Robert Swift, chief executive officer of the MENA Infrastructure Fund, takes a closer look at the infrastructure and energy investment opportunities in the MENA region.

STRENGTH IN DIVERSITY

The Middle East and North Africa (MENA) region is undoubtedly one of the most diverse and interesting parts of the world, not only in terms of its geography and cultures but also its economy, demographics and wealth. Spanning more than 20 countries with a combined GDP touching $1 trillion in 2006, MENA is an economically diverse region including the oil-rich economies of the Gulf as well as countries that are populous and resource-scarce such as Egypt, Morocco and Yemen.

Having benefited greatly from high energy prices in recent years, the region is currently enjoying rapid economic expansion, with growth over recent years exceeding that in the OECD economies (4.2 percent per annum from 1996 to 2003, versus 2.6 percent per annum). Economic forecasts project regional GDP to continue growing rapidly in the coming years (forecast growth of 5.6 percent per annum from 2006 to 2011).

Given that the population of the region exceeds 306 million (2005 estimates), is growing at a rate beyond the OECD average and is characterised as young relative to more developed markets, the region undoubtedly has a growing infrastructure and energy requirement which governments and the private sector must provide. Key aspects of this need relate to transport, healthcare, education, utilities and energy.

SURGING DEMAND

The widespread socio-economic development of the region, coupled with the increasing sophistication of the region's energy industry and its advancement up the value chain, has meant demand for infrastructure is increasing at a rate in excess of 1.5 times the underlying GDP growth rate of the region. This demand is further exacerbated by the historical neglect of infrastructure investment.

It is estimated that commercial investment in the infrastructure and energy sectors will exceed $300 billion over the next ten years, covering both private sector-led initiatives as well as public-private partnerships. Prominent sectors for development include: transport, broadly covering roads, ports, airports and logistics; the power generation and water desalination components of the utilities industry; social accommodation, such as schools, hospitals and universities; and the many derivatives of the oil/gas-related and energy-intensive industries including petroleum refineries, downstream petrochemicals processing, metal processing and fertilisers.

Many such initiatives comprise public-private partnerships involving both the public and private sectors in a risk-sharing arrangement, harnessing the skills and resources of both. Over the last few years templates have emerged, country by country, for build-own-operate or PPP-style concessions which have been financed in the regional and international markets. For instance, the first-ever IPP (independent power project) in the region was implemented in Oman over a decade ago.

PRIVATE EQUITY POTENTIAL

In terms of infrastructure equity requirements for the region, one can examine two relevant measures: the size of the project finance market and the growth of private equity investment in the region.

The project finance market is a good proxy for the size of the commercially financed infrastructure and energy market and, therefore, the potential for infrastructure equity investment. According to *Project Finance International*, MENA had a project finance debt market of $30.6 billion in 2006, representing 17 percent of the total global market. Equity invested in these projects was estimated at between $9-10.5 billion. Of note was the size of the Saudi Arabian project finance market in 2006, representing 50 percent of the regional and 8.5 percent of the global project finance market.

From a private equity perspective, MENA is becoming the fourth global centre after the US, Europe and Asia, though it is still a small market by global standards. In 2006, the region saw total private equity fund flows of $8 billion, representing growth of almost eight times the previous year. With persistently high energy prices, the liquidity surplus being generated in the region is increasingly being diverted to alternative assets such as private equity. While in the past, most of the funds raised in the region have been invested outside, that trend has now definitely changed with the establishment of a number of funds focusing on MENA.

UNIQUE FEATURES

Particular features of the region which are conducive to private equity investors and provide the backdrop for intelligent investment are: economic liberalization; privatization; major public and private infrastructure investment; oil-driven budget surpluses ($600 billion current account surplus forecast for 2007-11 across the Gulf countries); and excess liquidity in global debt and equity markets.

The unique features of the region which private equity firms can look to tap into include the following:

- Prevalence of greenfield projects due to the market's youth. More operating asset sales and transfers will be seen in the future, likely accompanied by secondary market private equity activity.
- Importance of energy to the growing region, which drives investment opportunities directly (such as petrochemical/fertiliser/refinery) and indirectly (transport/utilities).
- No single concession structure but build-operate-transfer (BOT) template is emerging with elements of public-private partnerships and service-style contracts. It is generally accepted in the regional and international banking markets that these contracts have a reasonable risk-reward balance for the private sector developer and the level of international bidding appetite for such contracts is exceptionally high at present.
- Substantial appetite of international and regional banks for regional infrastructure and energy projects, facilitating easy access to debt on competitive terms. Adequately structured greenfield projects can secure very high leverage. The appetite and sophistication level of regional banks continues to grow, leading to intense competition for large sized deals.
- An established exit option exists via single project company IPO, an option not seen widely outside the region. This increases the number of exit options to the private equity investor compared with other regions. Oman, in particular, has had a number of successful single project company IPOs over the last five years.
- Government investment in project companies brings credibility and stability to the table. The experience of the international developer and operator of assets with a government shareholder is generally considered positive, implying a supportive approach to future development.
- Across the region you have a contrast between the mineral-rich Gulf countries (rated AA or better) and North African countries (at best investment grade) with the consequential differences in return opportunity for the private equity investor.
- In most countries, particularly in the Gulf, there is generally considered to be no currency risk as the currencies are linked to the US dollar.
- The range of investment regimes and incentives (free zones/supply contracts/offtake contracts) continues to grow in the region to provide benefits to new projects being developed.
- The legal and regulatory environment in the region continues to develop, with sound concession-based structures now familiar to the international as well as the regional financing community.

With the infrastructure and energy investment opportunities which present themselves in MENA, investors can look forward to good returns as the region continues its strong growth and exploits its natural resources and geographic position as a hub for trade. It comes as no surprise that some of the largest private equity firms in the world and the limited partners investing in their funds are developing a focus on the MENA region.

The MENA Infrastructure Fund, for example, was established by three leading sponsors in the region: HSBC, the global bank; Dubai International Capital, the UAE-based international private equity firm; and Oasis, the leasing company. Established in the Dubai International Financial Centre (DIFC) and regulated by the Dubai Financial Services Authority (DFSA), the MENA Infrastructure Fund is now a major investor in the infrastructure and energy sectors in MENA.

The fund has been seeded with $50 million by each of its sponsors, and has established a profile with investors across the region and internationally. It has also been recognised as a sound financial partner in the region for international operators and developers of infrastructure and energy projects.

The MENA Infrastructure Fund has a long investment horizon to accommodate the cash flow profile of infrastructure and energy projects and acts as a strategic financial partner to co-sponsors, developers and operators of assets, investing broadly in both greenfield and brownfield projects and acquisitions.

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CONCLUSION

The MENA region is emerging as a significant market for infrastructure finance as it seeks to address historic infrastructure shortfalls at the same time as building out a robust infrastructure backbone to support future economic growth and socio-economic development. The private sector is playing a major role, both as the developer and operator of infrastructure and energy assets and as an investor in debt and equity.

Infrastructure equity in the region offers global investors a unique opportunity to gain exposure to the region, as they look for geographical diversification in their asset allocations. ■

Robert Swift is CEO of the MENA Infrastructure Fund. He has over 15 years of experience as an infrastructure specialist in his 19-year investment banking career and has broad experience across the transportation, Public-Private Partnership and utility sectors. The MENA Infrastructure Fund, established in the Dubai International Financial Centre and regulated by the Dubai Financial Services Authority, is jointly-managed by HSBC, Dubai International Capital and Oasis.