

Outlook for Private Equity - MENA Region

Preqin Research Paper

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Outlook for Private Equity – MENA Region

- Outlook
- The Crisis Has Only Begun...
- ...But Growth Will Return In The Medium Term

On November 18th – 19th Preqin had the privilege of taking part in the 2008 Private Equity World MENA conference in Dubai, run by Terrapinn. Coming so soon after the market dislocations of October, and in the midst of the renewed turbulence in November, this was a great opportunity to gauge the sentiment of 281 leading institutional investors, private equity firms and advisors active in the MENA region.

Together with Terrapinn we used the opportunity to conduct a series of participant polls to assess how these key players see the current situation and prospects for private equity over the short and medium term.

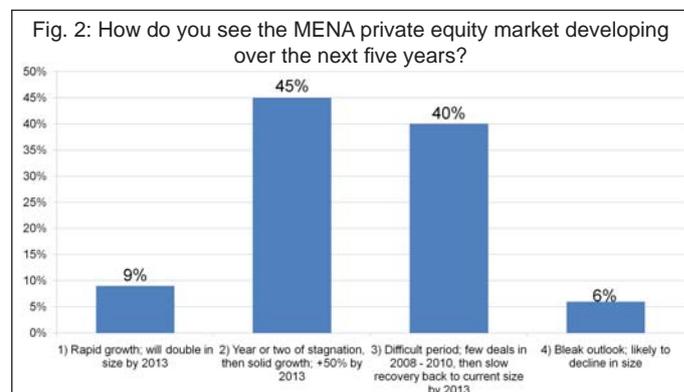
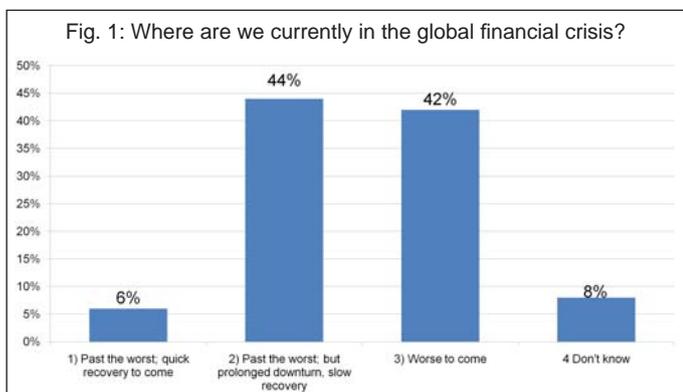
The Crisis Has Only Begun...

On Preqin’s previous visit to Dubai (as recently as mid-October), there was some optimism that the MENA region could escape the worst of the global crisis. No longer. The first week of November had seen a 37% decline in the Dubai Stock Exchange index, so there is now widespread recognition that MENA will suffer.

We asked participants where they thought we were in the crisis, and there are now no illusions as to the severity of the downturn or its likely duration (Fig. 1.) 44% of respondents felt that we are past the worst, but that recovery will be a long and slow process. Worryingly, 42% of respondents felt that worse is yet to come.

...But Growth Will Return In The Medium Term

We asked participants to select the most likely scenario for how the MENA private equity market will develop over the next five years. Bearing in mind the widespread view that we are still in the early stages of the current crisis, it is unsurprising that most participants felt that at least two years of stagnation or decline are likely, but the slightly more encouraging finding is that most respondents are expecting the market to have recovered and grown over the next five years (Fig. 2.) 45% expect growth to resume after two years, and for the market in 2013 to have grown by plus 50%, while 38% expect recovery and growth over this period, but only back to the current market size.



Outlook for Private Equity – MENA Region

- Guarded Optimism Over PE Returns

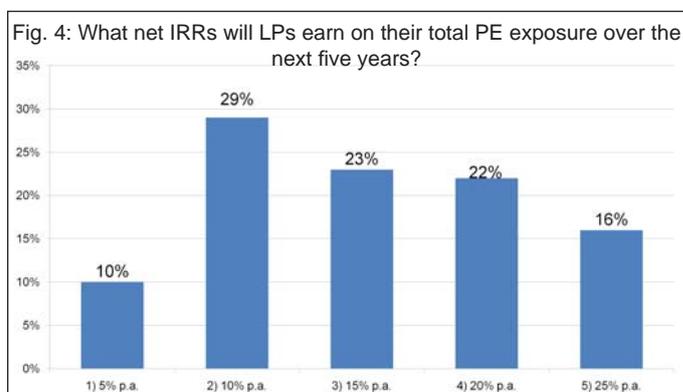
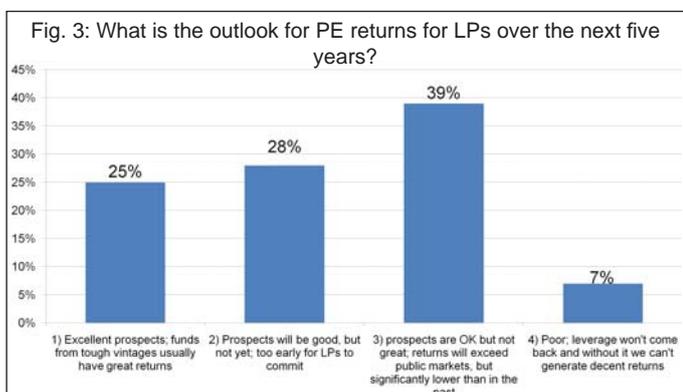
Guarded Optimism Over PE Returns

The same guarded optimism over private equity's medium term prospects comes through in return expectations over the next five years. We asked the participants to select what they felt was the most likely scenario for returns for limited partners over the next five years, choosing from a range that covered a wide variation in outcomes (Fig. 3.)

- 25% of respondents were unreservedly optimistic, feeling that vintages investing in difficult market environments usually have good returns, and that we are currently in precisely that situation;
- 28% of respondents feel that prospects will be good, but that (in line with their views that we are still at an early stage of the current recession) it is still too early for LPs to commit to new funds;

- The highest proportion (39%) feel that prospects are reasonably good, and will exceed public markets, but that the returns of the recent past are unlikely to be matched; and
- A small minority of respondents (7%) feel that returns prospects are poor, as the absence of leverage compromises the basic private equity model.

Asking the participants to give a more precise forecast of LPs' returns from their total private equity exposure over the next five years shows that the vast majority (74%) believe that returns will be in the range of between 10% and 20%, with smaller proportions believing that returns will be either above or below this band (Fig. 4.) The mean expected return is 15.3%.



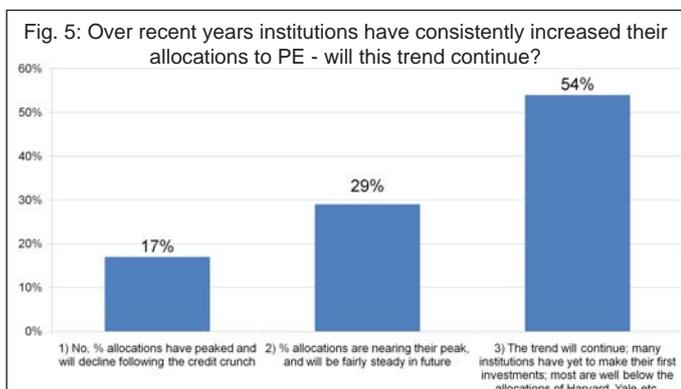
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- LPs' Allocations Continue to Increase, SWFs Growing in Importance
- MENA LPs Focusing on Local and Emerging Markets

LPs' Allocations Continue to Increase, SWFs Growing in Importance

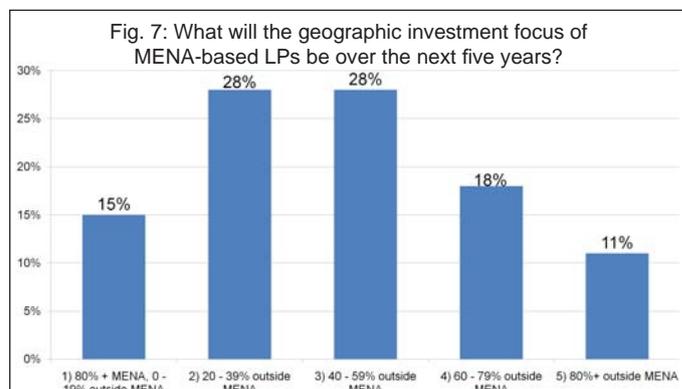
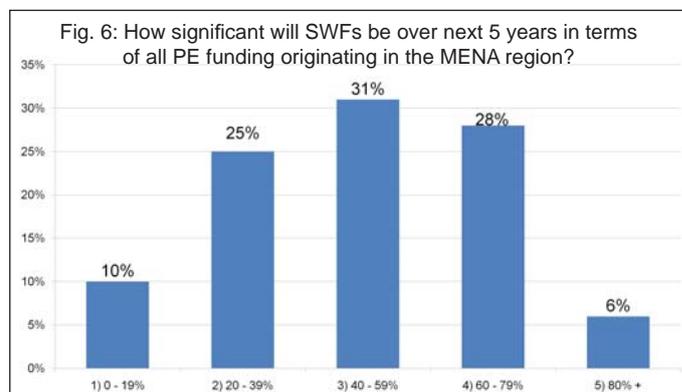
Perhaps unsurprisingly given the benign expectations for LP returns, most participants (54%) believe that the trend for LPs to allocate progressively higher proportions of their total investment portfolios to private equity will continue. However, a significant minority (29%) believe that allocations may be nearing their peak, while 17% believe that allocations have peaked and may now start to decline (Fig. 5.)

Sovereign Wealth Funds (SWFs) are obviously an important feature in the MENA region, and are expected to account for around half of all PE funding originating in the MENA region over the next five years (Fig. 6.)



MENA LPs Focusing on Local and Emerging Markets

MENA-based LPs have been important investors in private equity funds for many years, and as stated above, this trend looks likely to continue with the growing importance of SWF funds. Historically, these MENA-based LPs have invested most heavily in North American and European-focused funds, so we were keen to understand whether this geographic focus would



Outlook for Private Equity – MENA Region

- Growth Capital, Distressed, and Infrastructure Growing

continue, or whether funds would be directed elsewhere in future.

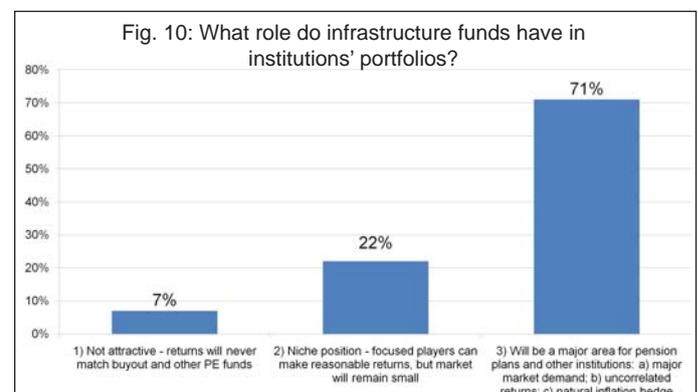
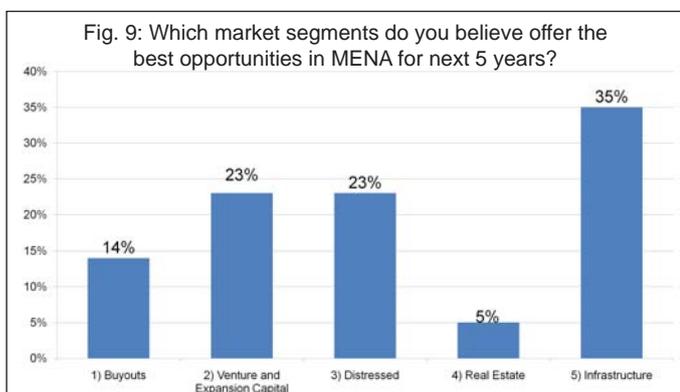
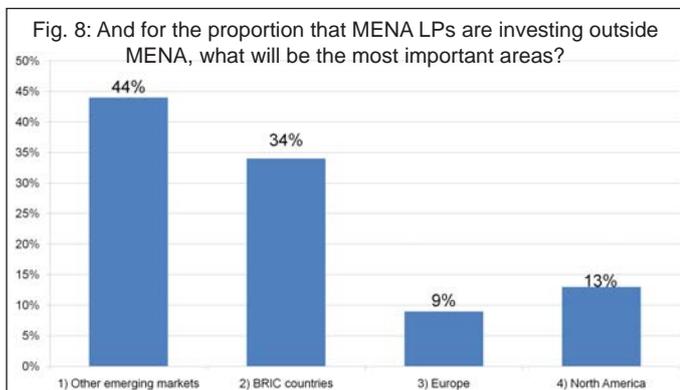
Interestingly, respondents felt that approximately half of funding from MENA LPs would be directed into the MENA region itself, and that a high proportion of the funding going outside MENA would be focused on other emerging markets (44%) or the BRIC economies (34%), with only 9% directed at Europe and 13% at North America (Fig. 7 and 8.) This represents a major shift from

the recent past, and if true would signal a major shift in investment flows towards emerging markets.

Growth Capital, Distressed, and Infrastructure Growing

We asked participants what fund types they felt offered the best investment opportunities in the MENA region over the next five years. Infrastructure was the clear leader, with 35% of respondents, followed by expansion funding and distressed opportunities, each with 23%. Buyouts were selected by only 14% of respondents, and real estate by only 5% (Fig. 9.)

Delving further into the respondents' positive views on infrastructure, we asked them whether they saw this as a niche opportunity, or as a mainstream investment area for the future. It clearly appears to be the latter, with 71% of respondents selecting this option (Fig. 10.) Furthermore, most respondents feel that infrastructure investment opportunities will be greatest in the MENA region, other developing markets, and the BRIC economies, with



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- Changing Patterns of Competition

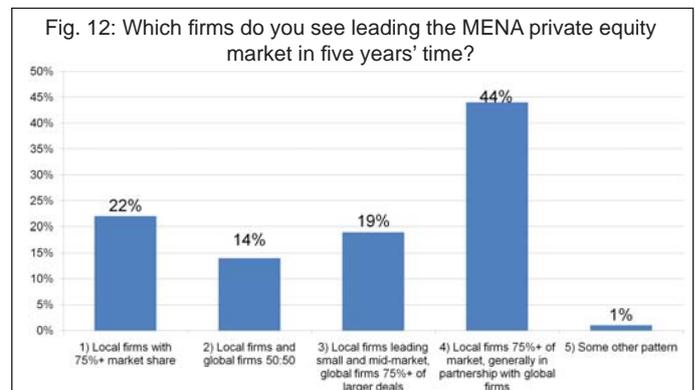
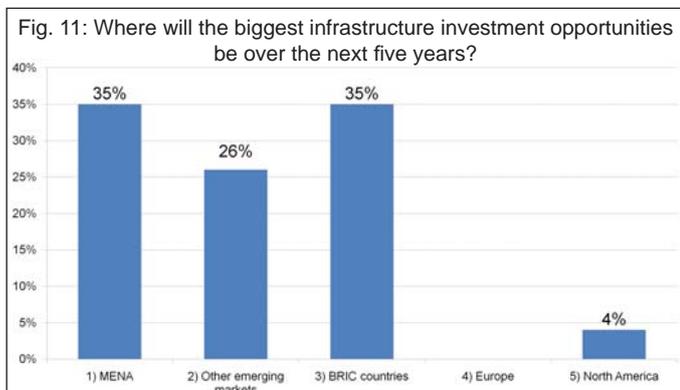
much smaller interest in Europe and North America for infrastructure (Fig. 11.)

Changing Patterns of Competition

Finally, we asked participants about the sorts of firms that they felt would be the market leaders in the MENA region over the next five years. A high proportion (44%) felt that the pattern of competition would evolve, with local firms leading the market, but generally in partnership with global firms (Fig. 12.)

In summary, we found a mood of sombre reality from our MENA survey, but combined with a firm base of optimism for the medium-term future, and growing interest in new fund strategies like infrastructure, and away from the traditional private equity hubs of Europe and North America.

We hope that you have found this Preqin Research Paper of interest, we welcome your feedback and suggestions for future research.



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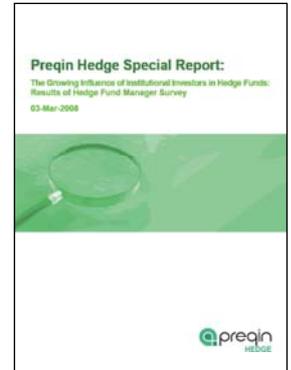
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