Mena well served by old-school principles

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Keystone Equity Partners strongly believes in the GCC markets and in select locations of the Mena region.

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The private equity business in developed markets and the Mena region is still taking stock of the events sparked by the collapse of Lehman Brothers in September 2008.

The period between 2000 and 2008 was tainted with excessive leverage and dominated by financial engineering, rather than extraction of value through operational efficiencies. But the definition of maximising shareholders' value cannot be confined to one investment strategy.

Borrowing a mountain of debt from willing lenders at record low rates to buy undervalued assets was viewed as the path to superior returns. If that is not maximising value, what is?

In fairness, few horror stories came out of the private equity industry as compared with the more established, and much more regulated, banking sector. Perhaps the lack of a "too big to fail" policy in private equity - as opposed to the large banks - has caused a natural curbing of "moral hazard" and limited the downfall.

But private equity was not untouched. Those firms that used excessive leverage to make overvalued acquisitions, only to see their value evaporate in the economic meltdown, have paid a dear price - both economic and reputational. Think of TPG and Washington Mutual, Terra Firma and EMI and the now defunct Candover.

Today the private equity industry - especially in the recovering US - is back into the borrowers' market. Total private equity investments last year were US$204.9 billion (Dh752.57bn), according to the industry consultancy Preqin, compared with $91bn in 2009 and $181bn in 2008.

The Mena region has been spared most of the horrific effects of the global financial crisis. This was not due to a superior breed of managers or to exceptionally good assets.

Simply put, the region has been practising the trade according to "old school" principles: no excessive leverage (if at all); reputable and experienced owner-managers; solid income-producing targets; and mid-level enterprises with plenty of growth potential. The companies that played by these rules will reap the benefits of the global recovery.

Few firms in Mena have been landed with bad assets. Others have missed on growth opportunities but very few (if any) have suffered from the weight of excessive leverage and the distressed restructurings that follow except for a limited number of Dubai-based vehicles that have invested outside the region.

Banks in the region trust in hard collateral only, ranging from property to personal guarantees to cash deposits. All other forms of lending are denied even to the best names in business.

This has erected a safety wall against excessive lending and as a result has disciplined private equity firms in deploying their equity capital more wisely, if not more thinly, among several investments. This has also robbed the industry from its ambitious plans to conduct multibillion-dollar deals.

A number of firms have based their investment strategies on short-term holding periods in anticipation of an initial public offering (IPO). Those instances of equity arbitrage worked well during the boom times (2005 to early 2008) but such realisations were brought to a halt when the IPO market went into hibernation in late 2008.

As a result few private equity firms were stuck with some assets but they did not falter under the weight of debt repayment as their western counterparts. The exit horizons got prolonged and the returns to investors delayed, but value was not wiped out, except in a few instances that were not related to the debt component of acquisitions.

In mid-2007, we set up GrowthGate Capital Corporation, which is managed by Keystone, as a specialist buyout firm (not a fund) comprising a select group of government-owned banks, public pension funds, and single-family offices.

At such time, and without the benefit of hindsight, we set our investment strategy of "acquiring stakes in well managed, profitable and growing middle market companies located principally in the GCC markets". (A single-family office is a professional team assembled by a merchant group or a wealthy family to manage and monitor its personal investment portfolios.)

We have shunned excessive leverage as a matter of principle, not due to lack of bank funding, and have not insisted on size (both in terms of equity stake acquired or volume of targets).

We have emphasised quality of management, commitment of owners, the premium nature of the services offered or products sold, and the chances for such businesses to grow from a domestic market to a dominant regional position.

Between mid-2007 to mid-2010, we have completed eight platform acquisitions, mainly in the GCC, with equity stakes ranging from a high 57 per cent to a low 10 per cent, and in industries as diversified as logistics and transport, private jet management and aviation services, manufacturing and distribution of building materials, waste management and environmental services, animation studios, biometrics, steel fabrication and food processing and distribution.

(A platform acquisition is a term used in private equity to describe the main private enterprise that is acquired by the buyout firm, and which becomes the platform to conduct and add to it other acquisitions to take the business to the next level of size.)

Additionally, we have conducted in excess of 15 bolt-on acquisitions for our portfolio companies. Our total assets under monitoring have grown from a mere $50 million in June 2007 to circa $1.25bn as of last December.

Having bravely invested during the crisis years we are planning two exits this year, one through an IPO and one through a trade sale, in the Mena region to respective public investors and strategic buyers, each depending on the nature of the business and its future plans.

Following a "buy & build" strategy has served us well in the region, where businesses of a large size are either state-owned or held by traditional merchant groups who are unwilling to part with any of their "sacred cows", let alone share their crops with investors.

We strongly believe in the GCC markets and in select locations of the Mena region. We are adamant supporters of promising mid-sized enterprises that are starved from cash by the traditional capital providers (banks) but that are abundant with growth opportunities.

We also trust PE investments that follow a disciplined and charted approach will be the primary partner of such promising businesses and will play a key role in the revival of a swathe of economic sectors, and in the creation of few, durable regional champions.

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