KEYNOTE INTERVIEW

Taking growth capital to growth markets

A blended equity and debt approach can pay dividends when expanding companies throughout emerging markets, say Gulf Capital CEO Dr Karim El Solh and managing directors Omar Rifai and Kaiser Jasrai

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Q Why is the Gulf such a good starting point for investment in growth markets?
Dr Karim El Solh: The Gulf is in a very central location. Dubai is the single most connected city into Asia and Africa, and entrepreneurs can travel and expand into adjacent territories from here. To provide an example, at the start of last year, we closed our largest ever deal, acquiring 100 percent of IVI-RMA's Middle Eastern IVF fertility operations for $100 million. We immediately expanded the business from the Gulf, where it was already a market leader, and took it into India, where we are in the process of rolling out 18 IVF clinics. The next stop will be South-East Asia and beyond. Ultimately, we are aiming to build a global IVF platform out of the GCC, because when you build a global leader, the exit avenues and exit multiples increase.

We pursued a similar strategy with one of our first ever deals, water desalination and treatment company Metito. Metito used its base in the UAE to expand into Africa, Indonesia, India and China and before we knew it, the company was operating across 22 emerging markets. We made almost four times our money when we sold our stake in Metito because we had been able to build a global leader in a high growth sector. Taking companies from the Gulf and expanding them across growth markets is a winning formula.

Q The two examples that you have given are from very different sectors. Are there certain industries that you see as particularly exciting right now?
KS: We do not see ourselves as geographic investors. We are thematic investors. And so, when we launched

our third private equity fund with $750 million of commitments, we hired a global consulting firm to look into the future. We analysed 80 mega-trends and studied 45 sectors. Any sectors that were facing headwinds and growing at an anemic growth rate, we left behind. Instead, we chose to invest in the fast-growing technology, payments, healthcare and business services sectors and recently we have been focusing on sustainability as a new investment theme.

One investor once told me that you want to buy the future and sell the past. We have done exactly that. Our thematic approach has ensured that our portfolio companies in Fund III are growing at double-digit rates, even during the pandemic.

Q You have the capacity to invest across both equity and debt. How do you see the two strategies converging?

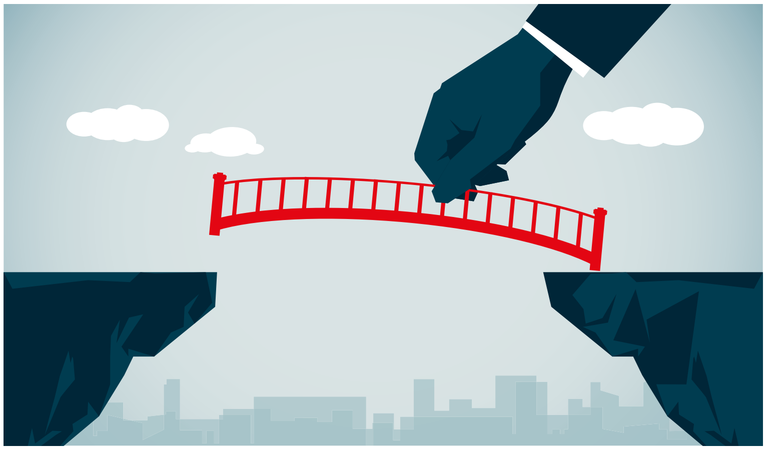
Omar Rifai: We operate two main investment strategies at Gulf Capital. One is a buyout strategy, where we take controlling stakes in fast growing market leaders and are currently investing out of our third private equity fund. The other division, we call growth capital. Our growth capital portfolio includes a combination of mezzanine, convertible debt, preferred equity and sometimes pure growth equity investments, but subject to us having alignment with other financial investors.

That is important, because we are not making control investments with our growth capital fund, and the emerging markets where we operate have a history of issues with returns and realisations. We solve that problem through structuring with a big emphasis on downside protection.

Q In what sorts of situations does this approach make sense?

OR: We often see a fast-growing company looking for $15 million, for example, to support a longer-term use of funds such as organic growth acquisitions, or expansion into other geographies. First, those companies will go to the banks, which, most likely, will be uncomfortable with the longer-term risk and lack of assets to lend against. So, they then go to the private equity market to raise growth capital. Given the minority stake limitations and illiquidity of the investment, oftentimes striking a deal that balances valuation and protective measures becomes difficult as entrepreneurs behind the SMEs will want to limit dilution and maintain as much control as possible, whereas investors want to maximise upside and exert some influence.

Our Growth Capital Solutions strategy looks for the right balance of returns and downside protection



Q How would you describe LP appetite for emerging markets?

Kaiser Jasrai: Private equity in developed markets has obviously had a very good run of growth over the past few years. A lot of allocation has been going into the US and Europe. But the recent crisis has caused many LPs to readjust their allocations and place greater emphasis on diversification and so we think emerging markets are very much on the agenda today.

In particular, LPs see us as a bridge between the Near East and Far East. They understand that we offer an interesting way to access the Asian growth story, in that we are able to buy at more attractive entry multiples in the Near East than would be possible investing directly into India and China, for example.

Once we acquire a stake in a platform, we encourage management to expand rapidly into the rest of Asia, organically such as in the case of ART Fertility or via acquisitions such as in the case of Metito. Investors recognise that value arbitrage of buying at lower multiples in the Near East and then expanding rapidly into the high growth (and expensive) Far East.

KS: At the end of the day, pension funds and sovereign wealth funds are investing 30 or 40 years out. If you look 30 years into the future, it is clear that 80 percent of global GDP growth will come from Asia, the Middle East and Africa. How can you afford not to be investing in these high growth economies? Emerging markets should form a core position in every alternatives portfolio.

without insisting on a controlling stake in the business, but with a lot of focus on structuring to mitigate against the fact that we do not have operating or exit control. We do this through having flexibility and ample experience to invest in mezzanine, convertible debt and preferred equity.

Another example is our investment in a leading Turkish broadband connectivity business, Turknet. Turkey has been an extremely tough market to operate in, in recent years, due to the sharp currency devaluation. However, because of the structure we had in place, when things started to go wrong, we were able to convert our minority position into a 70 percent stake and effectively take operational control and put in place a new growth strategy. We left the existing management team and minority shareholders in place, but the dynamics were very different.

We went from sitting across the table to sitting on the same side of the table and despite the challenges of devaluation and other negative trends, Turknet ended up doing pretty well. From 2017 to exit, we increased EBITDA by 4.5 times in local currency and 2.5 times in dollars. There have been almost no private equity exits in Turkey over the past couple of years, but we were able to exit, and generate a positive outcome from that exit as well.

Q What are the principal challenges that your emerging markets strategy presents and how do you overcome them?

KS: When you invest in emerging markets, there are always surprises. The way we deal with that is through country diversification. We like our companies to be operating across 10, 15 or even 20 countries. Some of those countries will be oil importers and some will be oil exporters. Some will have currencies that are appreciating, others that are depreciating. We always aim to avoid single country risk and go for the portfolio approach.

Q What about the challenges, or opportunities, that ESG presents in emerging markets?

Kaiser Jasrai: ESG is a central focus for us at the moment on two levels. At the firm level, we have recently become a signatory of the United Nations Principles for Responsible Investment, as well as Terra Carta, HRH Prince Charles's sustainable markets initiative. We are also looking to implement strong ESG practices within our portfolio companies.

We have set up working groups to develop strategies and are looking to integrate ESG principles into term sheets when we complete a new deal, as well as working closely with management teams to make sure they adhere to the highest standards of ESG throughout our investment.

KS: We like to push our companies to think like us and to embrace ESG. That is easier, of course, in the buyout business, where we typically hold a majority controlling stake, sit on the board and can push our management teams to be more proactive and embrace ESG fully. Yet we have also had success with our growth capital strategy.

For example, we took a minority stake in Egypt's Middle East Glass Manufacturing, which supplies glass bottles to Coca-Cola, Pepsi and Nestle, among others in Egypt and Africa. As a board, we took a collective decision to exit plastics, which is harmful to the environment, and to divest our PET division and instead to double down on recyclable glass. We did not just pay lip service to ESG, we acted decisively in this case. We actively try to encourage our portfolio companies to embrace ESG. We tell them that, ultimately, good ESG is good for business and good for valuations on exits – we are all aligned here.

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>
> **KARIM EL SOLH**

Q Do you see a bright future for emerging markets?

KS: I can put it this way: when I started out in my career, people would say, "Go west, young man." I tell my children today that they should head east. The future is in the Middle East, Asia and Africa. That is where the excitement lies, and we want to be part of that. I am convinced that the pendulum will swing. Yes, the last few years have been amazing for private equity in the US and Europe, but now it is our turn.

We believe in the sectors we have chosen – technology, payments, healthcare, business services and sustainability. Indeed, our Q4 results have just come in and our average portfolio company sales in Fund III are up 20 percent in Q4 alone and EBITDA up 193 percent. We wrote up our Fund III 20 percent in one quarter alone, which just goes to show the momentum that is there in our portfolio.

Our thematic approach of investing in the fast-growing sectors of the future is paying off nicely today, even during the pandemic. Sector trumps geography all day long. We are buying the future. ■