Industrialization and know-how transfer – Private Equity as potential deal source and success factors for direct investments within the GAS Region

Joint Ventures and Foreign Direct Investments offer an excellent opportunity for Arab investors to enter small and medium sized companies. Therefore, Private Equity Funds are evolving as the most favorable deal-source. Using investor specific synergy-potentials, direct investments in the GAS-Region foster the Arab world in striving for acceleration of industrialization and know-how transfer.

Arab countries as Egypt, the United Arab Emirates, Oman and Qatar strive to accelerate industrialization and the transfer of know-how to their home countries through their investments. Qatar's National Vision 2030 for example, aims to transform the country, enabling it to sustain its own development and providing a high standard of living for its population and future generations. Thereby a diversified economy that gradually reduces its dependence on hydrocarbon industries is aimed at.

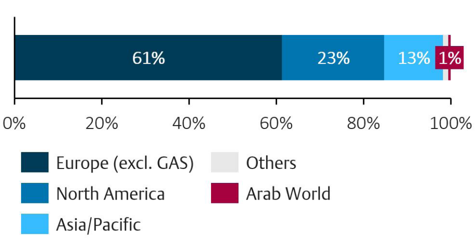
This can, among others, be attained by (I) purchases of products and services from foreign companies and inbound investments from these countries, (II) own investments in research and development, human resources and production facilities, (III) Joint Ventures with foreign companies or (IV) Foreign Direct Investments (FDIs). While (I) and (II) represent protracted processes with uncertain success potential, Joint Ventures (III) provide a balanced ratio between the gain in know-how contrasted to the carried financial risk. Furthermore, FDIs (IV), in the form of equity participations with a stake of more than 20%, allow to influence the strategy of the target company. Thus, investments in foreign production facilities can be induced, bringing technology and know-how into the domestic market of the investor. Therefore, Joint Ventures and FDIs present beneficial options to gain further know-how and import new technologies. The so-called GAS Region (Germany, Austria and Switzerland) is hereby regarded a as a favored target area, offering highly qualified workers and a well-developed infrastructure paired with economic and political stability. Understanding this potential, i.e. Qatar plans direct investments of EUR 10 bn in Germany in the upcoming five years.

Mergers and Acquisitions (M&A) within the GAS Region

The current market environment within the GAS-Region offers low interest rates, high market-liquidity and comparably low volatility. These factors favor the increase of M&A activity. Considering a five-year period from 2014 to 2018, the deal volume of M&A transactions in the GAS Region peaked in 2017 at EUR 146 bn with a total of 2,328 deals. Excluding the Real Estate and Financial Industry, 2018 shows the highest deal volume with an amount of EUR 97 bn. Thereof about 30% came from inbound investments. Over the considered five-year period, an average of about 470 inbound transactions with a total deal volume of c. EUR 48 bn was observed each year. This results in an average value of EUR 100 m per transaction. The targets of these inbound transactions are predominantly small and medium sized companies. This so-called "Mittelstand" encompasses more than 99% of all firms in Germany and accounts for more than half of Germany's economic output and almost 60% of its jobs.

Despite the continuously positive economic environment and high foreign demand for acquisitions of companies in the GAS Region, investors from the Arab world (in the following defined as Ghorfa members), are of little importance. Prominent examples of Arab investments include the participation in Volkswagen, Deutsche Bank and ThyssenKrupp by Qatar, the takeover of Oxea by the Oman Oil Company as well as the participation of Samih Sawiris in Raiffeisen Touristik and FTI Touristik. However merely 1% of the inbound investments within the GAS Region originate from Arab Investors. In contrast, c. 60% of the FDIs within the GAS Region come from Europe (excl. GAS Region) and about one fourth of the Investments originate from North America (see graph "Buyers by geography").

Buyers by geography

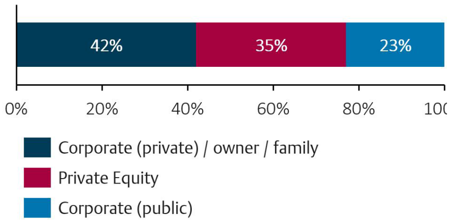


Sources of potential targets

Assessing different types of sellers within the relevant FDI-transactions, a distinction between private companies (Mittelstand), Private Equity (PE) Funds and public companies can be made (see graph "Sellers by type").

Compared to public and private companies, PE Funds as the second largest seller, offer several advantages for Arab investors. As natural sellers, PE Funds usually divest their portfolio companies in the course of an IPO or by selling the investment company to a strategic investor after a holding period of five to seven years. Additionally, current market trends show, that an increasing number of PE investments is sold to financial investors and further PE Funds on the so-called PE secondary market. This secondary market represents a convenient entry opportunity for foreign investors.

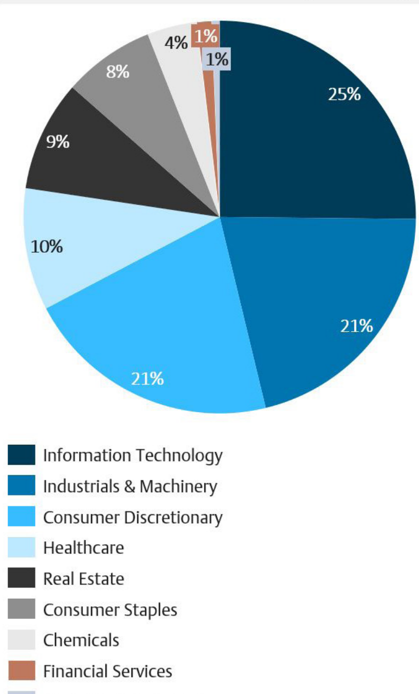
Sellers by type



The graph "Active investments 2019 by industry" offers a deep dive into the portfolio of the top 15 PE Funds specialized on the Mittelstand within the GAS Region. The most frequent industry represented in the portfolio of these PE Funds is Information Technology, followed by Industrials & Machinery and Consumer Discretionary. On average, each of the top 15 PE Funds within the GAS Region holds 21 investments. Therefore, especially for investors with limited market knowledge, PE Funds offers a suitable deal-source to obtain significant equity participations within the Mittelstand in the GAS Region.

Considering the holding period of investments within the relevant PE Funds, investments within the industries Healthcare, Consumer Discretionary, Chemicals, Industrials & Machinery as well as Energy & Renewables show an average holding period of four up to six years. This makes an exit of the PE-Fund within the upcoming years appear likely. (see graph "Average holding period by industry").

Active investments 2019 by industry



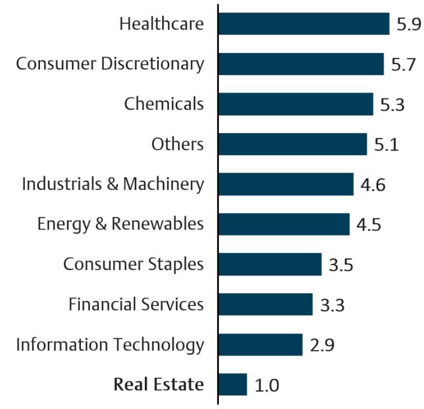
Considering the top 15 PE Funds in the GAS Region within the period from 2014 to 2018, the number of PE Fund divestments remained stable between 53 and 63 sold companies each year. Therefore, PE Funds offers a continuous range of investment opportunities which can be used to create an entry, especially into those industries, which enable the investor to transfer know-how into his domestic market. The companies being divested by PE Funds in 2017 for example can be divided into six major industries. 25% of the companies are operating in the Industrials Sector, 20% in the Non-basic Consumer Goods Sector and 18% in the IT Sector. Healthcare, Basic Consumer Goods and Materials together represent one fourth of the divested companies.

Additional to a variety of investment options, PE Funds offer further advantages for a foreign investor entering the market. While small companies often do not compile extensive reporting figures, PE Funds usually built up a reporting system and conduct an accurate due diligence, providing relevant information for potential investors. Furthermore, management structurers and incentive schemes are often pre-installed by the PE Fund. In addition, co-investments can be made in collaboration with a PE Fund, as the latest example of Abu Dhabi and the PE Funds Triton as well as EQT illustrates. In February 2019 they announced to acquire a German world market leader in the field of packing solutions in the course of a joint acquisition for USD 2.5 bn. Additionally, in May a potential USD 10 bn co-investment with EQT into a Nestlé spin-off was announced.

Success factors for Arab FDIs in the GAS Region

The M&A market in the GAS Region is characterized by high competition. Therefore, in order to carry out a successful transaction,

Average holding period in years by industry



investors need a well-established network, knowledge about the local processes and an accurate assessment of relevant synergy-potentials within their portfolio. A local network (typically comprising of corporate finance advisors, banks and lawyers) provides information about upcoming opportunities and grants access to decision-makers in target and seller companies (i.e. PE Funds). In addition, a targeted image and PR campaign also supports the setup of a widespread network, gaining the right contacts and staying on the radar of relevant decision-makers. Furthermore, it is necessary to be familiar with local conditions and particularities. The M&A process typically takes about six months and follows clear, predefined structures. Moreover, the current highly competitive environment requires investors to focus on their core industries. Therefore, an individual evaluation of synergy-potentials, exploiting the maximum potential of possible increases in value from platform-, sales- or cost- synergies is needed to place a competitive bid.

In conclusion, considering easy access to a wide range of potential targets with well-established corporate governance and management structures, PE Funds turn out as the most favorable deal source for FDIs and Joint Ventures within the GAS Region. Further success factors comprise a comprehensive network and an clear defined acquisition strategy, which is based on Arab world's goal to accelerate industrialization and the transfer of know-how into their native countries to establish their own Mittelstand.