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Private equity: New reality enforces need to work harder

By Camilla Hall

Energy needs: Qatar Petroleum is an important investor in Citadel Capital's $3.7bn refinery project deal signed with Egypt in June

For the region's fledging private equity industry, the onset of the Arab uprisings hard on the heels of a global financial crisis has made for a tough few years.

Valuations of the investments held by the slew of new Middle Eastern companies set up in the mid-2000s have plummeted after the credit crunch and western bank meltdowns were followed by the popular revolutions that have swept the region from Tunisia to Bahrain.

In the new reality of an unpredictable political future and more subdued equity capital markets, private equity groups are having to work harder to increase the value of their investments to generate returns.

"As we think about the business cycle, it was pretty clear that it will take longer for us to exit our transactions," says Abdalla Elebiary, managing director at Citadel Capital, the Egyptian private equity group. "We need to hold on to our platforms [investments] longer to make sure we sell at the right part of the cycle."

With that in mind, the region’s companies are trying to make sure that they are more geared towards portfolio management, given that they may have to hold on to their assets for longer periods.

Adding real value to the businesses they acquire has become central to their ability to exit, as international investors have been unsettled by political unrest.

It also means that regional companies are trying to pick investment themes that can be applicable over a longer period, as opposed to buys that can be turned around to make a quick return.

While the Arab uprisings have played a role, some managers say that longer holding periods are the norm now globally. “In private equity in general, holding periods are getting longer – it’s back to basics,” says Mustafa Abdel-Wadood, chief executive at Abraaj Capital, the emerging market private equity house in Dubai.

“The environment in terms of the Arab spring … the short-term visibility … does not lend itself to exits and there is no pressure to exit at the wrong time.”

Mr Abdel-Wadood says when markets are soft, it is the time to look for buying opportunities as opposed to seek to sell assets.

Amid recent unrest from Egypt to Bahrain, some specific sectors and countries have caught the eye of regional private equity groups. “The Arab spring has restated the safe haven markets,” says Karim Souaid, managing partner at GrowthGate, in Bahrain. The group is seeking investment opportunities in Morocco, the United Arab Emirates, Saudi Arabia and Turkey. They are seen as relatively stable compared with some of their neighbours.

While geography is driving decisions at GrowthGate, consumer goods and retail are on the radar of Abraaj, as Gulf government spending trickles down into consumer demand.

By contrast, companies such as Egypt’s Citadel are more focused on the infrastructure and energy demands it sees in its vicinity.

Economic growth may have tapered in some parts of the Middle East but growth rates are still attractive from a global perspective, investors say. Growth in the six-member Gulf Co-operation Council is forecast to slow to 3.7 per cent in 2013 from 5.6 per cent this year, according to the International Monetary Fund.

Growth in the region’s oil importers, including Afghanistan and Pakistan, is set to increase to 3.3 per cent next year from 2.1 per cent in 2012, according to the fund.

The model of investing in the Middle East to take advantage of that growth is still valid and differs from the western private equity industry that has been dominated by taking on debt to exploit short-term opportunities, investors say.

There has been a number of sizeable private equity deals in the Middle East over the past year.

Citadel sealed its $3.7bn petroleum refinery project in June, alongside Qatar Petroleum International and European and Asian development banks. Qatar plans to invest with Citadel again, agreeing last month to work on a liquefied natural gas project that would help Egypt meet its energy needs.

Bahrain-based Investcorp, with $11bn under management, has also been active this year, announcing its first exit from its Gulf opportunity fund in February. The sale of Redington International Holdings, a distributor of IT and telecoms products in the Middle East, Africa and Turkey, generated a net internal rate of return of 17 per cent.

In September, it said it would take a 35 per cent stake in Kuwait's Automak, the independent vehicle leasing company, through capital injection.

But while some business has been continuing as usual, other Gulf investment companies have struggled after taking on excessive levels of debt for their deals.

Bahrain's Arcapita has sought bankruptcy protection in the US, while Kuwait's Global Investment House and The Investment Dar have had to restructure their debt.

"I'm seeing a bit of a natural selection, whereby those that have survived will have a better chance in the recovery," says Mr Souaid. "Many came with less experience and more ambition than prospects and now they have been set aside."

For those that have survived, it looks like the private equity groups of the Middle East will be holding off on selling some of their biggest assets until they see scope for better returns.

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