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MENA Private Equity confidence survey 2013
On the verge of a new investment cycle

87 Eighty seven years in the Middle East

General Partners remain optimistic towards continued long-term growth prospects the MENA region; however, as the industry enters a new investment cycle, adequate preparation to maximise exit value on vintage assets will be crucial to demonstrate a positive track record and persuade often skeptical Limited Partners to commit to new fundraisings

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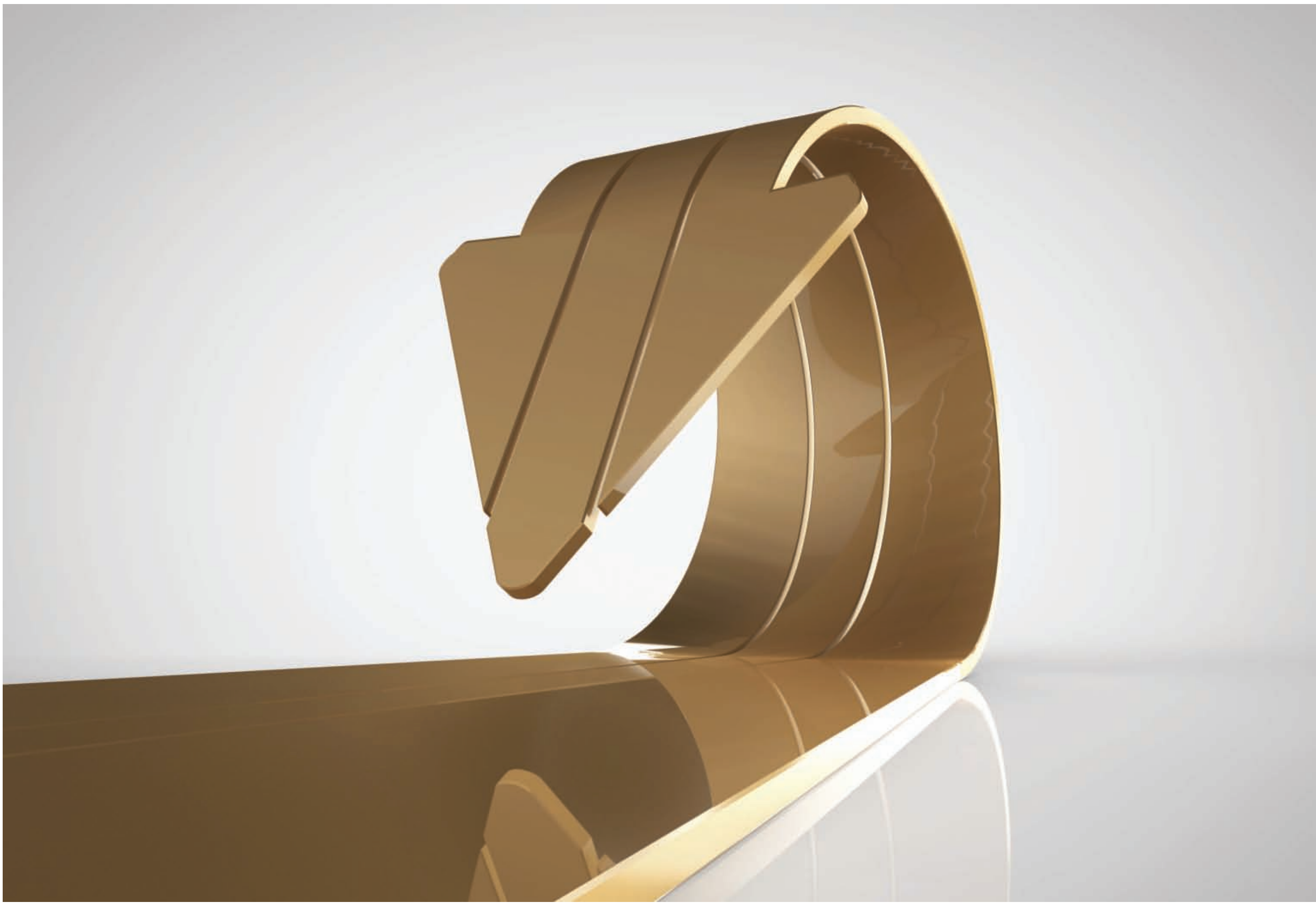

Foreword

It is approaching five years since the global credit markets seized up and private equity confidence dropped to an all-time low. Since then, the region has experienced a remarkable recovery which saw last year's investment optimism amongst private equity professionals reaching pre-crisis levels. The results of our sixth MENA Private Equity (PE) confidence survey provide unique insights and confirm a continued optimism for growth in regional investment activity, but a shift in immediate focus for many General Partners (GPs) towards asset monetisation from vintage funds and capital raising for a new round of acquisitions.

As a consequence of the downturn, regional funds have retained a backlog of portfolio companies from pre-crisis investments, many of which have required extended holding periods to revive performance levels and improve Internal Rate of Return (IRRs) towards those originally forecast. Whilst Limited Partners (LPs) have been waiting for performance improvement in these remaining assets, it appears that with exit options now available, they are keen to cash out. Two thirds of respondents expect an increase in exit activity within their fund this year, with 23% confirming it will be their primary focus.

This year's survey confirms continued optimism for growth in investment activity but shift towards asset monetisation and capital raising

The most common exit route is expected to remain a trade sale to a strategic buyer; however, with global equity markets rallying to new highs, nearly a third of respondents see exit via Initial Public Offering (IPO), either on a regional or international exchange, as both viable and their most likely option within the next 12 months. This represents a significant increase on last year. Some respondents even see potential for secondary investments, an almost unheard of phenomenon in the region, from financial investors who see further upside in PE asset sales.

Whilst GPs have continued to deploy capital, regional fundraising has been limited since 2007. Many funds are now running short of cash reserves, with our survey results suggesting that the majority of traditional PE funds in the region, i.e. those not backed exclusively by High-net-worth individuals (HNWIs) or government money, will be looking to raise new capital within the next 12 months. The ease with which this will be achieved is yet to be seen, but based on recent global fundraising trends, it is likely to vary significantly by PE house. Whilst 41% of respondents did not foresee any significant issues in fundraising, there is caution amongst LPs including family offices who were in some cases disappointed by return from PE funds in recent years, and skepticism remains in committing new capital to those who have little more than unrealised gains to demonstrate a track record.

With LPs demonstrating less appetite for blind pools, and tending towards direct investment, or co-investment strategies on an ad hoc basis, our survey indicates a potential change in the investment landscape with 43% of respondents now expecting family offices to be the most active investor at the deal table. This shift in investor type, with differing objectives, timeframes and target return rates may yet alter deal dynamics in the region.

Regardless of funding issues or changing competition, a clear appetite is evident from all respondents for continued investment activity, with an expectation that interim financing or warehousing can always be sought for the right opportunity. Now GPs foresee the biggest challenge to growth as a shortage of quality opportunities particularly given the more limited geographical area of focus.

With political instability in countries such as Egypt and Syria, and a general lack of quality investment opportunities coming to market in other North African, Levant and low populous GCC countries, the focus has been limited largely to KSA, UAE and Turkey. Many respondents recognise there are likely to be significant growth opportunities and less competition in countries such as Iraq, Libya or Egypt; however, consensus is that these would not provide any significant deal flow in the next year and there will be no active pursuit of transactions in these locations on a proprietary basis.

From an industry perspective, there remains a general preference towards defensive investments; however, there is also a recognition that the favourites such as education, healthcare and oilfield services are now very competitive. Consumer focused businesses and those complemented by favourable regional demographics and high disposable income are also rapidly becoming hot property, and typically tend to attract significant PE interest.

GPs remain optimistic towards continued long-term growth prospects in the MENA region; however, as the industry enters a new investment cycle, adequate preparation and maximisation of exit value on vintage assets will be crucial to demonstrate a positive track record and persuade LPs to commit to new fundraisings.

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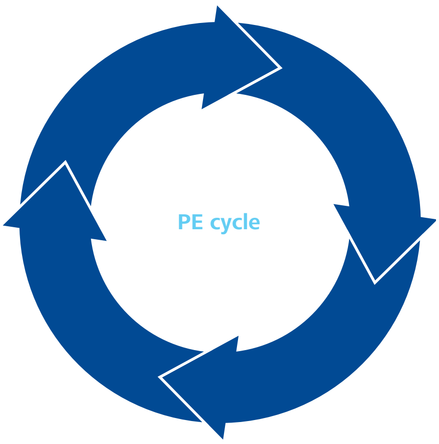
The survey summary

Investment activity

1. 65% of respondents predict increased investment activity in the MENA region over the next 12 months.
   - Due to a limitation of quality assets and continued political instability in areas such as Egypt and Syria, the geographical area of interest is becoming more concentrated with the majority of GPs now focusing almost exclusively on KSA, UAE and Turkey.
2. 41% of respondents expect deal size to increase, with the remainder assuming no significant change.
   - Whilst overall economic growth and availability of credit can often drive an increase in deal size, most respondents foresee no specific catalyst to bring larger deals to market, or shift sellers' desire away from minority interest sales.

Fundraising

7. 69% of respondents plan to raise new fund over the next 12 months
   - With no significant fundraising since 2007, regional PE firms have limited dry powder remaining and are being forced to seek deal financing on an ad hoc basis or through warehousing arrangements with LPs until a new fund has been raised.
8. 47% of respondents expect fundraising will be more difficult. A similar number (41%) predict no notable change in difficulty.
   - With a variable track record and only unrealised returns on remaining investments, LPs may be less keen to invest in blind pools and instead tend towards principal investments and other alternative funding strategies.



Portfolio management

3. 53% of respondents expect they will have more involvement in operations of their portfolio companies over the next year.
   - Strong involvement reflects the increased focus towards hands-on value enhancement and exit preparation of portfolio companies.
4. Over a third of respondents expect the average holding period of portfolio companies to fall in the next year.
   - With improved valuations currently being experienced and increased market confidence, required IRRs can be achieved quicker and exit time horizons will shorten.

Exits

5. Nearly two thirds of respondents expect increased exit activity in the MENA region within the next year.
   - GPs are feeling pressure to realise returns for LPs and now hold a backlog of assets that require monetisation.
6. 50% of respondents expect trade sales to be the most likely route to exit, with 29% suggesting IPO.
   - Whilst FY13 results suggest a significant growth in confidence for exit via equity capital markets, and even the possibility of some secondary buyouts, trade sales remain the most common exit strategy.

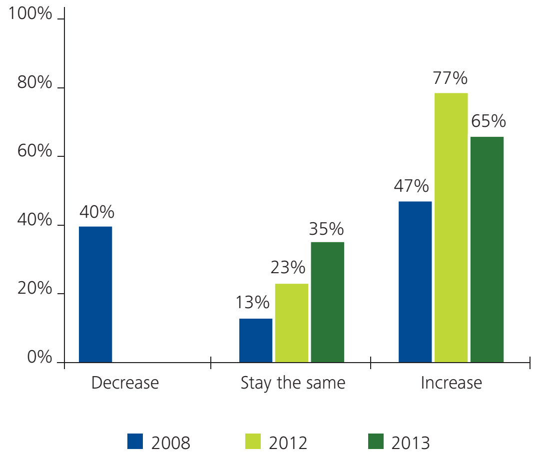
Long-term confidence

On a scale of 1-10, this year's respondents rated the long-term growth confidence in the MENA PE industry as 7.4.

- PE investors in the MENA region remain confident of 'long-term' growth; however, this is tempered from levels seen last year (8.0). Despite a general improvement in economic activity and valuations currently being experienced, uncertainty remains over future fund raisings and a limitation on the number of assets available within the more concentrated target area.

Investment activity

Over the next 12 months, what do you expect to happen to investment activity in the MENA private equity market?



"The level of investment activity in the MENA region will continue to increase over the next 12 months, but the relative year-on-year growth will vary significantly between countries. For the time being, investors have all but disregarded Egypt and other countries with political instability such as Syria. Stable countries with high forecast population growth and liquidity from oil wealth will likely see the biggest increases, i.e. KSA, UAE and Kuwait."

"Investment activity as a whole will increase, but with a shift in investor type - family offices playing a bigger part. Many of them have accumulated large cash piles as a result of both a stock market and real estate boom and are now actively looking for quality assets, bolt-ons and ways to diversify their portfolio."

- Market confidence remains high with over 65% of respondents expecting an increase in investment activity over the next year, primarily driven by convergence of the buyer-seller valuation gap, higher levels of free cash in both corporates and family offices, and an increased availability of credit.

- Optimism for continued growth in the next 12 months is, however, slightly more reserved than that seen in 2012, with political instability in some MENA countries and concerns over fund raising in local PE firms.

- No respondent believes deal activity will decrease from the prior year, as was the case in our 2008 survey.

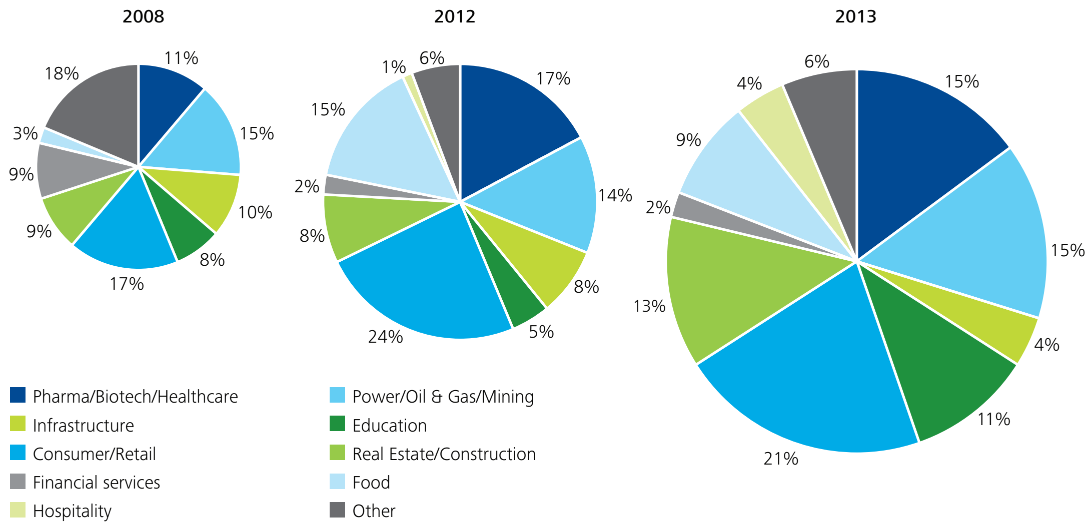
"Economic recovery in Western markets is ultimately the primary indicator for investment activity in the region. If you buy into the European and US long-term recovery story, then it is highly likely that regional investment activity will increase at an even greater pace."

"There is no reason why investment activity will increase above levels experienced in the last 12 months. Whilst there is a general improvement in the global economic situation and associated confidence, there is no specific catalyst in the MENA region to drive further immediate growth, and conversely there is no specific deterrent either."

"The level of MENA PE activity will remain flat – however, there should be ample opportunities within the region if investors are willing to look for diversified opportunities and take risks, especially in real growth markets such as KSA, North Africa (including Libya and Egypt) and Jordan."

Industry sectors

In which industry sectors do you expect to see most deal activity over the next 12 months?



- Given the regional demographics and forecast growth rates, the key sectors of focus remain broadly in line with the prior year. Around 34% of respondents indicate a preference towards retail and consumer businesses including Food and Beverage (F&B) and hospitality.
- A marked increase in the number of respondents interested in real estate/construction suggests confidence in a sustainable long-term recovery of the real estate market in the GCC specifically.
- Defensive sectors such as oil & gas, healthcare and education make up the majority of the remaining sectors.

"Favourable demographics and strong sector trends including a high-level of disposable income make consumer focused businesses and in particular F&B sought-after assets for financial investors. We are in a part of the world where shopping and eating are very much a focal point and central to social interaction. In that sense they are also quite defensive plays."

"Oil & gas related businesses including support services remain attractive as do education and healthcare assets, but the number of good quality companies coming up for sale is minimal and the level of competition in these sectors is huge. Everyone is seeking investments in this space, so the trick is to source them through proprietary channels, or diversify the net into less trendy sectors or regions."

"There are positive returns to be made in real estate and construction sectors, with what appears to be a sustainable recovery in prices and positive upsides such as rapid infrastructure development in KSA or Expo 2020 in Dubai. Most funds avoid anything directly related to real estate after last time, so there are good opportunities for those looking."

Geography

- The target geographical area for regional PE houses is becoming increasingly focused on fewer countries. Around 71% of respondents believe their investment activity will be centered around KSA and UAE over the next 12 months.

- MENA PE firms are also increasingly concentrating on Turkey as a key market, despite some of the current macro issues.

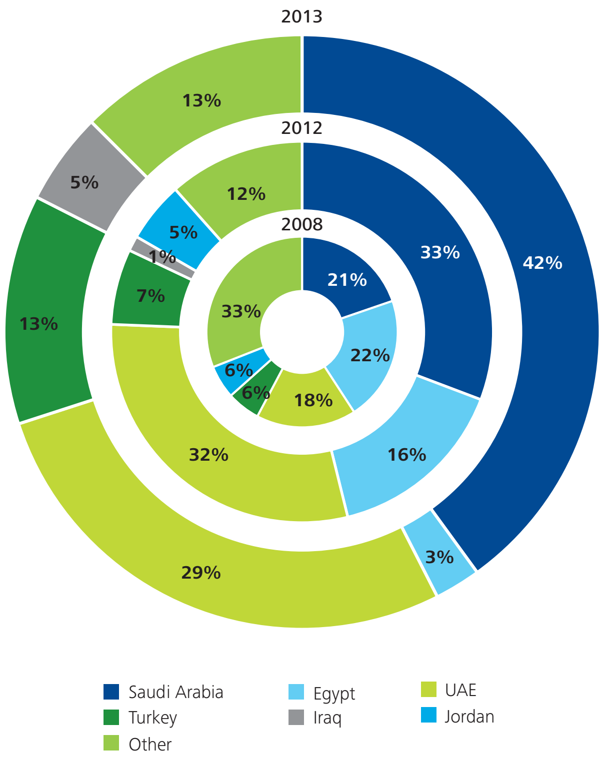
- Turmoil in Egypt and Syria practically rule out these countries as current markets of interest.

"*Whilst it is likely the UAE, North Africa and possibly Iraq will see the greatest increase in deal volume, Saudi Arabia will continue to see the greatest level of deal activity in absolute terms. Despite issues around foreign ownership, Saudi Arabia remains the most attractive growth option and the only feasible capital market in the region.*"

"*Saudi Arabia will see most deal activity due to size of the economy, the GDP growth and the number of investment opportunities available. The sheer difficulty of doing deals in Saudi Arabia, and the length of time it takes to close a deal, is beginning to encourage investors to seek alternatives, but for the moment investors will keep going back due to a lack of attractive assets elsewhere.*"

"The UAE has sufficient opportunities in the market and most intermediaries are based in the UAE to make transactions happen. Valuations in the UAE are also more modest than KSA and Turkey so it is more likely that deals will happen."

Over the next 12 months, which countries will see the majority of regional investment activity?



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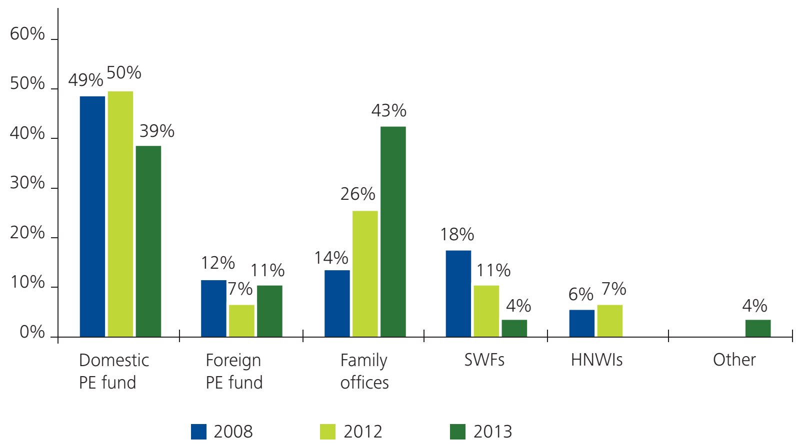
Investor

Over the next year, which types of investor do you expect to be most active in the MENA region?



Family offices are considered likely, by 43% of respondents, to be the most active investor in the region over the next year. This represents a significant increase on last year, and largely at the expense of local PE funds.

- Family offices are considered likely, by 43% of respondents, to be the most active investor in the region over the next year. This represents a significant increase on last year, and largely at the expense of local PE funds.
- Many believe that local PE will be more focused on portfolio exit, and that funding will be the key determinant of buy side investment activity in the short term, favouring family offices or investment companies backed by HNWIs or government money.
- Other respondents also suggest the required holding period and IRR requirements of the different fund types may provide a competitive advantage to family offices.

"Local private equity companies are coming to the end of their funds, but this won't hamper PE investment. The funding structure may change, but we can always find capital for a deal with positive returns."

"Sovereign wealth funds are generally increasing assets under management and are becoming much more active. Historically however, this has been largely focused on outbound investment from the region."

"Family offices and quasi family offices, including private equity funds financed by a small number of wealthy individuals, are very active in the market at the moment. They are under pressure to deploy capital into suitable deals. They have huge stockpiles of available capital, and after the shock of the previous economic downturn, they are keen to diversify their sometimes concentrated portfolios, as quickly as possible."

"There is no real driver for an influx of foreign PE funds. The forecast for regional growth may well be greater than could be achieved in their home countries, but there are other developing markets which don't have the same level of restrictions, such as foreign ownership and which offer an equal or greater number of sizeable opportunities."

Competitive differentiators

- More than half of the respondents consider vendor/investor relationships to be amongst the most critical when it comes to completing transactions in the region. This is seen by most as a prerequisite to getting a deal done, and therefore even more important in the initial phases than proving the ability to add value.

- Whilst it is highly likely that any successful party will have demonstrated a variety of attributes, one factor that appears to remain of lower importance is immediate price paid. The results suggest that in many cases (particularly minority interest sales) vendors are less interested in short term monetisation, and more focused on maximisation of future asset value.

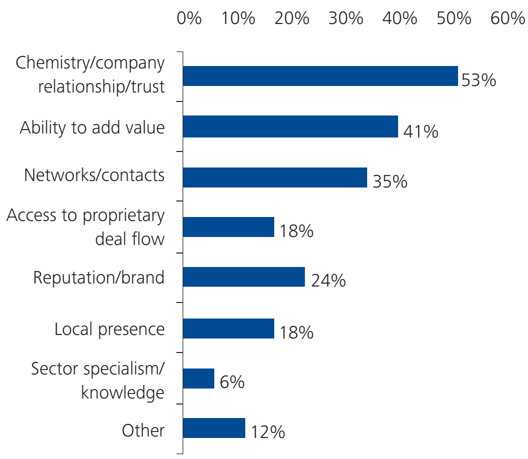
"Price is not a differentiator in the region, in fact we haven't been the highest bidder on any of the last transactions we have completed. It is all about being able to demonstrate additional value items you can bring to the table, either through access to markets, or more likely through synergies with portfolio companies."

"It largely depends on the size and type of the transaction. When it comes to company buyouts, or full stake sales, price is still very much the most important factor. When transactions involve the sale of a minority interest stake, the purchaser will be required to work alongside the original owner, it becomes all about relationships and ability to build trust."

"Given the level of competition in the market for each deal, the most important differentiator for a PE house is their network and ability to source deals on a proprietary basis. If you can avoid becoming embroiled in a structured auction processes, the necessity to 'outperform' competitors on relationships becomes less important."

The ability to build strong relationships with the target stakeholders remains the most important factor when doing deals in the region

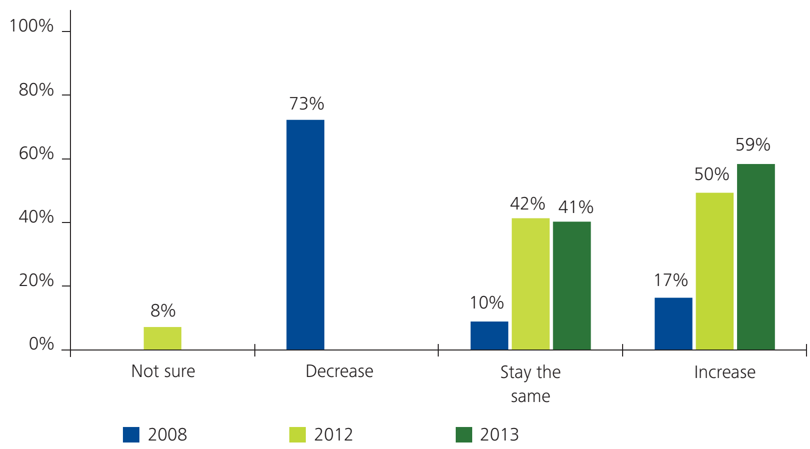
What do you believe are the most important competitive differentiators for private equity firms in the MENA market when it comes to winning deals and why?



"All the good PE firms know that building relationships with potential vendors is just a prerequisite. The underlying differentiator will always come back to value - either a higher upfront price, or a proven ability to add value going forward."

Exit activity

Over the next 12 months, what do you expect to happen to exit activity in the MENA private equity market?



- The majority of respondents believe that exit activity will increase over the next year, with GPs under pressure to monetise returns on assets held in vintage funds from pre-crisis years. This proof of return also appears instrumental to the firms' ability to raise future funds.

- The exit decision can, however, be a difficult one for GPs, as lengthy holding periods and slow growth in recent years may have depressed IRRs on portfolio investments. Whilst this may encourage further extension to the holding period to allow time for recovery, current growth/valuation improvement may still not be adequate to regain returns to levels initially forecast.

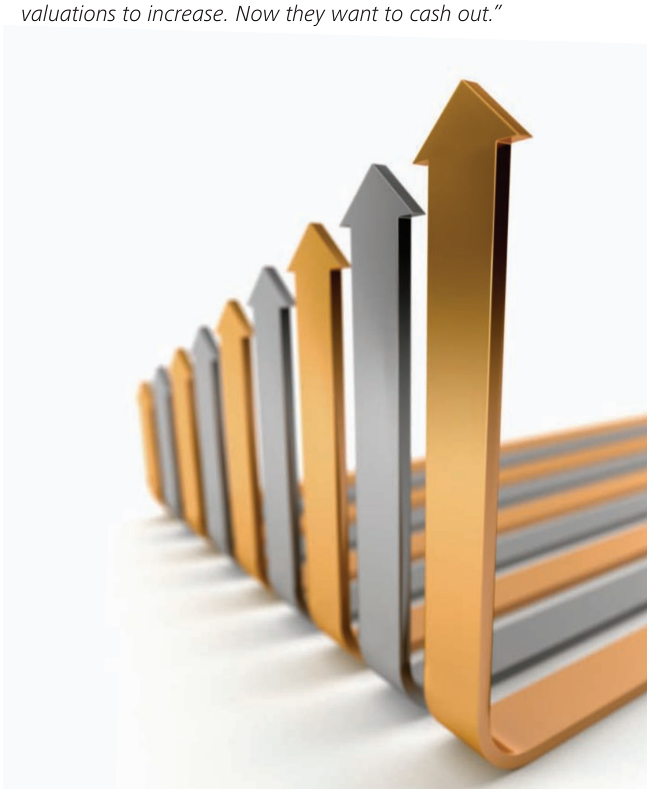
- Exit channels are opening and whilst many respondents see no real increase in exit activity over the short term, most concur that a more diverse variety of exit opportunities is now available.

"With an improvement in valuations and a return to economic growth, exit time horizons will likely shorten as target IRRs can be more quickly achieved. That said, people often assume that the 3-5 year investment cycle found elsewhere in the world can be replicated here. It can't. Deals take far longer to source and execute, and even with an improvement in deal prospects, we should assume a cycle of around 5-7 years."

"Whilst there is certainly pressure to exit investments from our older fund, now is not necessarily the optimal time. A lot of assets took a hit during the downturn, and whilst the bad debt may have been cleaned out of the business now, and working capital has been repaired, they are still only part way through their recovery. This is where we may end up seeing the start of secondaries in the region, when people recognise that there is still money to be made from the investment.

"I wouldn't expect a dramatic increase in exits in the next year. Finding buyers prepared to pay a reasonable price remains difficult. The secondary market is immature and other than PE there is a limited number of big spenders."

"LPs were onside during the downturn, keen to wait for valuations to increase. Now they want to cash out."



GP time allocation

- The primary focus of GPs in the near term is shifting, with a notable difference from the prior year. The results suggest that significantly more time will be spent on both exits and fund raising over the next 12 months.

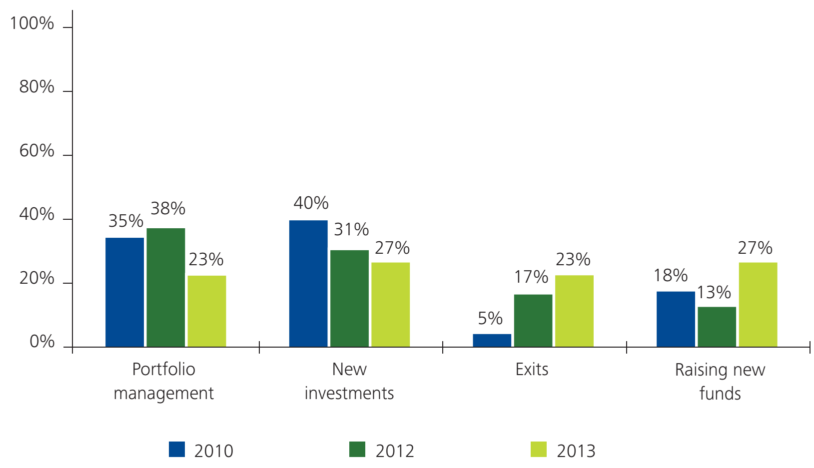
- The desire for new investments remains solid, however, with more than a quarter of respondents indicating that this will be their primary focus.

"We probably won't be spending as much time inside our portfolio companies as we did during the downturn. It depends on the strength of the management team and also on the sector. We have done a lot of the hands-on operational improvement now, so we just need to grow the businesses."

"Fundraising is our focus right now. We have the ability to warehouse a few deals with our LPs, but we really need to get the new fund secured."

"As a company with secure backing, the primary focus is closing at least another two deals this year. Our strategy is less about changing the business operationally. We tend to invest in a significant minority with a competent management team, whom we can then support where required."

Over the next 12 months, which elements of your business do you expect to spend the most time on?



Two thirds of respondents expect to raise a new fund over the next twelve months. GP's will need to show returns on current investments in order to be successful in this round of fundraising

Challenges and barriers

What do you see as the biggest challenges and barriers to growth for the MENA private equity industry to overcome?

Shortages of quality investment opportunities	Oversupply of capital/competition	Exit opportunities / ability to exit	Market regulation
Governance / transparency	Human capital deficiencies	Fund raising	Foreign ownership
Valuation gap	Length of transaction process	Lack of dept finance	Legal framework variances

- Overall, a wide variety of challenges were mentioned by respondents, mostly relating to experiences suffered on individual transactions.

- The most prominent challenge to growth is a shortage of quality investment opportunities in the region. The significant competition in the market, particularly in 'hot' sectors can lead to overpayment and lower return.

- Whilst GPs also note the difficulties with finding a suitable exit opportunity, this grievance has become less prevalent than in prior years, with the rebound in capital markets and increased numbers of corporates seeking inorganic growth.

"Most of the family offices and high net worth individuals that invested into private equity funds had their fingers burnt during the downturn, and have subsequently lost confidence in the 'blind pool' investment method. They have instead chosen alternative strategies such as direct investment or co-investment. Whilst it's difficult to conclude given the limited time period, I don't believe it has necessarily worked out for them as planned, and I believe that we will see these investment pools returning to private equity in due course."

"Governments do not provide enough funds to private equity through their sovereign investment vehicles. We are also finding that family offices are influencing deal activity as they often have lower IRR requirements."

"The ability to exit is difficult. Valuation requirements on assets purchased in '07 and '08 can still be a little high. There is also no real secondary PE market, as regional firms do not want to be providing a track record or lining the pockets of their competitors. There may be a real opportunity for international PE funds with no current position in the market."

Legislation

- Legislation varies significantly between countries of the MENA region, therefore responses are often specific to a particular country in which the respondent is investing.

- Foreign ownership restrictions and capital market regulations feature prominently in the list of key legislation the PE community hope will change in the MENA region to facilitate growth.

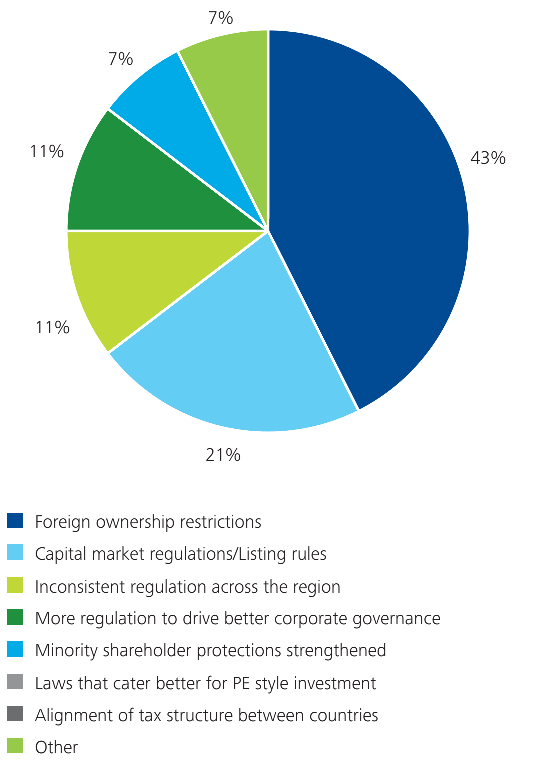
- In terms of regulation, most PE houses feel that they are both restrictive for some aspects of their business, and lacking in protection for other areas.

"Listing regulations for regional capital markets must become more transparent. There are currently multi-year backlogs of companies waiting to list, who are desperately trying to comply with ever changing standards and requirements. This time drag is extremely damaging to returns for any PE firm and will begin to put them off."

"A strengthening of minority shareholder protections, including those related to pre-emption obligations."

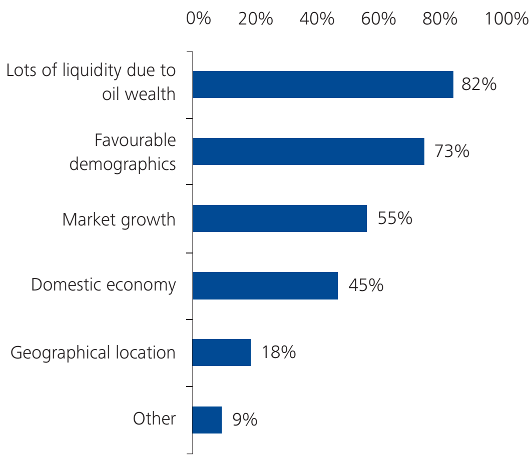
"Various elements should be changed:
- *Bankruptcy laws should be improved to promote entrepreneurship and risk taking;*
- *Regulation across the region should be aligned more, as currently it is too difficult to do cross border deals in the region (e.g. structure and ownership issues); and*
- *IPO processes need to be made easier, the rules and requirements should be more transparent."*

If you could change any element of the legislation affecting the MENA private equity market, what would it be and why?



Regional strength of MENA

What do you see as the key strengths of MENA relevant to the long-term growth of the private equity market?



The majority of the respondents believe that favourable demographics are a catalyst for the private equity market in MENA. Providing oil price levels are sustained, this liquidity will continue to drive growth

- Providing oil price levels are sustained, liquidity from oil revenue makes the GCC and other oil-wealthy countries an attractive investment destination, particularly compared to the austerity measures being enforced elsewhere in the world.

- Government spending on infrastructure and public services, as well as high disposable income, ensure relative attractiveness across a variety of sectors.

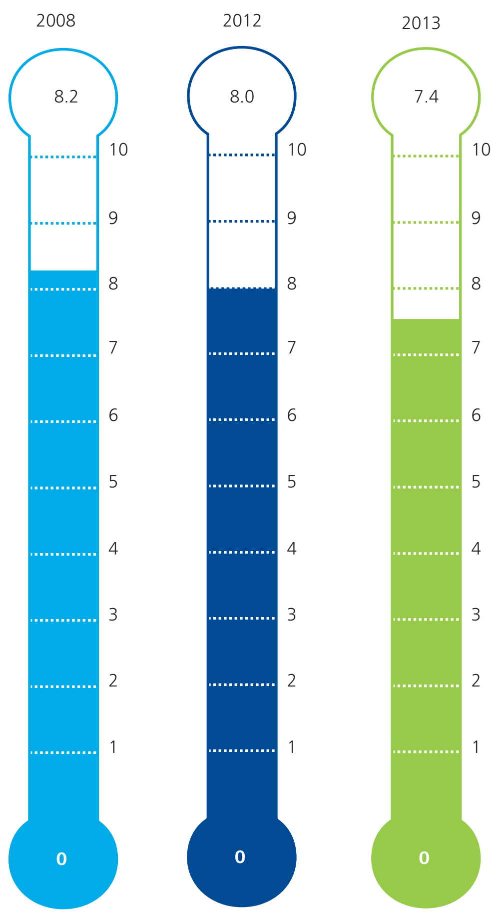
"The MENA region cannot be considered like this anymore. The countries within the MENA region vary significantly and whilst some of the stable countries with favourable demographics, significant oil wealth and high GDP/capita will continue to provide lucrative investment opportunities, other countries with political instability are unlikely to attract attention."

"A significant amount of family companies are moving from the 2nd to the 3rd generation, which may provide opportunities for PE if an element of monetisation is required."

"There is a huge amount of money sitting with LPs looking to invest in emerging markets or markets with higher levels of return than can be achieved in Western Europe or America. A slowdown in China, as well as the significant problems facing counties like India, mean that the MENA region, with significant forecast GDP growth, looks relatively attractive."

Long-term confidence

On a scale of 1-10 (10 being the highest), how confident are you in the long-term growth prospects of the MENA private equity industry?



Whilst investment optimism remains, longer term confidence in MENA private equity industry is marginally lower than prior year, reflecting funding uncertainties and asset sourcing within the more concentrated geographical area of focus

- After last year's confidence amongst private equity professionals reached levels not seen since pre-crisis, this year's survey indicates a slightly more cautious view with 'long-term confidence' for the private equity industry marginally lower at 7.4.
- The slight divergence of long-term private equity investment confidence from the positive predictions for both the general MENA economy and the overall level of investment activity in the region indicates a potential uncertainty over the role that family offices or other well funded investment types will play in the industry going forward.

About the survey

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Our MENA Private Equity confidence survey serves to provide a barometer of market perception and confidence amongst private equity professionals focused upon investments within this region.

Canvassing the opinions of General Partners operating at a local level, the survey examines how sentiment reflects the current market situation, identifying trends and providing commentary and insight into how professionals regard the private equity industry in this region.

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Special thanks also go to Joost Goesten and Ali Taki in assisting to compile the results of the survey.

To participate in the next **MENA Private Equity confidence survey**, please contact Joost Goesten at jogoesten@deloitte.com