Coming of age

MIDDLE EAST AND NORTH AFRICA

Clear signs of improvement can be observed in the climate for Middle Eastern private equity, driving the successful fundraisings seen in 2005 and propelling the industry into its next phase of growth. By Judy Kuan.

Over the course of 2005, a notable sum of capital was accumulated for private equity investment in the Middle East and North Africa (MENA) region, building upon the trickle of funds that had begun to be directed to the region in 2004. Record-sized vehicles, such as Dubai-based Abraaj Capital's new $500 million buyout fund, were raised. Local institutional and strategic investors provided much of this capital, although there were signs of participation by international institutional investors as well.

To outside observers, this flurry of fundraising was perhaps the most noticeable development in the Middle East's private equity industry last year, but the phenomenon was based on a number of underlying improvements in the investing environment. "Successful fundraising is clearly linked to the fact that, while the Middle Eastern economies are doing well and there is a great deal of liquidity in the region, there still are not a lot of investment vehicles, so there is a place for new funds to fill the gap," says Nabil Triki, partner and head of private equity at Geneva-headquartered Swicorp, which launched three MENA-focused private equity fund vehicles last year.

While in the past, local investors were reluctant to re-invest their profits in the region due to geopolitical risks and tended to channel capital overseas instead, changes in world markets and improvements in local markets have caused them to take another look at opportunities on the home front. "The Gulf investors are by far the biggest participants in the Middle East's private equity industry. In a way, the perception is that their time has come. There is now a recognition amongst themselves that their markets are prime investment markets," says Zachary Venegas, co-founder and partner at Scimitar Global Ventures, a private equity firm currently invested in Northern Iraq and Morocco. "Perhaps the biggest change in perception is that big money can be made here."

PATHWAYS TO PROFITS

The forces driving this change are many, but instrumental has been increased exit options for private equity-backed companies in the region, say GPs active in the region.

Abe Saad, managing director of Dubai-based SHUAA Partners, attributes last year's fundraising activity to increased liquidity in the region and the increasing availability of exit opportunities, particularly through IPOs on the stock market. "We have had quite a winning stock market in the region which has created some substantial exit opportunities for private equity investments. Consequently, we are seeing more people take the plunge and try private equity," he says.

With the increased accessibility of public markets, more businesses are looking toward private equity for the boost necessary to achieve IPOs – whether on the Dubai Financial Market, one of the other local exchanges, or even on the newly opened Dubai International Foreign Exchange. "We have seen a lot of family businesses wanting to take advantage of the stock market to go public. They tend not to have the experience to do it alone, so they are beginning to team up with private equity firms to institutionalise the business before going public," says Saad.

In addition to developments on the exit front, GPs see the current environment as attractive for a number of other reasons. Swicorp's Triki points out that economies are being reformed in order to make them more open to investors. Local companies are beginning to move away from being purely family-owned entities and are obtaining increasingly professional management. More privatisations of state-owned assets are taking place, providing larger-scale investment opportunities.

It is also important to note that opportunities for private equity involvement are growing, not just in the Gulf States, but also in Jordan, Morocco, Egypt, Syria and other countries in the MENA region, says Romen Mathieu, managing director of Capital Trust's Euromena fund, which was launched last year and has a target capitalisation of $100 million. Many funds in the Gulf region are involved in privatising government companies and backing pre-IPO government companies in Dubai. "These investments differ from the type of private equity seen in the Middle East where groups help prepare family businesses to go public," he notes.

Despite these improving investment conditions, private equity funds in the region don't often come across what might be described as "ready-made" private equity deals. More often than not, companies encountered are not currently of large enough scale to be of interest to private equity investors. Consequently, part of the activities of Swicorp's largest fund, the $500 million Swicorp Joussour Company focusing on energy-related investments in Saudi Arabia and the GCC, will involve constructing deals – which may at times involve bringing in international companies with a strategic interest in the region to help structure new entities, says Triki.

According to Arif Naqvi, executive vice chairman and CEO of Abraaj Capital, one factor that has greatly helped Abraaj in raising its new fund and finding investments is that the team has been actively investing in and owning businesses in the Middle East for the last 20 years. The process of building up a network and reputation is something that can only be cultivated over time. "Patience and dedication is key," says Naqvi. "Some of our best investments have been several years in the making."

For those GPs currently building out their network in the region, getting recognised takes time. According to Scimitar's Venegas, whose group was founded in 2003 and whose investment professionals include a mix of American and Lebanese nationals, the main challenge – particularly in the Gulf countries – is access. "There are many restrictions – both legal and cultural – to foreigners coming in here to make large investments," says Venegas. For example, factors such as a cultural aversion to downsizing companies and sensitivity toward the treatment of domestic workers can create structural and legal challenges for foreign investors trying to operate in the region.

Scimitar has taken pains to prove it has a long-term view of the region. As local groups began making note of this, the firm claims, more doors were opened to it. "We started off with one deal in the telecommunications sector in Northern Iraq. It's doing okay and the returns are pretty good, but it was not exactly the sector we wanted to be active in. But we kept the deal up, and as the Kurdish government saw that we were really focused on the business and were not there to exploit government relations, the market has really opened up for us," says Venegas. "This is more the case for someone coming in externally. For those who are native to the region, they can still do business through family connections."

NEGOTIATING RISKS

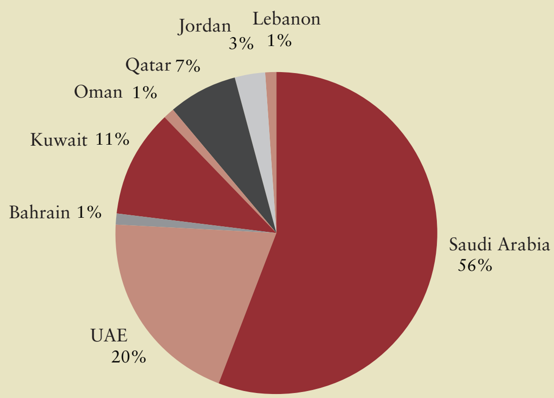
Investors that have not yet put down deep roots in the region need to take more precautions and put greater effort into navigating the investment environment in the Middle East and surrounding areas. "Once we approve a country [for investments] on a macroeconomic and political level, someone from our firm has to spend 12 months travelling around, learning the language, understanding the culture. My personal experience has been that you have to focus on country-specific nuances to be able to get in and out. If you just speak the language, that's not enough. You have to understand the culture as well, and you have to understand that family businesses are the predominant business structure – and that this can mean different things in different countries," says Venegas. "You need to have good predictive abilities and a disciplined process."

Perception of the risks of investing in the Middle East tend to be less negative for those investors that are based on the ground than those that are further from the action. "It is true that some of the local market characteristics and requirements are different from the norm in the US or Europe and necessitate alternative solutions to achieve the same results. But this has never been a problem for us," says Naqvi. "We understand the requirements and then get on with it."

According to Naqvi, in the case of Abraaj's investment in regional logistics company Aramex International, having a local perspective was an invaluable competitive advantage.

"When we looked at [Aramex's] figures, what jumped out was that in every time of uncertainty – the Gulf Wars for example – Aramex's revenue actually jumped and it consolidated its lead in the market," says Naqvi. "Why? Because not only did its main competitors scale down operations in the region, but Aramex saw the potential, knew it could take advantage and increased its own service and network accordingly." The continued growth of the company through good times and bad allowed Abraaj and Capital Trust

MIDDLE EASTERN STOCKMARKETS BY SHARE OF TOTAL MARKET CAPITALISATION OF US$1.16 TRILLION (2005)



Source: Abraaj Capital

to reap six times their investment when taking Aramex public through an IPO on the Dubai Financial Market last year.

THE ROAD AHEAD

When it comes to summarising where the industry is now, and where it is headed in the future, GPs agree that the industry is young, but going in the right direction.

"If you go back and read the prospectus for our first fund in 2002, you will see a long list of trends we identified in the region – including further liberalisation of foreign ownership rules, free trade agreements, greater depth and sophistication of capital markets, increased cross-border trade and investment, evolution of corporate law, family group restructuring and regional industrial expansion and consolidation. Compare this to our 2005 prospectus and you will see that all these items have moved forward, some significantly and some more gradually, but the direction is clear," says Naqvi.

"There's a long road ahead, but we think the trend is very positive, and we think today is the right time to start playing in that field," says Triki. "Currently, there is little competition from existing European and US-based private equity firms, so there will be a window in coming years where existing firms focusing on the region can leverage a first-mover advantage in the industry before international private equity investors start looking seriously at the region."

Even though many established private equity groups based in the US and Europe have yet to declare their interest in having a presence in the Middle East, some investors – particularly those with a strategic interest in the region – are likely to move in. "With a consumer base of roughly 300 million in the Middle East and North Africa, it's a great prospectus for consumption and for growth, and most international groups would be interested in having a strong foothold in this region," says Capital Trust's Mathieu.

"We also see a lot of talent trained in the West coming back to the region. We can now hire top investment banking and private equity talent by Western standards, and this has fuelled the whole industry," says SHUAA's Saad.

According to Mathieu, there are also signs that the geographic focus of private equity on the GCC area has started to change in 2006, and investor attention will shift toward the rest of the MENA region. "The stock markets in the Gulf countries are beginning to show some slowdown, so different institutions and money providers are beginning to take their profits and exit their positions, and they are looking to comparable profitable markets, so it makes sense to look at the Middle East and North Africa, particularly given what's happening in the Beirut, Jordanian, and Moroccan stock markets right now," says Mathieu.

Despite the overall positive forecast, the road ahead is not without its challenges for investors, and some key concerns include how inflation and liquidity in the public markets will be managed, says Naqvi. However, such factors are present and need monitoring in most markets, even in more developed parts of the world. "These are the growing pains of rapid development," says Naqvi. ■

TOP SELECTED FUNDS RAISED IN MENA REGION IN 2005

MANAGEMENT COMPANY (HEADQUARTERS)	FUND NAME (*STILL FUNDRAISING)	RAISED (END 2005)	TARGET	INVESTMENT FOCUS
Abraaj Capital (Dubai)	Abraaj Buyout Fund II	$500m	$500m	Buyout deals in the Middle East, North Africa and South Asia
Capital Trust Group (Beirut)	EuroMena Fund*	$60m	$100m	Pharmaceuticals/chemicals, food processing, logistics, banking/insurance and retail in Lebanon, Syria, Egypt, Morocco and the GCC area
Injazat Capital (Dubai)	Injazat Shefa Healthcare Fund*	N/A	$100m	Healthcare providers and ancillary services in MENA region
SHUAA Partners (Dubai)	Shuaa Partners Fund I	$200m	$150m	Opportunistic investing in GCC and neighboring countries
Swicorp (Geneva)	Intaj Capital Fund*	$60m	$200m	Consumer-related investments in the MENA region
Swicorp (Geneva)	Swicorp Joussour Company*	$400m	$500m	Energy-related projects in Saudi Arabia and the GCC
Swicorp (Geneva)	Swicorp Emerge Invest*	$100m	N/A	Energy, consumer goods, communications, financial services and infrastructure investments in Iran, Algeria and Sudan
The GCC Energy Fund Managers Ltd (Dubai)	GCC Energy Fund	$300m	$300m	Energy sector in the GCC area
The Group (Sharjah)		$55m	$55m	Real estate and recreational projects in the UAE

Source: Private Equity International

QUOTABLES

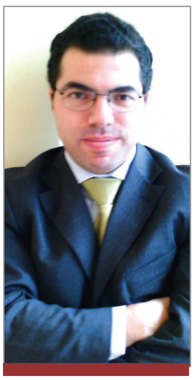
Reflections: Middle East

We asked key private equity professionals across the Middle East for their thoughts on 2006. Below is a selection of their views.

"What is clear...is that the pace of growth, development and structural change taking place in the Middle East and surrounding region has made global investors sit up and take notice of this region. As these investors take the time to understand the region further, I have no doubt that the level of international investment will continue and increase substantially."
Arif Naqvi, executive vice chairman and CEO of Abraaj Capital, the Dubai-headquartered private equity firm

"...our experience in acquiring companies in the Middle East is that it's more difficult and tedious than in Europe or the US to successfully execute interesting transactions. Companies in the region are generally not used to opening up their capital to outside investors, and they may not be used to seeking advice from advisors on issues such as structuring or valuation."
Nabil Triki, partner and head of private equity activities at Swiss-based investor Swicorp

"In general, I expect 2006 to be a very strong year in the Gulf region. Deal flow and IPOs will still make headlines. In our markets, deal flow in the last month was equivalent to that in all of 2004."
Zachary Venegas, co-founder and a partner at Scimitar Global Ventures, an investment firm targeting Northern Iraq and Morocco, as well as Tunisia and Algeria, where Scimitar plans to expand its activities.



"The best thing that can happen in the region is more competition in private equity. No deals, or very few if any, have been done through an open bidding process, which shows that the market is not mature yet."
Romen Mathieu, managing director of Lebanese banking and investment group Capital Trust's Euromena fund.

"Private equity investing in the Middle East is still in an early stage. People are experimenting with various models, and seeing which model works best. Also, because there are not many established private equity firms in the market, the playing field is pretty open at this stage. It's a good time to build an institution that can take a leadership role in the region."
Abe Saad, managing director of SHUAA Partners, the Dubai-based private equity arm of SHUAA Capital, the Middle Eastern investment bank.

"In terms of its overall preparedness for foreign direct investment, I think the Middle East and North Africa are much more ready than many other regions I have seen. However, we need to polish our image here in the region. What many people still don't understand here is that perception is reality."
Hussein Rifai, CEO of Dubai-based Injazat Capital, noting the need to manage public relations effectively in the MENA region to leverage the strong improvements in the investment environment that have been seen over the last five years. ■