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'Survival of the fittest' as Gulf PE firms battle crisis

By
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The region's private equity sector will enter the survival of the fittest phase and only a handful of the firms will survive in the next two to three years, experts said.

Industry experts speaking to **Emirates Business** said there have been too many players and that eventually, there will be a break out of the leading firms from the rest of the pack and not everyone will survive.

"The market will solidify," Karim El Solh, CEO of Gulf Capital said. "There are more than 125 equity funds launched, and a number of players are still coming to the market. There are simply too many players in the sector. There is a lot of cash chasing few opportunities so there will be a shaking up of a sector and not all of the firms will survive."

El Solh said there are not so many transactions being closed to justify the large number of funds. "Obviously, productivity is an issue for a large number on these funds," he added.

Yahya Jalil, Senior Vice- President, Private Equity at The National Investor, concurs saying, in time, only the top tier firms are able to complete deals in these difficult market conditions.

'The rest of the pack will wither away over time, as they fail to deliver returns to investors," he said.

"There is just too much private equity capital and too many private equity funds in the market today, and not enough deals."

He said there are also other players in the game including family, and multi-family offices, that also act in parallel as investment companies.

"Add that and you have far too many players. Plus all those bankers from Lehman, Merrill and others being laid off will end up starting hedge funds or private equity funds, so expect to see further increases in the number of private equity funds," Jalil said.

Some, however, believed that instead of withering, there would rather be a consolidation. "Private equity markets were heading for consolidation even before this crisis happened. Now, it's happening at a faster rate," said Zulfi Hydari, Managing Director of HBG Holdings.

Jalil, however, debunked this idea, saying consolidation in private equity is unlikely because private equity funds are not subject to redemptions. "An investor who puts money into a private equity fund commits to having that capital stay invested for the life of the fund, typically seven to 10 years. As such, private equity funds are not directly under financial pressure in times of financial turmoil. I would expect private equity funds to continue to stay and operate independently," he said.

Imad Ghandour, Chairman of information and statistics committee at Gulf Venture Capital Association, added: "The dynamics are different in case of financing companies and banks. Private equity players will probably continue to operate as independent shops rather than as larger financial conglomerates. There are very few benefits to consolidate private equity players, and such consolidation trends have not been witnessed neither globally nor regionally."

According to Global Investment House (GIH), more than $13 billion (Dh47.7bn) in private equity capital is currently under management in the region. What is noteworthy is that until recently, many local and international private equity operators had looked at the Mena region only to raise cash.

However, due to the rapid economic growth and fundamental strength of the Mena countries, many of them are looking for investment opportunities as well.

The Carlyle Group was one of the first to set office in the region and is actively looking at investment avenues in many of the regions own companies.

Similarly, Investcorp, which until recently was using the Gulf money to invest in foreign markets also launched Gulf Growth Capital Fund, that solely looks for investment opportunities primarily in the GCC.

And while the real estate and construction sectors are attracting a large share of these investments for the time being, opportunities in private-sector transportation, financial services, travel and tourism, energy,

and other sectors are flourishing as well.

Rasmala Mena Private Equity Fund 2, which was closed on January 5 was able to raise $120 million (Dh441m) – is looking at investing in the banking, oil and gas, logistics, healthcare and education sectors.

"We see an abundance of opportunities in the region and believe this is an opportune time to be investing – given the liquidity needs in the market and attractive valuations," said Tamer Bazzari, Deputy CEO at Rasmala.

At the same time, due to the financial carnage happening in the developed countries, international investors' appetite to invest in the region has also increased.

The Gulf Equity Partners Fund, jointly launched by Gulf Capital and Credit Suisse, for one is receiving substantial interests from international investors.

"We have Asian, European, North American and regional investors," El Solh said. "It's one of first and few globally-backed funds.

"It's also interesting as we have a lot of international intentions and they want to invest here. It's also refreshing because it used to be that most of the money was coming from here. Now you see international money coming from the region and outside the region and they are the of the highest calibres such as pension funds and governments," he said.

While the momentum to invest in the region is building up, the desire to raise money from the region continues to mount due to the liquidity squeeze.

Banks are not lending and if they do, the money comes with high interest.

And initial public offering (IPO) activity in the Middle East is also paralysed. According to Ernst and Young's year-end IPO update IPOs declined by 99.6 per cent in October and November of last year, reflecting the investor sentiment and the global economic downturn.

And if companies need to raise capital right now, they need to go to the private equity market that offer attractive evaluation, says Robert Mckinnon, Managing Director of Al Mal Capital.

After witnessing stellar growth in 2007 on the fund-raising front, as well as fund sizes, private equity in the Mena region witnessed some moderation in the first half of 2008. According to GIH, the fundraising for private equity investment in the region has grown manifold over the past five years and has increased from a meagre $680m raised in 2003 to more than $5bn in 2007.

Average fund sizes have also grown from $215m in 2005 to $265m in 2007. However, fundraising declined to $1.14bn in the first half as compared to $1.8bn raised in the first half of 2008.

According to analysts, private equity firms have also become cautious. The financial turmoil has cast a shadow of uncertainty over the private equity industry with institutional investors remaining highly cautious when presented with new investment opportunities.

Consequently, the number of investments made until the first half of 2008 is far fewer with only 16 reported as per Zawya Private Equity Monitor, down from 33 during the same period in 2007. Not only have the number of transactions fallen significantly in 2008 H1 but so has the size, with the largest deal closed being Intaj Capital's purchase of a majority stake at an announced $188m transaction size.

Fewer companies are also willing to take exits. The crisis has pushed Ithmar Capital to delay its exit plan for one of its portfolios in Fund 2 until the end of 2009.

"We have not had any exits in Fund 2," Khaldoun Haj Hasan, co-founder and managing partner at Ithmar Capital said. "We planned to divest one of our portfolios in Fund 2 by the end of this year or first quarter of next year. But given the current market situation, that has been on hold."

Overall, the Mena private equity market is relatively young. Due to lack of maturity, a number of PE investments continue to go unreported. Furthermore, some PE houses have not revealed the size of their PE investments.

El Solh said: "If you look at Gulf Capital, we are public joint stock company. We run our firm like a private company in terms of disclosure and reporting to our 250 shareholders. We try to increase our transparency to our stakeholders. We are even adapting the reporting and corporate governance standards of the Abu Dhabi Securities Market. It's as much as we can do as a private company. But frankly, private companies are private and they don't have to be more transparent."