Bought up: Union National Bank was acquired by Abu Dhabi Commercial Bank

# THE GCC'S CONSOLIDATORY MOVE

*There have been a high number of mergers and acquisitions across the GCC region in recent years, with lower oil prices leading lenders to increasingly look to consolidation. John Everington reports.*

Consolidation levels in the banking sector in the six states of the Gulf Co-operation Council (GCC) – Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Bahrain, and Oman – have shown few signs of slowing in the past 18 months, as tighter economic conditions continue to press governments and lenders to scale down in often overbanked markets.

All six countries experienced merger activity in their banking sectors in 2019, as lower oil prices have forced governments to look for ways to cut cost and improve efficiencies across multiple economic sectors, including banking.

"Economies in the Gulf are continuing to look for efficiencies across all sectors, not just banks," says Nassib Ghobril, head of economic research and analysis at Byblos Bank. "Mergers and acquisitions [M&As] are not simple to implement, particularly within the banking sector, but I believe that authorities will still attempt to find areas where efficiency can be improved."

## SLOWING GROWTH

The GCC's finances remain under pressure following the collapse in crude oil prices in 2014. The International Monetary Fund (IMF) estimates the six-state bloc posted gross domestic product (GDP) growth of just 0.7% in 2019, compared with 2% in 2018. Before the collapse in oil prices this figure stood at 4%.

And while the region's banking sector remains in relatively good financial shape, the prospect of higher non-performing loan (NPL) levels make further M&A activity an attractive option for lenders.

"While GCC banks' capital buffers are expected to remain resilient at between 12% and 16% of assets, the ongoing wave of mergers from 2009 in the GCC will also help buffer the expected increases in non-performing loans," says Wissam Haddad, head of investment banking and real estate at Manama-based SICO.

"NPLs, lower interest rates and their accompanying lower profit margins, as well as slower loan growth, are all expected to further justify regional consolidation."

## GETTING COMPLICATED

Yet the flurry of mergers agreed in the past five years in the GCC region have – for the most part – occurred between domestic institutions with common shareholders, making deal making considerably easier than purely market-based transactions.

The continuation of such consolidation – attractive as it may be in financial terms – may be difficult to sustain in the future, as deal structures become more complicated.

"If you look at the shareholding structure of the banks involved in consolidation for the past five years, many of them had the same shareholders sitting on both sides of the table," says Mohamed Damak, senior director and sector lead for financial institutions in the Middle East and Africa at S&P Global.

"Yes, the economic environment has contributed to accelerating discussions, but another lens to use is that shareholders have different assets and have come to the conclusion that by regrouping some of those assets they can enhance efficiencies."

## UAE CONSOLIDATION

The clearest examples of the regrouping of banking assets in 2019 came in the UAE, with deal activity among the biggest banks in the two largest emirates of Abu Dhabi and Dubai.

The largest deal of the year across the Middle East and Africa region as a whole was the merger between Abu Dhabi Commercial Bank (ADCB), Abu Dhabi's second largest lender by assets, and Union National Bank (UNB) and Al Hilal Bank, which was formally completed in May. All three banks have a common shareholder in the Abu Dhabi Investment Council.

The deal, first announced in September 2018, created another banking powerhouse in the UAE, with about $115bn of assets, making it the country's third largest lender. The newly merged entity combines the strong retail and corporate offerings of ADCB and UNB with Al Hilal's strength in the burgeoning Islamic finance market, and accounts for about 21% of the country's total loan market. UNB's business is to be incorporated into that of ADCB, with UNB dissolved as a legal entity, while Al Hilal will retain its existing identity.

A tie-up involving ADCB and other banks had long been expected, following the start of consolidation in Abu Dhabi's banking sector in 2017 with the coming together of First National Bank and National Bank of Abu Dhabi to form FNB, the UAE's largest bank by assets.

The ADCB deal was followed by a similar deal in Dubai, when Dubai Islamic Bank (DIB), the emirate's second largest lender, agreed a merger in December 2019 with smaller rival Noor Bank. Once again, the deal's progress was made easier by the fact that Dubai's sovereign investment group, Investment Corp of Dubai (ICD), was a common shareholder in both DIB and Noor.

This merger creates an Islamic finance giant in the GCC region, with about $75bn-worth of sharia-compliant assets, and taps into growing demand for sharia-compliant financial services across the region.

"Islamic banking has been a growth area for the past 10 years, with most GCC countries trying to build their Islamic financing capabilities and create domestic Islamic finance hubs," said Fitch Ratings in a research note. "However, in an overbanked region, some of the newer franchises have struggled to find good growth opportunities and attract cheap and stable deposits, given the strength of existing competition."

**SAUDI JOINS THE PARTY**

Saudi Arabia, meanwhile, has seen its first banking merger in more than 20 years with the completion of the union between Alawwal Bank, the country's oldest lender, and the Saudi British Bank (SABB). The deal – which creates the country's third largest by assets – saw SABB's shareholders take 73% of the shares in the newly created entity, with Alawwal's shareholders owning the remaining 27%. All of Alawwal's assets and liabilities will be transferred to SABB.

Merger talks between the two entities began in 2017, with the deal only completed in June 2019, reflecting the relatively untested regulatory environment for bank mergers in the country.

Perhaps more significant than the SABB-Alawwal merger was the breaking off of merger talks in December 2019 between National Commercial Bank, Saudi Arabia's largest lender, and Riyad Bank, the fourth largest.

The coming together of the two entities, which was first floated in December 2018, would have created a $180bn mega-bank with a 30% domestic market share, according to Moody's. The omens for the deal were good, with both institutions counting Saudi Arabia's Public Investment Fund and pension fund General Organisation for Social Insurance as shareholders. No reason has been given for the ending of talks.

Qatar, meanwhile, marked its first ever bank merger in April 2019, with the completion of a union between International Bank of Qatar and Barwa Bank. Qatar is one of the most heavily banked markets in the GCC region, with 18 banks serving a population of less than 3 million as of December 2018.

The deal creates the country's third largest Islamic bank and the sixth biggest financial institution in the country. The merger between the two banks came a year after plans for a three-way merger – including Masraf Al Rayan – were called off.

**OMAN'S ACTIVITY**

Of particular significance in the past 18 months has been bank mergers in Oman and Bahrain, the two Gulf economies feeling the greatest impact of ongoing low oil prices.

Oman's economy was the worst performer in the GCC in 2019, with the IMF estimating zero growth for the year. The fund estimates the country's debt rose to 59.9% of GDP in 2019, compared with just 4.9% in 2014.

Oman Arab Bank (OAB) and Alizz Bank began discussing a merger in 2019, with Alizz's board approving a share swap ratio in January that would give OAB about 81% control of the merged entity to its shareholders. This move will create the third largest Islamic financial institution in Oman behind Bank Muscat and Bank Nizwa.

"The merger would provide OAB with a larger Islamic franchise and market share, allowing it to increase its interest income and enhance its deposit-gathering ability," said Moody's in a research note in January. "Alizz would continue to operate as an Islamic bank with management autonomy, which would likely help preserve Alizz's existing customer base."

The deal comes after merger talks between Bank Dhofar, Oman's second largest lender, and its smaller rival National Bank of Oman came to an end in March 2019, after the parties failed to agree terms.

Yet the challenges facing Oman's economy suggest that further consolidation is on the cards. "Depending on how much »

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cross-ownership there is in the Omani banking sector, [the OAB-Alizz merger] is not likely to be the last," says SICO's Mr Haddad.

**BAHRAIN'S PRECARIOUS POSITION**

While Bahrain's economy grew slightly more than Oman's in 2019 – by 2% according to the IMF – the country's debt situation is even more strained, with a debt-to-GDP ratio of 101.7% at the end of 2019.

Once acting as the original banking hub of the Gulf region, Bahrain's banking sector looks ripe for consolidation as the country implements a challenging fiscal reform programme (see article on page 66).

In January, Bahrain Islamic Bank accepted an offer from the National Bank of Bahrain (NBB) to raise its shareholding in the sharia-compliant lender from 29% to 78.8%, in a bid to take advantage of growing demand for Islamic banking services in the country, even though the two banks will continue to operate independently of one another.

**ACROSS BORDERS**

Also in January, shareholders of Kuwait Finance House (KFH), Kuwait's second largest bank and its largest Islamic financial institution, announced their approval of a bid to acquire fellow Islamic bank Ahli United Bank (AUB) of Bahrain, which, in addition to its Manama-based operations, boasts shareholdings in banks in Egypt, Libya, Iraq, Kuwait and Oman, together with an office in the Dubai International Financial Centre. The merger is particularly significant for AUB's Kuwait operation, which contributes about 40% of AUB's loan book.

When completed, the deal – one of the first cross-border transactions in the GCC region – will create an Islamic superbank around the same size as Dubai Islamic Bank, creating another rival to the region's largest Islamic bank, Al Rajhi.

Yet even as the pace of consolidation hots up, the prospect for further cross-border deals remains small going forward. "Cross-border consolidation is very complicated; this is the first for Bahrain and it is subject to strict regulatory approvals," says Mr Haddad. "We do not believe this will be a trend without solid cross-shareholdings before a deal is struck."

The pace of consolidation in the wider Middle East region beyond the Gulf remains glacial by comparison. In November, the Jerusalem Contribution Tribunal cleared the way for the merger of Mizrahi Tefahot Bank, Israel's third largest bank, with sixth placed Union Bank, overriding a ruling from the country's Competition Authority in May 2018 that had blocked the deal.

In Egypt, Lebanese lender Bank Audi's Egyptian subsidiary struck a deal in May 2019 to acquire the Egypt-based banking operations of the National Bank of Greece, consisting of 17 branches.

**LEBANON CRISIS**

Although it is outside of the GCC region, the political and economic crisis in Lebanon that erupted in October 2019 has called into question the health of the country's banking sector, leading to calls for consolidation. Concerns are rising for the sector amid fears that Lebanon could default on its debts for the first time in its history, with a $1.2bn Eurobond due on March 9.

"There are 49 commercial banks in Lebanon, and the central bank has been calling for smaller banks to join together to be able to better compete with larger and medium-sized banks, but that hasn't happened so far," says Mr Ghobril at Byblos Bank. "Given the crisis the economy is going through, it is normal for the subject to come up again."

In November 2019, Lebanon's central bank instructed the country's financial institutions to raise their capital levels by 20% in a bid to boost liquidity by attracting dollars from abroad.

"If the crisis continues it might prompt some banks to explore M&A options, but for the moment it is too early to say," said Mr Ghobril. "The priority for banks for the moment is to manage the ongoing liquidity crisis within the financial system."

**MORE OF THE SAME**

Looking ahead to 2020 and beyond, the economic drivers of the GCC region's banking mergers are set to remain as entrenched as ever, suggesting that consolidation levels will continue at a similar pace.

Yet such a trend is not a given, as many of the simpler consolidation deals – involving banks with common shareholders – are either completed or well under way, according to S&P Global's Mr Damak. "I think most of the [straightforward] deals in the banking space have happened already and there will be fewer transactions in the next year or two," he says.

What could change the equation would be a further deterioration caused by a significant geopolitical shock or a further sharp deterioration in the price of oil, he adds, saying: "If we were to see a significant deterioration in economic conditions, we might see a new wave of acquisitions that are motivated by pure economic reasons."

Banks and governments of the region and beyond will surely be hoping that the situation does not come to that any time soon. TB