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Private Equity & Venture Capital in the Middle East

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Legal Tools for Private Equity in the Current Economic Environment

Over the past several years, the legal profession has advanced in the Middle East in response to a growing and increasingly sophisticated private equity client base. International best practices and standards have been adapted to a region characterised by family ownership, minority investments, greenfields, carve outs and foreign ownership restrictions.

2009 presents a new set of legal challenges for private equity. While deal pipelines and investment appetite may be weak, private equity should emerge gradually, particularly in sectors that are relatively recession resistant (such as healthcare and education), as well as in depressed sectors where bargains may be available (such as hospitality and property). Yet, for so long as price volatility and dry debt markets persist, private equity should consider certain legal tools to address real challenges.

- **Increased use of vendor financing and earn outs.** Financial sponsors need to bridge value gaps and deal with very tight debt markets. Larger equity cheques and the use of mezzanine finance may be part of the answer, though more costly and necessarily impacting leveraged returns. Vendor financing and earn outs can be employed to bridge gaps and, to a certain extent, as a form of financing. It is critical to write legally unambiguous definitions of ill-defined accounting concepts (such as IRR and even EBITDA) and to define mechanics for measuring future financial performance that are at the same time accurate, inexpensive, quick to achieve and not prone to disputes.

- **Improved corporate governance.** Partnering with family owners requires careful attention to corporate governance, meaningful minority protections, enhanced risk management systems and timely and reliable information flows. Today more than ever, private equity needs to manage working capital and cash flows and worry about the operating results of portfolio companies. Financial sponsors will therefore focus greater attention on contractual rights to facilitate stewardship and oversight and ensure prompt and accurate financial reporting.

- **Addressing the downside.** Insolvency laws in the Middle East are poorly understood and, until now, rarely tested. 2009 may very well prove to be a year in which a large amount of new learning will emerge. Sponsors will increasingly seek guidance on "what if" scenarios, some of which can impact the structuring and documentation of deals. Careful attention will increasingly be paid to contract rights relating to exits, deadlocks, dispute resolution and rescue funding.

- **Increasing the legal value add.** While some sponsors have viewed legal services as an afterthought, to be purchased on a commodity basis, increasingly many firms are realising the added value of more thorough documentation and advice from experienced private equity lawyers. Although worsening economic conditions will inevitably put more pressure on cutting expenses, if there was ever a time to seek value added advisory services, that time would be now.