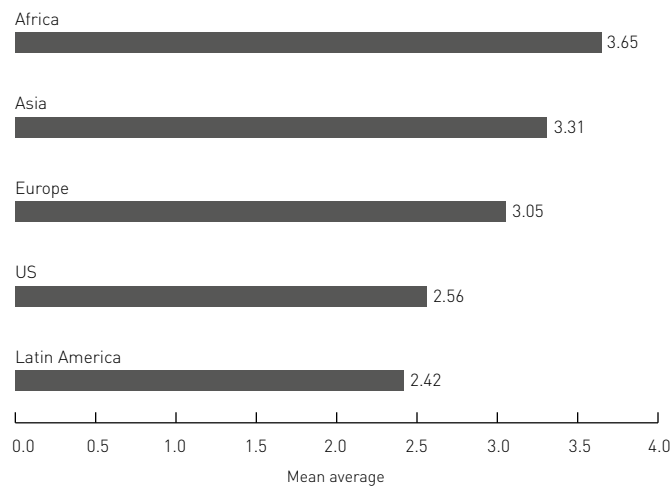
**Which of the following regions will make the most foreign investment activity into the GCC region in the next 12 to 24 months? (Rank where 1=least activity and 5=most activity)**



**“The GCC’s continued promising economic growth prospects from hydrocarbon sales, and more importantly, its growing non-oil based industries have made the region very appealing not only to its historical trading counterparts in Europe but to high-growth economies in Asia-Pacific.”**

**Scott Burrell, Managing Partner, Blake, Cassels & Graydon LLP**

**Which of the following regions will see the most inbound investment activity from the GCC region in the next 12 to 24 months? (Rank where 1=least activity and 5=most activity)**



Outbound flows will mostly focus on Africa, according to respondents' expectations. TMT remains a sector that is actively expanding on the African continent, with one of the recent announcements from March 2014 being the UAE's Etisalat considering a stake in Benin's mobile operator Libercom.

Europe is also under consideration as one respondent noted. "The European continent has businesses that are undervalued which can be considered as a valuable target and also there is scope for consolidation activities, which will be a driver for businesses in the GCC region."

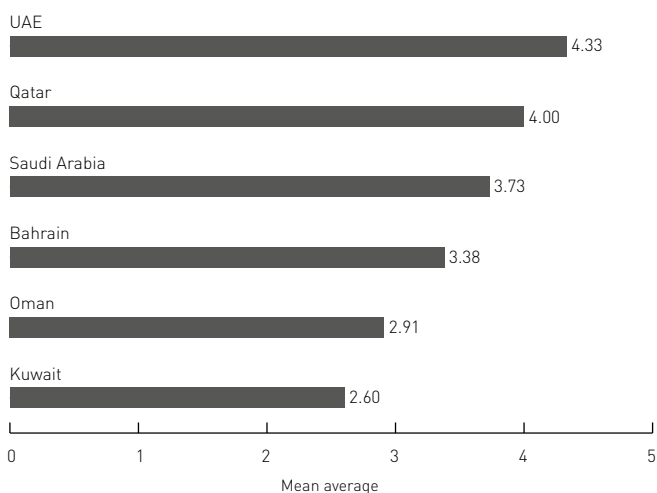
Many GCC companies are also continuing their investments in Asia's financial sector, with Malaysia's Islamic finance presenting an attractive target, and retail markets, which have benefited from the rapid extension of the GCC's aviation business with new flight routes into Asia.

**"Companies in the GCC have expanded their investment horizons to specific markets in Asia-Pacific, most notable of which is Malaysia, the world's largest Islamic bond market. The GCC's aviation industry is also growing by leaps and bounds as Dubai- and Qatar-based airlines are rapidly gaining market share over European and American carriers."**

**Tim Sunar, Partner, Blake, Cassels & Graydon LLP**

# Country focus

Which of the following countries will see the most intra-regional investment activity over the next 12 to 24 months? (Rank where 1=least activity and 6=most activity)

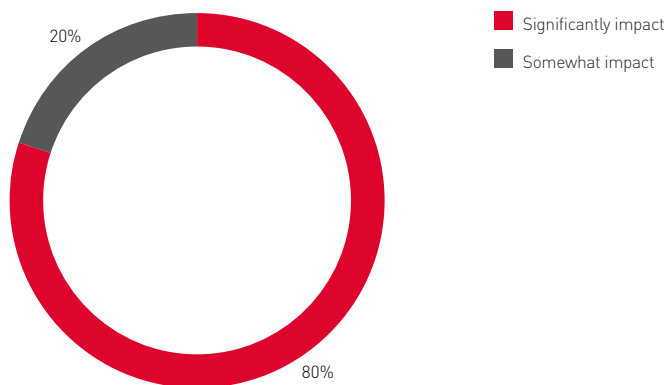


Foreign investors are also closely eyeing Qatar, where the FIFA World Cup 2022 and the government’s economic development program for 2030 will most likely result in increased lending for related sectors such as infrastructure (35%), transportation (24%) and real estate (15%), as well as tourism (7%).

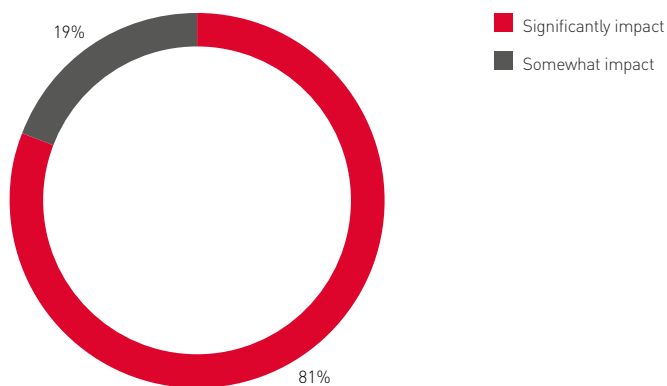
Meanwhile, respondents thought the UAE and Qatar would see the most intra-regional investment activity. This is mostly due to high growth and availability of capital in the UAE, and the expansion of sectors, such as airlines, tourism and financial services in Qatar. Qatar is also expected to present opportunities for expansion to established GCC companies as demand for services and materials is set to increase with preparations for the World Cup.

Respondents described infrastructure development related to the World Expo 2020 in Dubai and the World Cup in Qatar in 2022 as “game changers” that will impact significantly on the GCC region’s economic growth. In addition, the construction of the GCC rail link will considerably impact on investment activity in the region, 81% said, while only 19% projected a moderate impact on investment.

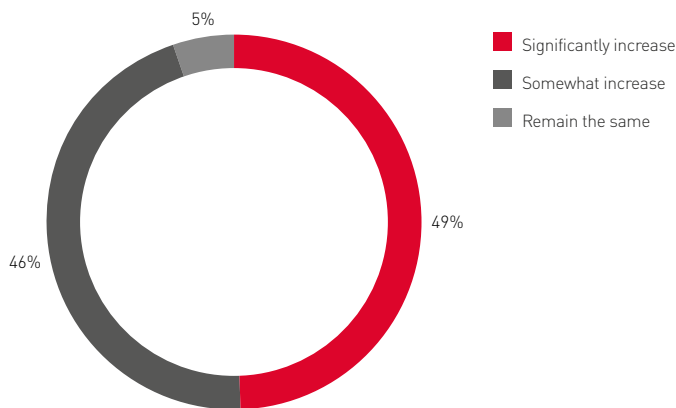
Dubai successfully bid to host the World Expo 2020 while Qatar is set to host the World Cup in 2022. How much do you think infrastructure development related to these events will positively impact economic growth in the GCC region?



The construction of a rail network linking GCC member states will soon begin. How much do you think the new network will positively impact investment activity in the GCC region?



**Saudi Arabia's stock market will allow foreign investors to trade in 2015. What do you expect to happen to the level of overseas investment into Saudi Arabia as a result of the opening up of the country's stock market to foreigners?**

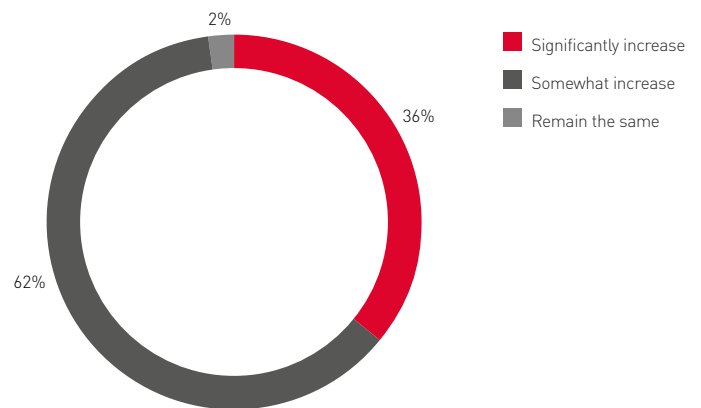


Opinions were divided over the impact of Saudi Arabia's stock market, Tadawul, which will allow foreigners to trade, starting sometime in 2015, leading to an eventual entry into the MSCI's global equity index. Forty-nine percent said overseas investment would increase significantly as a result, while 46% only saw a moderate increase of investment as a result, and 5% said there would be no impact. "The level of overseas investments into Saudi Arabia will significantly increase; the stock exchange, which is now open to foreign investors, will lay down opportunities for the foreign companies that are facing crisis in their domestic markets," one respondent said.

**"Although less publicized than elsewhere in the region, Saudi Arabia allows for 100% foreign ownership onshore, which has been a major driver of foreign investment, and coupled with the opening up of the Tadawul, will only make the region's most lucrative market more attractive."**

**Tim Sunar, Partner, Blake, Cassels & Graydon LLP**

**The UAE and Qatar were upgraded to emerging market status by MSCI. What do you expect to happen to the level of overseas investment into these two countries as a result of the upgrade?**

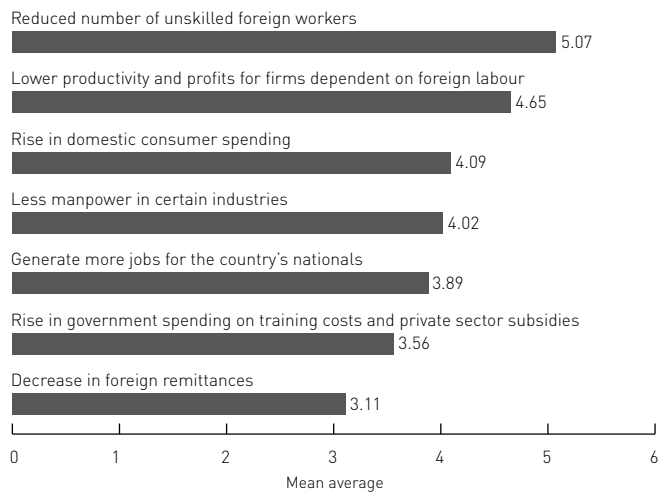


Respondents were lukewarm over the upgrade of the UAE and Qatar to emerging markets by MSCI and only 36% said investment from overseas would increase significantly as a result, and 62% said it would increase moderately.

**"Saudi Arabia's decision to open the Tadawul to foreign investment demonstrates the continued commitment of regional governments to legal and structural reforms that will facilitate the diversification of GCC economies, create high-value employment opportunities in the region, and allow local companies to compete on a global platform."**

**Graham McLeod, Partner, Blake, Cassels & Graydon LLP**

**Which of the following factors do you think will be the biggest impact from new Saudi Arabian labour laws? (Rank where 1=least impact and 7=most impact)**



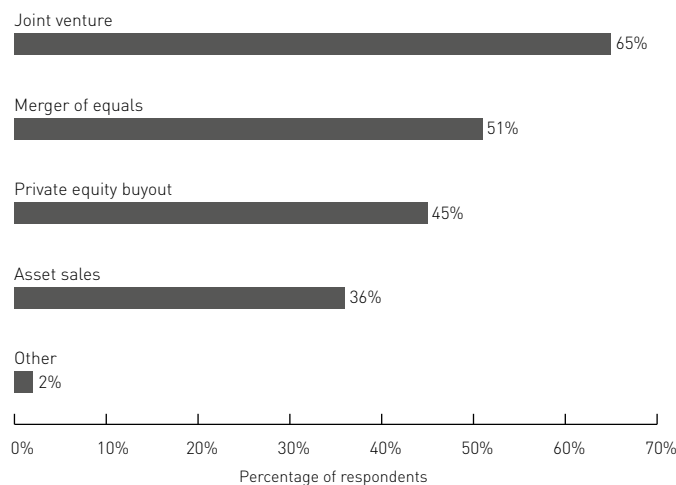
As Saudi Arabia grapples with high unemployment figures among its young population, new labour laws aimed at increasing local content and visa restrictions for foreign workers are expected to introduce new dynamics. Respondents said that the greatest impact from a change in labour laws will be most visible in a reduced number of unskilled foreign workers in the country and lower productivity and profits for firms dependent on foreign labour. Positive results would manifest in an expected rise in consumer spending with the employment of nationals and the concurrent decrease in the outflow of remittances.

**“Fiscal pressures have compelled the Saudi Arabian government to limit the flow of foreign labour and boost the number of nationals who work for private companies. The daunting challenge now is to create sufficient employment opportunities for the significant rise in young citizens who are entering the labour force. If accomplished, this will reduce the burden on the government, increase consumer consumption and lower the amount of remittances by foreign workers, all of which are bound to lift the country’s economy.”**  
**Michael Quigley, Partner, Blake, Cassels & Graydon LLP**



# Structure type

Which of the following deal structures do you expect to be the most common in the GCC region over the next 12 to 24 months? (Select the top two)

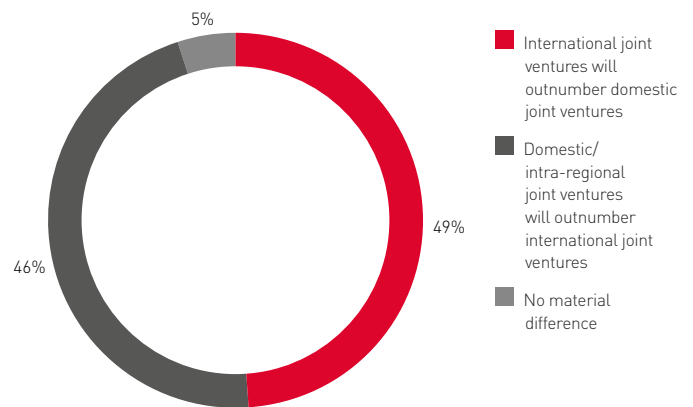


The majority of respondents (65%) think joint ventures will be the most common deal structure in the GCC region in the next 12 to 24 months, followed by a merger of equals deals. Private equity buyouts ranked as third most common deal structure expected by 45% respondents.

**“Joint ventures continue their predominance as the preferred deal structure for investment in the GCC, allowing for bespoke solutions that provide the necessary transparency and flexibility to suit the needs of domestic and international investors.”**

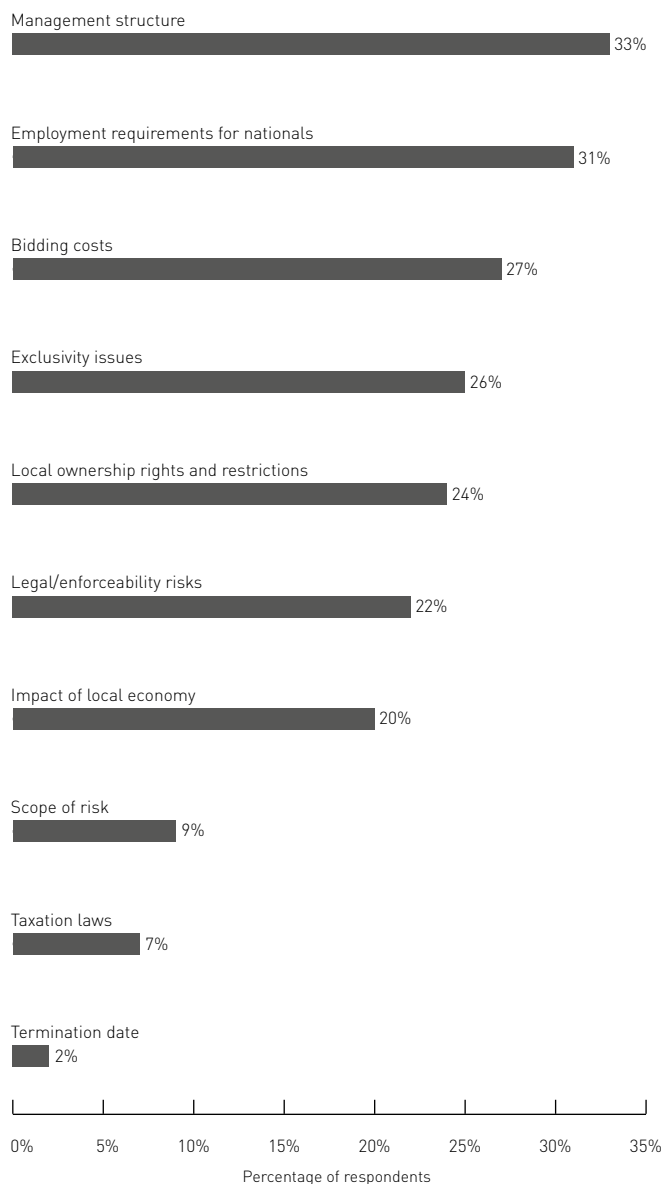
**Graham McLeod, Partner, Blake, Cassels & Graydon LLP**

How do you expect the volume of domestic/intra-regional joint ventures to compare to the volume of international joint ventures in the GCC region over the next 12 months?

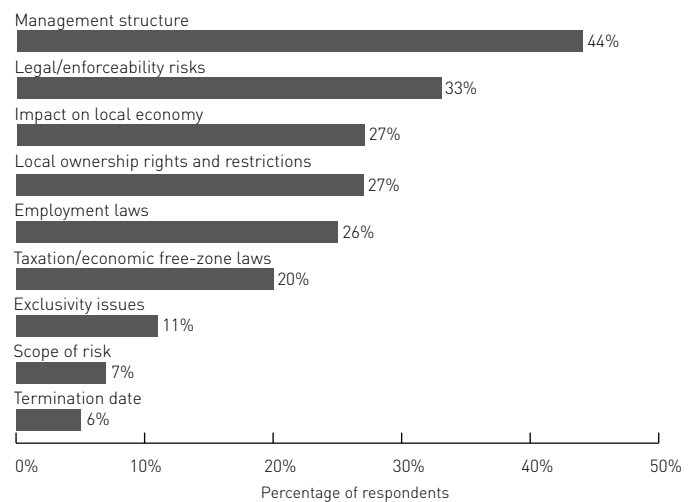


Forty-nine percent of respondents also think that international joint ventures will outnumber intra-regional ones, compared to 46% who think that domestic joint ventures will be more popular than international ones over the next 12 months. The expertise and technology of foreign venture partners is highly valued for GCC companies, which are well-capitalised but often lack skilled labour and advanced processes.

### What are the top two most important factors to non-GCC entities entering into joint ventures with GCC-based entities?



### What are the top two most important factors to GCC-based entities entering into joint ventures with non-GCC-based entities?

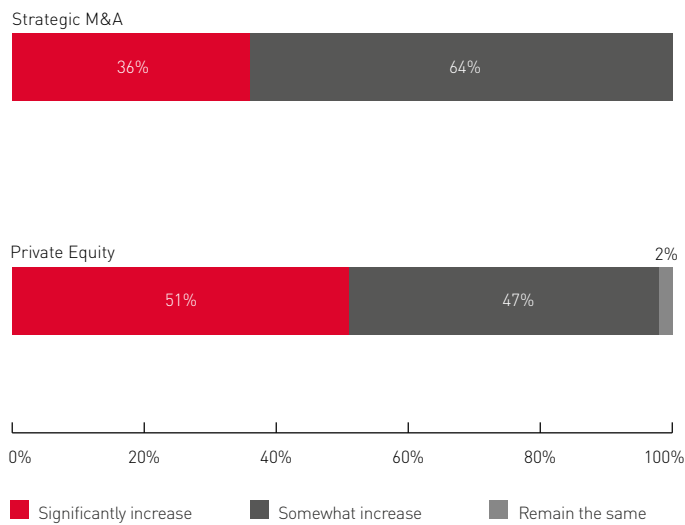


As the most important factors for foreign companies to enter into joint ventures with GCC-based companies, respondents cited management structure (how ventures are structured and managed at an executive level and how involved each party is in the venture) and employment requirements for nationals (local content requirements), whereas bidding costs were only ranked as third-most important.

Meanwhile, for GCC-based companies, management structure and legal/enforceability risks were the two most important factors to consider in joint ventures with foreign entities.

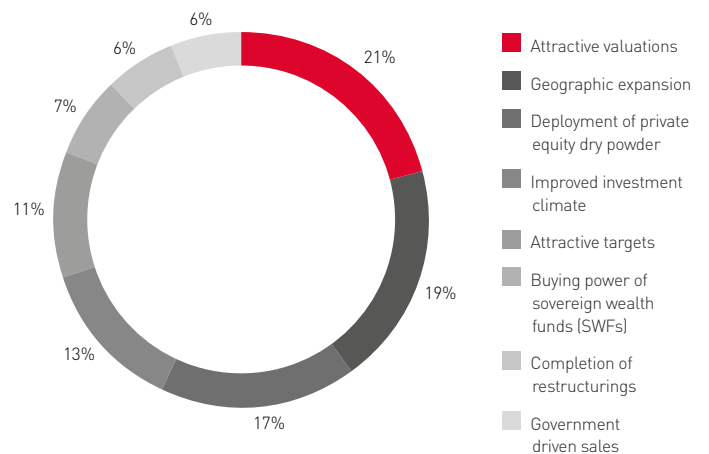
However, despite these potential concerns, World Bank ratings show that the commercial environment in five out of the six GCC countries is particularly conducive to companies looking to start and operate businesses. In the Ease of Doing business ranking, UAE (23), KSA (26), Bahrain (46), Oman (47) and Qatar (48) are all in the top 50 (out of 189 countries). Only Kuwait falls outside the top 100, positioned at number 104.

**What do you expect to happen to the overall level of strategic M&A and private equity activity in the GCC region over the next 12 months?**



Strategic M&A will increase significantly, according to 36% of respondents, while 64% thought it will increase moderately over the coming year. Respondents were more hopeful for an increase in private equity activity over the next 12 months, with 51% saying it will increase significantly and 47% saying it will increase somewhat, and 2% said it will remain at the same level.

**Which of the following drivers of M&A activity in the GCC region do you expect to be strongest over the next 12 months?**

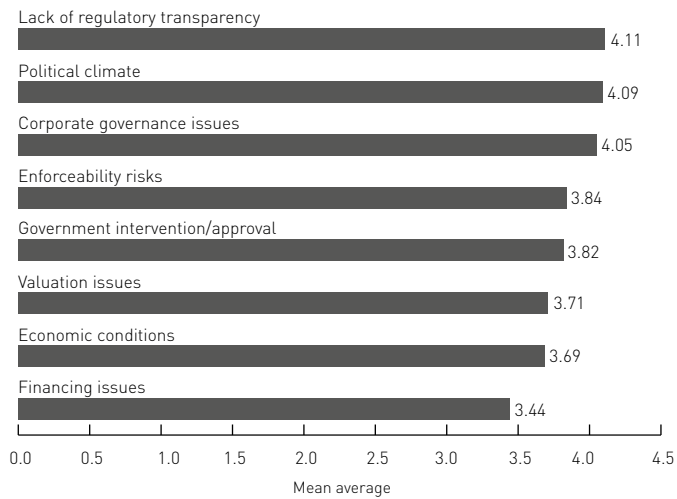


As the strongest drivers for M&A in the region, respondents named attractive valuations (21%), geographic expansion (19%) and the deployment of private equity dry powder (17%).

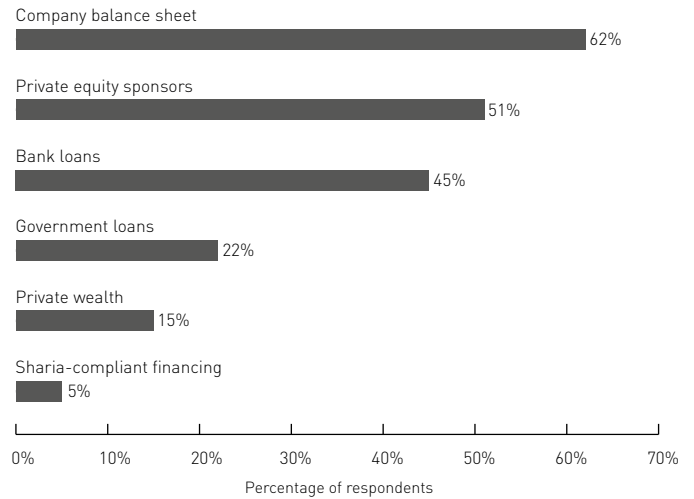
**“Despite the volatile conditions in the Middle East, sovereign wealth funds and private equity firms remain quite active in the GCC, drawn by the region’s economic growth, rising consumer demand and government spending. Given the strong financial markets, specifically in the UAE and Saudi Arabia, these firms are leading the way as assets managers that want to take advantage of high-yield opportunities that the GCC presents.”**

**Tim Sunar, Partner, Blake, Cassels & Graydon LLP**

**How likely is each of the following issues to negatively impact potential M&A activity in the GCC region? (Rate where 1=unlikely and 5=highly likely)**

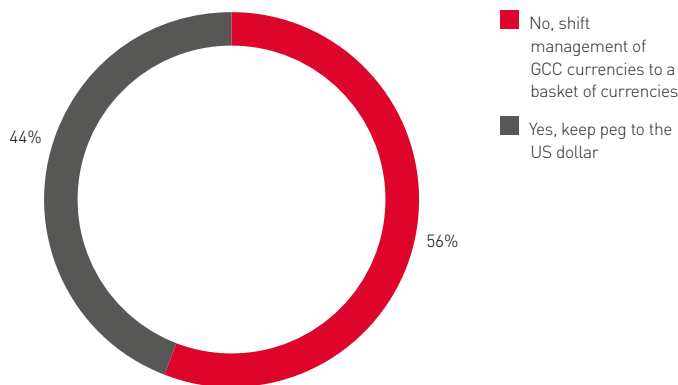


**Which of the following financing sources do you expect to be used most frequently for M&A transactions in the GCC region over the next 12 months? (Select the top two)**



Meanwhile, as the biggest obstacles to potential M&A respondents cited lack of regulatory transparency, political climate and corporate governance issues. Respondents were least troubled by potential financing issues and economic conditions. As the top two financing methods over the next 12 months, respondents listed company balance sheets and private equity sponsors, while ranking Sharia-compliant finance as the least frequent source for funding.

## Do you think GCC member states' currencies should be pegged to the US dollar?



As a common currency for the GCC remains on the agenda, however, without progress, notably 56% of respondents were still in favour of a shift from pegging GCC member states' currencies to the US dollar to a basket of currencies, while 44% believed currencies should remain pegged to the US dollar.

**“To reduce volatility, we are definitely better off with pegging GCC member states' currencies to a basket of currencies.”**

**Michael Quigley, Partner, Blake, Cassels & Graydon LLP**

**“Although the GCC's currency peg to the US dollar has arguably increased foreign investor demand, the US Federal Reserve's expected interest rate hike will most likely introduce volatility and consequently slow economic growth since the GCC has to undergo a similar rate rise. With the GCC's economies more advanced, the argument for the use of a multi-currency peg has become stronger as a stabilising force against inflation.”**

**Scott Burrell, Managing Partner, Blake, Cassels & Graydon LLP**

# Positioning the Region for more FDI

By Dr. Saud Al-Ammari

The Gulf Cooperation Council (GCC) region<sup>1</sup> is one of the world's most prominent economic zones. For example, the Kingdom of Saudi Arabia is the Arab World's largest economy, one of the world's 20 largest economies and the world's third fastest growing economy. Several decades ago, the region's countries realized that their economies were facing a dire challenge by being single-sourced and massively oil-dependent. In the 1970s, even before the creation of the GCC, each country took its own steps, at its own pace, towards diversifying the economy and building up on its previous experiences of opening up to Foreign Direct Investments (FDI). Saudi Arabia, for example, launched the Royal Commission for Jubail and Yanbu which successfully established what became two of the largest fully integrated industrial cities in the world. At the same time, the Kingdom instructed its oil giant, Saudi Aramco, to build the Master Gas System, which continues to grow and supply fuel and feedstock to the Kingdom's prominent petrochemical industry. The Kingdom also launched its Saudi Basic Industries Company (SABIC), which by attracting FDI and creating joint ventures became a world petrochemical industry giant. The creation of the GCC in 1981 provided an even greater opportunity for each country to grow by taking advantage of economic integration.

With oil prices fluctuating, sometimes sharply, and the world economy shaken and appearing vulnerable at times, in the East and West, the cusp of the 21st century witnessed further steps of economic diversification and more focus on attracting FDI in the GCC region. The results of such steps were more visible in Dubai of the United Arab Emirates, in Qatar and in Saudi Arabia. Despite the fact that FDI contribution to the overall GDP in the GCC countries hovers around 5%, it is being encouraged and welcomed for a whole lot of different, yet strategically important reasons. In addition to FDI helping in the area of economic diversification, the GCC countries are actively promoting it because it helps in creating new businesses in new economic sectors, it facilitates transfer of technology and know-how and it provides opportunities for job creation and development of human capital. The latter in particular is extremely vital for the GCC as some 60% of the population is below 25 years of age and are or about to be job market ready.

In 2000, Saudi Arabia took a major step in encouraging and welcoming FDI by establishing the Saudi Arabian General Investment Authority (SAGIA). SAGIA built on the Kingdom's record of previous successes in FDI attraction and work on further improving, simplifying and facilitating the related regulations and procedures to make sure that almost all sectors would be open to foreign ownership. Currently, Saudi Arabia is the only country in the region that allows 100% foreign ownership of an investment in almost all activities. Other Gulf States also adopted similar open investment regimes and pursued additional changes that provided a greater incentive for strategic investors to establish long-term presence.

The six GCC States undertook reforms that made it easier to start businesses and enforce contracts, building on tax regimes already highly attractive to foreign investors. In addition, they have all improved their legal systems, introduced new arbitration laws, established world class arbitration centers, created anti-corruption commissions and ensured fair and transparent mechanisms are in place to enforce awards and

judgments. Since then, Gulf States have risen inexorably up the World Bank's Ease of Doing business ranks, the UAE taking the lead with a global ranking of 23 while Saudi Arabia ranked 26 in 2013.

The results of these efforts were reflected in numbers. FDI in the six GCC states grew from US\$6.1 billion in 2003 to US\$60.1 billion in 2008, a tenfold increase. However, in recent years, the rate of FDI into the GCC has subsided — from US\$28 billion in 2012 to US\$24 billion last year, a fall of nearly 15%. The GCC's share of world FDI has dropped to 1.6%, compared to a high of 4.2% five years ago. Only Bahrain and the UAE have achieved four consecutive years of rising FDI inflows as investors returned to the property, manufacturing and services sectors.

Some of the decline can be explained by the lower risk appetite of foreign corporations in the wake of the global financial crisis, and the drying up of credit. Yet, a part of the decline may be explained by a shift in how Gulf governments think about foreign investment.

## Assessing the Impact

Since the mid-2000s, the surge in oil prices has largely replenished state finances, removing some of the pressure and haste under which the initial opening to foreign investors was considered. This gave the GCC States, and their relevant organizations, more time and space to mull over the approach to foreign investments. A new model became more prevalent and was adopted by investment authorities in the GCC countries, where organizations like SAGIA emphasized that interested foreign investors considering Saudi entry have to show serious intent to provide added value to the economy. This can come in the form of technology transfer, job creation, or establishing Saudi Arabia on a regional or global supply chain. Adoption of this recent and sensible line of thinking did not come abruptly. Figures show some startling facts about the concentration of FDI. In Saudi Arabia for example, 90% of FDI came from 3% of the licences, almost 40% of the licences are concentrated in very low quality activities confirming the notion that it is more of a residency and work permit convenience rather than a true investment.

In Saudi Arabia, the concentration of FDI in one or two mega projects, such as Japan's Sumitomo Chemicals joint venture with Saudi Aramco to build a multi-billion-dollar petrochemical plant on the Red Sea Coast, or Sadara, the joint venture between Saudi Aramco and the Dow Chemical in Jubail, the largest complex of its kind in the world, is expected because of the exceptional size of such projects which are intended to capture, for the Kingdom, the value-added from its pivotal position on the global hydrocarbons industry. Yet, while such ventures with global blue chip companies have drawn billions of dollars worth of investment into the kingdom's chemicals sector, they are expected, and from the looks of it are working towards further contributing to the national economy by supporting and jump-starting important sectors such as downstream industries, manufacturing by facilitating transfer of technology and, probably most importantly, by creating viable and sustainable jobs for nationals. Other major recent entries, like confectionery giant Mars' establishment of a US\$60 million manufacturing facility in King Abdullah Economic City (KAEC) near Rabigh, north of Jeddah, may make sense as a marketing and a

<sup>1</sup> Includes the Kingdom of Bahrain, the State of Kuwait, the State of Qatar, the Sultanate of Oman, the United Arab Emirates and the Kingdom of Saudi Arabia.



**Saud Al-Ammari**  
Chair, Saudi Arabia and Middle East  
**Dr. Saud Al-Ammari Law Firm in association  
with Blake, Cassels & Graydon LLP**

Telephone: +966-13-847-5050  
Email: saud.ammari@blakes.com

job-creating opportunity but may not necessarily create a new area of expertise which adds to the competitive advantage for the Kingdom.

### Competitive Advantage

There now appears to be some divergence among the GCC States from what were once homogenous hydrocarbon-based economies. However, at a broader level, the GCC has still not nurtured the emergence of a competitive industry or cluster. Most are individual disjointed investments that do not create a competitive advantage. Today, when you ask the question of what industry did any GCC State develop as a competitive advantage, the answer is regrettably nothing to report. Diversification means industry and manufacturing, sectors which the GCC is trying to develop. That will not happen unless an optimum environment is in place for diversification, including financial and regulatory initiatives. So, while the six GCC States are clearly on their journey to a post-oil future, creating a competitive advantage in one or more industries remains the most challenging undertaking for each GCC State. The race to the post-oil future is definitely on. How each country embraces a new economic, political and investment world order will determine who gets there first.

### On the Right Fast Track

The Kingdom of Saudi Arabia is serious about creating an investment climate that is more geared to attracting investors with something additional to offer the Kingdom. In May of this year, SAGIA, the foreign investment facilitating arm of Saudi Arabia, unveiled a fast-track process which has assured applying investors a response in six days, and involves only a few required documents. This system offers a faster application process if the investment involves a public company investing directly, or at least using the intellectual property of a public company. The aim is to attract firms committed to spreading the value chain across specifically targeted sectors such as transportation, healthcare, education and technology that are bringing in further associated investments.

### FDI: A Two-Way Street

At a deeper level, these changes reflect a wider paradigm shift that can be regarded as a second generation of the FDI effort, a kind of "Gulf FDI 2.0". While the first generation outreach was all about letting the world know the Gulf was open for business, there is now an increased recognition that more needs to be offered to attract and sustain quality investors.

For Saudi Arabia, at the heart of making sure the investments are creating the desired positive impact is the Kingdom's efforts to develop investment plans for its key economic sectors, with the aim of creating integrated competitive investments across the value chain. In addition to the traditional oil and gas and petrochemical downstream sectors, healthcare, transportation, information and communications technology, and education are all witnessing major transformations. With more than two trillion Saudi Riyals of capital expenditures, these sectors are ripe to emerge as truly competitive sectors and not merely sectors that are dependent on government spending. They represent themselves as great opportunities for long-term savvy investors. Putting this into a larger Gulf Region perspective, this means moving towards a menu of products, rather than repeating the mantra that they are great places to do business; offering structured packages to investors which can vary according to sector and according to

the investors. It is in this context that the recent Saudi investment modifications should be viewed.

The idea of clustered investments is also taking root. In King Abdullah Economic City (KAEC), for example, contracts were signed this year for three companies setting up in the city's Industrial Valley, which seek to capture opportunities in light manufacturing. A Saudi-German joint venture is establishing a plant to produce high-quality paints, while another is investing in a plant to manufacture aluminum windows and doors to service residential and commercial buildings. In Qatar, there has been a sustained effort to find a place in the global auto supply chain, having signed a memorandum of understanding in 2010 with German automakers Volkswagen and Porsche to set up an R&D facility in the Gulf State. The Qataris saw scope to turn the country into an international hub for the manufacture of innovative automotive components.

With such clusters, there is a greater opportunity to build a wider ecosystem for the local generation of ideas. This has already started in certain sectors, such as financial services, logistics, and transportation. Tapping FDI to accelerate the transition to a knowledge-based economy is now gaining traction as a theme, leading to the creation of products and services that are indigenous to the region but catalyzed by foreign investors.

### Leaping the Hurdles

Although clusters present a more distinct paradigm in which foreign investment entries can be structured, foreign companies still have sizeable challenges to overcome in the Gulf. Overcoming certain negative perceptions about the region – the difficult environment, lifestyle constraints and the need to employ unskilled and unsuited local workers – may be a leap too far for some less forward-thinking investors. For larger organizations, such as Dow and ExxonMobil, which have a core business tied closely to hydrocarbons, Saudi Arabia, and the rest of the GCC countries, is a more attractive proposition. What's more, the GCC States are far more stable than other locations in the region and the economic fundamentals remain appealing.

Companies mulling successful entries into the GCC will need to adopt a mindset that matches the evolutionary change in Gulf attitudes to FDI. Back in the early 2000s, the impetus was to establish a presence on the ground, and to go after the lowest hanging fruit. The entries then were more about understanding the market and making contacts. That stage has ended. Now, companies have a better understanding of what they can and can't achieve, and what is the best way to approach the market and make it profitable.

There is, generally, a greater willingness by foreign investors to lay down roots and invest in local talent. Such commitment has proven to be effective and a major ingredient for success for foreign investors who came to the region many decades ago. Companies that are able to engage local businesses and seek a partnership approach, rather than one driven by the need to make money and "take it home," may find a warmer reception in the GCC today. Visionary and bold investors should know that the days of quick wins may be over but long-term triumphs could lay ahead for the patient, dedicated and progressive.

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**For further information about this report and investment in the GCC region, please contact:**

**Saud Al-Ammari**  
**Chair, Saudi Arabia and Middle East**  
saud.ammari@blakes.com  
Al-Khobar: +966 13 847 5050 x9321  
Bahrain: +973 1715 1500

**Scott J. Burrell**  
**Managing Partner, Middle East Offices**  
scott.burrell@blakes.com  
Bahrain: +973 1715 1507  
Al-Khobar: +966 13 847 5050 x9323

**For further information about Blakes, please contact:**

**Brock Gibson**  
**Chair**  
brock.gibson@blakes.com  
Calgary: +1 403 260 9610

**Robert Granatstein**  
**Firm Managing Partner**  
robert.granatstein@blakes.com  
Toronto: +1 416 863 2748

**Mathieu Rompré**  
**Director, Communications and Marketing**  
mathieu.rompre@blakes.com  
Montreal: +1 514 982 5085

[www.blakes.com](http://www.blakes.com)



# GLOBAL OFFICES



## **MONTREAL**

600 de Maisonneuve Boulevard West  
Suite 2200  
Montréal QC H3A 3J2  
Canada  
Telephone: 514-982-4000  
Facsimile: 514-982-4099  
Email: montreal@blakes.com

## **CALGARY**

855 - 2nd Street S.W.  
Suite 3500, Bankers Hall East Tower  
Calgary AB T2P 4J8  
Canada  
Telephone: 403-260-9600  
Facsimile: 403-260-9700  
Email: calgary@blakes.com

## **LONDON**

23 College Hill  
5th Floor  
London EC4R 2RP  
England  
Telephone: +44-20-7429-3550  
Facsimile: +44-20-7429-3560  
Email: london@blakes.com

## **BEIJING**

7 Dong Sanhuan Zhonglu  
Suite 901, Office Tower A  
Beijing Fortune Plaza  
Chaoyang District  
Beijing 100020  
People's Republic of China  
Telephone: +86-10-6530-9010  
Facsimile: +86-10-6530-9008  
Email: beijing@blakes.com

## **OTTAWA**

340 Albert Street  
Suite 1750, Constitution Square, Tower 3  
Ottawa ON K1R 7Y6  
Canada  
Telephone: 613-788-2200  
Facsimile: 613-788-2247  
Email: ottawa@blakes.com

## **VANCOUVER**

595 Burrard Street  
P.O. Box 49314  
Suite 2600, Three Bentall Centre  
Vancouver BC V7X 1L3  
Canada  
Telephone: 604-631-3300  
Facsimile: 604-631-3309  
Email: vancouver@blakes.com

## **BAHRAIN**

Blake, Cassels & Graydon LLP  
in association with  
Dr. Saud Al-Ammari Law Firm  
5th Floor, GB Corp Tower  
Bahrain Financial Harbour  
P.O. Box 11005  
Manama  
Kingdom of Bahrain  
Telephone: +973-1715-1500  
Facsimile: +973-1710-4948  
Email: bahrain@blakes.com

## **SHANGHAI\***

1376 Nan Jing Xi Lu  
Suite 718, Shanghai Centre  
Shanghai 200040  
People's Republic of China  
Telephone: +86-10-6530-9010  
Facsimile: +86-10-6530-9008  
Email: beijing@blakes.com

## **TORONTO**

199 Bay Street  
Suite 4000, Commerce Court West  
Toronto ON M5L 1A9  
Canada  
Telephone: 416-863-2400  
Facsimile: 416-863-2653  
Email: toronto@blakes.com

## **NEW YORK**

Blake, Cassels & Graydon (U.S.) LLP  
126 East 56th Street  
Suite 1700, Tower 56  
New York NY 10022  
U.S.A.  
Telephone: 212-893-8200  
Facsimile: 212-829-4948  
Email: newyork@blakes.com

## **AL-KHOBAR\***

Dr. Saud Al-Ammari Law Firm  
in association with  
Blake, Cassels & Graydon LLP  
Apicorp Building  
P.O. Box 1404  
Al-Khobar 31952  
Kingdom of Saudi Arabia  
Telephone: +966-13-847-5050  
Facsimile: +966-13-847-5353  
Email: saud.ammari@blakes.com

\* Associated Office

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For more information, please contact:  
Erik Wickman  
Global Managing Director, Remark  
Tel: +1 212 686-3329



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[www.mergermarketgroup.com](http://www.mergermarketgroup.com)

330 Hudson St. FL 4  
New York, NY 10013  
USA

t: +1 212.686.5606  
f: +1 212.686.2664  
[sales.us@mergermarket.com](mailto:sales.us@mergermarket.com)

80 Strand  
London  
WC2R 0RL  
United Kingdom

t: +44 (0)20 7010 6324  
f: +44 (0)20 7010 6101  
[sales@mergermarket.com](mailto:sales@mergermarket.com)

Suite 2401-3  
Grand Millennium Plaza  
181 Queen's Road, Central  
Hong Kong

t: +852 2158 9700  
f: +852 2158 9701  
[sales.asia@mergermarket.com](mailto:sales.asia@mergermarket.com)

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