



Private Equity in MENA: Growth, Institutions and Capital Markets

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November 13, 2007

DIFC | Dubai International Financial Centre



Agenda

- Fundamental Role of PE
- Global PE & US Mortgage Market Turmoil
- New Breed of PE Funds in MENA
- Scope of PE in the GCC
- PE Challenges in MENA
 - Regulatory Issues
 - Legal Issues
 - IPO-Related Issues
- PE & DIFC: Infrastructure & Markets
- The Road Ahead



Fundamental Role of PE

- Financing for early and later-stage private companies
- Attractive prospect for portfolio diversification and opportunity to earn high returns.
- Candidate firms:
 - Long-established family businesses and/or SMEs
 - Entrepreneurial start-ups
 - Buyouts (troubled companies perceived to be undervalued).
- Success factors:
 - Enabling public policy environment
 - Reliable legal system
 - Political and economic stability
 - Developed financial markets
 - High professionalism of all parties



Global PE

- **IMPACT:** Improved efficiency of capital flows and management pools, internationalization of investment markets, greater economic diversification, support of private sector development, high returns (relative to traditional market benchmarks); driver of economic competitiveness
- **INVESTMENT ACTIVITY BY SECTOR:**
 - In US (most mature market): energy, technology, service, and environmental investments;
 - In UK (largest centre in Europe): technology, industrials, and consumer services.
 - In India (promising environment for PE): initially IT and outsourcing sectors, but now including everything from finance to pharmaceuticals.



Global PE & US Mortgage Market Turmoil

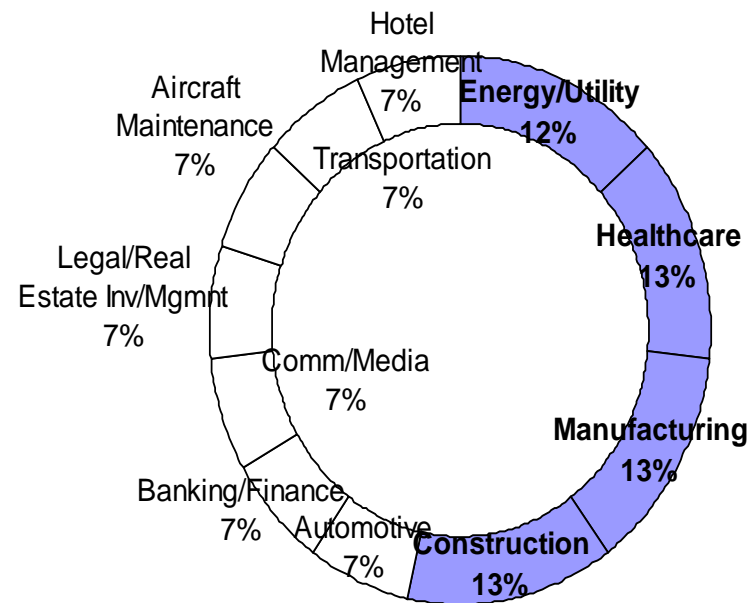
- Credit squeeze leading to:
 - Tighter credit conditions for PE funding
 - Slow down in M&A activity
- Economic slowdown affecting acquired company cash flow, making it harder for PE funds to pay back borrowed money.
- Equity market volatility makes exit strategies more difficult for PE funds
- However outlook is promising:
 - Leading PE firms continue to outperform traditional investment managers.
 - Industry consolidation as less competitive firms are weeded out



Impact of PE and VC on Development of PE-Backed Companies: GVCA and KPMG's 2006 Survey

- Interviews conducted with top management of 15 companies in GCC between August and October 2006.
- Average amount of PE or VC invested in surveyed companies is USD **263 million**.
- **SUCCESS RATE: 70% of ALL DEALS**

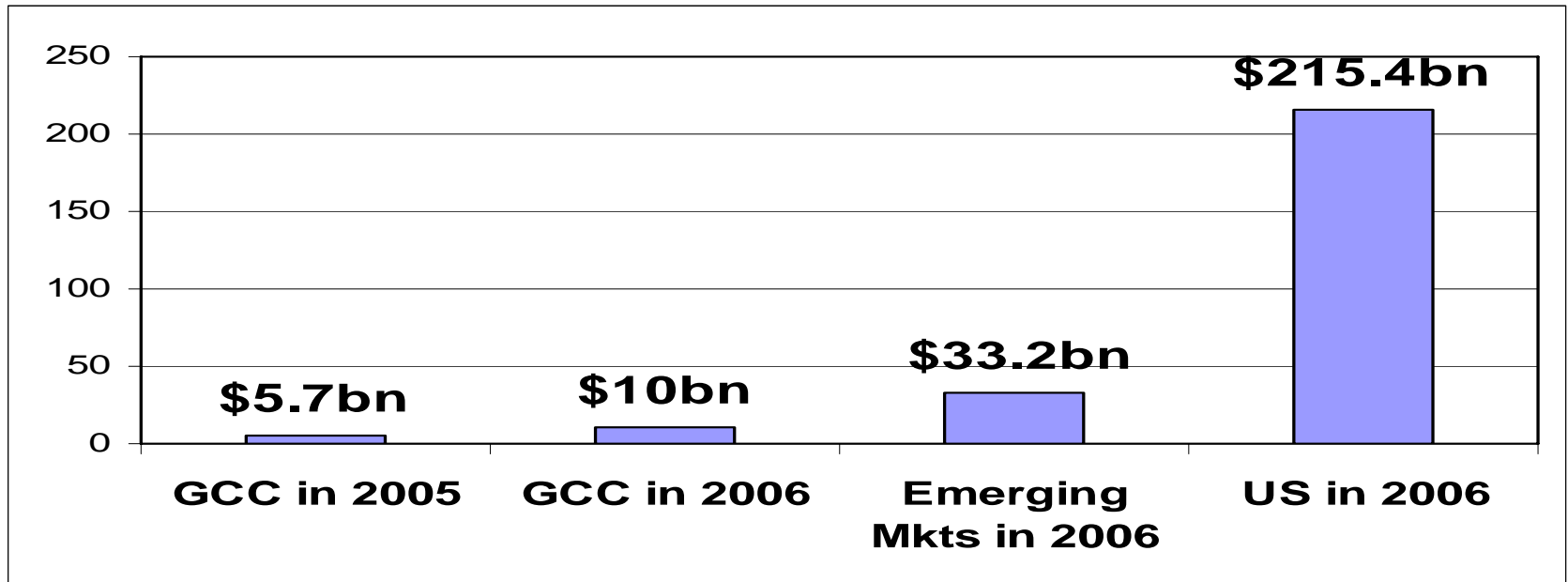
Percentage of Respondents by Main Business Activity





New Breed of PE Funds in MENA

- PE fundraising in GCC reached \$10 billion in 2006; \$25 bn. expected in 2008

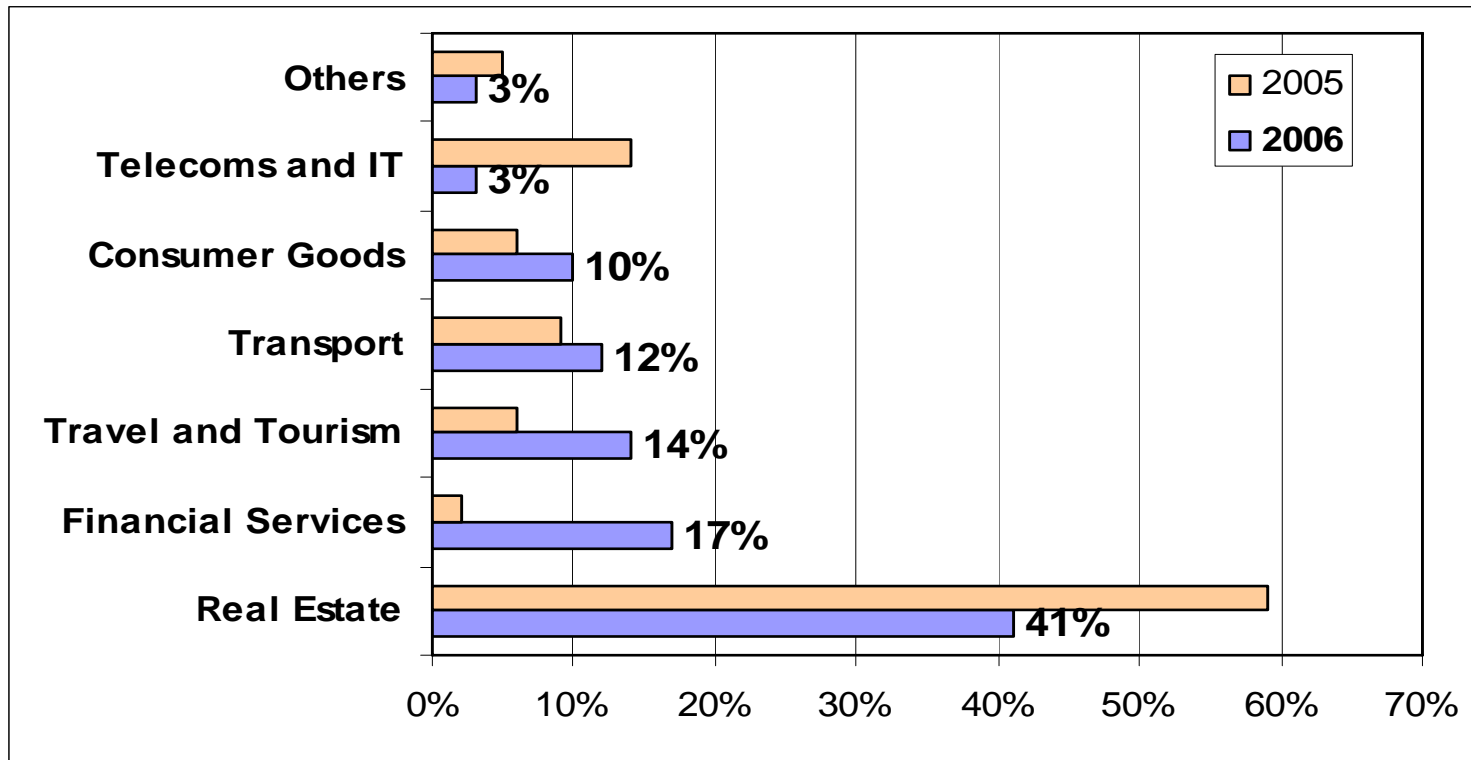


- Funds include sizeable contributions from international investors, enjoy flexibility to invest internationally, and have surged in size and number.



New Breed of PE Funds in MENA (2006)

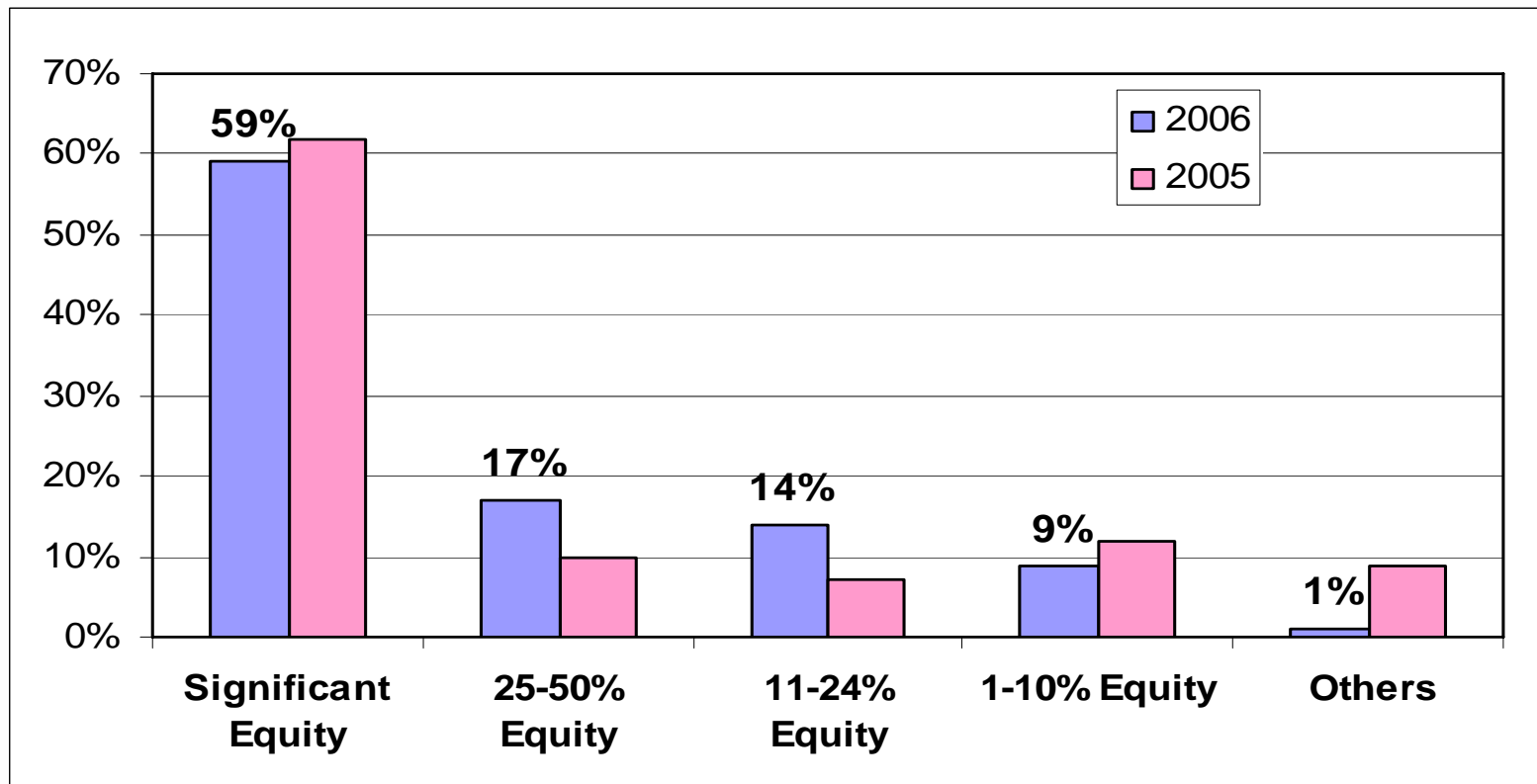
- **Sector Focus in Investments revealing ↑ popularity for sectors other than real-estate, IT& Telecom.**





New Breed of PE Funds in MENA (2006)

- Nature of Investments revealing a slightly diminished preference for obtaining control, from year before.





Scope for PE in the GCC

Scope for PE in GCC reinforced by:

- Strong growth prospects (over 7% real GDP growth in 2007) and proliferation of new investment opportunities stimulating PE, VC, and M&A activity
- Strong liquidity climate (in excess of \$2.3 trillion in MENA)
- Dominance of family-owned firms and their importance in the process of generational change: 3/4 of the private sector in the GCC consists of roughly 5,000 family businesses w/ 1/2 million USD in assets (MEED, 2006)
- Governments' commitment to greater private sector role
- Increased foreign participation from investors in US, European & Asia PE.



PE Challenges in MENA

However, PE financing in the region remains underdeveloped, with growth challenged by:

- Low standards of corporate governance in terms of transparency & disclosure; quality of information required to make investment decisions and monitor performance once investments have been made
- Weak legal system in terms of enforcing contracts and protecting all classes of investors
- Inability of domestic equity markets to offer a reasonable prospect of exit through IPOs.



Regulatory Issues

Low Standards of Corporate Governance:

- Lack of timeliness, accuracy, protection, and transparency of financial information provided to investors,
 - Unwillingness on the part of managers to subject themselves to scrutiny and accountability from outsider shareholders (family-owned businesses), and
 - Inadequate minority shareholder protection, often impairing a suitable exit.
- *Potential Areas of improvement.* (a) raise shareholder awareness, (b) increase monitoring, transparency and disclosure w/ regards to controlling shareholders, (c) protect minority shareholders, (d) provide shareholders with private and collective rights for redress, (e) focus on even-handedness when it comes to the public sector, etc.



Legal Issues

Weak Legal Systems:

- Lack of enforceability of key contractual rights and of statutory protection for minority rights,
- Generally weak framework for disclosure/audits and low confidence in existing local laws, and
- No reliable outlet for resolving disputes

Potential Areas of Improvement: (a) provide adequate legal means to eliminate self-dealing, (b) enhance capacity, resources, and independence of regulatory and judicial mandates, (d) focus on increasing number, skills, and independence of accountants and auditors, (e) achieve consistent interpretation/implementation of IFRS (International Financial Reporting Standards) and adoption in other instances (Saudi Arabia and Egypt) to allow for increased reliability, etc.



Capital Market Development: IPO-Related Issues

- Domestic equity and credit markets closed to all but the largest companies
- Barrier to the diversification of ownership and control structures
- Failure to provide steadily viable outlets for the sale of companies in PE portfolios (w/ 2005 IPO frenzy dying out lately) despite extraordinary demand for IPOS fuelled by high oil prices and small number of currently listed stocks
 - *Potential Areas of Improvement:* (a) strengthen board requirements to offset weaknesses of the regulatory framework of shareholders, (b) diversify ownership structures, (c) promote a more equitable investment environment, (d) stress market liquidity to go away w/ current volatility allowing for lucrative exits for PEs, (e) increase investor awareness, etc.



PE & DIFC: Infrastructure & Markets

- DIFC attractive hub, midpoint between ‘local domestic equity and credit markets’ and ‘hard-to-penetrate international financial markets’, including:
 - 100 percent foreign ownership;
 - zero percent tax rate w/ a renewable 50yr tax holiday;
 - a wide network of double taxation treaties available to UAE incorporated entities;
 - no restrictions on foreign exchange or capital/profit repatriation;
 - high standards of rules and regulations;
 - strict supervision and enforcement of AML/CFT
 - major institutional investors and global players
 - opportunity to capitalize on the success of the DIFX and a whole cluster of ‘financial services’ institutions conveniently located in a purpose-built financial district;
 - state-of-the-art technology and infrastructure, data protection/privacy, operational support and business continuity facilities



DIFC Financial Infrastructure to Support PE:

A Pioneering Effort

- **Hawkamah Institute for Corporate Governance** to promote and strengthen CG standards in the region
- **Family Office initiative**
- **Collective Investment DIFC Law no. 2 of 2006**
- **DIFC Investment Trust Law no. 5 of 2006**
- PE model that worked successfully in the US, UK, and handful of emerging markets may travel well to DIFC, providing real opportunities to fund management firms looking to establish themselves in the region.
- At present, there are 157 authorized institutions in DIFC, almost half of which are engaged in asset management activities, of which many include PE services.



DIFC Investment Funds Regime: REITs

- **The DIFC Investment Trust Law- DIFC Law no. 5 of 2006**
- Legislation permitting setting up Collective Investment Funds in the form of an **Investment Trust**.
- Rules to permit the operation of REITS within the DIFC have also been introduced.
- REITS have become the most favoured method for attracting public ownership in property investments.
- They provide a convenient form for listed and tradable property ownership with transparent pricing and liquidity.
- Under these Rules it will be possible to issue REITS for the first time in the region, utilizing the facilities of the DIFX. Innovation for ME's property markets



The Road Ahead: Growth, Institutions & Markets

- Economic Renaissance & structural change in MENA promises strong growth of PE industry, with a wave of IPOs benefiting from liquidity and market infrastructure
- Endgame? Challenges ...
 - PE firms must educate the local market/corporate sector alike on best practices from its more mature counterparts.
 - PE firms should adopt stronger CG standards
 - Governments must recognize the role that PE can play in deepening and broadening the private sector and willingly strengthen regulatory environments by instituting the necessary reforms
 - Need to focus on **‘Institutionalizing Family Businesses’**
 - ***DIFC will play a major role in making PE an engine of growth for region***