

Private Equity & Venture Capital Market in the Middle East – GVCA Third Annual Report Launch

Of the \$19.6 billion raised since 2000, \$11 billion remains available for acquisitions

Middle East private equity fund managers raised a record \$6.4 billion in 2008, up more than 10% over 2007 and more than double the amount raised in 2005, according to Gulf Venture Capital Association's (GVCA) 2008 report on Private Equity & Venture Capital in the Middle East, which was released today at the Dubai International Financial Centre.

Large size funds are primarily responsible for this growth, with the average fund size in 2008 being \$258 million, compared with \$213 million in 2007 and just \$177 million in 2006. This trend is driven by the need for more flexibility in structuring deals and the past success of large buyout transactions, according to the 2008 GVCA report, developed in cooperation with KPMG, and Zawya, and supported by Hawkamah – The Institute for Corporate Governance.

Three regional funds have crossed the \$1 billion mark, and as the report notes, the current economic downturn may make it more difficult for all but the most established fund managers to secure the successful closure of these larger funds.

Yet, there is also tremendous liquidity among regional funds, which are cash rich with \$11 billion in capital under management yet to be deployed. The report notes that this "dry powder", as it is called, gives private equity a strategic opportunity vis-à-vis target companies, given the limited scope of other funding sources available in the current environment. This liquidity results from both an increase in

fundraising and a decrease in deals, with the number of private equity investments dropping by 22% between 2007 and 2008, as well as the total investment size, which fell by 31%. The report found that over the past four years, Egypt, Saudi Arabia and the United Arab Emirates were the largest recipients of private equity funds, at 33%, 15% and 14% respectively. The majority of funds are Middle East and North Africa (MENA) focused, with Turkey sometimes included as part of that region. Regional players are experiencing an increasing request for funds with a mandate that includes MENA, to expand and include South Asia, Southeast Asia and/or Africa.

The sectors of focus for portfolio acquisitions during 2008 were healthcare, transport, power & utilities and construction. Healthcare likely would remain a top recipient of private equity funds in the next few years.

In terms of fund strategies, more and more funds are seeking controlling stakes. While in 2005, only 3% of transactions were control buyouts, by 2008, some 26% of transactions volume and half of transactions values were control buyouts.

The report was optimistic about the future of private equity in the region, noting that as an asset class, it does not have a short-term investment horizon and so is well placed to weather the current crisis.

Imad Ghandour, Chairman of the GVCA Information & Statistics committee, said, "The economic fundamentals of the region remain strong and are supported by aggressive fiscal policies. Governments' reserves will continue to trickle down to the rest of the economy – sustaining corporate profits and public investments. A sober market will offer better valuations, and hence better returns for private equity. Although the increased attention from international players that the region witnessed in 2007 may be disrupted, we expect the disruption to be temporary. As a matter of fact, we expect the robust economic performance of the region to attract additional allocation from international institutional investors over the medium term."

Although fundraising in the region has been strong, when compared with the total value of announced fund sizes, it is clear there have been delays in reaching target sizes. In fact, after excluding one major fundraising, only 16% of the total amount announced in 2008 was actually raised in the same year, compared with 65% in 2005. Roughly half of the funds announced in 2006 have so far been raised, and approximately \$11.7 billion of announced funds in 2006-8 have yet to make a close. The report suggests that this is because fund sizes are much larger, as well as recent constraints on liquidity.

While 2008 saw an increase in the total value of sale activity, which reached \$3 billion, most of this was due to one major exit of \$2.5 billion; excluding this one-off transaction, sale activity decreased by approximately 60%, as did the number of exits, which dropped from 17 in 2007 to 11 in 2008. The report suggests that there will be fewer exits in the current economic climate, as funds won't be able to achieve the returns traditionally targeted and exit options shrink, particularly with the sharp decline in regional IPOs. Trade sales were named as the most likely exit over the next couple years.

Ihsan Jawad, CEO of Zawya and board member of GVCA, said "Private Equity in the region is developing in many ways that are unique in comparison to the developed world. Transparency remains a major barrier that hinders this mode of investment from becoming a strong component in the GCC financial system. More research efforts and collaboration is needed by all practitioners to elevate the current opacity of the private equity market."

Of the 18 private equity fund managers interviewed for the report, most said they were established in the last five years. They expressed an expectation of consolidation in the industry, a decrease in investment, and lower portfolio company growth. This means portfolio companies will be held longer and fund managers will be increasingly active in managing their companies in order to add the maximum value. These efforts should include corporate governance, according

to Dr Nasser Saidi, Director of Hawkamah. "MENA private equity can, and should, play a critical role in diffusing good corporate governance practices across portfolio companies, in terms of board structures, executive compensation better aligned with long term shareholder interest and underlying risk, improved risk management, transparency and disclosure requirements and minority interest protection. This benefits all parties, as empirical evidence shows that investors are willing to pay a premium for companies with good corporate governance. The current global financial crisis has reinforced the view that improved corporate governance practices lead to sustainable growth and value of companies, with a focus on the medium and long-term and away from short-termism. This is why Hawkamah has launched a Private Equity Task Force to develop corporate governance guidelines for private equity firms and portfolio companies in the MENA region."

Elaborating on the role of fund managers toward their portfolio companies given the current environment, Vikas Papriwal, Partner in KPMG's Private Equity and Sovereign Wealth Funds practice, said, "With attractive exit options scarce at present, the focus for many private equity firms is now the workout of their existing portfolio – with operational improvements, debt restructuring and working capital management at the core. Discretionary spending is being restricted, including expansionary capital expenditures, and business plan timelines are being reassessed, as entities look to weather the storm. However, no one doubts that opportunities will exist once we are over the worst."

The GVCA report compiles comprehensive information and statistics about private equity funds and investments across the Middle East, and contains nine articles on current topics in the industry. The 125-page report also provides a detailed survey of 18 private equity fund managers regarding their views looking back at 2008 and ahead to 2009. There also is a special section dedicated to sovereign wealth fund strategies and investments.