M&A activity in the MENA region: a new period of self-discovery

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The Middle East and Africa are core areas for TMT transactions in the next 2-3 years, with potential deals being discussed among the investment community. The next stage of market development is to consolidate gains by leveraging synergies and operational efficiency and, to achieve such goals, three key corporate activities are required: defining strategic footprint; starting small, then expanding; buying capabilities instead of assets.

Following a dry spell of M&A activity in 2009, operators have caught up and are now ready for a new wave of growth. The Middle East and Africa are core areas for TMT transactions this year, with assets worth between US$25bn-US$30bn being considered for sale in the region alone. Potential deals that are being discussed among the investment community in MENA include Zain Africa, Orascom Algeria, Meditel Morocco, Korek Telecom, and the infrastructure and tower assets of Zain Africa, MTN, Cell C, Millicom and Saudi Telecom Corp. There are also the potential privatisations of Turk Telecom and Batelco.

The availability of attractive targets is thanks to market consolidation and government privatisation programmes, combined with the presence of buyers with cash-rich balance sheets – which is conducive to a new phase of M&A, but with more well-defined strategic objectives and more prudent investment principles.

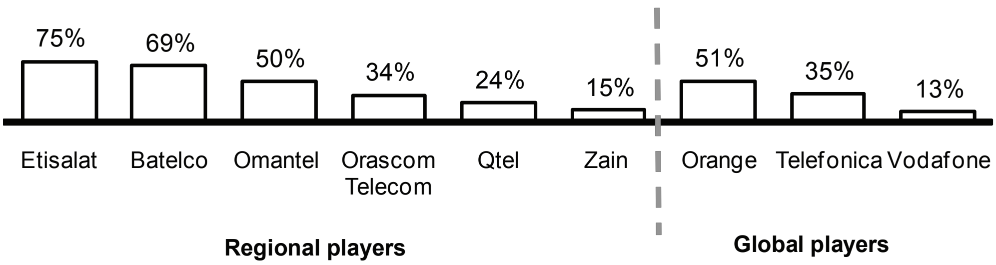
The last wave of M&A activity focused on acquiring operations in growing markets in the region and beyond. Corporate strategy was geared towards creating the largest possible footprint and joining the ranks of the top global companies through market capitalisation. Unrealistic acquisition valuations were based on planned operational and strategic synergies, which were never achieved.

It should be noted that several operators did succeed in making acquisitions that created value for their shareholders. But two objectives of the acquisition activity have generally remained elusive:

- The sought-after diversification of revenues has not been achieved, as home markets still constitute the largest source of revenue. Telecom groups in the region have ownership in a relatively large number of operations, but the revenue contribution of these operations is significantly smaller than that of their global counterparts;

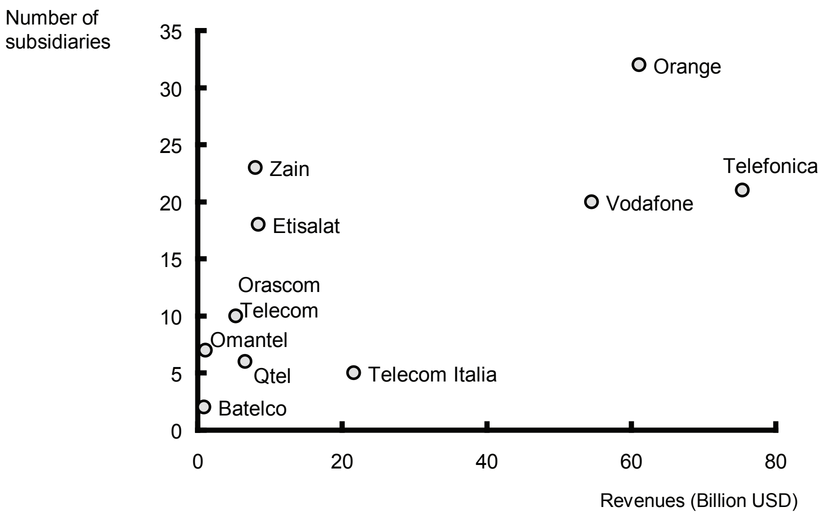
- Cost and revenue synergies have not been exploited, partly due to the large number of acquisitions in a short period of time and the diversity of the target markets.

Revenue contribution of home markets



Source: Operator's website

Revenue contribution by number of country operations



Source: Operator's website

Zain was able to diversify its revenues with a large number of acquisitions, but its average revenue contribution per subsidiary is below that of its peers. Orascom Telecom succeeded in diversification and growth by acquiring a small number of subsidiaries that make a large revenue contribution to the group. Orascom Algeria, for example, contributed 38% of group revenues in 2008.

The next stage of market development is to consolidate gains by leveraging synergies and achieving operational efficiency. New trends in M&A activity are taking place to support this, with more focus on making strategic acquisitions and leveraging them to achieve synergies and develop capabilities.

Three key corporate activities are important in achieving these goals.

Defining strategic footprint

While acquisitions during the economic boom were part of aggressive expansion plans, the current phase of consolidating gains and streamlining operations will be more focused on either making acquisitions of a strategic importance, or on the opportunistic acquisition of assets as a medium- to long-term investment vehicle. Possible strategic objectives for acquisition include the diversification and growth of revenues, setting up a regional "single network" operation, leveraging regional critical mass to set up content creation activities, or acquiring an operation from which significant knowledge transfer can be achieved. Opportunistic investment acquisitions should be developed with a clear timeline for investment, and a clear target price for exiting.

In both these cases, the acquisition activity should be driven by top-level corporate strategy, setting both growth plans and prudent investment principles.

Capturing synergies: start small, then expand

Synergies have traditionally been difficult to capture, for both human and technical reasons. Differences in company culture, an overly optimistic assessment of synergies, and leadership struggles are common human causes. Technical problems lie in the complexity of setting up common platforms due to legacy systems and skill sets available within the organisation.

To counterbalance these effects, corporations should set up group-level working teams, with the leadership of empowered programme managers and the participation of their counterparts in local subsidiaries. Priority initiatives that should take place at the group level include:

- Network optimisation and energy saving initiatives: group-level best practices should be established and adopted by all subsidiaries;
- Procurement: cost savings can be achieved by setting up lists for global preferred vendors that provide scale discounts to all subsidiaries;
- IT infrastructure: long-term cost savings can be achieved by using common IT platforms, and establishing group-level IT governance guidelines;
- Billing systems: common (or at least interoperable) billing systems are an important step towards delivering a "one network" experience across all subsidiaries.

Huge potential bottom-line savings can be achieved in the short term by simply setting up the proper group-level organisation necessary to identify and establish group-level best practices across the different disciplines.

This is ideally achieved through setting up a working group for compiling best practices, and then performing a gradual rollout, where pilot countries would be selected prior to full scale group-level rollout.

Buying capabilities, not assets

In addition to defining the right footprint, the next wave of acquisitions will aim to grow capabilities in other revenue-generating services. Hence, another focus will be on acquiring capabilities in technology, content, and innovation.

On the technology side, partnerships have emerged in the development of IPTV technology, with Etisalat announcing its acquisition of a share in an IPTV technology developer. Further activity is expected as IPTV technology matures in the region, and popular platforms emerge.

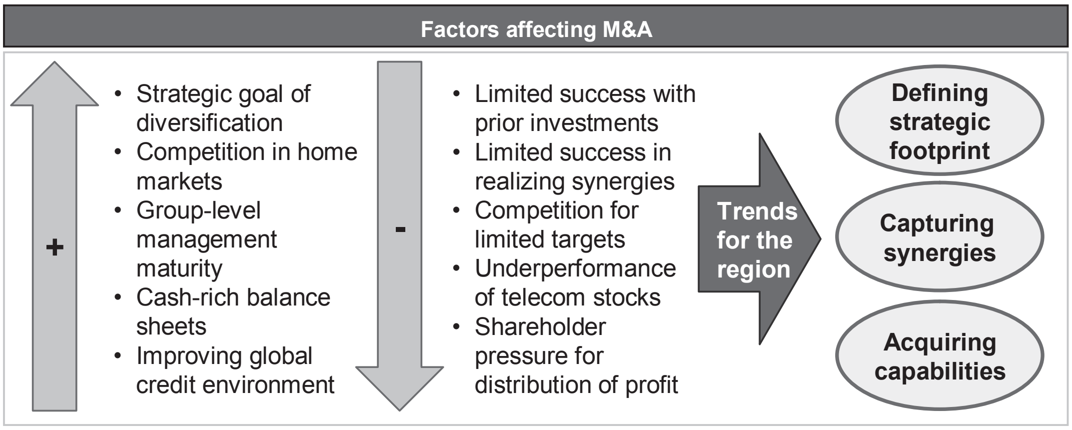
The acquisition of media content providers and producers has been limited, understandably, in light of the low uptake of IPTV and mobile TV in the region. This trend may change if regional operators develop a business model capable of achieving the critical mass required for amortising the cost of content production and sports rights. Etisalat has taken the lead on this with its purchase of exclusive mobile media rights for the UFL (UAE football league). Orascom Telecom has also ventured into this area, looking to capitalise on the opportunity to deliver popular sports content with the set-up of OTV as a popular satellite TV channel. However, there is no convergence in sight between Orascom's telecom and media platforms.

The development and monetisation of Internet content has also been limited, despite ownership of the content delivery means. Opportunities to develop Internet content platforms, such as portals and e-commerce platforms, or use the operator's marketing edge for launching the services, have not been exploited. Opportunities for the delivery and monetisation of local media content over the Internet are also not exploited. The commoditisation of access services and the gradual increase in user and device sophistication opens an opportunity for leveraging the untapped VAS revenue stream.

Acquisitions and investments are required to capture the opportunity in content services and seize a first mover advantage.

Further horizontal diversification opportunities in sectors such as banking and utilities are yet to be explored in the region, as the operators develop and test the delivery model of these services.

Drivers for M&A activity in the MENA region



Conclusion

M&A activity is likely to pick up significantly in the next few months, with several high-profile deals already in the pipeline. Following a peak of M&A activity in 2008, operators are now focused on divesting non-core assets and defining their strategic footprint. Having made the acquisitions, they are also focused on achieving synergies and generating value out of group-level activities, such as cost savings and common branding. There is evidence of some partnership in telecom-related services such as content (media and Internet), but M&A activity is limited on this front. This may change as operators are squeezed on access services and seek to capture opportunities in other value-added services.

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