Foreword

By Mr. Arif Amiri,
Chief Executive officer of DIFC Authority

In the last decade, the MENA Private Equity Association (MENA PEA) Annual Report has established itself as one of the most comprehensive studies in its class across the region, offering private equity investors a greater understanding of this unique industry and its most significant trends.

Capturing milestones in the MENA region’s private equity industry in 2015, this 10th edition profiles differentiating strategies, latest trends and structural changes influencing the investment industry.

2015 was a year of continued investment across the MENA, with private equity and venture capital approaching levels of investment activity higher than in the days prior to the global financial crisis.

A significant increase in the number of disclosed transactions to 175 across both private equity and venture capital reflects the ongoing development of the industry in the region. A high concentration of deals in Saudi Arabia, the UAE and Lebanon indicate strong investor appetite across the MENA region. Interestingly, the Private Equity inflows manifest strong and sustained investment activity, despite the challenging geopolitical and economic environment. Private equity investors and venture capitalists are now looking to strengthen their portfolio with new investments that reflect the momentum of the region’s equity landscape.

From a portfolio and diversification perspective, investments channeled into the consumer goods space - including the retail sector - continue to show growth potential, primarily driven by a young educated population, disposable personal income and the relatively non-cyclical nature of consumer focused businesses.

More specifically, information technology related transactions have significantly scaled up in recent years accounting for 33% of all transactions, reflecting the strong focus of venture capital in the sector.

Furthermore, from an investment perspective, the increased investment activity can be attributed to a number of important factors. First, the growth in opportunities in the region. Second, the need for an effective diversification
strategy across MENA. Third, the tangible increase in the maturity and sophistication of key investor segments, such as family businesses and entrepreneurs. And, finally, the MENA region is more attractive to investors due to the increase in regionally based fund management expertise.

With a robust pipeline for investments, a clear opportunity exists today to accelerate investment activity in 2016 and beyond.

Such optimism is good news for Dubai International Financial Centre. The Centre’s financial expertise, independent and conducive regulatory framework and world-class infrastructure enables fund managers to successfully operate in the region and effectively overcome any potential limitations on their business.

In addition, with several other regions continuing to see changes in their favourable tax status, such as the renegotiation of the India/Mauritius tax treaty, the DIFC continues to be viewed as the leading fund domicile in the region.

These opportunities are in line with DIFC’s 2024 growth strategy that outlines fund management as a strategic focus area for the financial hub in the long-term. In recent years, DIFC has introduced supportive legislation to tap into the significant potential the sector offers throughout the MEASA region.

It is clear that, given its strong macroeconomic fundamentals and the demographic change that drives long-term investor appetite, the MENA region has tremendous growth potential.

On behalf of Dubai International Financial Centre, I commend the seasoned professionals of the MENA Private Equity Association for collating this comprehensive report that will serve as a knowledge resource for this important industry.

I am confident the report’s findings will have a far-reaching impact in shaping a viable future for the private equity and venture capital industry in the MENA region.
More than ten years ago, a random group of entrepreneurs, corporates and financial institutions gathered in Manama, Bahrain to discuss how to stimulate private equity and venture capital investments in GCC. For some reason, Aramco was the main sponsor of the event. Most attendees had a vague or no idea about the terms “venture capital” and “private equity”. Nevertheless, everyone was excited to make it happen.

Some of the attendees of that meeting were Dr Khalid Al Falih, current Saudi minister of Petroleum; Ihsan Jawad, partner in venture capital firm MEVP; and Hussein Rifai, ex-CEO of Injazat Capital. Few funds were present, and the only ones I can recollect were Abraaj Capital and Injazat Capital. The outcome of this first meeting was exceptionally productive. The 100 plus attendees formed the Gulf Venture Capital Association, the predecessor of the MENA Private Equity Association, and elected its first board of directors.

Ten years (and three major crises) later, the growth trajectory of most of the characters and institutions present in Bahrain is an attestation of the growth of the industry itself. Abraaj Capital grew from a newly formed $115 million fund to a $9 billion plus global asset manager; Ihsan Jawad was transferred from an entrepreneur managing Zawya to one of the most active VC investors in the region; and myself, I grew from a curious consultant to a leading growth capital fund manager. During that period, the industry as a whole grew by more than 20 fold with hundreds of investments and exits completed.
The growth of the industry is the product of the contribution of its most successful fund managers. Ten years ago, the ecosystem was non-existent and skilled people and advisors were in shortage. Private equity investment strategy was summarized in three letters: IPO. None of the current ecosystem and sophistication existed.

It took a lot of sleepless nights, countless travel, and many many failed investments for the industry to reach its current mature state. Today every essential part of the ecosystem is present in the region. There are venture, infrastructure, growth, large buyout and mega funds catering for investments opportunities as low as $10,000 and as high as $1 billion.

Since the early days, the MENA Private Equity association played a critical role in forming a unifying platform. Its reports and data were present in almost every industry conference and fund information memorandum allowing the industry to speak with one voice. It played a small, but essential, role in the success of the industry.

The association will have different challenges in its next ten years. It needs the contribution of all its members and supporters – fund managers, legal advisors, financial consultants, etc – to shape its direction. But its prospects and the prospects of the industry remain, as in the first 10 years, up, up and rising.
The MENA Private Equity Association extends its sincere appreciation to Zawya – Thomson Reuters for sharing primary data used for this annual report. We are most grateful to our knowledge partners Deloitte for developing the report analysis.

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**Steering Committee of the MENA Private Equity Association**
We also thank the association’s steering committee members as well as the thought leadership and survey participants, for their contributions towards the development of this report.

We thank the public relations and media task force for their support.

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1.1 Basis of the Annual Report Preparation

This report has been prepared based on data sourced from Zawya - Thomson Reuters Private Equity Monitor and primary research initiated by Deloitte.

Historical data was updated from that used in the 2014 annual report to reflect increased disclosure of information in the market.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is or will continue to be accurate. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

In analyzing and determining the parameters of available data, it has been necessary to apply certain criteria, the most significant of which are as follows:

• Private equity is defined to include houses that have a General Partner/Limited Partner structure, investment companies and quasi-governmental entities that are run by, and operate in the same way as, a private equity house.

• Venture capital for the purpose of this report is defined as a fund specifically dedicated to venture capital investments. This includes funds by venture capital firms, and venture funds under private equity firms.

• Funds managed from MENA, but whose focus is to invest solely outside the region, are excluded from the fundraising and investment totals.

• MENA includes Algeria, Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, the United Arab Emirates, and Yemen.
• Investment size represents the total investment (both the debt and equity portions). However, fund size only considers equity invested, as we have no visibility on debt exposure by funds.

• The fund raising totals are the amounts closed/committed for fund raising funds, closed funds, investing funds, fully vested funds, and liquidated funds.

• Exits are defined to include partial exits, although simple dilutions have not been included.

1.2 Definitions and Assumptions

For analytical purposes, we have considered the following types of funds, as defined by Zawya’s Private Equity Monitor:

• **Announced**: Official launch of funds which are yet to commence fund raising.

• **Rumored**: Funds expected to announce their intention to commence fund raising.

• **Fund raising**: Funds that have been announced and are in the process of raising capital.

• **Investing**: Funds that have closed and are actively seeking and/or making investments.

• **Fully invested**: Funds that have invested all capital raised. Some of the investments may have divested in this stage, but not all.

• **Liquidation**: Funds that have divested all investments and have fulfilled all obligations to shareholders.
1.3 Data Filtering

The primary data sourced from Zawya - Thomson Reuters has been filtered according to the definitions used in the Emerging Markets Private Equity Association (EMPEA) research methodology. In particular, we have used the following definitions:

**Fund Size:** In the case of funds yet to make a first close, or where no close information is available, fund size is equivalent to the target amount, and is noted as such. For funds achieving at least one official close, fund size is reported as the capital raised to date, while for funds that have made a final close, the fund size is the total capital raised. All amounts are reported in USD millions. Rumored funds are excluded.

**Currency:** Where funds data has been provided in a currency other than USD, exchange rates applied are from the last day of the month in which each close is reported, e.g. first close reported in € on 15 April 2015 would be calculated using the exchange rate for 30 April 2015, taken from publicly available sources.

**Funds of funds or Secondaries are excluded.**

**Region:** Statistics are based on the “market” approach and funds are categorized based on the intended destination for investments (as defined in a fund’s announced mandate) as opposed to where the private equity firm is located. With regard to multi-region funds, we have included these to the extent that there is a focus on the MENA region. EMPEA methodology includes only those multi-region funds whose primary intention is to invest in emerging markets. However, the source data does not provide visibility on primary geographic intention.

Funds established with a specific mandate to invest in real estate are excluded from the fundraising, investment and exit totals. The remaining real estate investments relate to funds with mixed investment mandates.

Conventional infrastructure funds, or funds investing directly in greenfield infrastructure projects (e.g. bridges, roads, etc.), are excluded from fundraising totals. However, funds that make private equity investments (determined based on target returns) in companies operating in the infrastructure sector are included.

EMPEA does not track or report other alternative asset classes, including hedge funds, real estate funds, and conventional infrastructure funds. In our analysis we have excluded data from investment-type companies, real estate firms, and sovereign wealth funds.
For the second year Deloitte is delighted to be partnering with the MENA Private Equity Association in its annual report on the regional private equity and venture capital industry. We have collaborated on an analysis of performance (including investments, divestments and fund raising activities in 2015) and in surveying fund managers to gauge their outlook for the industry going forward in a continuation of our regular Deloitte Private Equity confidence survey.

2015 can be seen as a year of consolidation and growth for the private equity and venture capital industry across the MENA region. Investment volumes increased significantly accompanied by values remaining at post global financial crisis highs.

This is an impressive performance in a year that was not without a number of socio economic and geopolitical challenges. The industry should take comfort from its ability to continue to deploy capital effectively, suggesting that the underlying strengths of the region, growth and age of population and demographic shifts, continue to support a positive investment outlook.

The growth in venture capital investments was particularly notable in the year with the number of disclosed deals more than trebling as an evolving technology driven, entrepreneurial ecosystem continues to attract the interest of investors.

Fund raising levels declined but investors in the region appear to be increasingly less tied to the formal GP/LP structures prevalent in western markets. A number of managers are adopting the “deal by deal” approach to fund raising, thus announced funds understate the level of raised capital in the industry. This flexibility reflects local market preferences in part and may also be indicative of challenges in attracting blind pool capital into the region at a time when the landscape includes areas of political and social instability.
Surveyed fund managers indicated that fund raising will remain challenging through 2016 and we expect to see the deal by deal trend continue, if not increase in popularity.

Overall, 2015 is a year in which the private equity and venture capital industries appear to have demonstrated their ability to continue to find investment opportunities while partially withstanding a downturn in market conditions to effect an increased level of divestments, with exit values increasing by 35%.

2016 is likely to provide further opportunities and challenges for the industry given ongoing economic uncertainties.

We would once again like to thank Zawya - Thomson Reuters, the MENA Private Equity Association (MENA PEA) and the members of the MENA PEA annual report committee for their assistance in the development of this report. Their contribution of both data and insight has been invaluable.

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3.1: Funds raised and investments completed

2015 continued the positive trend for private equity and venture capital that was evident in 2014. In that year investment values more than doubled and reached their highest levels since 2008. In 2015 investment values decreased marginally by 4% (versus 2014) while disclosed transactions rose by over 100 from 72 to 175 (versus 2014), reflecting growth in investments in both private equity and more markedly in venture capital.

Average private equity deal sizes decreased from a 2014 high of USD 70m to USD 51m. 2014 average values were boosted by a number of major transactions. While 2015 continued the trend of some very large transactions including investments in the regions from international private equity investors, there was an increased number of deals overall and a broader spread of investments from GPs across the size range, which overall can be seen as a positive.
• Investment activity was also well spread across the region. Whereas in 2014 over 75% of investments by value were concentrated in the UAE and Saudi Arabia, in 2015 Egypt, Jordan, Tunisia and Lebanon also each accounted for 10 or more deals as managers were able to more effectively deploy across a range of geographies.

• As expected, private equity GPs focused on consumer driven sectors such as retail, healthcare, F&B and education (accounting for over 60% of investments by value), with an understandable and expected shift away from investing in the oil and gas sectors given the decline and volatility in oil prices – oil field services companies had previously been among GPs’ more favoured targets.

• Exit activity increased by 35% in value terms with some major transactions such as Abraaj’s sale of its stake in Network International to a consortium of international private equity investors; however, while exit volumes remained consistent with the prior year, we expect a degree of caution in effecting exits in 2016, as seller and buyer price expectations may show divergence given some of the headwinds in the market from the impact of oil prices.

• Funds raised in the year declined from the post 2008 high seen in 2014. There is little doubt that the fund raising environment has remained challenging given the impact of economic headwinds and geopolitical factors on external investor perceptions, allied to a still youthful industry with a relatively limited track record. However, fund managers have continued to be creative in their approach to sourcing capital and the deal by deal model continues to gain traction across the region.
3.2 Investments

- Investment information is necessarily not fully comprehensive as it is estimated that up to 30% of PE and VC transactions in the MENA region are not announced, and not all announced transactions include details regarding the size of the investment.

- As in prior years, there is a lack of visibility over the funding structures used by fund managers to effect transactions and therefore investment values reflect total transaction size rather than equity investment.

**Investment value and volume by year**

- 175 disclosed investments were made in 2015, a significant increase over 2014 levels and this represented the highest number of deals in any year post 2008.

- In part this reflects a growing willingness of fund managers to publicly disclose completed transactions, rather than solely reflecting a like for like increase in deal activity. This in itself is an encouraging trend, as the industry becomes more forthcoming in publicizing its achievements.

Source: Thomson Reuters - Zawya and Deloitte
The trend was most noticeable in venture capital where disclosed deals increased from 33 to 122 with private equity transactions increased more modestly, but still significantly, from 39 to 53.

The were 14 transactions in the MENA region with an investment value greater than USD 25 million, in line with the 13 identified in 2014.

There is no doubt that the growth in venture capital transactions is reflective of the development of this capital source over the years post global financial crisis. The region’s technology focused entrepreneurial base continues to grow and mature, affording increased investment opportunities, reflected in the upsurge in deal volumes.

The value of disclosed investments decreased marginally by 4 per cent to USD 1.5 billion. 2014 was notable for a concentration of larger deals in the region while 2015 saw deal activity more widely spread across the value range but still included major transactions such as the Abraaj Group and TPG investing in Kudu, the leading KSA restaurant group; Standard Chartered Private Equity leading a USD 175 million consortium investment in FINE, a Jordanian headquartered major integrated tissue manufacturer; and Warburg Pincus and General Atlantic acquiring Abraaj’s investment in Network International.
3.2.1 Investments by sector:

Consumer and IT related sectors dominated investment activity.

As we discuss in more detail below, investment activity in 2015 was widespread across the region, both in the terms of the locations and sectors of businesses.

- 2015 was a year in which acknowledged industry sector preferences were largely borne out in deal activity. Consumer goods (including retail) related transactions saw the highest levels of activity reflecting the commonly held investor focus on businesses that directly benefit from the region’s relatively young, growing, and affluent demographic profile. Financial investors remain wary of more cyclical industries such as construction, real estate and businesses that are contracting in nature.

- Consumer goods investments were widespread across the sector, including personal care and grooming, luxury goods retail and ecommerce. This reflects a desire to invest in businesses with strong fundamentals rather than a focus on particular sub sectors.
In other sectors, the level of healthcare transactions increased to 11 per cent of total deals. The sector has been long prized by the industry and the increase in deals demonstrates continued appetite for healthcare and encouragingly an increased ability to effect transactions in this competitive sector. Investments ranged across the sector including primary and secondary healthcare providers and pharmaceuticals. Venture capital also increased its activity in the sector including investments in fitness related products and health insurance tools.

**Investment volumes by sector**

- IT: 33%
- Consumer goods: 15%
- Other: 12%
- Oil and Gas: 2%
- Manufacturing: 2%
- Media: 5%
- Financial Services: 4%
- F&B: 6%
- Transport: 7%
- Services and education: 6%
- Healthcare: 8%

Source: Thomson Reuters - Zawya and Deloitte

The continued low level of oil and gas related transactions was in line with expectations of fund managers as reflected in last year’s report, as the decline in oil prices has largely led private equity investors to steer clear of the sector for the time being.

The largest number of transactions by volume was once again in the technology sector, reflecting venture capital’s focus on entrepreneurial, technology driven businesses. The growth in volume terms of technology deals therefore results from the overall significant growth in venture capital transactions.

Deal trends in 2015 are expected to continue in 2016, with fund managers continuing to indicate a strong preference for consumer driven, defensive sectors.
### 3.2.2 Investments by region:

- **MENA investment activity was more widely spread across the region than in 2014 when the UAE and KSA attracted over 75% of MENA investment activity by value.** This reflects a positive trend with most funds being GCC or MENA centric and diversification of invested capital across the region should be regarded positively.

- **Fund managers were successful in deploying capital across MENA with Egypt, Turkey, Jordan and Tunisia all showing investment levels increasing over the prior year.**
Investments in Egypt increased significantly in value terms in 2015. Fund managers remained enthusiastic about the growth opportunities afforded by the jurisdiction which has the largest population in the MENA region with a growing middle class. However, increased concerns regarding security and foreign exchange instability may make investment into the country more challenging in 2016, with a number of fund managers expressing caution in this regard.

Investment volumes were led by the UAE and KSA. In the UAE this was partly as a result of the increased levels of venture capital activity.

It should also be noted that while at a headline level there has been a reduction in the value of investments in the UAE, this does not fully reflect investment activity in the country as a number of businesses headquartered elsewhere in MENA have significant operations in the UAE and it remains a primary target for investment. We therefore expect that UAE based investments are likely to increase in 2016.

### 3.3 Divestments

We commented in the 2014 report that divestments would remain a major focus for portfolio managers and this proved to be the case with divestment values increasing by 35% and volumes increasing marginally from 20 to 21, as GPs maintained their focus on exiting pre global financial crisis investments and increasingly realized value from more recent vintages.

The impact of initial entry prices coupled with the global financial crisis appears to continue to affect the ability of fund managers to fully exit their pre 2008 legacy portfolios as the large majority of exits were from post Global Financial Crisis era investments.
High profile major transactions included Abraaj’s sale of its stake in Network International and TVM Capital’s exit from its investment in ProVita International Medical Center.

The large majority of exits have been realized through sales to strategic or financial investors as IPO exits have continued to be challenging with a limited number of assets held by private equity funds in MENA that would attract sufficient coverage for an international listing and local market capital market conditions generally making IPOs less favourable as an exit option than a direct sale.

2016 is likely to be a potentially more challenging year for fund managers to realise satisfactory valuations, given prevailing market conditions and a perceived gap in pricing expectations between buyers and sellers as a result. Many managers have indicated a willingness to hold assets through this period.

As with previous periods the data set does not reflect all divestments as a number of exits are either not announced or when disclosed do not include deal values.

3.4 Funds

Fund raising declined against 2014 but remained above levels seen in 2012 and 2013

![Graph showing funds raised and number of closes over FY10 to FY15](image_url)

Source: Thomson Reuters - Zawya
2015 disclosed fund raising levels declined against the post 2008 peak experienced in 2014 but remained above levels achieved in 2012 and 2013.

The number of closes in the year was consistent with 2014 at 12. In line with the previous two years, three funds raised in excess of USD 100 million.

Fund raising in the region remains one of the major challenges faced by market participants. The combination of economic headwinds, external views on geopolitical factors and the absence of a lengthy track record for some players have all been factors.

As a result, and emphasising a trend seen in 2014, GPs are continuing to explore alternative fund raising solutions. This reflects the increasing willingness of LPs to consider direct or co-investment options as a viable alternative to blind pool investing.

Regional family offices are also continuing to invest directly, setting up private equity style operations to support the co-invest model, in acknowledgement of the opportunities in the region.

Cumulative funds under management increased to USD 26.5 billion in 2015.

In 2015 five funds disclosed closes in excess of USD 50 million each, with three of those funds raising in excess of USD 100 million, both levels being consistent with 2014.

The largest MENA focused fund raised was the Abraaj Group’s USD 375 million Abraaj North Africa Fund II, a mid-market focused fund, targeting both majority and significant minority stakes. Other major funds raised included the USD 300 million Egypt focused Duet-CIC Egypt opportunities Fund.

There was great progress made in the time taken to raise funds on average with four funds announcing and closing in 2015, against only one fund closing within a twelve-month period in 2014.
3.4.1 Growth capital funds remain the largest asset class

Growth capital represented the largest type of funds raised by value, in line with fund raisings in each year since 2011. GPs continue to target investments in businesses where they believe they can add value to an existing platform, with less emphasis on financial engineering or use of leverage than is seen in more developed markets. Fund managers consistently stress this desire to target investments in growing, entrepreneurial businesses as their priority. This necessitates a higher level of operational involvement in portfolio companies, something that managers expect to increase given potentially more adverse market conditions for a number of these businesses in 2016.

The growth capital/minority stake model also results from the prevalence of family owned businesses, seeking this type of investment while still retaining an element of control.

It is, however, important to recognize that a number of these growth capital funds will consider majority investments with a buy out element, should the transaction dynamics warrant this.

Venture capital fund raising levels were consistent with those seen in 2014, emphasising the development of the industry as both years witnessed fund raising significantly higher than any other year post 2008.
4.1 VC funds raised and investments completed

VC investment activity levels increased materially in 2015
VC funds raised and investments completed

- 2015 marked a significant year for venture capital in the MENA region. Disclosed numbers of transactions more than trebled to 122 with investment values also showing a positive trend, reaching USD 123m. While we caution that this may partly reflect fuller disclosure by VC investors there is little doubt that this reflects a positive and encouraging trend for the sector.

- Venture capital has long been identified as a major opportunity for the region, with a growing class of start-up entrepreneurs finding it a challenge to attract more traditional forms of funding, such as bank finance. The growth in ecommerce and other innovative technology driven offerings attracts increasing numbers of VC investors.

- Burgeoning entrepreneurship is supported by a young and growing consumer market with high rates of technology adoption. The level of ecommerce penetration in the region is growing and for VC investors this
is regarded as a major opportunity over the coming years. It has been estimated that the value of ecommerce in the MENA region will reach USD 200 billion by 2020.

- Fund raising levels were consistent with 2014, and remained significantly above other periods from 2010, further pointing to a positive outlook for the VC industry in MENA.

4.2 VC investments by region

- The UAE experienced a major increase in VC investing in 2015, with the number of deals increasing to 50, as a number of high profile transactions were closed including a USD 60 million fund raise by Careem, the app based car service. The growth of the entrepreneurial technology sector affords VC investors increased investment opportunities, driving this growth in the UAE.

- Lebanon continued to represent an important hub for VC investing in the region, (evidenced by the number of deals at 22 in 2015 vs. 8 deals in 2014), with Berytech and Middle East Venture Partners being particularly active. The prevalence of SMEs in the economy and support from the Lebanese Central Bank (Circular 331) have stimulated VC activity and boosted the Lebanese startup environment, with a reported trend of Lebanese investors and entrepreneurs returning to their home country to launch startups and establish VC funds.

- KSA experienced higher deal volumes in 2015 with 17 deals versus 2 in 2014 which reflects a developing ecosystem supported by government and private sector initiatives to further the spread of venture capital activity in the Kingdom.
4.2 VC investments by sector

In line with 2014 and prior years, the major areas of investment for VC practitioners have primarily been technology related, as would be expected given the nature of the industry. In addition to investments classified as IT, other sectors tend to have a critical technology component, such as ecommerce.

Reported exits from VC investments remain at a low level with four disclosed in 2015 (two in 2014). It is likely that disclosures of VC divestments remain understated but this is also a reflection of the more recent growth in the industry, meaning average hold periods have not yet reached maturity.
Deloitte and the MENA Private Equity Association are pleased to present their survey of confidence levels within the regional private equity industry. The survey addresses the key issues facing fund managers and acts as a barometer for changing attitudes.

5.1 Survey of General Partners (GP’s) in the MENA Region

The survey focuses on GPs in the MENA region. The aim of the survey was to obtain a greater understanding of the sentiments of the MENA region’s PE industry from the perspective of GPs.

Methodology

The survey was prepared by Deloitte and was conducted in a series of face to face meetings and teleconferences in the first quarter of 2016. Participating firms had investments in a range of industries across a wide geographical area.

Scope of The Survey

The survey briefly examines the impact of the economic downturn and political instability in the region during the period of 2015 – 2014, and aims to understand GP expectations and views around the outlook for 2016 and beyond.

The fall in oil prices has had a significant impact on investor confidence. While there is a belief that opportunities remain, three quarters of respondents believe investment activity will remain stable or decline over the coming twelve months.
1. Over the next 12 months, what do you expect to happen to investment activity in the MENA private equity market?

- “Activity levels will decline not because there are fewer available deals but because people are more cautious and will not rush into transactions.”
- “There are funds to deploy given what has been raised over the past couple of years, but investors will be cautious as they want to see the impact of the down cycle on businesses’ financial results. You will also see more realistic valuations in the second half of the year.”
- “Fortune will favour the brave but there will be limited activity. Smarter managers will use this time for consolidation. The key is having dry powder as there are a lot of opportunities.”
- “This has switched to being a buyer’s market, but there will be a time lag in sellers adjusting their expectations. Buyers will take longer in their diligence and finance will be more difficult.”
- “Deal flow overall will increase due to a refocusing by family businesses on core operations. There are great opportunities for intelligent long term investors as exits are driven by a short term downturn. But the challenge is that sellers generally don’t have to sell and pricing discrepancies remain significant.”

- There has been a major shift in investor sentiment as to the likely levels of investment activity in the next 12 months. 40% of respondents expect a decline in executed deals primarily due to ongoing economic challenges driving a more cautious wait and see approach.
- Fund managers do consider that transaction opportunities do exist but remain concerned that sellers have not appropriately adjusted their pricing expectations downwards.
- A perceived increasing willingness of family groups to divest non core assets is, however, seen as an important trend.
2. In which industry sectors do you expect to see most deal activity over the next 12 months and why?

- “It will be easiest to raise funds for education and healthcare deals. Sentiment remains strong for these sectors.”

- “While we continue to favour the consumer driven sectors we see that pricing on food and beverage transactions remains steep and performance in retail has been impacted by economic factors so we are cautious.”

- “We see huge opportunities in ecommerce. It’s underdeveloped and evolving.”

- “There will be some great opportunities in oil field services. There will be consolidation plays, buying from weaker players.”

- Sector preferences remain broadly consistent with 2015, as consumer driven businesses remain the overwhelming focus for private equity investors. Targeted investments in healthcare, education, food and beverage and retail and other consumer assets account for around 85% of respondent preferences.

- There is a clear wish to avoid cyclical or contract driven businesses and the industry continues to shy away from oil and gas transactions, despite an acknowledgement that a level of distress in the industry could give rise to a number of potential opportunities.
Over 50% of respondents believe the UAE will see the highest levels of activity. This reflects the country’s relatively diversified economy, allied to increased concerns over economic and political factors in KSA and Egypt.

- This year saw a significant shift in regional investor sentiment with the UAE emerging as the preferred investment destination for over 50% of private equity participants.
- KSA remains attractive given its size and demographics but commentary from those surveyed did exhibit some caution over the greater dependence on oil and the attendant pricing impacts, in addition to the impact of current geopolitical matters.
- The most significant shift this year is in the decreased appetite for investing in Egypt. Only 11% see this as a priority market, a reversal of the more optimistic sentiment in 2015 when it was favoured by 27%. Currency instability was cited as a primary disincentive for investing in the country.

- “KSA remains attractive due to the government initiatives e.g. privatisation in healthcare. We think the geopolitical situation will stabilise.”
- “If I have a concern it is in KSA. There a number of macroeconomic and political changes occurring which demand funding and this has an impact.”
- “We expect KSA to settle down, but valuations do need to reduce in some cases, from currently unrealistic expectations.”
- “We were excited about Egypt but currency risk has become a real factor.”
- “We see opportunities in Oman as the economic conditions mean that family groups will be looking to divest assets.”
4. Over the next year, which types of investors do you expect to be most active in the MENA private equity market?

Domestic PE funds and family offices are expected to be the most active investors, as international investors and sovereign wealth funds are more sensitive to the impact and geopolitical and oil related economic factors.

- “I think the trend of family offices directly investing on a PE style basis is an increasing trend and one that is here to stay.”
- “Family offices are increasingly keen on diversification post the fall in oil prices. They want to work with PE houses to support them in that diversification.”
- “It is potentially easier for families to invest here – they can potentially take a long term view and worry less about exits and short term hurdle rates.”
- “We will see family offices, domestic and international PE all being active, but we do think that family offices may shift their focus more to investing outside of the region.”
- “International private equity is more sensitive to regional geopolitics. Financial investors will need higher returns to balance the risk.”

- 44% of respondents consider domestic PE funds and family offices will be the most active investors in the region over the next year, broadly in line with 2015.
- There is a continued recognition that family offices have a desire to establish their own private equity style investing operations, albeit in many cases to look at co-investments with existing PE players. However, there is also a belief that there may be an increasing desire from family offices to look for financial investments outside the region.
- There is a decline in expectations that sovereign wealth funds will be as active as other investor classes in the region, as the reduction in petro-dollars leads to a more cautious approach.
- International private equity is not regarded as one of the more likely active asset classes, given relatively limited numbers of investment opportunities of adequate scale, and a greater sensitivity to a more unsettled geopolitical environment.
5. 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?

The prevalence of growth capital transactions means that building a good relationship with the selling party is fundamental to successful transacting.

- The most important factor in winning deals is considered to be the chemistry between buyers and sellers and the ability to win the trust of the seller. Given the prevalence of growth capital and therefore an ongoing relationship between buyer and seller, respondents confirmed that establishing a successful working relationship during the deal stage is crucial to successful execution.

- Over fifty per cent of respondents consider the ability to add value to be amongst the most critical factors when it comes to doing deals in the region. In particular, investors who can demonstrate a historical track record in this regard believe it is a critical asset for them.

- Other factors cited were primarily price related. This was acknowledged as a critical factor, particularly in buy outs, but not necessarily as a key differentiator.

- “Relationships are key. Sellers need to have a level of comfort and confidence in who they are dealing with.”

- “We see the track record of following through on your promises, access to funds and the ability to structure deals as key.”

- “In minority deals it is all about the reputation of the PE firm. Owners want credibility from incoming shareholders.”

- “Price is always a factor, but deep sector knowledge allows you to anticipate and overcome deal obstacles and move fast which sellers value.”

- “Operational excellence is increasingly important. You have to be able to work your assets in this market.”

Note: respondents could each provide multiple differentiators they think are most competitive.
6. Over the next 12 months, what do you expect to happen to exit activity in the MENA private equity market?

The downturn in economic conditions has led to a major shift in expectations regarding exits. Only five per cent of respondents believe private equity sales will increase.

- There is strong consensus that now is not the right time to focus on divestments. The combination of economic headwinds, challenging IPO markets and reduced investor appetite from outside MENA leads the majority of GPs to conclude that holding assets for the coming twelve months is a preferable strategy.
- While there remains some pressure on GPs to realise returns on assets held in pre-Global Financial Crisis vintage funds, managers generally concur that where necessary it is better to work with LPs to explain that the preferable option is to extend fund lives in the expectations of improved realisations post market recovery.
- There is a belief that realisations will continue, but any such assets will need to have a strong track record and the ability to demonstrate their defensive strengths.
- Exit routes are also considered to be limited with IPOs largely not considered feasible and the private equity secondary market yet to gain traction.

“Why would you sell now? It’s preferable to explain to your LPs why it is better to hold assets in the short term.”

“Valuations will not be conducive to exits. GPs will stay in the businesses to drive revenue growth and cost controls.”

“Exiting though IPOs, foreign investors and family offices are all difficult at present.”

“We are confident that with the right business story you can still exit successfully in this market.”
7. Over the next 12 months, which elements of your business do you expect to spend the most time on?

- Portfolio management is expected to be the major focus for GPs in the coming twelve months.
- New investment activity will also be a major focus, particularly for those houses who have a good level of dry powder, believe that market pricing will be acceptable and are not invested in sectors such as oil field services, where portfolio assets are likely to be most impacted and require higher degrees of support and management.
- Fund raising is expected to be more limited, in part reflecting market conditions, but also as the deal by deal model continues to gain popularity.
- In line with fund manager expectations about declining divestment activity, reduced time is forecast to be spent in this area.

In a more difficult economic environment, private equity managers are prioritising portfolio management:

- “Our focus on our portfolio companies is a function of the market. We need to be close to them during these times.”
- “You have to focus on rationalising your companies’ cost bases and overhauling operating platforms.”
- “We do not expect an amazing year so are taking more of an introspective view of our business.”
- “We have plenty of liquidity and the focus will be on investments. When valuations were higher we were more focused on exits and portfolio management.”
8. Over the next 12 months, how difficult is fundraising going to be?

- Our survey demonstrated that 60 per cent of respondents consider that fund raising is becoming more difficult. This reflects the economic climate, allied to negative perceptions, particularly from investors outside the region, of current regional geopolitical factors. In addition, reflecting the still youthful nature of the industry in the region, there are a relatively limited number of PE funds with lengthy and demonstrable investment track records, a key factor in successful fund raising.

- These factors have combined to emphasize the diversification in the sourcing of capital from the blind pool model to other structures, particularly the deal by deal approach. A number of respondents commented that this is more in tune with the preferred investment approach of the large regional family groups who appear to increasingly prefer direct co-investments.

- “I really think the model has changed irreversibly away from the blind pool model.”

- “It will be a challenge to raise blind pools of capital without a real track record.”

- “The traditional LP/GP structure is no longer so prevalent. PE style investing will definitely grow but the funding arrangements will change. A lot of family offices believe they can replicate the PE model.”

- “I see more growth in the merchant banking model than classical LP/GP structures.”

- “Conditions are less positive but this is mitigated if you can demonstrate what you have achieved and articulate the market opportunity.”

- “We are positive about fundraising because investors understand cycles. This down cycle started in late 2014 and by the end of 2016 this will be the later stages of what we see as a two year cycle.”
9. What do you see as the biggest challenges and barriers to growth for the MENA private equity industry to overcome?

- Consistent with previous years, respondents articulated a range of perceived challenges facing the industry in its quest for growth.

- While the market has adapted to the challenges around blind pool fund raising, the fact that difficulties in this regard are cited as a leading concern, does suggest this would be the preferred source of capital for GPs, if achievable.

- The limitations around exiting, including capital markets challenges, are also a source of frustration.

- A number of respondents also confirmed that there is a perception that the addressable investment pool of assets remains constrained by the large sectors of the economies held by governments and large family groups, both typically long term custodians of assets.

Note: respondents could each provide an unlimited number of challenges and barriers they think need to be overcome

- “The structure of the market – i.e. dominated by family groups, reluctant to divest, remains the biggest challenge but it is a fact of the market.”

- “The asset class has matured hugely over the last ten years and there is a much greater acceptance of private equity as a funding option. But ultimately there is a major pool of assets held by people who do not need to sell.”

- “The industry needs to be more vocal about its benefits and achievements.”

- “There is a lack of sophisticated acquisition finance to facilitate getting the right returns.”

- “The oversupply of capital is no longer an issue. Valuations have been an issue in the past but we believe this is improving. Enforceability of contracts is still an issue but this is getting better.”
10. If you could change any element of the legislation affecting the MENA private equity market, what would it be and why?

- The biggest legislative challenges to effective deal doing in the region have remained consistent: capital market regulations and foreign ownership restrictions.

- While respondents highlighted that there are elements of legislation that could be developed or refined, there was a consensus that legislative concerns were not the greatest challenge faced by GPs.

- Other issues included the ability to achieve the perfection of security (particularly relevant to mezzanine funding) and the inconsistency of regulation across the region.

Note: respondents sometimes provide a number of elements they find are affecting private equity in MENA

- “We still think there need to be changes to the capital markets rules to make listings easier.”

- “Restrictions on ownership in certain sectors in KSA is one area where I would love to see movement.”

- “We would like to see an improvement in the ability to have multiple share classes.”

- “I do not see the legislative environment as being a material impediment for the industry.”
11. Over the next 12 months, what do you expect to happen to the overall economic climate and why?

- The downturn in economic conditions was evident in last year’s survey, and there is not yet a major belief that conditions will improve over the next twelve months.
- This is predominantly on the back of the low oil price and the trickle down effect it may have on the wider economy.
- Inevitably, economic predictions are uncertain. However, there is a wider range of views from GPs on the impact for their businesses, with a number clearly seeing this as a period to be cautious, while others take the contrary view that conditions mean the landscape is ripe for a long term investor.

Eighty per cent of respondents expect the economic climate to remain the same or deteriorate over the next twelve months

- “I take a prudent view that political factors mean that we should assume no major changes in the economic outlook for a couple of years.”
- “We do not think we yet have seen the full trickle down effect of the fall in oil prices.”
- “Over 12-18 months conditions will improve. Governments are making the right changes - reducing subsidies and introducing taxes. We are particularly bullish on Dubai and the UAE.”
- “I am impressed how quickly governments have reacted to the change in the economic landscape.”
- “I think we will see the end of the down cycle in the second half of this year.”
- “The economy is less relevant to private equity than it is to other asset management classes. If you have the liquidity this is a great time to invest especially with stock markets being so volatile.”
12. What do you see as the key strengths of MENA relevant to the long-term growth of the private equity market?

- Respondents have expressed a view that the region will weather the impact of oil prices and have commented favourably on government reactions in this regard. It is not seen as a long term factor in the region; instead the attractive demographics in MENA continue to drive long term investor confidence.

- “GDP growth for MENA ranks second in the world as a regional block. Consumer spending will continue at high levels.”

- “A large, young population, an expected recovery in oil prices and the need for governments to spend on infrastructure result in attractive, demand driven economies.”

- “The population growth story remains compelling. There is growth in consumption per capita, although the pace is going to slow. If you focus on what the mass of people want and need you will do well.”

- “The quality of the infrastructure in the region and the peg with the dollar are critical advantages compared to other emerging markets.”

- “The Gulf region has embraced capitalism and it is effectively enshrined in its systems, much more so than in many other emerging markets.”

- “A tech savvy population and social restrictions promoting consumption are both important factors in our view.”

- “There is huge untapped potential from the level of women not yet in the workplace.”
11. On a scale of 1 to 10 (10 being the highest) how confident are you in the long-term growth prospects of the MENA private equity industry?

- “We see real opportunities from the maturing of the market. A lot of the conglomerates are looking to be more efficient and that leads to divestment of orphan assets.”
- “The region has a fast evolving entrepreneurial culture which will be perfect for growth capital. The opportunities afforded by Iran and integration with Africa will also be key.”
- “Growth will be driven by the demand for returns. In North America, Europe and Asia there is too much capital chasing too few deals. The fundamentals of MENA’s demographics and GDP story will come to the fore once the geopolitical situation stabilises.”
- “Growth prospects are limited by the size of the private sector in comparison to government ownership. However, when conditions in Egypt improve this will be a big factor.”

Long term views as to the prospects for the industry remain largely unchanged despite more recent economic headwinds.
6.1 Jurisdictions: Shifting Sands

By Chris Divito
Senior Vice President - Wealth & Asset Management, DIFC Authority

Change is inevitable – and we are indeed witnessing a rapidly changing and constantly evolving global economic landscape.

The Asset Management industry is no exception. New markets and trends within the private equity sphere – a key component of asset management – continue to emerge regularly.

However, the alternative investment industry has proven adept at meeting the challenges of an ever-changing market. From regulation to economic headwinds, and from margin-squeeze to calls for increased transparency, the market has exercised flexibility, whilst, at the same time, generating value for investors.

The regional industry is being pushed to adopt a new way of thinking, primarily driven by OECD driven reforms & changes to tax treaties, and the emergence of financial technology, or FinTech.

**Taxing considerations for Investment Funds**

On 5 October 2015, the OECD released final reports on the 15 focus areas of its Base Erosion & Profit Sharing (BEPS) action plan. The BEPS concept equates to a coordinated approach by member Governments to address the widely reported tax-avoidance structuring of many multi-national businesses; i.e. the booking of profits in low-tax environments, as opposed to where the profits actually arose. The OECD estimates that between US$ 240-100 billion in tax is lost annually as a consequence of such structuring.

The BEPS packages are by far one of the most important tax developments in the world – with meaningful impact on the funds industry – and will place ‘substance ahead of form’ when considering applicable tax rates on profits, gains or income.
Additionally, domestic Governments, e.g. India, are taking strong action to ensure existing treaties are not abused. The soon-to-be-implemented GAAR regulations in India will require substance ‘in-location’ of any offshore fund structure before tax-treaty benefits can be claimed.

Further, on the 10th May 2016, it was announced that the Governments of India and Mauritius have signed a protocol amending the India-Mauritius tax treaty, thereby giving India the right to tax capital gains on equities in the years ahead. There is expectation that this significant change will have a knock-on effect to other similar treaties, such as between India and Singapore, and will result in a wholesale review of which jurisdiction is optimal for basing both funds and talented investment personnel.

Cost, speed-to-market, no layering of tax, general robustness, and acceptance by underlying investors will remain the key drivers behind the choice of fund jurisdiction. However, if there is a growing requirement for an increased level of commitment in terms of personnel and capital in the same jurisdiction as the fund, then additional considerations will emerge.

For example, there are benefits to locations that have significant physical connectivity to global and regional business centres and where a skilled financial services talent pool exists. Other considerations may be the level of engagement, quality and reputation of the regulatory authorities, as well as the general quality of life or social infrastructure in the chosen location. With taxation front of mind, fund management companies will also want to be clear on the tax applied to their profits (as opposed to the fund’s income and gains), and the tax-rates being paid by their staff.

A further driver is the degree to which money flowing into Africa from Governmental sources, such as the United States Agency for International Development (USAID), will demand even higher levels of probity and transparency.

These changes are opening up the debate on new jurisdictions, with DIFC in prime position to be a winner regionally with:

- Zero rates of tax applicable within funds and on corporate profits
- A robust and tested common law legal system
- 100% foreign ownership of businesses and no restriction on capital repatriation
- Regulated funds structures with low costs and rapid speed to market.
The Impact of FinTech

FinTech is no longer just a buzz-word for digital geeks, multi-national businesses and global banks with retail customer bases.

On the contrary, FinTech comes in all shapes and sizes – such as innovative money management, payments, peer-to-peer (P2P) and infrastructure solutions – and is set to impact the entire spectrum of financial services firms. In particular, it could have potentially transformational implications for alternative investment managers and private equity firms.

New forms of capital raising is just one example of how this is already in play. Distribution of investment funds is changing across the investment landscape and seeking investors for alternative investment strategies will not remain unchanged.

Raising capital for private equity investment has historically been driven by the activity of fund managers and investors - the coming together of General Partners and Limited Partners. This has generally been done through building and developing personal networks of contacts in different organisations and locations across the globe, generating costs and uncertainties along the way. Unlike with conventional asset management, there are few (if any) supermarkets for private equity investments, which allow a potential investor to identify interesting investment opportunities.

With the emergence of FinTech, however, the universe of potential investors has broadened exponentially – by bringing together General Partners and Limited Partners through digital platforms.

These platforms will provide several benefits to both the fund manager and the investor.

Typically private equity investments require a fairly significant initial investment, which may be affordable to an affluent investor but for whom placing such a large sum in the hands of a single manager may be outside their perceived risk appetite. While digital platforms still require a substantial minimum investment, they can allow the investor’s cash to be spread across several opportunities thereby diversifying their risk. The platform can then aggregate these investments and place a single investment with the private equity fund.
In addition, the private equity fund manager will gain higher operational efficiency by ‘outsourcing’ the Know Your Customer (KYC) function to the platform – thereby only requiring them to know their platform.

Furthermore, with interested investors utilising the platform as a search engine for potential investments, private equity managers are already better placed to promote their proposition to a new – and verified – customer segment.

Whether we agree with it or not, everyone in the world of listed securities investment is familiar with the Efficient Market Hypothesis. With markets becoming increasingly efficient and information more widely and instantly available, it is challenging – if not impossible – for fund managers operating in efficient markets to gain an edge and deliver alpha on a consistent basis.

This efficiency is less pronounced in the world of private equity investing given that:

- The majority of investments are not made into listed companies and information, by definition, is less freely available.
- The private equity markets are less heavily researched.
- More heavy lifting of data is required.

Private equity managers are required to identify opportunities from a seemingly endless stream of available (and partially available) information, scattered across numerous geographies and in respect of different functions and strategic business units. All with the intention of providing a relative score for one opportunity against another.

Traditional scoring methodologies are time-lagged and often incomplete, particularly for small or emerging companies with limited or no credit histories.

Smart market intelligence platforms may be providing the solution or, at the very least, introducing some much needed efficiency in data-sifting. These platforms provide a quantitative framework to measure the overall health and growth potential of private companies using metrics and signals not conventionally pulled together in a single view.
Typically there are several elements which are collated by the platform into a single score for any enterprise:

- **Direction/Trend Score** – Measures the individual performance of a target company relative to itself and peers using information from social media, news sentiment, mobile usage, web traffic, hiring trends, customer engagement and strategic partnerships development.

- **Financial Score** – Considers the financial strength of a company based on corporate capital structure, financial history, investor quality and cash burn whilst anticipating its future direction.

- **Market Score** – Assesses the overall status of the relevant industry based on many factors including funding, deals, employment trends and sentiment as well as exit activity and regulatory burden.

The individual output from the model then provides a short-cut for comparison of the current status of the target firm(s) as well as a prediction of what’s next.

Absence of such a platform within the armory of a manager could lead to a significant competitive disadvantage, forcing private equity firms to make a decision – innovate or dissipate.

In summary, the PE industry is in robust health, making a valuable contribution to the capital market and asset management industry. However, in light of the significant and inevitable changes ahead – from both regulators and the market – it is fair to say that only the fittest (or at least the most alert and active) will survive.
Since the global crisis of 2009-2008, there has been a palpable and growing sense that the world is in the midst of fundamental economic and political change.

But, as is the nature of change, the only certainty we have, is that there is a lot of uncertainty. We have more questions, than answers.

Can we create enough jobs, and the right jobs? Is the financial sector working for society’s benefit, or in its own self-interest? Are markets a force for good, or bound to fail us? Can current political systems handle fast-changing and competing interests?

For private equity practitioners operating in a region that has seen its share of economic and political volatility, these are very real issues that have an impact on the way we raise capital and invest.

Investors and other key stakeholders, including governments, are rightly asking whether we are making a positive societal impact, and how we manage risk. Such questions reflect the hopes and fears of a new generation that sees opportunity in an inter-connected, technology-driven world, but also harbours doubts over the current economic order’s ability to provide for them.

The World Economic Forum (WEF) predicts a $41 trillion wealth transfer from baby boomers to millennials over the next 40 years, so we cannot take these issues lightly. Institutional investors, from pension funds and insurance companies to sovereign wealth funds, are keenly aware of the need to deliver more in a low-rate, low return environment, at a time when long-term liabilities are only going to increase.

Here, the private equity industry should be stepping up. After all, research by McKinsey for WEF shows that funds created since 1995 appear to have substantially outperformed the S&P 500 index, even on a leverage-
adjusted basis, with other recent academic research suggesting that the outperformance is by a margin of 300 basis points.

Demonstrate motive

But just showing returns and track record is no longer enough. Investors are increasingly looking for a positive societal “impact”. For example, are we pushing an environmental agenda, and encouraging gender diversity in our portfolio companies? Research conducted by Credit Suisse shows that companies with greater diversity at board level tend to be better governed and deliver better financial returns – so it’s something we should take seriously.

In the MENA region, as in many emerging markets, job creation, skills development and economic diversification are key issues, and governments are looking to private investors to play a positive role. This provides opportunity for the private equity industry, but also means taking responsibility.

For example, at TVM Capital Healthcare Partners, we are investing in several emerging markets very much in line with government policies to promote private sector involvement in healthcare to help lift quality standards. The environment for investment is therefore conducive, but things are not that straightforward.

To build long-term standing with key stakeholders, companies such as ours have needed to ensure that our investments are well-researched and truly address unmet needs. We have also been willing to work very closely with healthcare authorities and other key players, such as insurers, to establish a fair and enduring licensing regime for private sector participation.

And finally, we must show that there is real value creation – that all stakeholders, from government agencies to insurers, and vitally patients and their families – are really benefitting from a private model. Without that, trust and goodwill can easily be lost, and the landscape for private equity becomes less favourable.

An investment made by TVM Capital Healthcare Partners in 2010, and which we exited in 2015, is an excellent example of these dynamics at work. ProVita International Medical Center essentially created the long-term care market in the UAE and, with private equity investment, became the foremost provider
of acute, ventilated care in the region.

The company was born out of the recognition that nationals of the Arabian Gulf countries were travelling abroad for specialist care, but mostly preferred to be at home, close to their families. To establish a presence, firstly in the UAE, it was necessary to develop a new licensing and payments regime. And to thrive, it was necessary to demonstrate that the care provided was as good, and even better than that provided in countries such as Germany and the United States.

The process of value creation was therefore holistic – and included building strategic partnerships with world-renowned Spaulding Rehabilitation Network and Joslin Diabetes Center to deliver the highest quality of care. The result was the provision of expert clinical care and therapy through a patient-centric approach, with a three-to-one ratio of carers to residents.

**Diversification**

But in today’s private equity landscape, it is not enough to show stakeholders societal impact as well as attractive returns. In an increasingly uncertain global economy, the ability to recognise and mitigate risks tops the institutional investor’s agenda.

Private equity firms in emerging markets are often frustrated that the views of investors from other parts of the world are overly clouded by perceptions of risk, and do not fully account for the enormous opportunity.

It is our job therefore to communicate clearly, and address the potential risks in a very practical sense. Realistically, the opportunities in emerging markets will only be truly appreciated by those who are persuaded to deploy their capital here, and see investment potential turn into reality.

Top of mind for many investors is geopolitical risk in the broad MENA region, which has heightened since the “Arab Spring”. It is difficult to shake off the perception of regional instability, even though anyone who lives here clearly recognises the breadth in geography, and the diverse nature of political and economic structures in a region of over 300 million people, stretching over four time zones.

This diversity needs to be explained, but also exploited - and there are several ways of integrating geographical breadth into investment strategies, in order to mitigate perceived country risk.
Successful private equity players will be those who can source investments, structure transactions appropriately to minimise risk, and adapt to business cultures across the broader region, and beyond. This means having the depth in expertise and experience to be able to operate effectively across the MENA region, but potentially further afield, using emerging markets expertise and wider networks to enter markets such as India, Turkey, Southeast Asia, and sub-Saharan Africa.

Furthermore, these same networks should be used to encourage growth of portfolio companies outside of national boundaries. Such growth is usually approached as part of the return equation, but should also be positioned as a way to effectively manage risk.

**Focus on operations**

While risk at the macro level is important, it is usually the ability of a private equity investor to get to grips with the detail – in other words, manage execution risk – that will give most comfort to limited partners.

Private equity in emerging markets is almost all about driving the growth of young and promising companies, so investors must be prepared to roll up their sleeves and get involved in day-to-day operations if they are to be successful.

Because the private sector is still a relatively new force in emerging markets, investment opportunities tend to be in companies that need growth capital, and also expert support, to professionalize. This is in contrast to private equity in many parts of the world, where investors can pick from a range of possibilities, including turning around failing firms, and financial restructuring.

As such, emerging market investors need to focus on how they can add value to a firm’s operations. And that means it often pays to be a specialist – to use deep sector expertise to promote efficiency and good governance, as well as to create new business opportunities.

At TVM Capital Healthcare Partners, for example, we are committed to running a strong “operations group” steeped in healthcare expertise – an accelerator company of 30 people that supports our growing businesses. It provides general management support, including the provision of management and strategy development, as well as back office services, such as legal, information technology, marketing, accounting, human resources.

Setting up this ecosystem is a significant investment in itself. But it brings
huge value-creating benefits for the companies we invest in, and reduces risk for the company and our investment partners.

It means that in their early years, our portfolio companies are left to concentrate on doing what they do best -- providing high quality healthcare services. Economies of scale mean that each company can save time and costs, and still employ high quality specialist skills.

Meanwhile, as investors, we have an excellent view on day-to-day realities and can help to find solutions to any issues the companies may face. This high level of transparency encourages good corporate governance across the company, which is highly valued, especially in an emerging market context.

The focus on motive and risk among institutional investors is only going to grow in the coming years. While it may be frustrating in the short term, private equity investors must embrace the trend if they are going to successfully raise and deploy capital, in the recognition that making a positive societal impact and addressing risks properly, is not just good practice, but will probably ultimately deliver better returns.
1. From a macroeconomic standpoint, why was 2015 an important milestone for private equity activity in the region?

The year 2015 was an inflection point in the history of private equity in the region. The post-crisis period was a bullish one for most GCC economies. GDP growth rates over 5% weren’t unusual and it consequently aided private equity firms in investing and realizing attractive returns. Understandably, oil prices have put the brakes on the short-term growth trajectory of the countries in the region. Nevertheless, some countries are now using the opportunity to reform their economies, which should further enhance their profile amongst investors over time. Cuts in government spending, reigning in deficits, increasing private sector participation and diversification away from oil are common themes emerging across budget forecasts for 2016 recently announced by countries like the Kingdom of Saudi Arabia, Kuwait and Qatar. Such reforms are expected to have a multiplier effect on the economies once oil prices rise.

2. Should the current concerns about the overall macroeconomic climate deter investors looking to invest in the Gulf?

The answer is an emphatic, “No!”. Although many sectors in the region are directly or indirectly linked to the price of oil, opportunities abound in industries that have relatively low correlation to the oil sectors, including Food & Beverage (F&B), healthcare, services, and so on. The investment thesis is further strengthened for companies which benefit from strong long-term fundamentals such as access to a growing demographic segment (For example, healthcare for aging population which is expected to grow at circa 8% as per a recent report on healthcare published by EY’), captive customer loyalty, pricing power, economies of scale, and so forth.

For private equity firms, the current period, which has been marked by a significant decrease in stock market valuations, presents a unique opportunity to acquire lucrative assets at reasonable valuations. As a result, multiple expansions become plausible during exits. From the sellers’ perspective, private equity firms are becoming increasingly attractive sources of capital given the liquidity crunch facing regional banks and tightened public markets. According to the World Bank, Small and Medium Enterprises in MENA face a
cumulative estimated shortage of $240 billion in financing, with 63% of them reporting a complete lack of financing sources\textsuperscript{2}.

3. What are the future implications of the current economic climate on private equity activity in the region?

We look forward to a resurgence in private equity activity in 2017-2016. Private markets, in general, tend to lag public markets by a year. Consequently, lower valuations will be an expected norm by 2016. The sellers’ valuation expectations will also be better aligned to reflect the temporary slowdown in the economy.

As briefly mentioned earlier, the timing is ideal for private equity firms to acquire assets at reasonable valuations. Private equity firms are fast emerging as viable alternatives to bank lending, which has experienced a liquidity crunch of late. Moreover, the IPO market seems to have slowed down recently, further enhancing private equity clout. The total number of IPOs in the region fell from 17 deals in 2014 to 6 issuances in 2015 recording a 65% decrease in annual activity\textsuperscript{3}.

Lastly, we believe that the upcoming period will usher in a new stage in the evolution of private equity activity in the region. Private equity as an asset class will continue on its path to maturity through increased secondary transactions and a sharper focus on operational improvements in portfolio companies.

4. What are the sectors that are poised to gain in the near future?

Industries that are relatively delinked from oil and gas are particularly attractive. Despite low oil prices, the private sector in the region has displayed sustained growth. For instance, the non-oil sector in the Gulf is expected to grow at a healthy 5-4\% in the near term. Sectors that fall under the non-oil category include consumer-centric industries such as F&B, education, healthcare and services. While F&B has displayed sustained growth over the years, it is our view that the trend will continue in the backdrop of a rising young population with increasing disposable incomes. For instance, Euromonitor predicts that the number of food retail outlets in Saudi Arabia is expected to reach about 50,000 by 2019. Healthcare and education are priority sectors earmarked by governments going forward and which continue to benefit from sustained government spending. The defensive nature of these sectors can be gauged from the fact that countries such as Saudi Arabia\textsuperscript{4} and Qatar\textsuperscript{5} still plan to set aside a majority of its budget to service these sectors in 2016 despite predicted deficits. Certain sectors such as labor services are also poised to
benefit from the onset of iconic events such as the World Cup in Qatar and the Expo2020 in Dubai, along with the infrastructure development that typically precedes such events. For instance, the Expo2020, which is targeting over 25 million visitors, is incentivizing construction in the hospitality and retail sector.

5. **As a proponent of the club deal mode of PE transactions, could you briefly shed some light on the common themes emerging from your discussions with your current crop of co-investors on potential deals in the region?**

Our recent engagements with local investors are constantly highlighted by a great deal of optimism for the region. Sophisticated investors in the region are fairly indifferent to the current macroeconomic climate given their diversified allocations. Local investors remain committed to the region while the recent push to liberalize FDI regulations and public markets in Saudi Arabia has prompted renewed interest from investors. In summary, most of our co-investors are local with a strong understanding of the market and are able to differentiate good deals from the rest while continuing to seize attractive opportunities in the region.

6. **What has been Swicorp’s response to the scenario unfolding in the region?**

Swicorp has always attempted to align its private equity structure to meet our investors’ bespoke requirements as well as the unique macroeconomic climate of the region. To this end, we have delineated our funds by structure (classic blind pools versus club deals) and geographic focus (Middle East versus Africa-focused initiatives).

Recognizing the region’s pivot towards renewable energy, Swicorp is also seeking to invest in renewable energy through ENARA, with a focus on solar and wind projects. Governments in the region have clear targets with regard to power generation through renewable means and have also recognized the importance of private entities in achieving those targets through public private partnerships. Through a strategic partnership with a world-renowned renewable energy operator, ENARA’s added value goes beyond the capital it provides. ENARA aims to reach $400 million in Assets under Management (AUM) through investments in renewable energy in the MENA region. Swicorp has also launched the Africa Industrialization Fund (AIF) in 2015 to aid companies that leverage the continent’s rich resource base to produce value-added goods. AIF seeks to accelerate Africa’s shift from an agrarian-based economy to a manufacturing and production hub. AIF was launched recently and aims to have $400 million in AUM. The club deals initiative aims to reach
up to $500m in AUM and will continue to address investors’ appetite for targets in the GCC region with full visibility into the underlying assets.

In the future, we will continue our efforts to better understand our investors’ requirements as well as the macroeconomic realities of the region and mould our private equity activities to suit them.

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6.4 Ten Tips when purchasing Middle East-based companies in healthcare, education and food and beverage sectors with a focus on companies in the Kingdom of Saudi Arabia and the United Arab Emirates (UAE).

By Nabil A. Issa and Osama Audi,
King & Spalding’s Dubai and affiliated Riyadh offices.

1. **Purchasers need to understand the regulatory issues relating to their nationality and the sector in which they are investing prior to making such investment.** If a purchaser has any non-GCC national ownership at any level of its equity capital structure, time will need to be spent confirming if the target sector is open to investment (and if investment is limited in the relevant sector whether such limitation applies to non-GCC nationals as well or to nationals of the country in which investment is being undertaken) and the relevant percentage which can be acquired by, as applicable, a ‘non-GCC’ purchaser or a national of a country other than the country in which the activity is being undertaken. For example, in Saudi Arabia a non-GCC investor can directly invest in a hospital with more than 100 beds or in an entity manufacturing medical devices, but cannot directly own a stake in a medical or dental clinic as health care clinics in Saudi Arabia can only be owned by Saudi nationals. In addition, non-GCC national investors can often invest in a business engaged in wholesale or retail sale of goods (including consumer goods) but not if such entity is a registered distributor of such goods. In Saudi Arabia, additional limitations will apply to quite a few other commercial activities including, among others, retail pharmacies, education, logistics, and security services. Even with regulatory hurdles, counsel should be able to explore alternative legal means through which a purchaser can acquire an interest in a target in such sector through alternative legal investment structures such as a fund or sukuk. The structure also may influence the ability to create a robust employee stock option plan, particularly if employees include non-GCC nationals.

“
investor can directly invest in a hospital with more than 100 beds or in an entity manufacturing medical devices”
2. While fronting arrangements are common, anti-fronting legislation must be complied with nonetheless. Purchasers should shy away from typical nominee structures that may result in a party running afoul of a relevant anti-fronting law and, depending on the jurisdiction, if reported could face civil or criminal penalties. For example, the stated objective of the UAE Anti-Fronting Law is to prevent non-UAE nationals – whether natural or juristic persons – to practice any economic or professional activity that is not permissible for them to practice in accordance with the law and decrees of the UAE. Despite the existence of such laws in Saudi Arabia and the UAE, some lawyers have advocated for the use of simple side agreements. We are aware that certain lawyers in the UAE often point to the fact that there is actually evidence that the highest courts in the Emirates of Dubai and Abu Dhabi have historically upheld “side” agreements and focused on the economic rather than statutory relationship of the parties. Moreover, the argument has also been repeatedly made that if “side” agreements were invalidated such would result in adversely affecting foreign investment in the UAE and would be contrary to various declarations by the governments at the federal and emirate level that the UAE is encouraging foreign investment. We note, however, that the Union Supreme Court in Abu Dhabi in late 2012 decided that “side” agreements are not valid and any agreement to vary the economic or other rights of the shareholders in a UAE joint venture should be in the registered articles and/or be recognized by a local notary public and undergo the normal recognition of the licensing authorities in the relevant Emirates. While such case does not have precedential value in creating binding precedent as in a common law jurisdiction, foreign parties need to be mindful that there are examples of the judiciary invalidating such agreements and that such “side” agreements likely violate the anti-fronting law. Moreover, there are often legal means of achieving economic control. For example, in the Emirate of Abu Dhabi it is possible to have the registered articles provide that the foreign

“...Union Supreme Court in Abu Dhabi in late 2012 decided that “side” agreements are not valid...”
49% registered owner is entitled to at least 90% of the dividends. Further in Saudi Arabia, the local authorities are regularly prosecuting parties violating the Saudi Arabian Anti-Fronting law and actually reward parties for reporting those engaged in this activity. We also understand that auditors in Saudi Arabia are now required to report the extent they are aware of not only registered owners but of “beneficial” owners of a business in their filing with the Department of Zakat & Income Taxation. Finally there are greater demands and a higher level of liability on directors under the new companies laws in Saudi Arabia and the UAE and such directors should carefully review the legality of the ownership of companies and operation of such companies prior to agreeing to act as directors.

“in the Emirate of Abu Dhabi it is possible to have the registered articles provide that the foreign 49% registered owner is entitled to at least 90% of the dividends”

3. Term Sheet. Purchasers often wish to enter into a term sheet, memorandum of understanding or offer letter before documenting a complex share purchase agreement and, if applicable, shareholders’ agreement. We find, however, that parties can sometimes gloss over key-terms at the offer letter stage and, accordingly, do not have a true “meeting of the minds” which can lead to significant resources being expended on a deal that was never truly agreed. For example, we find parties will agree to certain points in a term sheet and not consider the fact that they may not be enforceable, such as drag/tag provisions, ability to get certain reserved matters in the registered articles, liability caps, time limits for raising warranty claims, employee stock options, escrow arrangements, acquisitions being subject to financing, etc. By spending more time at the term sheet stage, parties can clearly ensure that there is a clear understanding of the requirements of both purchasers and sellers.

“... Union Supreme Court in Abu Dhabi in late 2012 decided that “side” agreements are not valid...”
4. **Nominee Owners/Third Parties.** As with many other sectors, quite a few healthcare, education and food & beverage transactions involve the participation of either nominee owners or historically passive owners. We often find that when such owners become aware that a private equity group, strategic investor or fund is keen to acquire the underlying business that such nominees or passive owners suddenly wish to become actively involved and expect to sell their shares at a significant premium. In a UAE or Saudi limited liability company, from a practical perspective, one shareholder cannot sell without obtaining the written consent of all other shareholders. If one party does not provide written consent they can effectively hold their shares ransom until they feel they are adequately compensated. Thus, a purchaser may wish to negotiate a break-fee if sellers cannot complete a sale due to an uncooperative nominee/owner. Break-fees often at least include expenditures and some agreed amount to compensate the purchaser for time lost spent on the transaction. Also, indemnities should be carefully crafted to address issues which may arise as a result of a previous nominee owner being deemed to have been in violation of the relevant jurisdiction’s anti-fronting law. Purchasers will often want to ensure they are indemnified for the legal violations as a result of the way in which the previous owner held the asset.

5. **Exclusivity.** A company that is in negotiations to sell a minority or majority stake to a reputable purchaser may attempt to shop an offer letter to other potential purchasers. Despite confidentiality clauses, the Middle East is a relatively small market and other potential buyers will likely inevitably learn that a stake in a company is for sale. Therefore, it is critical that

“... it is critical that the concerned buyer negotiate a well drafted exclusivity clause with an enforceable termination or break-fee if sellers breach the exclusivity arrangements”
the concerned buyer negotiate a well drafted exclusivity clause with an enforceable termination or break-fee if sellers breach the exclusivity arrangements. In addition, depending on the governing law used in the offer letter, parties should consider whether a provision requiring parties to negotiate in good faith should be included in the offer letter. We have seen purchasers successfully demand payment of a break-fee when a seller changes its mind or pursue new purchasers. Depending on the governing law and jurisdiction used in the term sheet, the break-fee can be a liquidated damages clause that must be carefully crafted so as to not be interpreted as a punitive penalty clause which may not be enforced.

6. For transactions in Saudi Arabia, the Ministry of Labor’s Saudization program adds complexity and, if ignored, can lead to significant issues. Since the launch of Saudi Arabia’s Nitiqat Saudization program, labor intensive businesses have faced challenges trying to comply with the program without significantly increasing their overheads. In general, the program categorizes all businesses as either ‘red’, ‘yellow’, ‘green’ or ‘platinum’ depending on the number of Saudi nationals employed by such company and the activity/job description of such employees with a certificate being issued by the Saudi Ministry of Labor setting out each company’s current status. Depending on the color-coding of a target company, the Ministry of Labor will provide certain incentives or penalties (e.g. residency visa processing and renewals are quicker for ‘platinum’ companies while such services are not permitted for ‘red’ companies). Thus, a purchaser should be prepared to invest in a Saudization program to recruit and train Saudi nationals.

“… purchasers should discuss with counsel the benefits and detriments that a particular governing law and jurisdiction can have on their transaction”
7. **Competition approvals may be required for your transaction.** Purchasers should be aware that while competition approvals have been a long-standing feature of M&A/PE transactions in many jurisdictions, the competition approval processes in most regional jurisdictions are relatively new and untested. That being said both Saudi Arabia and the UAE have competition authorities to which certain transactions must be submitted and approved as a condition to closing.

8. **Governing Law and Jurisdiction.** Not infrequently a foreign buyer will agree to arbitration in London to settle any disputes arising under the joint venture, and perhaps will even agree to use English law as the governing law for the shareholder’s agreement. A foreign shareholder may initially feel elated at this “win,” but the reality may be different. There are only a handful of recent examples of arbitral awards rendered outside of the Gulf Cooperation Council countries ever being enforced in the UAE or Saudi Arabia. It may be preferable for the foreign partner to carefully consider whether to have the arbitration conducted in the English language under the DIFC-LCIA rules at the Dubai International Financial Centre (DIFC). While it is common to have the acquisition documentation governed by one law (e.g. English law) and, to the extent applicable, a shareholders’ agreement governed by another law (e.g. UAE or Saudi law), purchasers should discuss with counsel the benefits and detriments that a particular governing law and jurisdiction can have on their transaction. Parties should also be mindful that the official language of the GCC is Arabic and that should consider adding provisions in the relevant agreement that it will solely appoint a licensed translator in the event such documents require translation.

“...It is important to note... that courts in the UAE or Saudi Arabia rarely, if ever, grant specific performance -- which is to say that they will not make anyone do anything. Instead they may choose to award money damages for something done or not done...”
9. Improving Enforcement. Because the articles of association of limited liability companies incorporated on-shore in the UAE and in Saudi Arabia do not permit much flexibility or customization, purchasers acquiring less than 100% of a target will typically enter into a separate shareholders’ agreement setting out, amongst others, buy-sell provisions, or put and call options, or restrictive covenants of one sort or another. It is important to note, however, that courts in the UAE or Saudi Arabia rarely, if ever, grant specific performance -- which is to say that they will not make anyone do anything. Instead they may choose to award money damages for something done or not done, but that raises the question of the quantum of harm done.

10. Restructuring for Eventual Exit. A buyer must carefully consider its structure for making an investment. Buyers should create a structure that will maximize exit options. For example, a party outside of Saudi Arabia that holds shares directly in an unlisted company will be subject to a 20% capital gains tax on exit. By creating another SPV between the buyer and the target company, such capital gains tax can be eliminated resulting in a much lower taxation on exit. A buyer may also wish to agree upfront with the seller and remaining shareholders how an exit will work or the need to convert the company to a joint stock company for an eventual initial public offering.

Conclusion

To protect their rights, investors should retain experienced counsel that understand both Western documentation and local law implications. The region is witnessing an increase in transactions especially in healthcare, education, food & beverage and real estate/hospitality transactions. Regional governments are also working to support startups and small business through funding programs and will likely focus on such sectors of employment for nationals for economic diversification and a means to empower the young and increasingly educated populations. We also note that a number of public private partnerships are emerging in the healthcare, education, power, transportation and other sectors throughout the GCC.
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The MENA Private Equity and Venture Capital Association (MENA PEA) is a non-profit entity dedicated to supporting the private equity (PE) and venture capital (VC) industries in the Middle East and North Africa and acts as an Ecosystem enabler. The association was established in 2010 in Dubai to support the development of a nascent private equity and venture capital industry in the MENA region. It represents the largest MENA based funds with more than US$ 30 billion in assets under management.

As an industry body, The MENA PEA aims at boosting the entrepreneurial ecosystem in the region and UAE in particular, and believes that moving towards innovation will foster greater economic prosperity. Because innovation occurs at the intersection of ideas and diversity of skills, cultures and backgrounds, the MENA PEA and its members have regular dialogues with legislative body in the region through its legal task force who’s aim is to petition regulators where necessary to bring about some key regulatory changes across the MENA region. These include removing barriers to capital and supporting new innovative models of equity funding.

To further advance the interests of its members and wider industry players, the MENA PEA issues research and industry reports that highlight the PE and VC successes to local and international stakeholders, and hosts a number of events that bring together PE and VC fund managers, Family businesses, Limited partners, Industry practitioners, Investment Bankers, Advisors and Lawyers.

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### 7.2 Private Equity and Venture Capital Firms in MENA
*(Excluding real estate and infrastructure funds.)*

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<td>Wamda Capital</td>
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