Amazon of Arabia: Jeff Bezos' Giant Buys Souq in a Move to Enter the Middle East Market

Amazon.com (NASDAQ: AMZN) — market cap as of 31/03/2017: $423.03bn

Introduction

On March 28, 2017, American electronic e-commerce and cloud computing company Amazon.com announced its acquisition of Dubai-based Souq.com, in a move that is expected to bring a significant impact on the Middle East's small but fast-growing e-commerce sector. According to people familiar with the deal, Amazon payed c. \$650-\$750m for Souq's operations.

Rather than entering the Middle East on its own, Amazon chose to secure Souq's existing customer base and infrastructure. The combination of the target's regional footprint with Amazon's expertise is expected to favourably position the U.S giant to capture the fast-growing Middle Eastern e-commerce market.

About Amazon.com

Headquartered in Seattle (USA), Amazon is the world's largest online shopping retailer, operating in 189 countries and employing more than 341.000 people across 5 continents. The company, listed on the Nasdaq, was founded in 1994 by Jeff Bezos, who to this date is the CEO and President.

The online retailer behemoth aims at being the world's most "customer-centric company", offering its products through different platforms better and faster than competitors. The corporation delivers innovation across its multiple businesses, ranging from drone delivery system to manufacturing of electronic devices. Among the recent innovations introduced, it is worth mentioning "Amazon Prime Now" - a service which allows customers to buy products and have them available in one hour.

Amazon's strategy has been characterized by a continuous focus on external growth, running more than 50 acquisitions in the last ten years. This approach, combined with consistent R&D efforts to seize new opportunities, has delivered outstanding results. In FY2015, Amazon posted c. \$107bn in revenues and it is expected to close FY2016 with over \$130bn, which implies a 5-year CAGR of about 30%. Likewise, operating income is predicted to reach \$4bn, a six-fold increase with respect to FY2011 (\$676m).

About Souq.com

Based in the United Arab Emirates (UAE), Souq.com is the largest online retailer and marketplace platform in the Arab world, offering more than 400.000 products across 31 categories, including but not limited to consumer electronics, fashion, and household goods. The company - commonly called the "Amazon of the Middle East" - was founded in 2005 by Ronaldo Mouchawar and is present in several markets of the region including Kuwait, Qatar and Oman.

Souq, which employees over 3000 people, is a leading player that attracts 23 million customers every month.
There is consensus among analyst that the company is growing significantly and they expect its growth to further accelerate in the future.

With a business model similar to Amazon's one, the company has been able to tackle the difficulties associated with payment and delivery system. The scarce availability of credit cards in the region has spurred Souq to create a prepaid card purchasable in brick-and-mortar stores, as well as to develop its own payment gateway, Payfort. In addition, the online retailer has tackled the lack of logistic infrastructure by developing its own delivery system (partnering with local logistic companies).

So far, Souq has raised $425m from investors, and the latest fundraising round implied a valuation of c. $1bn. Despite new competition from start-ups like Noon, an e-commerce firm backed by the Saudi sovereign wealth fund and real estate company Emmar's Mohammed Alabbar, Souq remains the leading player in the region, and the one best positioned to capture the potential of the Middle East market.

Industry Overview

According to data compiled by A.T. Kearney, the Gulf Cooperation Council (GCC) –which includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates - is on the edge of becoming one of the world's fastest growing e-commerce regions. Yet, at the moment, the e-commerce market is very small.

In the region, Souq.com the is the largest online retail and marketplace site. However, the Dubai-based company will not be alone in this race. Mr. Mohamed Alabbar, a Dubai-based businessman and owner of Alabbar Enterprises, plans to expand into the UAE retail e-commerce thanks to the $138m joint venture with online retailer Yoox Net-a-Porter to target luxury spending in the Middle East.

Despite the prospects of growth, players in the industry faces an important challenge, as growth in core markets mature, the e-commerce leading companies are looking for new avenues of growth either through new products and services or by expanding to new markets. This process of expansion will likely attract new players (e.g. Alibaba Group) which might dramatically increase competition in the region.

Deal structure

Although Amazon did not disclose the price they have paid, the Financial Times puts the price tag at c. $650-750m. Based on past transactions in the e-commerce retail industry, companies typically go for 1.5-2.0x EV/Revenues, according to research from the M&A advisory firm Peakstone Group.
Souq does not disclose its financials, but Mouchawar has stated that the company was expected to hit revenues of c. $270m in 2015. Based on these numbers, Amazon payed c. 2.5-3x EV/Revenues in this transaction, which is in line with the industry multiples. However, considering the last fundraising round, which valued the company at $1bn, the price tag on this transaction looks like a write-down. In light of Amazon's M&A expertise, it seems more likely that investors in the last fundraising round overpaid for their stakes.

The transaction will conclude a nine-month sales process for Souq after Tiger Global Management and South Africa's Naspers sought for an exit for their investment. One of the bids, from rival Noon, was rejected because it was said to be too low.

Initially the deal was envisioned as a 30% stake sale but the price has since slipped and the transaction moved to a 100% sale. Barring any regulatory complications, the deal is expected to close in 2017.

Deal rationale

The rationale for the deal seems straightforward: Amazon wants to increase its presence in the Middle East region.

Amazon presence in the region is, as of now, very limited. Indeed, only a few items can be purchased from the US retailer in most cities of the region.
Not surprisingly Amazon decided to grow through an external acquisition, and Souq, with over 45 million visits per month, has been chosen as the best target given its position of leadership in the region.

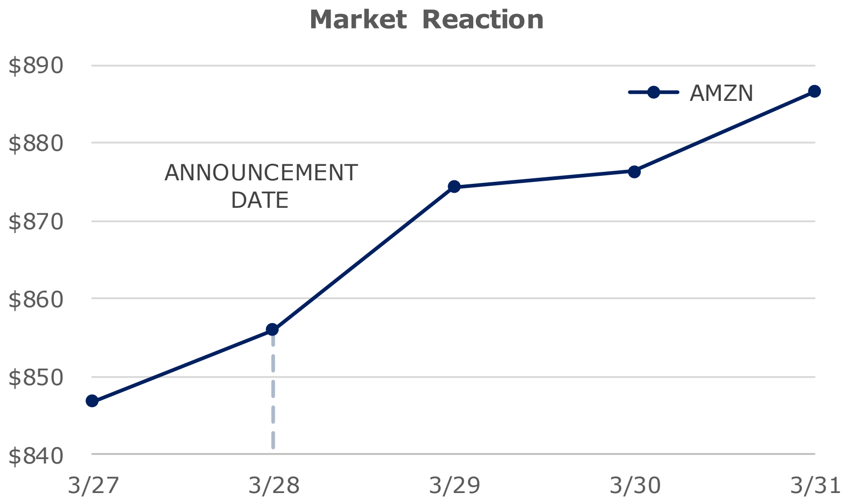
In the above-mentioned report, consulting firm A.T. Kearney estimated the e-commerce market in GCC countries to be worth approximately $5.3bn in 2015, corresponding to 0.4% of the region's GDP. This figure reflects that the market is not yet well-developed, nonetheless it is undoubtedly growing at a fast pace. The estimated CAGR for the market in the Middle East until 2020 is c. 30%. In turn, total sector sales are expected to reach $20bn in

2020. Furthermore, the penetration rate for banking and credit cards in some of the region's major economies, like Saudi Arabia, is estimated at 40%, still a relatively low level when compared to the 80% figure registered in developed economies. Yet, given the opening of middle eastern economies to foreign investments, it is likely that payment systems will evolve along the path of those in mature markets. All these features make the Middle East market attractive to Amazon.

Further, the operations of the two companies shows a great deal of complementary: With this deal Amazon will extend its resources and infrastructure to Souq's operations. Also, Souq will benefit in terms of both delivery capabilities and customer selection. On the other hand, Amazon will have access to the largest online customer base of the region, enabling potential cross-selling synergies. At the same time, it will be able to leverage Souq's infrastructure to store and deliver products.

On a cultural standpoint, the integration will not probably be overly complicated. In fact, the two companies are "both driven by customers, invention, and long-term thinking", as declared by Amazon Senior Vice President's Russell Grandinetti.

Market reaction



On the day the transaction closed, Amazon stock closed at $856, 1.1% up over its previous close. Furthermore, over the week, the shares rallied up to $886.54, which represents a total 4.7% improvement since the deal was announced. Together with the strong rationale and the positive expectations about the transaction, the market reaction indicates that Amazon's investors believe the company made a good move.

Financial Advisors

Souq has been advised by Goldman Sachs Group Inc., whereas Amazon has not disclosed its advisors (if any).