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Global Private Equity Initiative

Private Equity in the Middle East: A Rising Contender in Emerging Markets

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A Note of Appreciation

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The INSEAD-Booz & Company PE Survey in the Middle East

In March 2010, INSEAD and Booz & Company jointly conducted a survey among limited partners (LPs) and general partners (GPs) in the region. Respondents were surveyed by qualitative questionnaire for their current market sentiment, confidence and expectations. The survey included 29 GPs from across the region and 17 LPs investing in the Middle East.

GPs were surveyed on their sentiments on the general overview of the PE landscape in the region, their perceptions of PE firms' performance, asset allocation, and risk return factors. LPs were similarly surveyed on the general overview of the PE landscape in the region, their perceptions of GPs performance, asset allocation, their investment intentions in the short term, and their relationship with GPs.

The results from this survey have given us unique insights into this market on which little formal research has been done in the past. As primary research focuses specifically on this region it elucidates key areas and opens up future avenues for enquiry in what we hope will become a focal study point for the benefit of the Middle East region.

Contents

1 Introduction: Understanding a Growing Industry

The private equity (PE) industry in the Middle East (ME) has grown remarkably quickly for an industry that barely existed a decade ago. Today, there are around 150 funds in the region, with a further 12 announced and six rumoured to be happening. In 2008, total funds raised increased to more than $6.4bn.[1] However, PE as an asset class in the Middle East is relatively new and, on a global scale, still very small. In 2001, its share of emerging market PE was less than two per cent. By 2008, however, it accounted for 10 per cent.[2]

Beyond the occasional mention in larger global PE surveys[3] or specific case studies,[4] little research or literature exists on PE in the region. Criticisms frequently levelled in commentary include limited information, lack of transparency and the general opacity of the industry.

There are a number of reasons for these characteristics. Much of the regional PE activity is driven by closed networks, resulting in restricted information flow, making available data in PE in the region a scarce commodity. Although sources such as the Zawya Private Equity Monitor compile data specific to the region, the information environment still relies heavily on informal sources.

The lack of reliable information is not only a source of frustration for analysts but may also be a factor in holding back the development of the region's PE firms. Difficulties in obtaining accurate financial information on companies have been cited as a key problem faced by potential buyers in the region.[5] Last year, Zawya CEO Ihsan Jawad, a board member of the Gulf Venture Capital Association, was reported as saying that transparency was a major barrier preventing PE from becoming a bigger component of the GCC's financial system. He suggested that more research and collaboration were required to redress the current state of opacity of the sector.[6]

This paper seeks to provide some insight into the region's PE sector, to identify some of its key characteristics and trends and to contribute to the understanding of PE in this region. The foundation of this report is the INSEAD-Booz & Company survey of PE firms, their general partners (GPs) and their investors (limited partners- LPs) conducted in early 2010 by Booz & Company and INSEAD's Global Private Equity Initiative (GPEI). This report also draws on Booz & Company's and INSEAD's experience working with leading PE firms in the region. We hope to contribute in a meaningful way to the understanding of the PE market in the Middle East.

2 Private Equity in the Middle East: Beginnings and Early Evolution

In the years before the Middle East had a domestic PE industry, the region (in particular the GCC) was an attractive fundraising geography for international PE. By the end of the 1990s, regional sovereign wealth funds (SWF) and several large family offices were already seasoned PE investors. As regional wealth increased exponentially, driven by the strength of oil prices (see Figure 1), demand for domestic consumption and investment opportunities grew enormously. In addition, the 2001 terrorist attacks in the USA had the almost immediate effect of re-deploying large amounts of local capital back into the region, compounding the local investment momentum during this incubation period for private equity.

Before 2000, PE activity occurred mostly in Egypt, given the favourable regulatory environment, strong macroeconomic fundamentals and privatisation activities in the country.

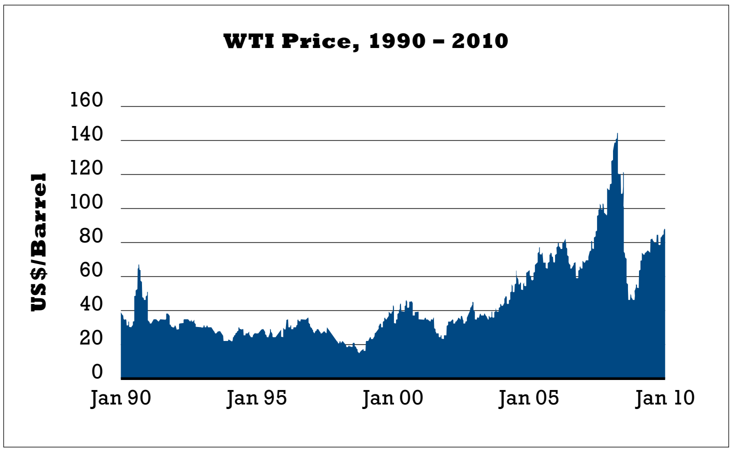
1 KPMG & Gulf Venture Capital Association (2009)
2 EMPEA (2010)
3 See, for example, EMPEA (2009); Groh and Liechtenstein (2009); World Economic Forum (2009); Groh (2009)
4 For example, Lerner & Bozkaya (2008)
5 Martin (2009)
6 The Saudi Gazette (2009)

Between 1994 and 2004 the number of funds active in the region grew progressively from eight to 26. In 2001, Bahrain's Emerging Markets Partnership (EMP) raised almost $1bn.

Adding to the investment momentum, some of the region's cash-rich governments started major domestic investment drives, mostly in strategic areas such as real estate, infrastructure, energy and health. These sectors became growth targets in which PE found and targeted opportunities.

In parallel, regional governments continued developing investment-friendly environments by prioritising currency stability, capital markets and banking. With a stable and progressive policy environment, a young and growing population and increasing domestic purchasing power, this constellation of factors brought the Middle East to a critical point in 2004 at which it became a credible target for private equity.

Figure 1. Oil Prices 1990-2010: A Key Source of Wealth [7]

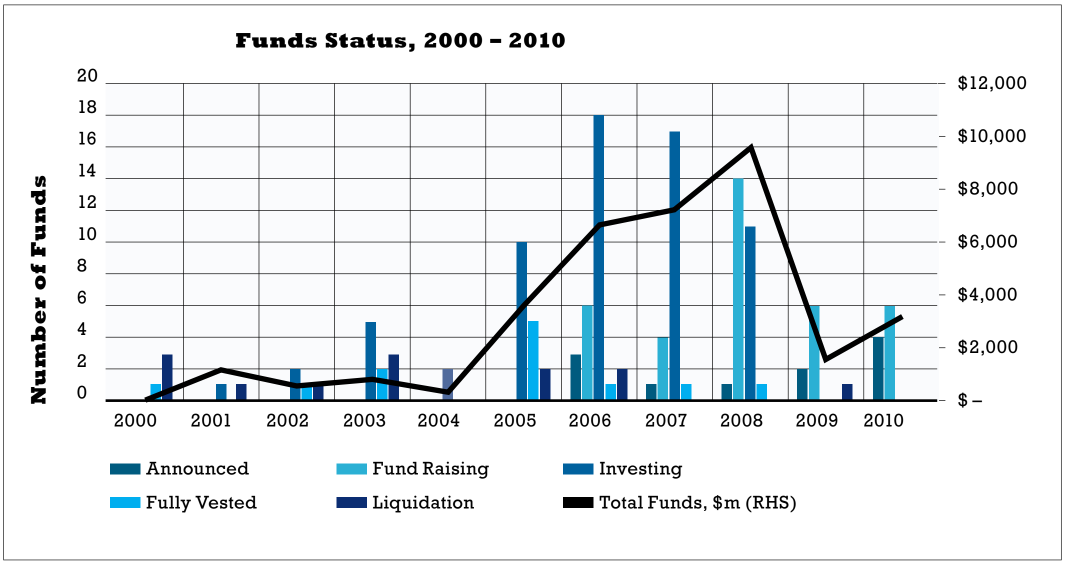


2.1 Private Equity Matures

The enormous wealth amassed in the oil producing countries supplied the region with cheap funds which local GPs were quick to access. The amount of money raised also jumped from less than $1bn in 2004 to $10bn in 2008. And, while only one Middle East fund made investments in 2004, acquisitions peaked in 2006 with 18 active funds (see Figure 2).

During this growth period the market was highly fragmented: over 72 GPs managed around 100 funds between 2005 and 2008. A very small number of firms controlled the bulk of the value. Abraaj, for instance, managed around 20 per cent of the Middle East market's fund values through just three funds [8] (see Figure 3).

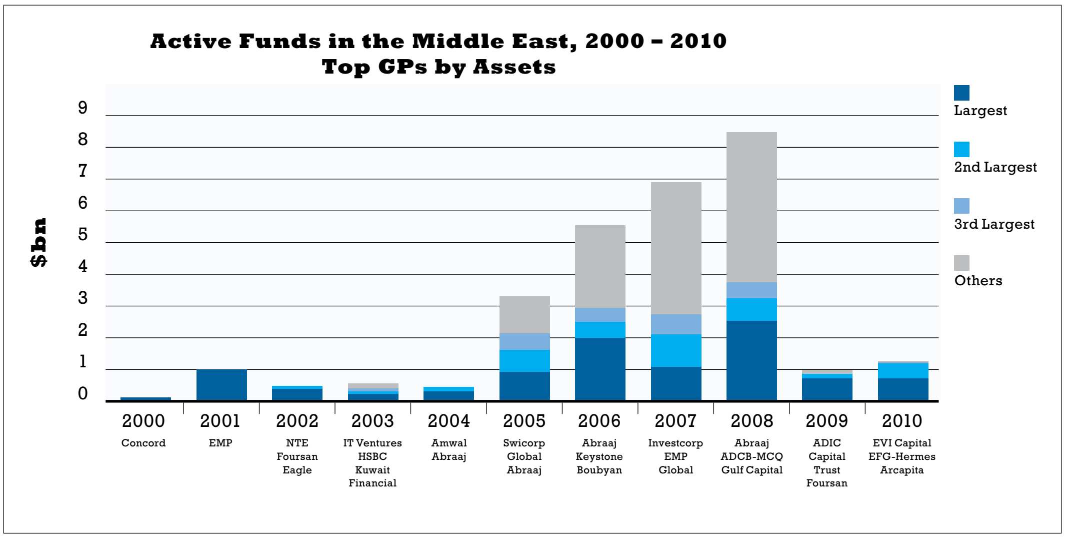
Figure 2. PE Funds in the Middle East, 2000-2010[9]



Source: Zawya Private Equity Monitor (2010b)

[7] Source: EIA, (2010). WTI prices in constant 2000 dollars
[8] The focus of MEs PE activity remained tightly focused on buy-out, with 68 per cent of total committed funds, or $21bn, in this period. Balanced funds and real estate accounted for 13 per cent and 6 per cent, respectively. As the industry began to get established and alternative investment styles became available, the investment focus diversified marginally to include growth capital, pre-IPO and mezzanine capital, amongst others
[9] For "investing" and "fundraising" the data reflects 'latest close' information

Figure 3. Main Players in the Middle East, 2000-2010[10]

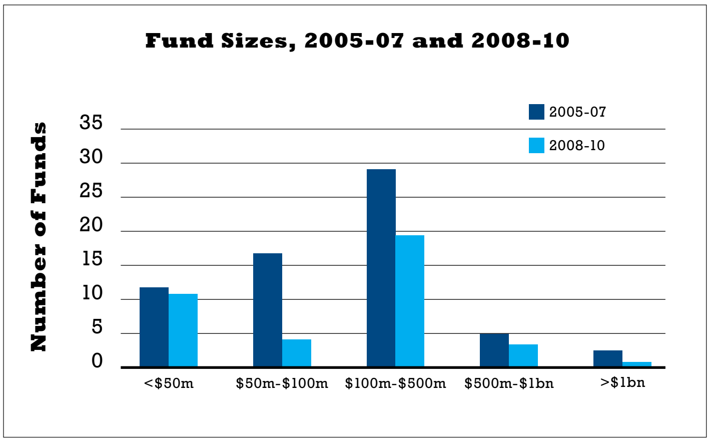


Source: Zawya Private Equity Monitor (2010b)

2.2 The Global Financial Crisis in the Middle East

The boom period came to an abrupt halt in 2009 when acquisitions decreased by over 30 per cent. In 2008, there were 73 recorded transactions; in 2009 this dropped to 49. Of these, 43 were acquisitions, perhaps reflecting a pursuit of distressed assets. As of June 2010 there were 13 recorded transactions, all but two of which were acquisitions. Although approximately $10bn of funds were announced in 2008, the global financial crisis severely affected the Middle East fundraising environment. By 2009, total committed funds in the region had declined to levels not seen since the end of the 1990s (See Figure 4).

Figure 4. Fund Sizes 2005-07 and 2008-10 [11]



Source: Zawya Private Equity Monitor (2010b)

The early sentiment in 2008 was that the global crisis had not, and would not, reach the Middle East.[12] Market attitudes were buoyant because financial institutions had little or no exposure to sub-prime credit products and credit derivatives, and because most PE business in the region had been done almost with no leverage. However, towards the end of 2008 such attitudes were rapidly readjusted when the effects of the slowing global economy started to be felt in the region. Oil prices collapsed, real estate prices went into freefall, tourism declined, leverage became scarce, risk appetite was curtailed, and portfolio valuations were questioned and faced downward pressure. More dramatically, previously abundant liquidity dried up and several companies turned to PE firms for funding.[13]

The stark retreat in macroeconomic strength across Middle East in 2009 had a direct impact on the PE industry as fundraising came to a halt, portfolio companies were affected by the economic slowdown, valuations dropped and/or were questioned, and banks restricted their lending. In several Gulf

[10] Includes funds fundraising, fully vested, and invested
[11] Includes funds fundraising, investing, fully vested and liquidation. Excludes funds announced
[12] As late as November 2008, the local media was publishing articles on the resilience of the regional economy. Source: MENAFN- Arab times http://www.menafn.com/qn_news_story_s.asp?storyid=1093220683
[13] Knowledge@Wharton, (2009b)

countries, SWFs shifted their focus towards strategic geopolitical investments, most notably into their financial sectors. For instance, at the end of 2008, the Qatari government requested its sovereign wealth fund, QIA (Qatar Investment Authority), to invest $3.5bn to acquire 20 per cent of all local banks listed on the Qatar Stock Exchange. Similarly, KIA (Kuwait Investment Authority) launched a fund on behalf of the Kuwaiti government to stabilise the local stock market and SAMA (Saudi Arabian Monetary Agency) injected $3bn into Saudi banks.[14]

The still under-developed nature of the financial regulatory environment compounded the impact of the economic downturn. For instance, the absence of proper bankruptcy and insolvency laws in several countries impacted the PE industry as portfolio companies floundered and, in some cases, failed, leading to increased regional risk aversion. Moreover, the current legal system, specifically in some GCC markets, punishes dishonoured debt with almost immediate imprisonment. When the financial crisis cut off cash-flow, company directors and executives were held responsible for unpaid debt and dishonoured cheques. In many instances they were jailed and company accounts frozen, with the immediate implication that they were not around to work through the crisis.

2.3 Middle Eastern Private Equity in Flux: The Crisis as a Catalyst for Transformation

Across the region, the macroeconomic environment appears to be improving, supported by oil price recovery, strong regional demographics, rebounds in consumption, increasingly progressive regulation, stability and strong cash reserves. Although several of the region's economies have implemented decisive economic diversification strategies, oil remains an important source of wealth and growth may therefore be slower than in the recent past.[15] As governments, particularly in the GCC, seek to diversify their economies and shift some of the burden of funding to the private sector, opportunities for PE will grow. GPs in Middle East are expressing cautious optimism.

That an economic recovery may have taken root in the region is perhaps evidenced by the reappearance of the super-large fund. As of mid-2010, three new funds over the $1bn threshold had been announced. A further three funds (2007 and 2008 vintages) over $1bn are at the investment stage (see Table 1).

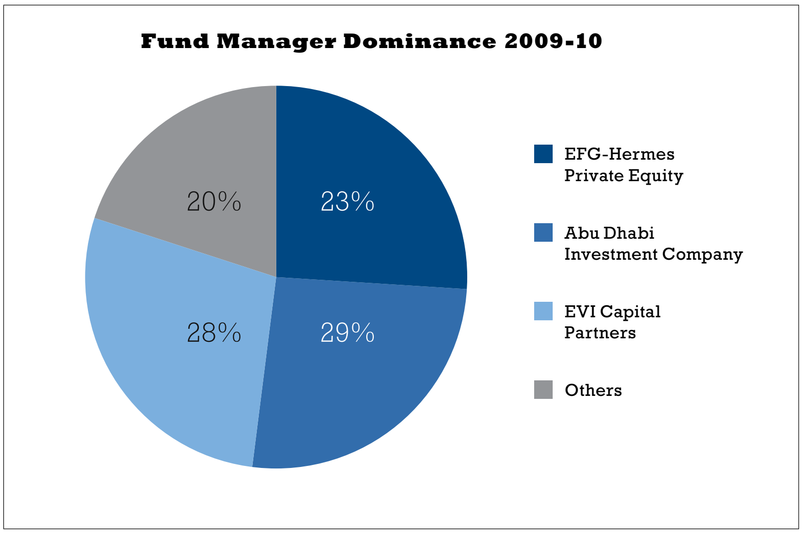
Table 1. Funds Over $1bn by Closing Date 2007-2010

Funds Manager	Status	Fund	Fund Size $bn	Year Announced/ Closed
Not assigned yet[16]	Announced	IDB Infrastructure Fund II	2.0	2010
Ithmar Capital	Announced	Ithmar Fund III	1.0	2008
Beltone Agriculture	Announced	Mahaseel Agriculture Investment Fund	1.0	2010
Abraaj Capital	Fund Raising	Abraaj Buyout Fund IV	2.6	2008
Investcorp Bank	Investing	Gulf Opportunity Fund I	1.1	2008
Abraaj Capital	Investing	Infrastructure and Growth Capital Fund	2.0	2007

Source: Zawya Private Equity Monitor (2010b)

[14] The Brave New World of Sovereign Wealth Funds – Wharton Leadership Centre
[15] Merrill Lynch (2009)
[16] The IDB Infrastructure Fund LPs include the Islamic Development Bank and Public Pension Agency. A fund manager has not yet been selected, although Abraaj, EMP Global and Manara 3i have been shortlisted. The fund manager was due to be assigned at the beginning of June 2010

Figure 5. Fund Manager Dominance: Funds Closed 2009-10



Source: Zawya Private Equity Monitor (2010b)

The number of funds operating in the market continued on a strong growth path and by May 2010 there were 150 funds identified in the region. This market is highly concentrated: three fund managers control about 79 per cent or $4.77bn of the total value of closed funds (see Figure 5).

Looking ahead, the historic role of oil as a key driver of wealth may be reassessed. Although several of the region's economies have implemented decisive economic diversification strategies, oil remains an important source of wealth and growth may therefore likely be slower than in the recent past.[17]

Special Issue 1: Insights from the INSEAD-Booz & Company survey

Key Lessons from the Recent Crisis: What GPs said

Respondents to the 2010 INSEAD-Booz survey shared their 'takeaways' from the crisis:

Legal:
- Tighter contracts and enforcement including binding default clauses in LPAs
- Follow closely changes in ownership laws

Acquisitions and Valuations:
- Assess carefully realistic exit options and exit strategies before making investments
- Make realistic, detailed and sound valuations, stick to valuation principles, and be disciplined
- Pay low valuations, look for yielding assets
- "Buy Cheap: entry is the first source of value"
- Don't count on multiples appreciation

Due Diligence and Risk:
- Strict auditing and compliance
- Focus on risks and prepare for crisis management
- Less inclination for risk taking

Ownership:
- Secure control ownership rather than minority with negotiated control rights
- "Buy into partners, not only companies"
- Involve shareholders in the business

Funding:
- Define and develop adequate capital structure: do not overleverage
- Secure long-term financing
- Manage commitment calls and LP defaults

Governance, Transparency:
- Conduct thorough due diligence
- Institute strong governance culture
- Enforce transparency and regular reporting

Value Creation:
- Build strong organizational structures and develop sound corporate strategy
- Build in-house post-acquisition teams
- Focus on fundamentals and operational value creation
- Enforce cost control and focus on cost savings
- Seek to develop regional champions rather than local (national) players
- "PE capital is patient capital"

Management team:
- Build an adequate professional management talent
- Thoroughly assess management capabilities

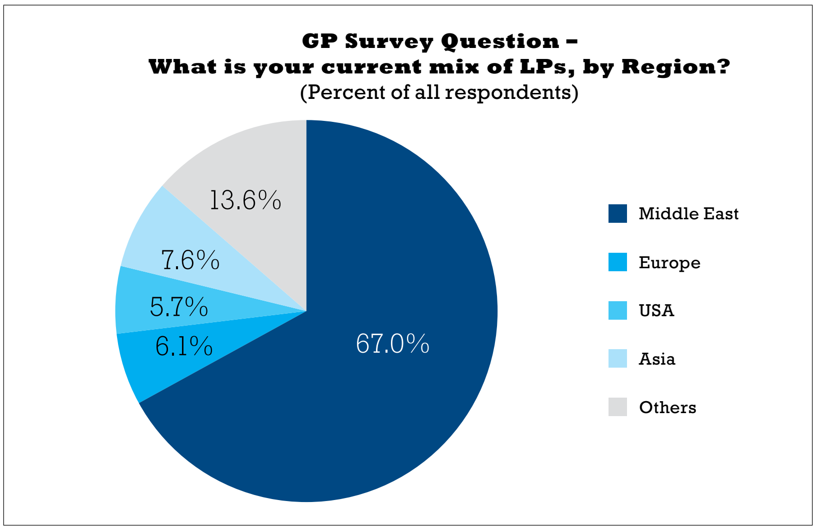
[17] Merrill Lynch (2009)

3 Private Equity in the Middle East: 2010

3.1 Key Characteristics of Private Equity in the Middle East

Around 120 firms have survived the recent economic turbulence in the region.[18] They fall, roughly, into three categories. The smallest group is regional pure plays. These are Middle East-based firms that focus their investments on the region, and include Abraaj Capital, Gulf Capital, Amwal al Khaleej and Citadel Capital. They have strong local roots, business networks and market knowledge. They are also typically backed by well-connected LPs which is critical as Middle Eastern LPs are the predominant source of funds for this region's PE industry (See Figure 6). This group's ability to tap into the closed business networks of the region helps explain their dominance of the market.

Figure 6. Regional LP Concentration



Source: 2010 INSEAD and Booz & Company survey

The second group are pure-play PE firms that are based elsewhere and include firms like Carlyle Group and Colony Capital. These international firms have the support of strong parent organisations in mature markets and can raise funds with relative ease. However, they lack the connections of the local pure plays. They may, therefore, have fewer opportunities than the pure plays to identify high-potential opportunities. They may also have been more cautious during the recent period of uncertain returns.

The third group includes PE firms that are linked to other entities such as investment banks or governments. Their credibility is rooted in their parent entities and their ability to leverage the larger organisation's network. This is the largest group, although it controls a relatively small share of the funds.

In the 2010 INSEAD-Booz & Company survey, LPs mentioned the following firms as upcoming regional leaders: Global Capital, Carlyle, Investcorp, Amwal Alkhaleej, Citadel Capital, Abraaj Capital, Gulf Capital, Eastgate, Investcorp and HSBC. Most of these featured among key competitors in the same GP survey.

Some analysts suggest that a model of buying-in rather than buying out is more suitable for the Middle East region given the market's stage of maturity.[19] Similarly, citing an aversion to high leverage and a preference for growth capital, Pathak[20] suggests that opportunities in the recovery will likely be on the growth capital side. Responses to the INSEAD-Booz & Company survey indicated that most GPs expected to see the best opportunities in growth and buyout type of deals (see Figure 7). This is in line with the nascent stage of the Middle Eastern enterprise structure, and the high prospects for regional economic growth.

By focusing on growth capital, PE firms will need to be more operationally involved with their portfolio companies in order to ensure the development potential is fully captured. Indeed, results from the INSEAD-Booz & Company survey strongly emphasized the quality and relevant experience of the management teams (and their sourcing) and a disciplined approach as a key success factors for local GPs.

[18] Source: Booz & Company analysis
[19] Knowledge@Wharton (2009b)
[20] Pathak (2009)

As a result of the requirement for higher operational involvement in the value creation process, most firms will need to expand their industry expertise and operational capabilities to be able to guide their portfolio companies for growth and provide tactical support. Key winning aspects will include importing and developing industry expertise combined with local expertise, deeper involvement in the day to day management of portfolio companies, and building strong management.

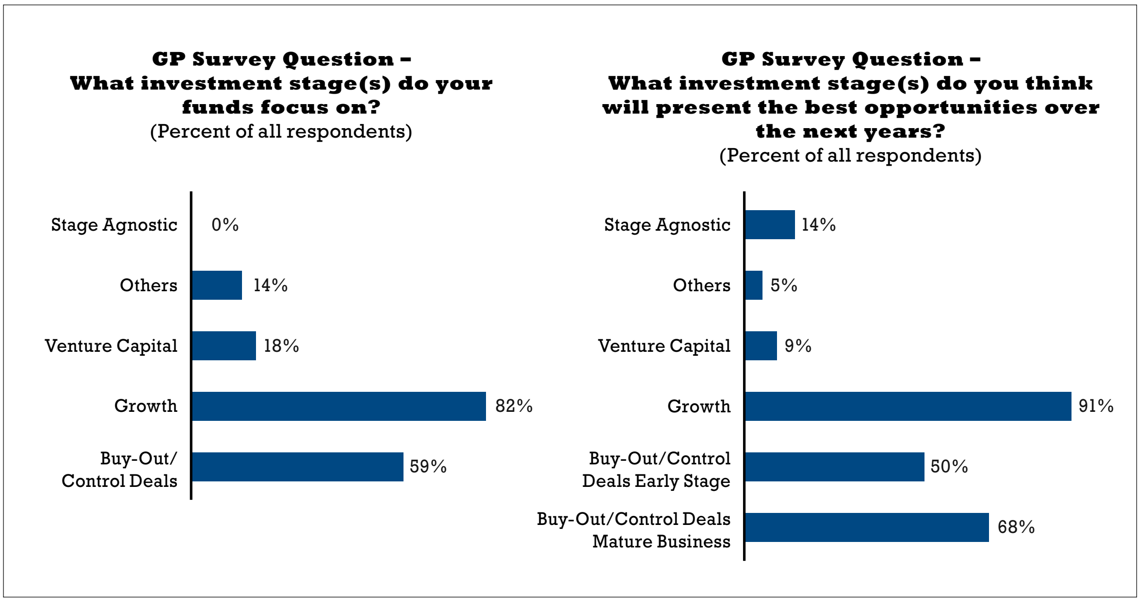
The minority stake model is consistent with the prevalence of family-owned businesses in the region (see section 3.3.2). Family businesses are often owner-managed, and the key role of contacts, relationships and understanding the business is not always readily replaced. However, the issue of control came across strongly in the INSEAD-Booz & Company survey – it was frequently mentioned as a key investment criteria.

Prior to the arrival of the economic downturn in the region, fundraising activities were at a peak. The Gulf Investment House[21] estimates that between 2005 and 2008 $20bn was raised by Middle Eastern funds. Of that, over half has not been invested and constitutes around $11bn[22] in dry powder. The real "actionable" dry powder figure will likely be lower, as some GPS indicated in the 2010 INSEAD-Booz & Company survey that some locally-backed funds may have had problems drawing on their commitments from LPs.

It is likely that a combination of weak investment opportunities and valuations in disequilibrium have slowed the investment flow. It has also resulted in a build-up of pressure to get these funds invested. This is not specific to the Middle East; international PE markets are facing a similar pressure to invest their capital promptly.[23] This pent-up investment flow is now looking for new opportunities.

Although a stabilising market with new investment opportunities will clearly encourage PE capital to flow out, there is also a chance that un-invested capital could destabilise the market. With GPs under increasing pressure to invest existing funds before they can raise new funds, there is a suggestion that, because they need to buy they will do a deal at almost any price.[24] Whether this will be the case in the Middle East will depend on the volume and pressure to deploy stagnating funds and on tighter stringency and discipline amongst GPs and LPs following the crisis.

Figure 7. Investment Profiles



Source: 2010 INSEAD and Booz & Company survey

[21] Hasam, Tanwar & Hayat (2010)
[22] GVCA Private Equity &Venture Capital in the Middle East Report
[23] Borel (2010)
[24] Borel (2010)

3.2 Middle Eastern Private Equity in a Global Context

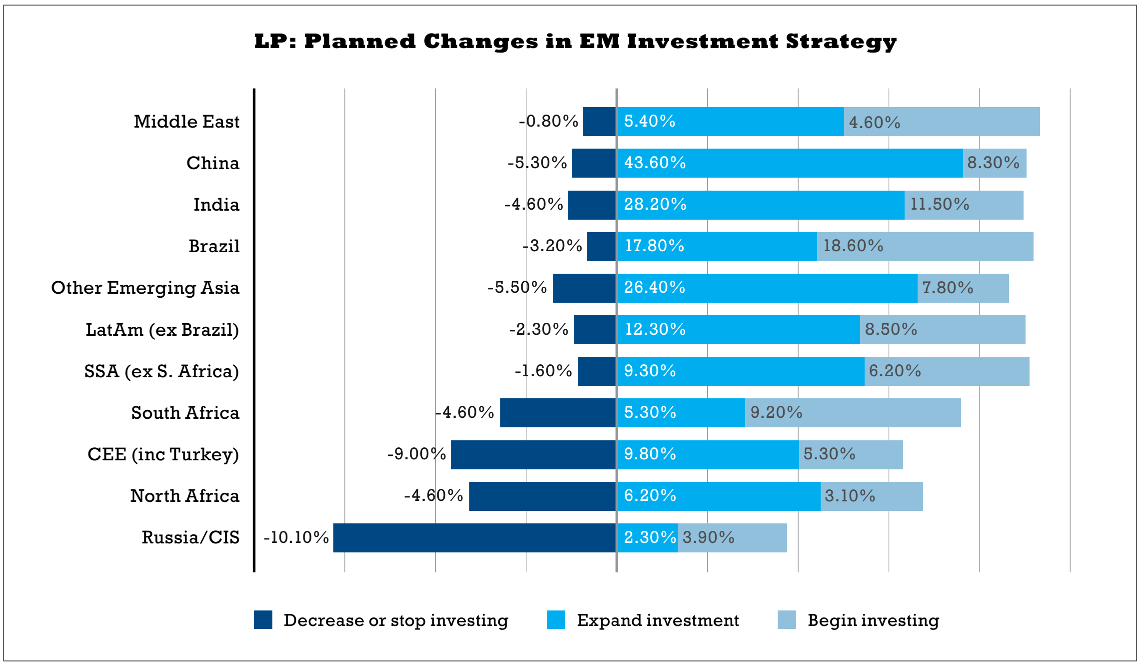
Globally, emerging markets have been more resilient to the financial crisis than developed markets and their growth fundamentals are attracting significant PE activity. A recent EMPEA and Coller Capital study[25] indicates that LPs with existing exposure to emerging market private equity plan to increase it from under 10 per cent of total commitments to up to 15 per cent over the next two years. In the same study, the Middle East ranked ninth out of 10 in terms of attractiveness, just below Africa and above Russia. This may be explained by a lack of familiarity with the region, its relative small size to other geographies and perceived regulatory weaknesses.

Preqin[26] noted in its 2010 Sovereign Wealth Fund review that "Only 32 per cent of SWFs seek private equity funds in the Middle East, despite the region housing the largest number of SWFs that invest in the asset class." The US and European PE industries continue to benefit from the region as a source of capital as their SWFs have grown exponentially and continue to diversify their investments.

Another study[27] finds that the Middle East[28] ranks fifth overall and first for taxation in the relative attractiveness of different PE and VC markets.[29] However, the authors reveal weaknesses especially with respect to entrepreneurial cultures and opportunities. In 2008, EMPEA[30] suggested that investments in Middle East reflected a heightened perception of risk, a very low level of intent to invest and an absence of positive sentiment for the next one to two years. However, in 2010, the EMPEA survey of PE in emerging markets reports that LPs are largely planning to expand their Middle East investments or begin investing in this market (see Figure 8).

Despite these perceptions we believe that the region presents attractive investment opportunities and its PE industry will grow significantly over the next three to five years, though its investor base may remain mostly niche. A more comprehensive understanding of the region and its PE industry may attract further investors.

Figure 8. LP Planned Changes in EM Investment Strategy



Source: EMPEA/Coller Capital Emerging Markets PE Survey - 2010

[25] Coller Capital & EMPEA (2009)
[26] Preqin (2010)
[27] Groh & Liechtenstein (2009)
[28] Middle East is defined in this study to include Egypt, Israel, Kuwait, Oman, Saudi Arabia, and the United Arab Emirates
[29] The overall rankings are: 1st North America; 2nd Australasia; 3rd Western Europe; 4th World; 5th Asia; 6th Middle East; 7th Eastern Europe; 8th Latin America; 9th Africa
[30] EMPEA (2009)

3.3 The Middle Eastern Private Equity Environment Today

3.3.1 Macro Economy

Regional macroeconomic indicators in early 2010 suggest that a recovery has indeed begun. At the lowest point of the financial crisis in 2009, the GCC economies grew just 0.7 per cent in real terms. Regional aggregates can hide marked disparities across individual markets.[31] Growth rates in 2010 are forecast to regain momentum across the region. GCC aggregate real growth is forecast to reach 5.1 per cent.[32]

The region has a persistent Achilles heel in its many pegged and managed currencies. All of the GCC's currencies,[33] as well as other regional ones such as the Jordanian dinar and the Lebanese pound, are pegged or managed. This truncates the monetary policy options available to manage issues such as inflation, which has been especially problematic in the Middle East economies over recent years. At a regional aggregate, inflation ran at an average of 8.3 per cent from 2003 to 2008. It peaked across the region in 2008 at 13.7 per cent, but again this masks individual market performances.[34]

3.3.2 The Importance of Relationships

A key driver of doing business in the Middle East is the importance of trusted networks, relationships and connections. While this may, in some instances, be a consequence of a disjointed information environment that forces investors to source information through networks, the dominance of family-owned businesses in the region's economy contributes to this. Family-owned companies are estimated to represent around 40 per cent of the region's non-oil GDP and around 50 per cent of private sector employment.[35] Barclays[36] recently estimated that family-owned businesses run 75 per cent of the private sector economy and hire 70 per cent of the labour in the GCC. Importantly, they suggest that ''Most of these businesses are unstructured, with no formal holding company structure in place and control being exercised entity by entity.'' So although the family-run enterprise is central to business in the Middle East, their lack of formal structure, coupled with a developing regional regulatory environment, makes this region a challenging investment target for PE.

Another distinctive feature of the local industry, and one which contrasts significantly with that in the rest of the world, is the active role played by LPs in deal sourcing. The lines between formal and informal roles in family businesses in the region are often blurred, and the industry relies heavily on closed and trusted networks of their LPs' family businesses to source investment opportunities. A further contributing factor is that, due to the evolution of local GPs, local LPs are significantly more experienced in PE investing than local GPs.

Indeed, the role of Middle Eastern LPs in supplying proprietary deal flows and potential exit avenues is central to regional PE. Where LPs in other geographies are more often passive HNWIs, in the Middle East they tend to be more actively involved and their access to government and corporate connections is frequently leveraged to facilitate deal flow. One estimate suggests that 60 per cent of GPs in the region expect key sources of deals to be proprietary.[37] In fact, this was confirmed in the 2010 INSEAD-Booz & Company survey, where all of the GPs surveyed expected to make acquisitions only through private deals. The survey also highlighted that the large majority of respondents indicated strategic partnerships and/or a strong local network as a key success factor.

While this offers a critically important method of navigating the region's sometimes opaque markets, it also exposes the industry to questions of conflicts of interest. Deal flows or exit avenues that are sourced through the closed and private networks of LPs may not be as open to careful due diligence as those sourced at arm's length. Similarly, family businesses are sometimes suspected of having unrealistic valuation expectations for investments, a phenomenon which some analysts believe contributed to a general slowdown in PE activity in the region in 2008-2009.[38]

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31 For instance, while Qatar managed to maintain a real growth rate of 9.5 per cent over this period, the UAE saw real growth contract by an estimated 2.7 per cent in 2009 EIU (2010)
32 Growth ranges from over 23 per cent in Qatar to 2.6 per cent in the UAE EIU (2010)
33 All GCC currencies are pegged to the US dollar, except the Kuwaiti currency, which is pegged to a currency basket that includes the US dollar
34 EIU (2010)
35 Executive (2009)
36 Barclays Wealth & EIU (2009)
37 Knowledge@Wharton (2009a)
38 Allam (2010)

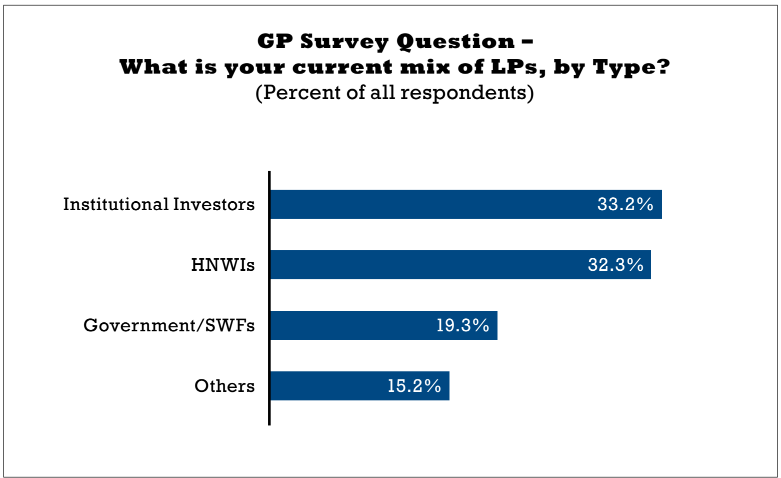
Despite issues of internal opacity, the region's banks are conservative and have demonstrated a historical preference towards name-based lending as opposed to collateral- and cash flow-based lending.[39] So strong is the role of reputation in the PE industry in the Middle East that it outranks by more than half all other factors thought to be involved in the competitive differentiation between PE firms.[40] Nevertheless, there is growing pressure for banks to change this preference. Recent high-profile cases of debt default, such as the Saad- Al Gosaibi case,[41] have provided an important catalyst for banks to make the transition away from name-based lending.

The distinction between 'reputation' and 'networks' appears to be important. Without a solid reputation, the existence of networks may hold little value when it comes to winning deals. GPs lacking a supporting reputation in PE may find it challenging to rely on networks alone. Here again, the role of well-connected LPs in the Middle East comes to the fore. Smaller business that are not part of the region's business and network inner sanctum often benefit from the investment of a connected LP. This sends a message of confidence to the target, equating an LP's investment with credibility.[42]

3.3.3 High Net Worth Individuals

The regional wealth growth saw an important rise in the number of high- and ultra-high net worth individuals (U/HNWI) in the region who became another growing and important source of funds. In fact, UHNWI's make up 32 per cent of LPs in the region as opposed to 13 per cent in most other markets[43] (see Figure 9).

Figure 9. LP Mix in Middle Eastern PE



Source: 2010 INSEAD and Booz & Company survey

The extent of participation from HNWIs and family groups in private equity is one of the industry's defining features in the Middle East. Many PE investments appear to be largely sourced by influential LPs who are often Gulf-based HNWIs,[44] relying critically on their networks, connections and reputations.

The 2010 INSEAD – Booz & Company survey found that within the current mix of LPs, HNWIs were ranked as the second most important, after institutional investors.

Merrill Lynch[45] estimated that in 2009 there were around 400,000 HNWI[46] and 3,600 UHNWI[47] in the Middle East. Their wealth has shrunk from a peak in 2007 of an estimated $1.7tn to $1.4tn in 2008 and recovering to $1.5tn in 2009, reflecting some contagion by the global financial crisis. The crisis has had a marked impact on the region's wealthy. Barclays[48] surveyed HNWIs around the world[49] and found that they had not emerged from it unscathed. In the GCC, Qatar featured among the five countries whose wealthy were worst affected, where 53 per cent of respondents said personal net worth had been 'very' or 'quite negatively' affected by the downturn. Conversely, Saudi and the UAE were among the five least affected countries, where 36 per cent and 21 per cent, respectively, claimed to have been negatively affected.

39 Executive (2009)
40 Deloitte (2009)
41 The National, June 17th
42 Knowledge@Wharton (2009a)
43 FAMILYOFFICEGLOBAL(Summer 2010) - Issue 321
44 Booz & Company & INSEAD, (2009)
45 Merrill Lynch (2010)
46 Defined as people who have at least $1m in investable assets, excluding primary residence, collectibles, consumables, and consumer durables
47 Ultra-HNWIs are defined as those having investable assets of US$30 million or more, excluding primary residence, collectibles, consumables, and consumer durables
48 Barclays Wealth (2010)
49 Barclays surveyed 2,000 HNWIs, all of whom had over £1m (or equivalent) in investable assets and 200 with more than £10m. Respondents were drawn from 20 countries around the world, across Europe, North America, South America, Middle East and Asia Pacific. The interviews took place between February and March 2010

Special Issue 2: Family Businesses and Corporate Governance: The Damas Case

The Transition from Family Business to Corporate Environments: The Damas Case

Tackling corruption has been a central focus of the region's governments in recent years. And while family-owned businesses are no more or less likely to be prone to corruption, their lack of transparency leaves them more readily open to question. Damas Jewellers is a case in point. The Dubai-based firm was a successful family-owned business of which Amwal[50] acquired a 23 per cent stake in 2005 for $82.5m. This allowed the firm to expand geographically into Saudi Arabia and other international markets,[51] and to more than double its profits from 2004 to 2007. However, in 2010 the firm, now publicly listed, was charged by the Dubai Financial Services Authority (DFSA[52]) with corporate corruption. In essence, family management was still treating the now listed firm like a private company when they withdrew large sums without disclosure. The DFSA blamed Damas for failing to apply sufficient internal oversight and for not preventing unauthorised transactions totalling more than $165m. Discussing the case, the CEO of the DFSA, Paul Koster, said "It's a lesson for family-owned companies – as soon as you move to the market, you have different requirements, one of them being obviously transparency, but also that you have governance systems in place that protect shareholders." [53]

Of particular interest in the Damas case is that it perhaps reflects a new maturity in the region's regulatory environment. Although Damas was accused of failing to apply internal oversight and control, the market that Damas entered already had the controls in place both to identify and take action against the inconsistencies. The company's founding brothers were banned from executive directorships with any company in the DIFC.[54] While all markets are vulnerable to corrupt practices, the Damas case has demonstrated that in the DFSA the regulatory environment is now able to tackle such issues. The fact that the regulatory system is starting to flex some muscle should give investors confidence.

Although this is an issue of corporate governance, there are marked implications for PE. Damas could have gone down the IPO route without the involvement of any private equity firm and would likely have suffered the same fate. However, the repercussions and implications of weak corporate governance are critical for private equity.

3.3.4 Regulatory Environment: Progressive Reforms

Aside from generous tax regimes, Middle Eastern PE investors do not enjoy a great many structural advantages. There are significant gaps in the region's legal and regulatory frameworks, particularly in investor protection and corporate governance. Bankruptcy laws, for instance, are still not in place in many countries in the region, leading to confusion when portfolio companies fail.

Across the region, the regulatory environment has struggled to keep pace with the fast economic growth. Following the financial crisis, several countries increased the scope and pace of regulatory reform to meet both international standards and local conditions. There are, however, still many areas in which further reform and development is required in order to support the PE/VC investment and banking sectors.[55]

While the region performs very well on global rankings for the tax regime,[56] it performs less strongly in the areas that will encourage the PE industry, namely investor protection, bankruptcy laws, and contract enforcement.[57] The IFC's rankings[58] show that regulatory environments vary widely across the Middle East.[59]

[50] Amwal Al Khaleej
[51] Including Jordan, Egypt, Libya, Sudan, Italy, India and Japan through investment in jointly controlled entities and associates. Source: Company website (June 2010)
[52] Dubai Financial Services Authority, the regulatory authority for the Dubai International Financial Centre
[53] Al Jazeera (2010)
[54] In 2010, however, they were appointed as senior advisors, just months after they were dismissed for financial irregularities (Bianchi, 2010)
[55] Gandier (2009)
[56] See, for example, Groh & Liechtenstein (2009)
[57] Obstacles created by bureaucracy and restrictions on foreign ownership have been cited as specific hindrances to global pharmaceutical companies seeking to set up more complex operations in the Gulf beyond manufacturing, distribution and marketing (Bains, 2009)
[58] IFC (2009a)
[59] While Saudi Arabia ranked 16th out of 183 countries for the protection it offers investors, it ranked 140th for enforcing contracts. On global rankings, Syria performed most poorly for enforcing contracts, ranking at 176th. The best performing MENA country for contract enforcement was Yemen, which ranked 35th in the world

The relationship-based, family-driven nature of the business landscape in the region has historically not yielded the transparency that global institutional investors and GPs expect.[60] There is limited history and a poor culture of corporate disclosure, and while this is improving, there is little precedent for the exercise of minority rights by investors, and the real and perceived potential for corruption remains high. Although important progress towards market liberalisation has been achieved in some regional economies, the future role of key markets still depends critically on government's ability to follow through with plans to make their economies investor-friendly. For instance, Dr Hafeez Shaikh of Dubai-based New Silk Road Partners stresses that Saudi's role in PE will depend largely on the government's continued success in liberalising the economy and domestic businesses'ability to adhere to international governance standards.[61]

Important reforms have already been achieved, particularly in the regulatory environment governing business practices.[62] Some of these reforms are likely to have a direct impact on the PE industry. Noteworthy is that several economies[63] in the Arab region have reduced or abolished the minimum capital requirement for starting a limited liability company.[64] This may, in turn, provide an important stimulus for the region's venture capital industry. Furthermore, Egypt is introducing a Corporate Governance code with which listed companies must comply.

3.3.5 Exit Options for Private Equity Firms in the Middle East

The number of exits recorde d by PE in the region is still small. This is due both to the recent crisis, the relative young age of the Middle Eastern PE industry, and the limited data availability on private placements. Most funds are still in their deployment stage yet several exits have been announced in the first half of 2010. Indeed, with around 90 per cent of GP respondents to the 2010 INSEAD-Booz & Company survey indicating a planned exit in the next 18 months, exit activity is likely to increase significantly.

In the past, exits were limited mostly to sales between family business groups as the array of alternative exit routes was relatively restricted. The perception is that Middle Eastern IPO markets are fractured and lack the maturity and depth of their more developed counterparts, and that there are limited corporate buyers for trade sales. The current growth and development of local stock exchanges and some recent successful trade sales may indicate a potential for expansion of viable exit routes in the region. Consolidation of local exchanges could add to the critical mass needed to achieve a larger IPO volume.

Exits, then, will likely take a new shape in the next stage of the industry's development. IPOs in the region averaged around $14bn for 2007 and 2008[65] but sharply declined to $2.1bn in 2009, reflecting the financial crisis. Going forward, some analysts expect a strong role for IPOs and trade sales. Deloitte,[66] for example, surveyed PE confidence and found that 39 per cent of its respondents believed that IPOs would be the dominant exit route, while 42 per cent held that trade sales would be the dominant driver. Not all analysts agree. According to Global Investment House,[67] the IPO market will improve but trade sales will continue to be the primary exit route. Market sentiment is strong but activity remains to be seen: 86 IPOS have been announced in the Gulf in 2010, but so far only $829m has been raised through eight share sales.[68]

3.3.6 Middle Eastern Capital Markets

Regional regulators and authorities are actively working on increasing the depth and structural strength of the investment environment, including their capital markets. However, reforms in some instances have not yet progressed far enough. In its annual market classification review for 2010, MSCI Barra[69] announced that both the MSCI UAE Index and the MSCI Qatar Index will remain under review for a potential reclassification to 'emerging market'. This means that they will retain

[60] Gandier (2009)
[61] PEI Asia. July/August 2009. Issue 32
[62] IFC (2009b)
[63] UAE, Egypt, Saudi, Tunisia and Yemen
[64] Five of these previously had some of the highest such requirements in the world, demanding the equivalent of up to $120,000
[65] Zawya (2009)
[66] Deloitte (2009a)
[67] Hasan et al (2010)
[68] Financial Times, (June 2001)
[69] MSCI Barra (2010)

Private Equity investments – local law impact on structuring and documentation

By Tim Field, Partner & Regional Head, and Isabella Roberts, Partner, Simmons & Simmons, Abu Dhabi

Whilst the basic legal documents used in private equity investments across the ME region are broadly those used across the world, local law issues have influenced structures and specific aspects of these documents in the region.

The investment model which has prevailed in the region is one where the private equity investor takes a substantial minority stake in the investee business. This differs slightly from the typical Western model and in part this is driven by prevailing local restrictions. In the majority of the GCC states foreign ownership restrictions apply, to limit the percentage holding that a non-local can have in the investee company. For many private equity funds which are domiciled overseas this operates as a real barrier to the size of the stake which they can take.

The typical Western private equity deal structure typically also uses different share classes to give different share rights to holders of each class and to allow private equity investors to invest in both ordinary and preferred shares. For example, the class of shares held by the private equity investor would typically carry significant voting and control rights, and the private equity investor might hold both these and preferred shares, having a preferential dividend right. Share classes are also frequently used to provide management incentive structures such as share options and equity ratchets. These types of structures are unavailable in many of the ME states as the applicable legislation frequently prohibits or restricts the availability of different share classes. Therefore the prevailing model of a simple minority stake is likely to continue.

The region has also not yet seen the kinds of complex, leveraged debt structures which have been used elsewhere. In the aftermath of the financial crisis there is little appetite for such structures globally. However, in the ME region local restrictions may also affect the attractiveness of these structures: heavily leveraged deals are incompatible with Shariah law, and the kinds of security packages available to secure debt funding generally less comprehensive than these available in the U.S. and Europe. For example, there may be requirements to take security through a local bank, and it may be difficult to take security over uncertain or future assets.

There are three broad categories of exit which are available: IPOs, trade sales and secondary buyouts or refinancing. To date, the ME region has seen a prevalence of trade sales, in part because regional IPOs have tended to be of large state enterprises. This reflects both the emerging nature of those markets and the legislation around IPOs, which tends to envisage large flotations by public subscription and consequently reduces the availability of IPOs as a possible exit route.

In terms of domiciling funds, most of the PE funds investing in the region are incorporated in jurisdictions such as BVI and Cayman, which reflects the relative ease and certainty attached to establishing funds in those jurisdictions as compared to domiciling funds locally where regulation is often less sophisticated, less clear (Bahrain being an exception) and more cumbersome.

From a regulatory perspective, managing private equity funds and fundraising for these funds will typically be activities which are subject to regulation. The extent and sophistication of the regulations which apply to these activities across the ME region vary. Similarly the fund structure and the target investor group will affect the extent of regulation – many funds investing in the region will be domiciled in other jurisdictions (typically BVI, Cayman etc) and will therefore be subject to the regulations of those jurisdictions. These regulations typically distinguish fund management from some other classes of regulated activities such as deposit-taking. The regulations in many ME jurisdictions do not make this distinction, meaning that fund management will often require a full banking licence.

Similarly, to the extent a fund is raising money from international investors, based for example in London or New York, the securities regulations applicable to these jurisdictions will be relevant. In general, discreet offers of such securities into the GCC are permitted as a ''tolerated practice'' although Saudi Arabia requires registration of private placement documentation. It is worth noting that many of the ME states do not have a sophisticated regime which distinguishes between institutional investors and other investment professionals on one hand and less sophisticated investors on the other, meaning that no regulatory relaxations apply with respect to offering fund investments to institutions or high net worth individuals.

their 'frontier' market status. Issues that MSCI raised in maintaining their status as 'frontier markets' include continued limitations on foreign ownership, the frequent use of dual account structures[70] and, in the case of the UAE, delays in the implementation of the proposed enhancements. As noted by one respondent to the INSEAD-Booz & Company survey, "GCC regulatory rules must evolve to keep up with changing investment practices."

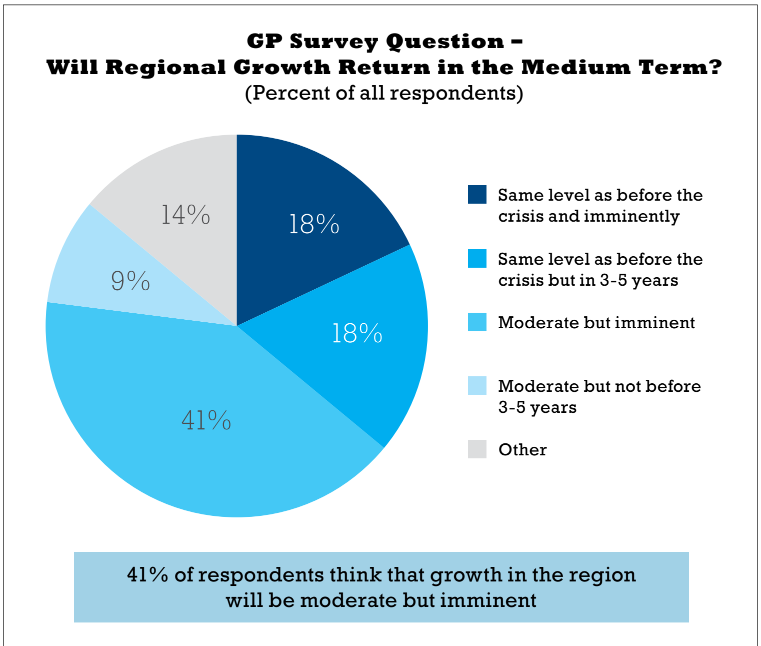
Middle Eastern stock markets, particularly those in the GCC, are fragmented and often dominated by small retail investors, though this is gradually changing with the steady institutionalisation of regional bourses and more attentive regulators. By increasing their transparency and strengthening their regulatory frameworks, these bourses are increasingly becoming populated with institutional investors.

Nevertheless, existing regulations in the region are still mostly skewed towards small investors. For example, Saudi Arabia's Tadawul, the largest stock market in the Middle East, has a six-month lock-up period for original shareholders, and the Capital Markets Authority (CMA), which must approve all share sales, typically stipulates a price that is about 20-30 per cent below the price set through a book-building process.[71] In the UAE, companies have to list at least 55 per cent of their shares through primary rather than secondary issuances, which means that anyone with a minority stake (as required by ownership laws in some Gulf countries) cannot exit their investment upon IPO. Additionally, original shareholders have a two-year lock-up period.[72] The increasing presence of institutional and other sophisticated investors in the local markets is expected to put pressure on regulators and possibly lead the drive towards much-needed changes.

4 Current Investment Outlook

To take advantage of Middle Eastern opportunities in 2010 and beyond, PE firms are being pushed into specialisation. They will also have to provide more operational support to their portfolio companies, helping with operational activities (such as executive recruitment, market positioning and partnership development) as GPs often do in developed markets.

Figure 10. Perspectives on Economic Recovery



Source: 2010 INSEAD and Booz & Company survey

The availability of capital may not pose overt problems. GDP is expected to grow 3.5 percent in 2010 as the region's economy emerges from the downturn. By historical standards, oil prices are still high enough to bring liquidity and wealth to the region. The general sense of optimism was evident in the INSEAD-Booz & Company survey (see Figure 10).

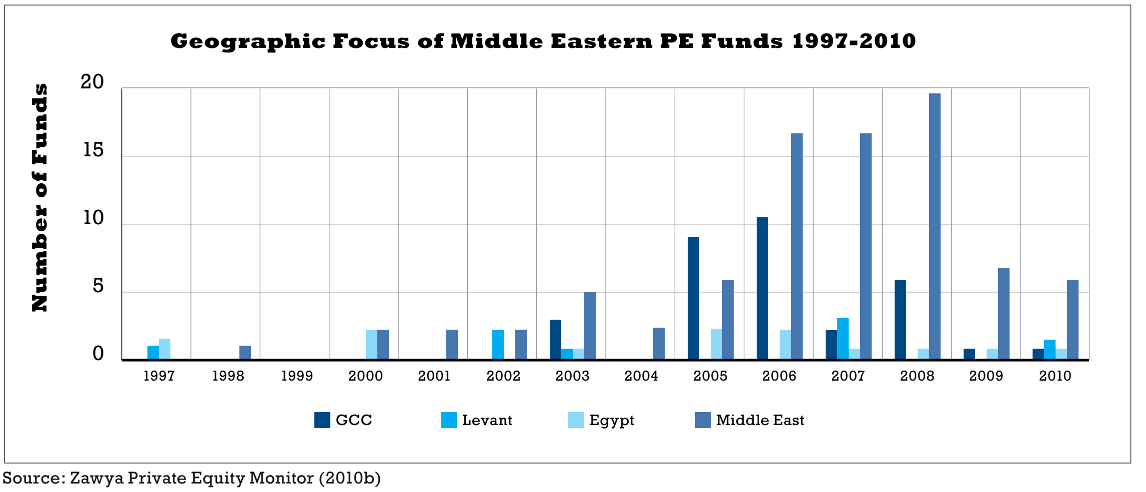
In addition, Middle Eastern PE firms are still sitting on about $11bn[73] in unspent funds—raised before the economic downturn. Even if investments were to return to the fast pace of 2005-2007 (around 70 transactions a year, with an average size of $30m[74]), it would take more than five years to place all of this capital.

[70] International institutional investors often establish segregated custody and trading accounts in order to mitigate the risk from local brokers having unlimited access to the trading accounts
[71] Private Equity and MENA Region, June 2009, Amwaj Khaleej
[72] Private Equity and MENA Region, June 2009, Amwaj Khaleej
[73] GVCA Private Equity &Venture Capital in the Middle East Report
[74] Booz & Company analysis

4.1 Geographic Focus

The dominant trend since the beginning of the region's PE industry has been a broad Middle Eastern focus with the majority of opportunities and transactions occurring in Egypt, given its maturity, depth and strong economics.[75] According to Citadel research, Egypt accounted for 40 per cent of deals in the Arab world, followed by the UAE (27 per cent) and Saudi Arabia (23 per cent). Funds have been opportunistic and have kept their regional scope relatively open (See Figure 11). Nevertheless, there seems to be a shift in investment focus.

Figure 11. Geographic Focus of Middle Eastern PE Funds



Source: Zawya Private Equity Monitor (2010b)

The 2010 INSEAD- Booz & Company survey indicated that the large majority of GPs are looking to invest in the GCC.

Although many of the GCC countries are relatively wealthy, they lack the critical mass of large population numbers, their economies are still not fully diversified and their regulatory environments are still under development. Saudi Arabia, by contrast, has a large and young population, a growing economy and a government dedicated to achieving wider economic diversification. Accordingly, it is drawing strong interest from the PE sector. Some analysts believe that, despite the distinct challenges that the Saudi market could pose (most notably economic and cultural conservatism, legal hurdles and visa issues), the economy is simply too big with too many resources for it not to make a compelling investment case. Furthermore, the Kingdom's latest budget is the largest ever, with projected spending of approximately US$ 144bn.[76] A number of international PE firms expect to open offices in Saudi in the coming months. Abraaj Capital inaugurated an eight-member team office in Riyadh in May 2010,[77] while Jordan-based Ithmar Invest and Revere Capital Advisors of New York are both reported to be intending to open offices in Riyadh.[78]

Among the main legal obstacles faced by investors in Saudi Arabia is the difficulty of crafting a reliable exit strategy after taking a position. Raising debt is uncertain and, rather than de-listing public companies, most private equity in the kingdom focuses on corporate restructuring. This is particularly so for family businesses seeking to sell a portion of the company. Moves to expand the industry have been slow and face a variety of hurdles: IPOs are often restricted to Saudi investors, the secondary market is thin and foreigner-unfriendly, and non-Gulf shareholders are liable for a 20 per cent capital gains tax. Indeed, but for legal hurdles and visa issues, some practitioners think Saudi may have commanded a much larger share of the regional PE market than the 23 per cent it currently accounts for.[79]

However, despite the restrictions that remain in place, Saudi Arabia has been undergoing a significant phase of liberalisation. As liberalisation begins to take effect, investors are noting a commensurate

[75] Over the years 2008 to 2010, Egyptian real growth ranges from 7.2 per cent (2008) to 4.7 per cent (2009), recovering to 5.2 per cent in 2010
[76] http://www.menafn.com/qn_news_story_s.asp?StoryId=1093320866
[77] http://www.abraaj.com/english/mediacenter/Files/Abraaj-Capital-Opens-Saudi-Office.pdf
[78] Zawya, (2010a)
[79] Allam, (2010)

rise in opportunities. For instance, Ahmed Heikal, chairman of Citadel Capital, expects at least $20bn in transactions in Saudi Arabia over the next five years in sectors such as mining concessions, microfinance, healthcare and education.[80]

4.2 Sector Focus

The open geographic focus of Middle Eastern funds has, to date, been matched by a similarly broad approach to sector focus. Many key players invest across a wide range of sectors and it is not unusual for a portfolio to comprise investments in health, agriculture, real estate, education and ICT.[81] However, given the operational expertise required to succeed in a more challenging environment, and more clear streams of growth in the region, a growing number of firms are focusing on very specific sectors, mainly infrastructure, consumption, healthcare and agriculture. The INSEAD-Booz & Company survey indicated a strong interest in consumer spending themes in line with demographic trends.

Given the anticipated economic growth, the large operational and sector focus, specialised talent is and is expected to be a challenge to source and an opportunity for differentiating and succeeding.

4.2.1 Infrastructure

Many ME economies have a pressing need to develop and/or upgrade infrastructure. Where they differ is in their financial resources to achieve this. Resource-rich GCC countries are currently pushing ahead with major infrastructure investments and development, and there has been a commensurate rise in private sector investments entering the sector. While other Middle Eastern markets lack the resources to undertake similar projects, PE investors may be able to create opportunities where governments cannot. Indeed, in markets such as Egypt, PE is perhaps playing a more traditional role as an important source of capital for financing infrastructure and communications with a different risk profile than those government-supported investments in the GCC.

Various estimates suggest that around $2.3tn is required in infrastructure investments in the Middle East and Levant region over 2010-2015, the bulk of which will be in the GCC. More than $900bn will be required to meet infrastructure capital demands in the region, of which $800bn will be in the GCC.[82]

4.2.2 Healthcare

The Gulf Venture Capital Association[83] has estimated that the healthcare sector attracted 16 per cent of all private equity investments in the GCC in 2008. This is a major increase from 2007, when healthcare accounted for just 8 per cent of total investments. Notable investments in the sector to date include those of Abraaj, Injazat, Ithmar, The National Investor and Gulf Capital.[84]

The healthcare sector, including biotech and pharmaceuticals, is expected to yield the most substantial investment opportunities in the near term with around 26 per cent of upcoming

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80 Allam, (2010)

81 Such 'sector agnosticism' is well illustrated by the example of Gulf Capital's recent Equity Partners II fund. The fund received capital commitments of around $467m by mid-2009. As of January 2010, the fund had investments spread across three sectors; oil and gas, education and healthcare. In the education sector, the fund invested in the largest group of schools in Saudi Arabia when it purchased 50 per cent of Al Maareef (Remo-Listana, 2010). Together these three deployments are reported to be worth around $150bn.
Similarly, Egyptian PE firm, Citadel, is diversified across agriculture, construction, mining, oil & gas, transport, banking and media. Citadel has seeded around 18 opportunity-specific funds that control Platform Companies. These Platform Companies are designed to serve as vehicles for add-on acquisitions, with the ultimate intention of transforming national companies into regional players in their respective industries. Deloitte, (2009)

82 Booz & Company, 2009a Indeed, with infrastructure spending ranging from between 16 per cent of GDP in Qatar to 49 per cent of GDP in Algeria (Booz & Co & INSEAD, 2009), opportunities for PE to be deployed within the region are likely to be plentiful

83 KPMG & Gulf Venture Capital Association, (2009)

84 In February 2010, TVM Capital MENA announced the Shefa MENA Health Fund with an initial target size of $100m and a first close of $40m.
In 2006, Injazat joined with Al Qudra Holding, National Holding and the Saudi Health Investment Company to launch Al Qudra Healthcare and Wellness Holding. With commitments aiming to reach AED20bn within the first five years, the group had ambitious plans to specialise in advancing the healthcare programme in the region. However, as of 2010 Al Qudra Healthcare has not proceeded with investments.
Similarly, Abraaj Capital expanded its investments in healthcare. Through its $2bn Infrastructure and Growth Capital Fund it acquired a 69.6 per cent share in Acibadem, a premium healthcare platform in Turkey. It further acquired a 50 per cent share of Turkish health insurance company, Acibadem Sigorta; in Saudi Tadawi Healthcare company, (KSA's largest pharmacy chain); and in Al Borg Laboratories, an Egyptian medical testing company.
Ithmar Capital invested in Belhoul Lifecare, with the intention of using it as a platform for M&A with other hospitals and polyclinics. Ithmar's other key health sector investment was into Pharma World with the intention of building it up through M&A, a partial divestment to a strategic partner, and with the objective to achieve pan-GCC operations and develop synergies

opportunities,[85] given the pace and volume of planned investment to meet rising demand. Indeed, respondents to the INSEAD-Booz & Company survey identified healthcare as an overarching investment theme in the Middle East. Similarly, respondents to the Deloitte MENA PE survey[86] expected the healthcare sector to yield the most opportunities in 2009-2010. Growth in this sector is expected to be driven by strong demographics, increases in healthcare needs given declining health levels as a result of newly affluent and sedentary lifestyles, and longer life expectancy. The healthcare sector in ME has been characterised by underinvestment for several decades, and countries like Kuwait have not build a new hospital in over 20 years.

Given that spending on healthcare in the GCC region is expected to increase fourfold from $15bn in 2008 to $60bn in 2025, and given also that the cost of providing ongoing healthcare services is largely born by the state,[87] there is substantial scope for PE to take advantage of opportunities in the healthcare sector.

4.2.3 Agriculture and Food Security

The agricultural sector has also gained prominence as an investment target in recent years. There has been significant interest from various GCC sovereign wealth funds in investing in agricultural land to assuage domestic food security fears. The recent rise of food security as a policy priority has contributed to an increase in private equity seeking opportunities in the agriculture and agribusiness sectors. Most particularly in the GCC, a region that is almost entirely food import dependent, interest in investing in these sectors has seen substantial growth.

In a direct response to concerns about food security in the region, GCC governments approved the allocation of $2bn in finance for an Arab agricultural holding company. The fund is planned for launch in 2010 and will be overseen by the Arab Authority for Agriculture Investment and Development, which is headquartered in Khartoum. The specific aim of the fund is to acquire stakes in existing food companies in Africa and the Middle East.[88]

In March 2010, Beltone Agriculture announced the Mahaseel Agriculture Investment Fund. The fund has an initial target size of $1bn and is focusing on investing across the agriculture chain in Sudan and Egypt. Similarly, Dubai-based Pharos Financial Advisors announced a $350m agriculture fund at the end of 2009. The fund will focus on the acquisition and operation of farmland in Eastern Europe, Eurasia and Africa.[89] Citadel's Gozour is a $250m platform company for an integrated regional agriculture and multi-category consumer foods group. Injazat Capital, while not raising a specific agriculture fund, is providing advisory services to the White Nile Sugar Company (WNSC) on completing the financing of its new $1bn sugar refinery in Sudan.

4.2.4 Energy

Energy (including oil & gas, power and utilities) has been among the most dominant sectors for investment for the last decade. Noteworthy regional energy funds include the 2005 GCC Energy Fund and the 2007 EMP Energy Fund. Additionally, several GCC SWFs invest actively in the international energy sector.

Although oil and gas have formed the foundation of the Middle East energy sector, several countries are now actively pursuing alternative forms of energy. The UAE, in particular, has placed great emphasis on diversifying its energy sector and investing heavily in renewable and nuclear energy. Abu Dhabi's 'Masdar Clean Tech Fund', for example, has just completed its first closure after successfully raising $265m. Other PE investments in clean energy include Jordanian Catalyst Investment's 81 per cent stake in Millennium Energy Industries, which has recently won contracts including the conversion of hot water from oil to solar for the Princess Noura University for Women project in Riyadh in Saudi Arabia.

[85] Deloitte, (2009a)
[86] Deloitte, (2009b)
[87] GCC governments are estimated to be paying for around 75 per cent of healthcare costs (MEED 2009)
[88] http://www.pioneersholding.com/egypt/page.php?pg=news_detail&news_id=134673&lg=1
[89] Trade Arabia. November 25, 2009

5 The Road Ahead: Challenges and Opportunities

Governments, particularly in the GCC, are seeking simultaneously to upgrade and diversify their economies. Coming through the financial crisis and with economic fundamentals appearing to be strong, a window of opportunity has presented itself for these governments to further strengthen the regulatory environment. As such reforms take hold and the economy responds accordingly new and varied opportunities for the private equity industry will be generated.

Consistent with the nature of infant nascent industry, the Middle East PE market is still dominated by a select number of key players, and large single deals. We do not expect this to change in the near future which is consistent with the majority of survey participants who expect consolidation and a reduction in the number of PE firms in the region.

The rise of private equity in the Middle East has coincided with a period of immense tumult in financial markets worldwide. The region's PE industry sprang up when equity prices were rising, and many local players enjoyed early success in the form of quick and profitable exits from investment positions. However, that dynamic soon reversed, and in the last few years, there have been more problems than profits in PE in the region. This down market has hugely affected local practitioners- most of them have taken and acted on at least a few lessons and opportunities for improvement. Many have swiftly changed their structures and approach to markets, redesigned their due diligence processes, and strengthened their operational teams.

The region holds specific opportunities that are open to discovery by disciplined, experienced and connected PE firms. The survivors of the financial crisis will most likely opt for increased specialization, greater emphasis on earlier stage investing and SMEs, improved economics for investors and more operationally focused sector-specific teams. The large number of funds competing for acquisitions may lead fund managers to re-think their investments or value creation strategies. The survey results gave mixed responses to the question of whether there were too many funds chasing few deals. This seems not to be an issue for the majority of participants partly because GPs are now more selective and more disciplined on valuations.

One key element specific to the region is the GPs relationships with family businesses, which in most cases are also clients and/or investors. Their managing owners are often sophisticated and proven entrepreneurs with privileged market access. Although the recent crisis may have affected their investment capital pockets, they still are a strong source of funds. As these family businesses enter into their third generation and re-evaluate their existing portfolios they may divest non strategic companies [90] presenting new opportunities for local well-connected PE firms. Successful PE firms will thus need to develop or enhance their collaboration with such families as a differentiation factor.

Private equity firms are now looking to the future trying to figure out what it will take to succeed and whether they have, or can develop, the attributes required. As alluded in different ways by survey respondents, success will depend on more fundamental sources of value.

As regional firms rebuild, they will need to do the basic fundamental strategies right: specialize, identify sustainable investment ideas, create value within their portfolio companies, reduce risks and gain the trust of the best possible investment partners. These are things that will work, and remain important, in good times and bad.

[90] **Booz & Company: GCC Family Businesses Face New Challenges, 2009**

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