Dubai International Financial Centre (DIFC) held its fifth Knowledge Series seminar on Wednesday 24 June 2009, on the topic 'Private Equity in the MENA Region'. The aim of the seminar was to discuss the challenges faced by private equity firms in the current economic environment and explore their prospects and opportunities in the GCC.

In his opening address, CEO of the DIFC Authority, Abdulla Al Awar noted that although private equity firms in the GCC had been affected by the global financial crisis, the region also offered unique opportunities for players that had been prudent in the past. Those firms that are able to access surplus investable funds could take advantage of the cash-strapped positions many otherwise well-managed businesses in the region now find themselves in.

Al Awar also highlighted that the Middle East generally has been relatively resilient during the global downturn as oil producing nations have benefitted from budget surpluses accumulated over the last few years. As a result, there is substantial investment potential in the GCC, and private equity firms could be on the verge of a period of expansion and acquisition. This view is supported by data that suggests that mergers and acquisition activity in the GCC is projected to increase, led by the UAE and KSA.

Private Equity in MENA is in its Infancy

Tamer Bazzari, CEO of Rasmala Investments, discussed private equity as an asset class in MENA, highlighting that the industry is still in the early stages of its development in this region compared with North America, Europe and Asia Pacific. This is true both in terms of the amount of capital raised in the region (just 2% of the total amount of private equity raised globally in 2008), and the investments made (1.2% of the global share). However, statistics show that private equity has outperformed other asset classes over a 10 year horizon, suggesting that there is tremendous potential for the private equity industry in this region to grow in the coming years.

Achmad Al Shahrabani, Senior Vice President of Abraaj Capital, echoed Bazzari's sentiments on the growth potential of private equity in the Middle East, North Africa and South Asia (MENASA) region. He argued that economic growth in the region would be driven by demographics, hydrocarbon wealth and continued structural reform and diversification. While the developed economies of the world are expected to recover only slowly from the current recession, Al Shahrabani expects the MENASA region to be the second fastest growing, after China, over the next 5 years.

Private equity also offers several advantages over other asset classes, particularly in the current economic environment. These include more control over the fate of the investment with an active management approach, and the subsequent contribution to real economic growth, as well as the ability to generate higher returns for investors. In the MENA region, there is the additional advantage that private equity is seen by many investors as a Sharia compliant asset class.

Trends in the Private Equity Sector

Of the various methods that private equity managers have used in the past to add value (including financial engineering and arbitrage), in the current environment most of the experts agreed that 'active ownership' was the key to delivering value and generating returns to investors.

Michael Kidd, Executive Director of Swicorp Private Equity, argued that active ownership was the differentiator between private equity and other ownership forms (such as equity index, mutual and hedge funds), and that the higher returns generated by active ownership in private equity fully justified the higher costs of this model. However, he noted that in the MENA region, active ownership faces unique challenges. These include a reliance on informal networks and country specific relationships to evaluate potential investments in the absence of hard data; managing the relationship with other (often majority) stakeholders particularly in family businesses; aligning managers' incentives with the strategic priorities of the business; and launching value creation initiatives, particularly where outside expertise or support is needed.

Vikas Papriwal, Partner at KPMG, outlined some of the changing dynamics in the private equity industry that have become evident in recent months. He noted that there was about U$11bn of 'dry powder' (or committed capital that had not been called) in the region and questioned whether it would be called in the current climate. He also highlighted the increased holding time of private equity investments, and the greater involvement of Limited Partners as recent slightly negative developments in the industry.

However, Papriwal noted that the more challenging environment has brought about some positive changes in the industry: pre-deal due diligence is more robust than it was before the economic crisis, and better reporting frameworks and corporate governance structures are now being put in place. Private equity firms are more focused on boosting productivity and making operational improvements as a result of the longer investment time horizons and lack of available acquisition funding.

DIFC

Dubai International Financial Centre
The Gate, Level 14
P.O.Box 74777, Dubai, UAE
Tel: +971 4 362 2222
Fax: +971 4 362 2333
Email: info@difc.ae
Web: www.difc.ae

Challenges Facing Private Equity in MENA

All the experts agreed that private equity in the MENA region in particular faces significant challenges, including a lack of financial data and reporting procedures in many companies, poor corporate governance and the lack of liquidity in the market.

Gavin Steel, Director of the Capital Markets Group, PricewaterhouseCoopers, noted that one of the benefits of a private equity investment into a business in MENA was to address some of these shortcomings. Typically the entry of a private equity or venture capital investor results in the implementation of systems and controls in the accounting and finance functions, with more timely data being produced. It also improves transparency at Board level and improves corporate governance generally. A private equity investor also has a big impact on the human resources of a business: non-family members are often put into senior management positions and incentives and remuneration must be aligned to the strategic goals of the business, both for the holding period of the private equity investment and the ultimate exit. Steel also noted that the exit strategy of the private equity investor has a direct impact on the strategy, operations and management of the business during the holding period.

Trading Facility Could Boost Liquidity

The difficulty in exiting private equity investments in the current liquidity environment was highlighted by many experts. Although IPOs have been the preferred exit route in the last few years, this is unlikely to be a feasible exit strategy for at least the next two years according to Steel.

Paul Koster, Chief Executive of the Dubai Financial Services Authority, discussed one option to boost liquidity in the asset class and encourage a more gradual exit strategy: the introduction of a trading facility that would allow private equity investors to sell part of their stakes in certain companies in their portfolios. This would release capital for the private equity fund, boost liquidity generally, and provide a partial exit strategy. Koster stressed that such a trading facility would offer both short and long term opportunities, but that there would need to be a slight change to current business models that would require consultation with investors. Nasdaq Dubai could play a key role in developing such a trading facility.

Regulatory and Legal Issues

Koster also said that in his opinion, private equity did not need the same level of regulation as banks and insurance companies, and that private equity firms would play a vital role in recapitalising troubled banks and getting the global financial system back on track. However, there was a need for checks and balances to be imposed by regulators, particularly with regard to conflict of interest issues.

Adrian Low, Partner at legal firm DLA Piper outlined some of the unique issues that affected private equity transactions in the MENA region, making it particularly important for both investors and sellers to get legal advice early in the process. These include nationality restrictions in the UAE, meaning that private equity investors would always have a minority stake in the business; simpler group structures due to the high cost creating subsidiaries in the MENA region relative to other parts of the world; and a lack of debt funding for private equity transactions.

Panel Discussion

The seminar concluded with a panel discussion on private equity in the MENA region, chaired by Dr Pablo Fetter, Member of the Gulf Venture Capital Association. Panelists included Michael Kidd (Swicorp Private Equity), Gavin Steel (PricewaterhouseCoopers), Tamer Bazzari (Rasmala Investments) and Vikas Papriwal (KPMG). The panel discussed various issues relating to the private equity industry including

- The attractiveness of private equity as an asset class for investors in the region
- The consolidation of private equity firms and the 'flight to quality'
- The different ways private equity firms can add value to the companies they invest in
- The trend of regional conglomerates divesting non-core businesses and the opportunities this provides for private equity firms
- Opportunities for more than one private equity firm to work together on the same project

Speaker presentations for this seminar are available on www.difc.ae under Knowledge Centre. For further information and the schedule of DIFC Knowledge Series seminars please email knowledgeseries@difc.ae