

PRIVATE EQUITY

The good, the bad and the ugly

In 2010, some Middle East private equity teams will make superior investments. But separating the best from the worst won't be easy

STEADILY improving capital and equity markets are an auspicious sign for the battered Middle East private equity industry. Backed by some of the strongest economic growth in the world and over \$13 billion in uninvested commitments, this year should mark a return to lucrative private equity deals based on strategic and operational value.

On a broader level and over a longer period, regional private equity's new professionalism – imposed by the end of easy credit and a winnowing of practitioners – will ameliorate balance sheet discipline and corporate governance, while encouraging consolidation and sowing seeds for new industries. All of this will eventually strengthen the Middle East's twin Achilles' heels of weak financial markets and economies that are overly dependent on hydrocarbons.

But while the Middle East's most competent private equity investors spearhead economic change and prosper through renewed emphasis on active ownership, the shakeout in the region's private equity industry will continue.

Roughly 130 private equity firms were founded in the oil-rich Gulf Cooperation Council, from the industry's regional beginnings at the turn of the century to

by Antoine Dréan
thegulf@tradedearabia.net



the apex of high oil prices and easy credit during the summer of 2008. Many, too many, of these new firms invested during a speculative bubble, fueled by soaring values on poorly regulated and opaque regional stock markets. They paid multiples of more than 30 times earnings for both listed and unlisted companies, as well as vastly inflated prices for companies with just a business plan and no profits.

While 2009 was a difficult period for the global private equity industry, the lack of discipline and experience of some Middle East private equity teams made it ironically an even tougher year for the region's investors than it was for their counterparts in more developed markets with more troubled economies. As credit dried up in 2009, the most over-leveraged local investors, including very high-profile companies with deeply stressed private equity operations, defaulted.

With asset prices up sharply from last spring's record lows, the most spectacular of the regional defaults are probably behind us. But many Middle East private equity firms will continue to die a slow death as loans fall due and they lose their equity in restructurings.

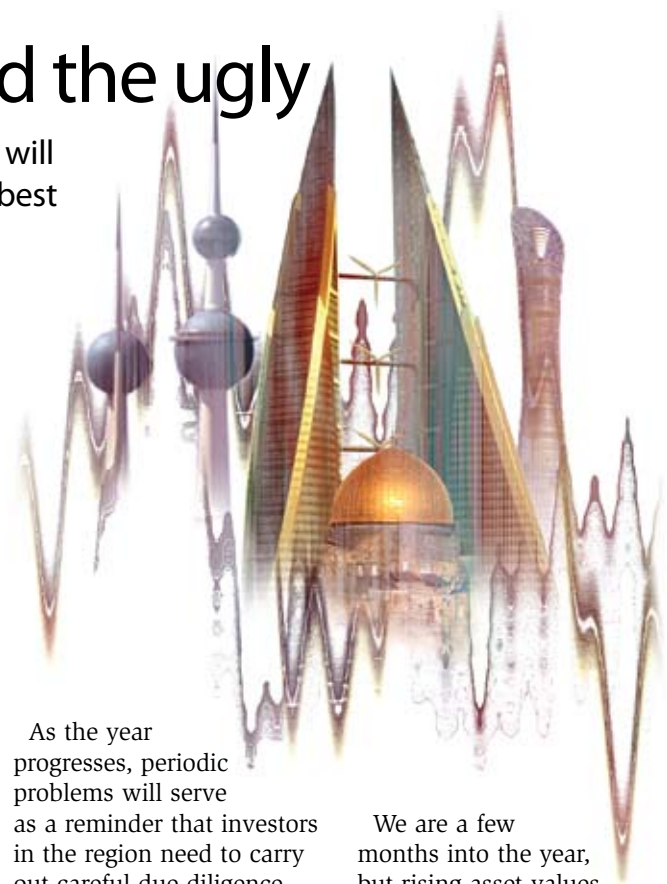


Illustration: Tim Gravestock

As the year progresses, periodic problems will serve as a reminder that investors in the region need to carry out careful due diligence. Given the infancy of the private equity industry in the Middle East, that will not be easy, but the region's exceptional growth potential should make the extra effort worthwhile.

It is probable that the best private equity teams putting money into the Middle East this year will achieve long-term double-digit annual returns that are considerably higher than those available in developed markets. Sectors most likely to benefit from the region's rapidly growing population, high per-capita income and multi-billion dollar privatisation programmes both this year and for the foreseeable future, include food, retail, education, healthcare, logistics, water, power and public-private partnerships in transport infrastructure and petrochemicals.

We are a few months into the year, but rising asset values and renewed bank lending are clearly making it easier for buyers and sellers to come to terms – an almost certain sign that the number and value of Middle East private equity deals in 2010 will surpass levels seen in 2009. But compared with the days of easy credit, deals will clearly be smaller and less dependent on debt, while targets, even those chosen with painstaking care, will invariably take longer to turn around. Good things – including satisfactory private equity returns – don't come easy. ■

Antoine Dréan is chairman and founder of Triago, a leading independent private equity advisor and fundraiser, serving both general partners and limited partners from offices in Dubai, Paris and New York