



Signs of regional private equity revival

After a tumultuous two years, private equity (PE) experts have started to feel confident. There are early signs of a gradual resurgence of the market. **Ritwika Chaudhuri** investigates.

If the voices of some of the most revered PE practitioners are any indication of what's happening in the PE space regionally, one may summarise the current sentiment as 'subdued' or 'cautious optimism'. Although the overall sentiment definitely lacks the earlier unrealistic euphoria, it does not portray the grey picture that many were anticipating.

Participants at the Super Return Middle East event, which was held in October, were somewhat divided about the future of the

PE industry in the medium term, two years, although a majority felt that the worst was over and saw signs of a slow recovery. Stephen Schwarzman, CEO of Blackstone Group, was one of those who emphasised that the worst of the downturn was over.

Experts in general believe that the year ahead will be challenging for the regional industry on a number of counts, primarily fundraising, as there is already considerable dry powder (committed funds) available on the sidelines. They also predict

that returns are going to be a far cry from those seen during the peak of the bubble.

Both Paul Queally, co-president of US buyout firm Welsh, Carson, Anderson & Stowe and Karim Al Solh, CEO of Gulf Capital, were of the view at the event that limited partners were now more realistic about returns they are likely get investing in the asset class in the next couple of years.

Some of the PE experts have been also predicting a number of general trends for the months



ahead. They have been insisting now that certain markets have become more interesting than others post-crisis. There is greater potential in Saudi Arabia, Egypt and Turkey compared to some of the other countries in the Middle East and North Africa (MENA) region, according to them. These experts also feel that there will be far fewer deals going forward than seen in past years, although the quality of the new deals will improve. They also say that the focus on due diligence has become real pre-acquisition; it's no longer about who gets to the deal first.

Zulfi Hydari, managing director of private equity at HBG Holding, said he expects there to be a shakeout in the industry. A number of players could go out of business sooner than later, he added.

Meanwhile, Al Solh suggested: "There will continue to be realignment within the PE space,

and firms that have invested in 2006-2007 might struggle in the near future."

PE funds around the world have been affected by the economic crisis and the consequent recession. Globally, deal transactions so far this year have totalled US\$58 billion, less than one-third of the figure for the same period in 2008 and one-tenth of the figure in 2007.

According to London-based researcher Preqin Limited, PE firms globally have about US\$500 billion in cash to spend. Regionally, it is estimated that Gulf PE firms are sitting on US\$13 billion, which is yet to be invested. But some, like Ammar A. Alkhudairy,



Ammar A. Alkhudairy

managing director of Amwal AlKhaleej, feel that the story is different in reality.

"During 2007 and 2008, fundraising sounded like distribution of cookies. As a result, a lot of them were not real," he said.

Alkhudairy attributed the anomalies in the numbers to the inefficiencies of the regional banking sector, the typical borrowing pattern by junior debt holders, the weak accounting norm, the lack of availability of an actual number of bargain-based distress sales and the inability of general partners to take punitive measures against the defaulting limited partners. However, he said he expects to see a full recovery towards the end of 2010 and the beginning of 2011.

"PE market availability of dry powder and actual transactions will improve towards the end of 2010 and the beginning of 2011," Alkhudairy said.

Growth pockets

It is quite significant that the regional PE industry is expecting the number of deals to improve from family businesses in the months ahead. David Rubenstein, co-founder and managing director of Carlyle, one of the world's biggest private equity players, is very confident that Saudi Arabia, Egypt and Turkey will offer some of the better deals in the months ahead. Saudi Arabia is always an attractive market with its fast-growing population.

The Kingdom offers lots of family-owned businesses and has plans for large-scale investments in transport and infrastructure, he noted.

In addition, when the war is over, Iraq will be the other potential market, said Rubenstein. He added that the capital

Snapshot: Deloitte's MENA PE confidence survey for 2010

- Investment activity levels: Investment activity will increase, but the type of activity will change. The major driver will be stabilisation of the markets.
- Deal sizes: The average will decrease due to most deals being development capital or venture focused. Deal sizes will remain the same overall. For growth capital, this is around US\$30-50 million, and for buyouts, it is within the US\$100-200 million range.
- Industry sector activity: It is best to stick to the space you know. Going forward, businesses that are more robust and less susceptible to stock market issues will be more in favour. It will depend on areas where deals are doing well, the sector is relevant and where each investor has strength and synergies.
- Entry multiples: Valuations will decrease. There is a mismatch between buyers and sellers. In general, valuations should be four to five times earnings at the lower end and five to six times earnings and the higher end.
- Differentiating in a competitive market: Quality of the team and management, track record and reputation – these are the key factors.
- Management and governance: 81 per cent of survey participants anticipate becoming increasingly hands-on in respect of involvement with portfolio companies over the forthcoming 12 months. Identified areas of portfolio management included operational, strategic, finance, business development and restructuring.
- Exits: There will be few exits over the next year. IPOs have dried up, but will come back again at some stage. There will be some opportunities to sell to strategic buyers, but this will still be difficult.
- Returns: This very much depends on when you invested. 2009/2010 vintage investments will have phenomenal returns, but returns from 2007/2008 investments will be dismal. There are two main drivers of value depreciation: 1) Multiples have shrunk or compressed and 2) You need to find buyers in the first place.

needed for the funds will mostly come from this region and, to a certain extent, from Asia and Europe, but definitely not from the US.

Both Alkhudairy and Richard Clarke, director of transaction and reorganisational services for the MENA region, Deloitte Financial Advisory Services FZ LLC, said that Egypt and Saudi Arabia have immense potential for the regional PE business.

A number of private equity firms are already pursuing deals in the countries mentioned above. Abraaj Capital, which is sitting on US\$4 billion in cash, is eyeing investment opportunities in Saudi Arabia, Egypt and Turkey, while Gulf Capital is looking to invest US\$500 million in Saudi Arabia, the UAE and Egypt, in sectors like oil and gas, healthcare, food and education.

Amwal Alkhaleej is also concentrating on Saudi Arabia and Egypt, along with the UAE.

“Each economy has its own strength. Saudi Arabia has the fastest-growing population in this region. The country is putting lots of emphasis on economic development and privatisation,” said Alkhudairy. “Likewise, Egypt, with its evolving economy, is all set to become a manufacturing base for Europe in future. The country’s demographic conditions demand lots of basic services, while the UAE economy is service-oriented.”

Way forward

There is hope in the industry that the global economy is coming out of the recession. The wait-and-watch attitude is shifting towards action, especially with the third quarter results of the banking industry showing some promising numbers and liquidity flowing back to oil the system.

Clarke said that banks in the region will be conscious of the multiple risks and will use

discretion in lending, as is the case in Europe.

According to Clarke, while traditional, non-cyclical and service-oriented sectors (and not necessarily capital-intensive industries) will be favoured, two distinct trends will emerge in the coming months: concentration of private equity in the oil and gas sector, which offers high multiples, and investment away from this sector.

There are always going to be opportunities in financial services (the non-retail, non-commercial banking segment) like general insurance, especially Takaful, he added.

Alkhudairy noted that the MENA region, unlike the west, is a high growth area, both demographically and economically. It offers more opportunities than the west, which is dominated by public limited companies offering less growth possibility. There, in order to have better profitability, it is important to use a turnaround strategy and more leverage. In the MENA region, though, PE companies have achieved much better returns than global benchmarks without using any leverage.

But exits will not be easy over the next year, and PE companies will have to continue to invest in their portfolio companies or in strategic good deals. Clarke said that trade sales and the secondary market would be slow through 2010. Once confidence comes back, companies will mainly look at the IPO market in next 18 to 20 months, he added.

Although the PE scenario looks challenging in the near future, activities are limping back and some firms are looking to raise new funds. As **MONEYworks** reports in this edition, Omani investment bank Fincorp (see page 16) is launching its first PE fund, while Al Masah Capital (see page 13) plans to launch one in April 2010. These are signs of a revival in activity, which is likely to pick up pace by the second half of next year. 