New opportunities for Arab investors in the context of Foreign Direct Investment (FDI) regulations

FDIs enable investors to expedite industrialization within their local economies while simultaneously broadening a firm's consumer base and prompting the transfer of technical and intellectual expertise to their given local economies. Thus, enabling firms and their economies to remain relevant and competitive on a global scale.

Nonetheless, FDIs have come under increasing political scrutiny due to both national security and political interests across the EU, which has become particularly noticeable during the last two years, with many countries expanding the scope of their FDI regimes, while other countries introduced FDI screening mechanisms for the first time. Germany has been at the forefront of these developments, with several revisions to its regime over the last two years. The most recent anticipated draft revision of the German Foreign Trade and Payments Ordinance (AWV) published on the 22nd of January 2021 by the German Federal Ministry for Economic Affairs and Energy (MOE), is expected to further expand and align the scope of review for FDIs to more closely match that of the EU Screening Regulations and fundamentally provide more control to German national and economic interests.

Foreign investors will require FDI experts, such as legal, financial, and M&A advisors to understand the new FDI regulations and how these new regulations can benefit Arab investors, while simultaneously avoiding disruption, maximizing synergies, achieving technological development and integration, and ultimately secure liquidity.

Mergers and Acquisitions (M&A) within Germany

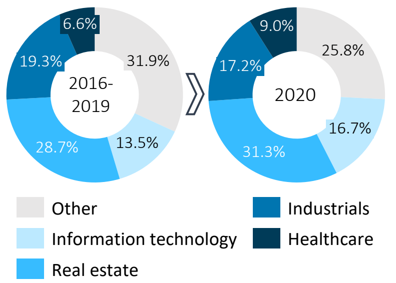
Overall M&A deal volumes are down 20.7% year on year (Q1-Q3 2019 through to Q1-Q3 2020) across Europe, given the Covid-19 pandemic side effects. However, M&A activity within Germany has increased over the same time period by 71.1% in volume, despite the deal count being rather low. This growth was predominantly driven by M&A's in the tech and healthcare segment, financial sponsors, and corporate carve-out activities, which unsurprisingly embody the underlying repercussions of the Covid-19 pandemic.

Furthermore, several analysts continue to see significant upside potential with regard to German stocks, as the average broker target price upside has recently increased from 5.6% in 2019. Germany's stock market performance and inbound M&A activity remains resilient given the prevailing market conditions and even outperforming core European members such as Spain, France, and Italy.

The targets of these inbound transactions are predominantly small and medium-sized companies. This so-called "Mittelstand" encompasses more than 99% of all firms in Germany and accounts for more than half of Germany's economic output and almost 60% of its jobs.

In addition to a variety of investment options, Private Equity (PE) Funds provide a suitable deal source to obtain significant exposure to the German Mittelstand. Given small companies often do not compile extensive reporting figures, PE Funds specialize in conducting an accurate due diligence, providing relevant information for potential investors, and forecasting potential revenue streams and exit opportunities. In addition, co-investments can be made in collaboration with a PE Fund, as illustrated by Abu Dhabi operating in conjunction with the PE Funds Triton as well as EQT.

German tech and healthcare M&A has significantly increased their market share

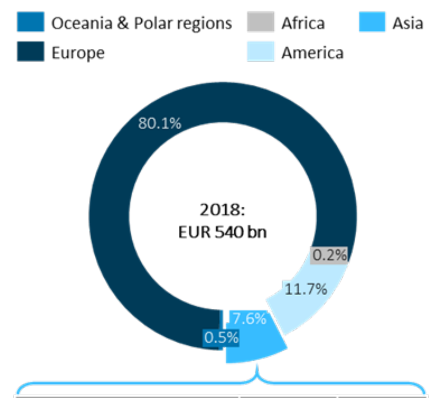


Source: S&P Capital IQ, as of November 27, 2020; Acuris, Mergermarket.

Nevertheless, even given Germany's durable economy and technological prowess, FDIs into Germany from countries outside of Europe have remained historically low, with Arab investors only accounting for roughly 1% of all inbound investments into Germany.

Historical FDIs into Germany

Furthermore, FDIs originating from Other Asian countries have come under increasing scrutiny due to national security and political concerns, thus enabling Arab investors the opportunity to become preferred bidders within the German market.



Thereof:	In EUR bn	of total FDI
Near and Middle East countries	3.9	0.7%
Kuwait	0.1	0.0%
Qatar	3.0	0.6%
United Arab Emirates	0.2	0.0%
Other Asian countries	37.2	6.9%
Asia Total	41.1	7.6%

Source: Deutsche Bundesbank, "Direct investment statistics", April 2020.

National security and political concerns

While political interference within Germany's M&A market was rather minimal prior to 2016, the environment abruptly transformed after two noteworthy transactions in 2016. Firstly, the United States intervened rather substantially by blocking China's Fujian acquisition attempt of Aixtron (semiconductor supplier) and secondly, China's Midea approved acquisition of Kuka (robotics manufacture). Both transactions involved the United States and German regulators, with a serious debate over the German technological prowess ensuing.

The uptick in FDI reviews within Germany is only expected to increase further, as the newly revised draft of the AWV is expected to broaden the scope of review to include 16 additional critical fields on top of the current 11 critical fields (27 in total) already covered under the cross sectoral-review.

The revised draft AWV also proposes several additions to sector-specific reviews (in essence defense and crypto technology fields) to cover a broader range of industries and clarifies the possibility of switching between both review schemes. The draft further proposes broadening procedural matters in order to better incorporate cross-sectoral and sector-specific reviews. All this may ultimately result in longer review durations, as even the MOE expects FDI reviews to increase by 96% in 2021.

Impact on foreign investors, a bidder's perspective

Transaction execution will fundamentally change for foreign investors as (I) FDI reviews will become more of a public opinion battle, (II) investors may require a high degree of flexibility to alter the transaction structure if necessary, (III) transaction documents may have to address potential IP and data concerns, (IV) targets may exhibit an upper hand in negotiations and (V) new opportunities may arise for bidders from Arab regions.

In order to address points (I), (II), and (III), investors may be required to hire professional PR advisors and FDI experts to brief stakeholders and investors on transaction-related issues, specifically, discussing items of potential controversy with interested government agencies. Thus, setting up early communication channels with German regulators will be vital to streamlining any future FDI's. Other issues that may need to be addressed by FDI experts include mitigation measures such as ring-fencing, enacting limitations on IP transfers, assistance with both national security and legislative concerns, as well as the implementation of pre-emptive remedial measures prior to the transaction announcement.

Additionally, FDI experts, such as legal, financial, and M&A advisors may assist with points (IV) and (V), with target support for the FDI review process, especially in circumstances involving the Committee on Foreign Investment in the United States (CFIUS), with regards to certain cross-border transactions.

Lastly, given regulatory implications and hurdles, Chinese bidders remain "critical candidates", and may not be able to invest in certain companies, thus providing opportunities for Arab investors to become preferred bidders or even a white knight within the German market.

Conclusion

In conclusion, FDI investments into Germany remain highly attractive for Arab investors, nonetheless, the changing political landscape will require a significant degree of expertise and due diligence in order to avoid transaction disruption, maximize synergies, achieve technological development and integration, and ultimately secure liquidity.

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