

Stiff competition for MENA deals

The Middle Eastern private equity boom is certain to continue, writes Neil Sackett of Arbor Square Associates.

The credit crunch is hitting private equity investment in developed markets hard. Investors looking to escape the gloom are heading for the MENA region - not for the year-round sunshine, but because the private equity market is still expected to grow. However, those anticipating rich pickings will find themselves up against stiff competition from increasingly sophisticated and well-networked local players, who currently dominate the market.

In Deloitte's June 2008 *MENA Private Equity Confidence Survey*, conducted by Arbor Square Associates, 94 percent of respondents expect to see an increase in investment activity, with none expecting it to decrease. The main drivers are availability of capital, strong macroeconomic growth, high oil prices and increased awareness of private equity, particularly among family-owned businesses.

"The region is booming and awash with liquidity," says Neven Hendricks, partner at Deloitte in Dubai. "But there is a level of circumspection creeping into deal-making activity. Funds are a lot more careful about the deployment of cash, given the concerns about overpricing of assets. They are choosing assets that have underlying value, rather than taking advantage of the boom and arbitraging on the irrational exuberance in the market. They are really focusing on the fundamentals."

A majority of investors (55 percent) expect entry multiples to rise, driven by high levels of liquidity and competition, including the increasing prevalence of auctions, and the macroeconomic growth prospects. However, a third (34 percent) expect pricing to stay the same, because of the global economic slow-down and because the peak has already been reached, as evidenced by falling multiples on public markets.

Concerns over pricing are offset by an overwhelming belief (89 percent) that the quality of investment opportunities is improving. There is a greater understanding of private equity's require-

ments, more mature companies, better advisors and better governance. For the few that were less enthusiastic, human capital shortfalls were the main concern (67 percent). However, Hendricks believes that this situation is improving at private equity houses: "The technical analysis of the underlying assets is a lot more thorough than it has ever been. The experience gleaned by deal execution teams is one reason, but there has also been an influx of talent into the region that has brought greater sophistication."

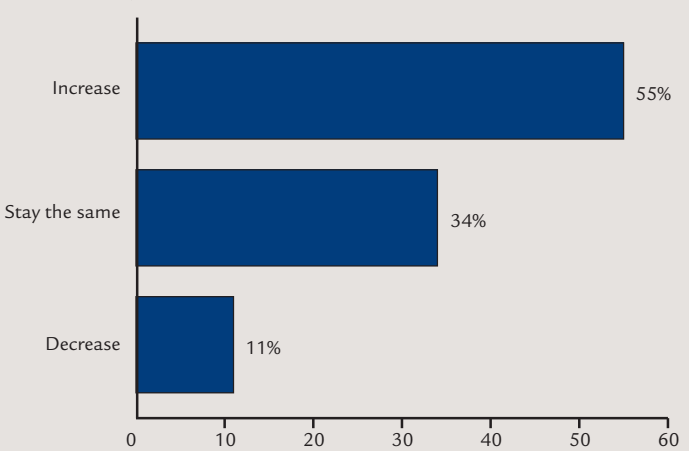
Investors are also positive about exit opportunities, with 71 percent expecting more activity in the next 12 months, driven by a large number of portfolio companies ready to exit, a favourable stock market and a rise in the number of trade buyers. According to Hendricks: "The acid test for PE firms in this region lies in their ability to exit at values that are commensurate with the returns they expect. In the past, exits have been predicated on IPOs, but in future the trick will lie in M&A activity, where you will need the depth of intellectual muscle to execute those deals."

MENA is, of course, a highly diverse region. Private equity activity is expected to focus on Egypt (31 percent), which is both large and industrialised enough to generate opportunities, Saudi Arabia (29 percent), which has scale and liquidity and was described by one local player as "the giant waiting to be awakened", and GCC (25 percent), which offers high growth but is highly competitive.

However, for all investors in the region, whether they adopt a pan-regional or a country-specific strategy, accessing deals will be the key. Whilst auctions are becoming more prevalent, proprietary channels remain the most important source of deal-flow, with successful private equity firms creating their own deals by building relationships with business owners and intermediaries. ■

PRICES ON THE UP

Respondents' views on the likely trend in entry multiples in MENA Private Equity over the next 12 months



Source: Deloitte, August 2006