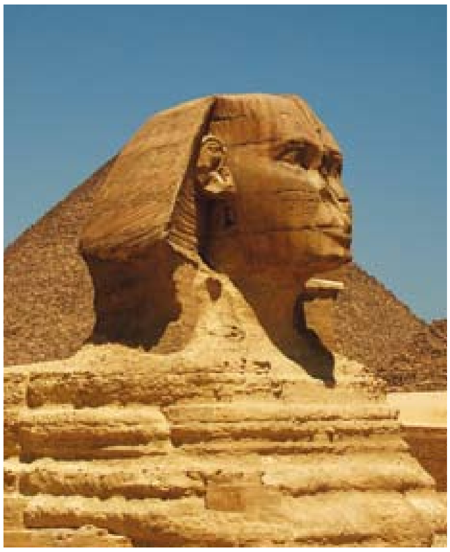
# Egypt: still North Africa's bright spot



## After a few years of rapid economic growth, Egypt's economy has slowed over recent times. But the country's private equity firms remain confident that its opportunities are sound and offer tremendous future potential. Vicky Meek reports

Last year, Egypt's growth seemed unstoppable. Following a few bleak years between 2001 and 2004, when the country experienced a deep recession and a banking crisis, it had already picked itself up and dusted itself down. It was top of the PricewaterhouseCoopers 2008 manufacturing index and came top of the list of countries that had made the most improvements to its business environment in the World Bank's *Doing Business* index. It was also the most attractive country for private equity firms in the Middle East and North Africa region, according to last year's Deloitte's private equity confidence survey.

Yet the world's economic crisis has certainly had an effect in Egypt, with much of the trouble emanating from the woes currently being experienced in the Gulf. "Egypt thought it would be insulated from the troubles in Europe and the US," says Hussein Khalifa, US partner at MVision. "But by September or October, it became clear that this was not the case as the Gulf started being affected by falling oil prices and some of the Gulf banks' less than prudent lending came to the fore, particularly in the real estate sector. Egypt had a lot of foreign investors in the market, including hedge funds, and once these started having to meet redemption requests, they took their capital out of the country."

In the months following the collapse of Lehmans, Egypt's EGX 30 Index fell by as much as 50%. "A lot of liquidity left the Egyptian market following the crisis and there was a lot less appetite for investment," says Sherif Elkholy, investment principal in Cairo for Actis. "That is still true today as investors remain concerned about current conditions."

### Lower remittances

But it's not just the stock market that has been affected. Many of Egypt's qualified workers moved to the Gulf over recent years to take advantage of the incredible growth story there. When that growth stalled towards the end of last year, those migrant workers suffered. "The events in the Gulf have affected Egypt because a lot of its people went there to work, such as professionals and engineers," says Khalifa. "Many have now either lost their jobs or have had to take a pay cut, so foreign remittances, which were a large element of the Egyptian economy, have fallen."

There has also been the impact of lower oil prices. While Egypt is not a major oil-producing country, its price has knock-on effects in areas such as receipts from the Suez Canal. "The economy has also been affected by the falling revenues from the Suez Canal," says Khalifa. "Lower global demand has reduced the overall amount of traffic in any case, but lower oil prices have also made it economic for vessels to go round the Gulf of Africa."

### Deals in hiatus

Naturally, the uncertainty and plunging valuations have taken their toll on Egypt's private equity players, many of which have been sitting on the sidelines. "People have wanted to see what would happen in the market," says Khalifa. "There has been a huge gap in expectations between buyers and sellers, with the latter camp looking at the peaks of last year as a benchmark."

Yet that doesn't mean the private equity houses have been idle. Many believe the falls in the public markets have created a potential opportunity for them. "Public markets are currently more attractive in terms of multiple," says Samer Yassa, partner at EFG Hermes Private Equity. Although it's far from clear whether Egypt is ready for a wave of take-private activity. "I'm not sure a public-to-private would be easier to close than a private transaction, even in the current environment in which it's hard to reach an agreement on valuation with private players," says Yassa. "I'm not sure you would get the response you'd be looking for from public shareholders."

"There have been some attempts to take companies private in Egypt before," says Rafik Dalala, country manager for Société Générale Asset Management's MENA fund Kantara. "But they haven't been successful. Egyptian law requires you to acquire 100% of the company and you have the added difficulty that many public companies are former public sector enterprises and so you'd need to negotiate with a 20% to 30% shareholder that may not have a capital markets mindset."

### PIPE dreams?

"It depends on the individual firm's investment strategy and whether their limited partners are agreeable to the idea," says Yassa. "But there is an opportunity to take a minority stake and play an active role in public companies to leverage their future direction."

Elkholy agrees. "Most owners of high quality unlisted businesses are not prepared to sell at current prices," he says. "If they don't have an urgent cash need, either because they are part-way through an expansion plan or because the sellers are dis-


Hussein Khalifa, MVision

tressed, then they won't sell. But there are some deal opportunities in Egypt for PIPEs. Here, the stock market valuations have dropped and companies are finding it hard to raise cash, yet there are some good businesses on the public market."

So far, PIPE deals have been pretty much non-existent, but some players say they are looking at possibilities. Actis is one. "There are a number of PIPE deals that are doable," says Elkholy. "You just have to look closely at the shareholder base and work out whether they would be willing to sell."

Yet the moment for some of these deals may have passed. Since April this year, Egypt's stock markets have seen something of a rally and, while they haven't gained all the ground lost since last autumn, they are up markedly; the EGX 30 rose from its low point of around 2,250 last November to over 3,750 in early June this year.

In any case, other deal prospects are starting to look up. Egypt's banks are comparatively robust and therefore able to provide acquisition finance for smaller deals and loans to small companies. The banking crisis of the early part of this century led to regulatory reform that curtailed the banks' activities. While the banks in most other parts of the world were being seduced by what turned out to be highly risky loans and instruments, those in Egypt maintained a conservative stance. "The banks in Egypt are in tremendous shape," explains Khalifa. "Their aversion to risk and preference for products such as asset-based lending and senior debt has stood them in good stead. The authorities were very against riskier instruments such as derivatives and made it very hard for institutions to invest in them."

"The public market valuations have come down considerably although there has recently been a bit of a rally, and GDP growth has halved, but otherwise, the Egyptian economy is fairly stable," says Marwan Elaraby, managing director at Citadel Capital. "The banking system is much more robust than many other economies, such as those in the Gulf. They are very liquid, with loan to deposit ratios of close to 60%, and no exposure to the sub-prime market."

## Local loans

This has meant those managing their portfolio companies have had more options at their disposal for refinancing. "We have changed the lender mix on some of our portfolio companies," says Elaraby. "The foreign lenders have now been replaced by Egyptian banks and the export credit agencies and development banks, which have a counter-cyclical mandate." Citadel has just managed to arrange an LE200m loan facility for Dina, the agricultural arm of its buy and build consumer foods platform Gozour. The capital came from three Egyptian banks; Ahly United Bank, Egyptian Arab Land Bank and United Bank.

This doesn't mean that all portfolio companies are in rude health; most firms say they are spending a lot of time working with management to get their businesses into shape. Export-led businesses in particular are suffering from a lack of global demand. Yet even these are not in dire straits. "Before the crisis, export-oriented business represented an attractive angle, having crossed the local growth barrier cap, as well as offering a hedge against local currency risks," says Baher Abdelmalek, vice president, investment banking, HC Securities & Investment. "However, these companies usually built their exports business over a foundation of strong presence in the local market. This is dampening the damage from the sharper slow down in export markets."

And, with some liquidity and comparatively low leverage levels, debt is much less of an issue than in some other countries, leaving many firms with available time and capital to make new investments. "We saw very little activity in the first quarter of this year as firms took a back seat and worked out how the Egyptian economy was going to be affected," says Dalala. "But in the second quarter, activity started to pick up. I think firms will start looking seriously at deals again this summer and we'll see a lot more deals closed towards the end of the year."

## Foreign competition

Two notable deals completed in Q2 were Citadel-backed Gozour's acquisition of milk and juice producer Enjoy and Saudi Arabian firm Eastgate Capital Group's US$40m investment in pharmaceutical company Sigma. Both attest to the continuing involvement of Gulf-based firms in Egypt. The Enjoy auction was so hotly contested because of the interest shown by Gulf firms that trade buyers were quickly forced to exit the competition, according to one local firm. And these are far from isolated incidents. "The Gulf-based firms are still interested in Egypt," says Elaraby. "Many of them raised capital last year and so are looking to deploy it. We're currently looking at selling one of our portfolio companies and we've got 14 international buyers signing a confidentiality agreement; over half of them are Gulf-based."

Indeed, local firms say, despite the low deal volumes, the involvement of Gulf-based firms is maintaining competitive pressure in Egypt. Despite this, some funds believe there are still opportunities to be had. Citadel, for example, is focusing on smaller deals than it might previously have done. "It's very hard to do big deals; seller expectations are just too high," says Elaraby. "The next year to 18 months will be about small acquisitions with rapid expansion plans; ones that can be bought with little equity." He also points to tiered expansion strategies as the way forward.

This belief is being translated into new funds being raised. Citadel is currently in the market with its first ever LP fund, which is hoping to reach a first close on US$200m this year. Beltone has joined forces with Siparex to launch a US$100m Egyptian subfund, with commitments from the IFC, the European Investment Bank and the Export Development Bank of Egypt. And Sphinx is out raising a US$100m turnaround fund for Egypt (see p14).

## Guarded optimism

"As the road towards recovery becomes clearer and risk appetite continues to improve, opportunities will crystallise faster than in the current quarter, especially if leverage becomes more accessible," says Abdelmalek. "We may start seeing consumer credit problems a little later this year," says Dalala. "And if delinquencies start rising, we may see stock markets down again. I think we're seeing the first wave of a ripple effect and I'm sceptical that the recovery will come as fast as the third quarter of this year."