MENA private equity sees new dawn on littered landscape

The MENA private equity market is emerging from years of relative chaos thanks to increased deal-flow and bigger deals. Gibson Dunn and Crutcher partner Paul Harter explains why it is a new dawn for the region.

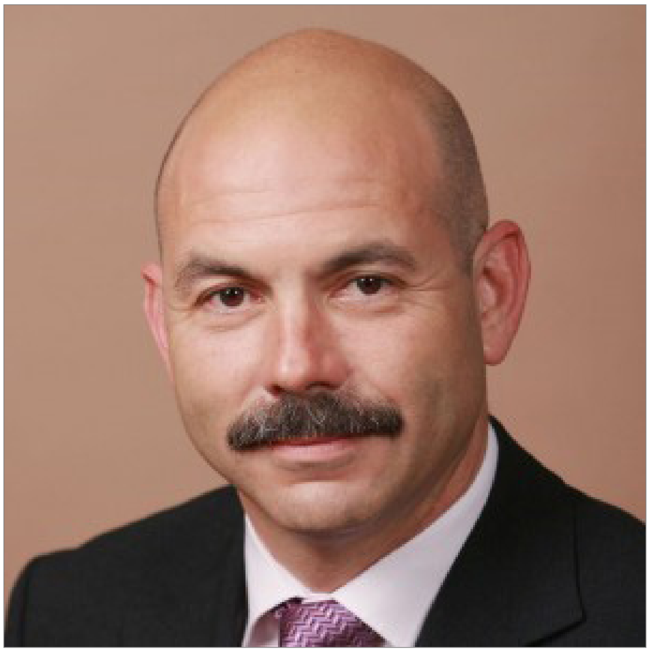
We looked at five years of data, eliminating all transactions valued at less than $50m in order to obtain an overview of the higher end of the market in that period. Because deal values are often undisclosed, our data is imperfect, but nonetheless telling. Where deal value was undisclosed, for the purposes of our study we looked at target company financial data and attempted to extrapolate probable deal value applying simple, but customary, valuation methodologies. We reached interesting conclusions.

More deals are being done. Deal flow at the higher end of the market has increased. From a low of 14 deals in 2011, we identified 28 announced transactions in 2013, and 21 in the first 10 months of 2014. From a low of zero exits in 2010, we recorded 7 exits in 2013 and 11 exits in the first 10 months of 2014. The barriers to an efficient PE market still exist: political instability, the relative immaturity of market participants, an opaque and antiquated legal landscape and, of late, falling oil prices and a resulting deterioration in investor confidence. However, in stable countries within the region, PE is boosted by increasing talent within a smaller number of surviving players, combined with local lenders flush with cash and an open and active IPO market (both regionally and internationally), facilitating for the first time the introduction of financial engineering and a new path to exit.

Bigger deals are being done. During the past year, much larger deals were completed than ever before. Fajr Capital successfully led a consortium of investors to acquire National Petroleum Services at a deal value in excess of USD 500,000,000, which is probably the largest private equity deal of the year. The ongoing auction of Kuwait-based Americana is reportedly drawing bids of several billion dollars. If successful, that deal will be a ground-breaking P2P transaction that will prove that mega-deals in MENA are indeed possible. Though deal sizes overall remain small relative to the world's mature markets, these and other transactions suggest increasing appetite for larger deals and increased resolve to overcome the regional obstacles that have kept private equity in relative obscurity for many years.

International private equity has entered the market for the first time. International PE houses have been snooping for MENA deals for quite some time, but until recently, they only completed a few transaction. Within the past 12 months: Carlyle completed two exits (Medical Parks in Turkey and General Lighting Company in Saudi Arabia); Blackstone

Copyright © AltAssets 2014



joined a consortium to invest in GEMS Education; Warburg Pincus acquired the Mercator business from dnata; TPG is reported to be part of a consortium to acquire Kudu and KKR and CVC are reported to be engaged in a joint bid for Americana. These transactions have dispelled the long-held belief that investment committees in Europe and the United States would forever be unable to assess and digest the risks of investing in the Middle East. While the international players generally approach the Middle East opportunistically, and few approach the region as a target geography, these recent transactions suggest that the regional players now have a new set of international investors to compete with.

Successful exits have been achieved and track records established. Recent successful exits represent the greatest step forward for the industry. Regional player Gulf Capital is the most notable. Gulf Capital closed its successful London IPO of Gulf Marine Services, with a market cap of over USD 740,000,000. Gulf Capital also sold a strategic stake of 32.9% in Metito to Mitsubishi Corporation and Mitsubishi Heavy Industries, at the same time raising growth capital from the Japan Bank for International Cooperation, sitting alongside prior IFC financial participation. Secondary buy-outs are also becoming more common in the region although still far less prevalent than in mature markets.

Acquisition financing is more readily available. Local banks, flush with cash, are providing LBO financing to the private equity markets with increasing appetite over the last twelve months. Notwithstanding the challenges they experience in taking and perfecting security and in pushing debt down to operating companies, several recent buy-side deals included substantial acquisition financing facilitating the introduction of financial engineering to private equity returns in the region. This recent development hopefully provides precedent for future transactions and will lead the adoption of generally accepted funding structures (including security packages).

Successful fundraising is difficult, but possible. A review of the current year in fundraising produces more mixed results. The MENA private equity fundraising market was dominated by Gulf Capital's heavily oversubscribed fundraising. Gulf Capital hit its hard cap of $750 million, riding the twin waves of renewed optimism in the GCC macro-economic environment and successful exits from their portfolio. In contrast, some regional private equity firms that are on the road are facing greater challenges raising money, perhaps due to the absence of a demonstrable track record of exits or lack of strong institutional investor relationships to anchor their funds.

Another notable feature of the regional private equity market in recent years is a desire among investors not to commit to blind pool funds. This has given rise to a move towards raising investment specific pools of capital. We expect these deal specific funds to become a defining feature of the regional market in the coming years.

Although the MENA private equity market represents but a small fraction of global private equity activity, recent history has demonstrated that private equity can thrive in the region. Sponsors, both global and regional, address the risks and challenges and sometimes achieve risk-adjusted returns that justify their investments in the region. Though the number of successful players are fewer, their teams are more professional than their predecessors, their deals larger and their future brighter. While the false optimism of past years has given way to a more sober assessment of the future, based upon the pipeline of deals currently in the market, theupward trend should persist.upward trend should persist.

Copyright © AltAssets 2014