Private Equity investments in the healthcare industry
Roundtable discussion summary
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MENA Private Equity Association

In collaboration with booz&co.
A list of participants is available in Appendix 1 at the back of this paper.

The MENA Private Equity Association would like to thank the participants in the roundtable for their insights, and would also like to specially thank Booz & Co. for their contributions to the report and the Dubai International Financial Centre for hosting the event.
EXECUTIVE SUMMARY

The healthcare sector in the Middle East and North Africa (MENA) region will require a significant upgrade in the coming decades. It is struggling to meet the demands of a large and growing population, even as it must work to improve the quality of care and make it more accessible. Private equity (PE) investors can help fund these improvements. However, there has been little regional PE investment in healthcare to date. In late March 2013, a group of investment, government, and healthcare professionals gathered for a roundtable discussion to explore the reasons behind this lack of activity and suggest possible solutions. This paper summarizes the major themes from that discussion.

The event was organized by the Middle East and North Africa Private Equity Association and chaired by Dr. Ahmed Emara, Founder and CEO of ReAya Holding. More than 30 delegates attended, including representatives of prominent PE houses, lawyers, auditors, consultants, investment bankers, and healthcare specialists. They represented Bahrain, Egypt, Qatar, Lebanon, Saudi Arabia, and the United Arab Emirates (UAE). A complete list of participants is in Appendix 1.

The four-hour discussion identified several distinct challenges that have prevented greater PE involvement in healthcare thus far, including the relatively long time horizon required for investment, a need for specific expertise, and the considerable influence of national governments, among others. In spite of these challenges, some potential solutions emerged as well, namely: looking beyond hospitals to adjacent healthcare investments, such as diagnostics facilities and pharmaceutical manufacturing plants; public–private partnerships (PPPs); and adjusting the investment approach of PE houses and the expectations of their clients.

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INTRODUCTION

The MENA region faces significant healthcare challenges. Demand is rising, due to demographic shifts and increases in lifestyle-related diseases such as diabetes and heart disease. Political changes across the region have further encouraged more government investment to satisfy basic needs such as healthcare and education. There are quality issues in the delivery of care, stemming from insufficient infrastructure and stiff competition for talent. In addition, many MENA residents do not have sufficient access to clinical specialties. Compounding these challenges is the unsustainable government-dominated healthcare model that prevails in the region. At present, the government assumes most of the financial burden, and much of the operational burden as well, which is placing a considerable strain on the budget. In other markets, PE firms have invested to address some of these issues, improving healthcare infrastructure and the delivery of services while generating attractive returns. Despite this potential, thus far PE has not played a significant role in the MENA region’s healthcare sector.
To explore why not—and discuss potential solutions—the Middle East and North Africa Private Equity Association recently hosted a discussion involving practitioners from established PE houses, along with lawyers, auditors, consultants, investment bankers, and healthcare specialists. The event took place at the Dubai International Financial Centre on March 26, 2013. It was moderated by Dr. Ahmed Emara, founder and CEO of ReAya Holding, the first permanent capital vehicle in the MENA region that is fully dedicated to private equity investments in healthcare and life sciences.

During a wide-ranging four-hour discussion several broad themes emerged:

- PE investors have seen few attractive opportunities in healthcare thus far. Valuation is a key divergence between potential vendors and PE houses.
- The holding period for investments is a key challenge.
- Healthcare investments require specific expertise, whereas most PE firms are generalists.
- Regulations are growing more stringent and less investor-friendly.
- Governments are crowding out private-sector investments.

In addition, the participants identified some clear steps that stakeholders should consider to facilitate greater PE involvement in healthcare:

- PE houses should look beyond hospitals into adjacent investments.
- PPPs are one potential avenue.
- PE houses should recalibrate their investment approach. They are better off investing alongside specialists, or adding experienced healthcare executives to their in-house capabilities.

Healthcare deals can be challenging even in ideal conditions. Given the lack of PE activity in the sector thus far, it is critical to separate market hype from the reality on the ground.

PE INVESTORS HAVE SEEN FEW ATTRACTIVE OPPORTUNITIES IN HEALTHCARE THUS FAR

The moderator, Dr. Ahmed Emara of ReAya Holding, began the discussion by asking participants how PE investments have contributed to the development and sustainability of the MENA healthcare industry thus far. The regrettable answer was that they have not, at least not in any meaningful volume. This is despite clear healthcare needs—and clear investment opportunities.

Tamer Bazzari, CEO of Genero Capital, a UAE-based firm focused on corporate finance advisory and private equity investments that covers the MENA region, highlighted the synergistic relationship that exists between healthcare companies and PE firms. “Healthcare players are cash-hungry and will need support to achieve a growth trajectory,” said Bazzari. Ahmed El Guindy, head of investment banking at EFG Hermes, echoed this, adding that most countries in the region lack proper health services. “There is a clear need for investments to enhance the quality of care to patients,” he said.
Yet while the need is there—and the right deal structure would likely benefit both sides—thus far PE firms in the MENA region have had limited opportunities to deploy their capital in healthcare investments. High valuations are part of the problem, according to some participants. Samer Sarraf, UAE country head at Amwal AlKhaleej, a PE firm, explained that despite the region’s favorable demographics, his firm had not invested in healthcare. “Valuation expectations of sellers are very high (even when compared to regional public comparables), and are being justified with high growth prospects that are not sustainable by the asset base, all of which results in low projected returns and hence less appealing investment prospects for a private equity firm,” Sarraf said.

Khalil Massoud, senior vice president at The National Investor (TNI), an Abu Dhabi-based investment and merchant banking firm that successfully exited a 10-year investment in a third-party administrator for healthcare claims, said that healthcare is a challenging and highly regulated industry with shifting regulations. It requires a complex set of competencies and a long investment horizon (five to seven years). Before compulsory healthcare, 10 years ago, this area was appealing to investors because the valuations were not inflated. Massoud suggested waiting for the next cycle, when valuations drop.

Dr. Hazem Zagzoug, CEO and vice chairman of healthcare operator Andalusia, which has facilities in Egypt and Saudi Arabia, agreed that high valuations have served as a deterrent over the past few years. However, he added, there are other challenges as well: “The MENA region does not lack funds, but rather is short on healthcare operational know-how and management experience.” Zagzoug said that the sector holds clear opportunities for those that can develop this expertise and properly craft deals. “PE firms need to recognize that the multiples for successful operators will be high,” he said, “provided they can establish the right structure.”

Dr. Sarper Tanli, vice president at Methodist International, a hospital management company with regional headquarters in Dubai, described the healthcare needs in the region as acute and agreed that high valuations have been an issue. In addition, he said, there is a disparity between the goals of investors (who want to maximize value) and the goals of operators (who do not want to take instructions from short-term partners).

Jens Zimmermann, a partner at New Silk Route, said that most of the potential deals he has seen in the MENA region were too small, while others were overvalued. New Silk Route is a regional growth capital fund with US$1.25 billion in assets under management and has healthcare as a target sector. It looks for investments in the range of $50 million to $100 million. “We are looking for, but not finding, opportunities at a good valuation with the possibility of adding value and a good exit,” Zimmermann said.

Mansoor Ahmed, director of Healthcare MENA Region for Colliers International, highlighted that there are not enough good assets or businesses available in the region for acquisition either due to ownership issues (especially the land or property) or the expectation gap between buyers and sellers.
The issues were summed up by Nicolas Murat, a partner at Levant Capital, a Dubai-based PE house. Murat said that while PE investors have made successful healthcare investments in many markets around the world, the MENA region presents a unique set of obstacles to overcome: governance, insufficient scale in most markets, regulations that vary from country to country, and a lack of exit opportunities.

THE HOLDING PERIOD FOR INVESTMENTS IS A KEY CHALLENGE

A principal challenge for PE investors is that healthcare deals require a longer time horizon. As El Guindy of EFG Hermes noted, there is a market thirst for short-term investments and high cash-flow returns—an indication, as he put it, that PE “does not play by the same rules” as the healthcare industry. El Guindy suggested that greater opportunities can be found in greenfield investments. Although these require a substantially longer time frame, they will clearly upgrade the region’s healthcare infrastructure. “Greenfield investments, and those requiring specific operational knowledge and service know-how, hold the promise of productivity gains for the healthcare facility—and high returns for the investor,” El Guindy said. He suggested a rule of thumb that PE investments in healthcare require a minimum of seven to 10 years.

Dr. Emara’s firm, ReAya Holding, follows this model. It acts like a healthcare holding company that retains investments for about 10 years or even longer if required, giving them time to mature. The approach has allowed ReAya to invest in some greenfield projects (including a first of a kind vaccine production facility in the region) where it is easier to deploy and exit the investment.

However, others said that a longer time horizon—even with larger returns—is simply not appealing. “MENA investors are used to large returns from real estate,” said Philip Lefebvre, managing partner of Whitewater Executive Search, a human capital company. Those deals tend to happen more quickly, Lefebvre added. “A long-term investment horizon of seven years is not alluring.”

Indeed, Qatar First Bank has invested a good bulk of its capital in healthcare, but is focused primarily on short-term investments. Sami Nabulsi, the bank’s director of private equity, claims that Qatar First Bank avoids any PE deal with an investment horizon of more than three to four years. Nabulsi also noted the lack of a clear exit strategy for MENA healthcare investments once they have achieved their target returns. Only a handful have successfully launched initial public offerings, such as Dallah Healthcare Holding Co. on the Saudi Stock Exchange in November 2012, or Abu Dhabi-based NMC Health Plc on the London Stock Exchange in August 2012.

Healthcare investments require specific expertise, whereas most PE firms are generalists

Jad Bitar, principal in Booz & Company’s healthcare practice based in Abu Dhabi, believes the problem has two aspects. “On the one hand, healthcare deals in general are highly overvalued, which does not make business sense to investors,” Bitar said. “On the other hand, the operational side is too complex for PE generalists.”
Ali Hashemi, managing partner of Avicenna Partners and a former consultant with Booz & Company, agreed that it is difficult for generalist PE firms to add value in the sector if they do not have strong sector knowledge and the specialists required to navigate all aspects of healthcare investments. Nevertheless, as the moderator, Dr. Ahmed Emara, pointed out, there are exceptions. For example, Abraaj, a generalist PE house, delivered hefty returns to its investors when it recently sold its healthcare investment in Istanbul.

Reflecting on his time as a consultant, Hashemi noted that he did a lot of work on various deals. “Yet none of them closed, often due to a wide gap in valuation expectations between buy and sell side algorithms underpinned by assessment of risk versus return,” he said. Hashemi highlighted a disconnect between real risk and perceived risk, which often inhibits deals. Specialists and strategists with healthcare experience are better at distinguishing real risks and assessing deals properly. However, a lack of knowledge leads to greater perceived risks that scare investors away. “Knowing more about the industry would demystify most perceptions,” said Dr. Emara. He acknowledged that this is challenging, given the scarcity of information sources and data regarding the region’s healthcare sector. “PE investors must educate themselves about the industry from the inside out.”

With that knowledge, however, comes the potential for greater returns. Zimmermann of New Silk Route gave the example of his firm’s investment in a generic antibiotic manufacturer in India. New Silk Route is using its internal healthcare expertise to help the company take advantage of its success and expand internationally.

**Governments are crowding out private-sector investments**

The last major challenge discussed by participants was the role of national governments. Throughout the MENA region, the public sector is still the dominant player in healthcare. PE investors are struggling to grab the leftovers and guess what the government’s next move will be. That uncertainty leads to a perception of greater overall investment risk. Bitar of Booz & Company gave the example of the Saudi Health Ministry’s recently announced plan to build 125 new hospitals. Once that expansion is complete, Bitar said, the government will operate a total of 390 hospitals, “flooding the market” and leaving little room for PE investors. Government-owned and -operated facilities also leave private-sector investors effectively competing with them for scarce resources such as talent.

A lack of clarity on regulations—both the introduction of new rules and unexpected or overly stringent enforcement of existing rules—is a factor as well. “We don’t necessarily dislike regulations per se,” said Murat of Levant Capital. “What we dislike are surprises: new rules that we didn’t anticipate, or an unexpected application of the rules.”

Still, said Hikmat Mukhaimer, senior managing partner at Rödl Middle East, an international audit and consultancy firm, the influence of the private sector will only grow, in part because of fiscal pressure. “Regional governments are now looking at balancing their budgets,” said Mukhaimer. “The future is privatization of the healthcare sector. This can’t be done by corporations, but mainly by PE firms.”
In addition to these challenges, participants in the discussion identified several potential solutions.

**PE houses should look beyond hospitals into adjacent investments**

First, Dr. Emara urged participants to consider other healthcare investments besides hospitals, which are complex and difficult to develop and operate, particularly for investors without direct healthcare expertise. Instead, he said, there are growing opportunities in adjacent businesses such as diagnostics, pharmaceutical manufacturing, and healthcare supplies. He cited the example of manufacturing active pharmaceutical ingredients. “These facilities are rare in the region,” Dr. Emara said, “yet there is a clear opportunity for investors to transfer the technology and begin exporting such ingredients.”

For example, Al Jazeera, a Saudi pharmaceutical company, built a manufacturing facility to produce cephalosporin, a type of antibiotic, while competitors considered the opportunity too small. However, Al Jazeera got its cephalosporin approved by the U.S. Food and Drug Administration and was then acquired by the Jordanian company Al Hikma at a high multiple, even though it consisted of a single small facility.

Similarly, said Jonas Voelker, vice president at Gulf Capital, it is possible to add value in the diagnostics sector by improving operations and implementing standardized procedures—and by using tele-radiology, which provides specialized services in smaller or more remote markets that would otherwise not be accessible. For example, Gulf Capital acquired a diagnostic imaging business in Egypt with 13 centers in 2009, and then made add-on acquisitions in Jordan, Saudi Arabia, and Turkey. Thanks to its combination of acquisitions and organic growth, the company expects to run 37 centers by the end of this year, making it by far the biggest diagnostic imaging chain in the region, enabling it to use its bargaining power to secure favorable pricing terms and financing on equipment. Voelker added that Gulf Capital is interested in tackling chronic diseases such as obesity and diabetes, but it has yet to identify suitable investment opportunities that are of sufficient potential scale.

Sarraf of Amwal AlKhaleej said that his firm would consider investing in auxiliary services such as laboratories and pharmacies once regulatory issues and valuation gaps are addressed, which will make the sector more attractive overall.

Wafic Faraj, CEO of Arabian Medical Marketing Co, a Saudi-based distributor of international medical and surgical products, added that interesting opportunities lie in building administrative, finance, and support capabilities for healthcare operators. “Operators can also take over some service elements from governments that are too busy building and operating hospitals,” he said. Such ventures would allow PE investors to tap into the expertise they have already built up in areas like software, equipment, and human capital, through their investments in other industries.
**PPPs are one potential avenue**

Given that the transition from government ownership to the private sector will take place over time, PPPs are a promising interim solution, particularly when used to build up local capabilities. They allow the government to reduce its involvement and stop operating facilities and delivering care. Instead, the government exercises an oversight role, identifying gaps in accessibility and quality, regulating the market, and offering incentives to attract commercial players. PE investors, for their part, can inject capital into profitable opportunities, such as promising for-profit companies, and contribute their expertise in clinical, administrative, or support services in order to improve performance.

For example, Egypt recently announced its first such deal, for the construction of a 200-bed gynecology and obstetrics university hospital, a new general hospital, and a blood bank and pediatric and emergency-care ward at an existing facility, all in Alexandria. The venture is moving ahead and recently secured funding from local banks, said Mohamed Metwalli, CEO of Egyptian PE house Arabiyya lel Istithmaraat.

The Saudi Health Ministry is currently investigating several PPP opportunities in areas such as e-Health, medical device manufacturing, vaccines, imaging technology, and others.

Bitar from Booz & Company suggested that in the short term, governments can build on this momentum by establishing the correct regulatory frameworks to enable such partnerships. “Ideally,” he added, “MENA countries would develop a common legal framework for PPPs across the region, while leveraging lessons learned from the countries where this model is more common, including Spain and several Scandinavian countries.”

**PE HOUSES SHOULD RECALIBRATE THEIR INVESTMENT APPROACH**

If PE houses are to invest in the healthcare sector across the MENA region, they may need to shift their investment philosophy and adjust their expectations. Specifically, this entails three components.

**Be specific in your investment targets**

A very narrow, precise approach can help investors to identify promising targets and avoid getting distracted by tangential opportunities. For example, Murat of Levant Capital said that a clear investment opportunity is to help successful self-financed companies to expand rapidly. “In these cases, PE can bring in more than capital,” Murat said. “It can help build administrative, finance, and other support capabilities while also providing access to a new set of relationships to help drive growth opportunities.”

Sami Nabulsi of Qatar First Bank shared the example of the bank’s investment in a hospital chain in Turkey. “Our core strategy was to stay away from heavy assets,” he said. Instead, the bank created value by ensuring that functions such as administration, finance, and accounting were well established, making sure that human resources and incentive schemes were in place to attract and retain top talent, and instilling sustainable corporate governance standards. “A consultative management approach with clinicians is critical,” he said.
Consider separating operational risk from property risk
Mohamed Metwalli of Arabiyya lel Istithmaraat presented a different perspective on healthcare investment: focusing mainly on real estate while forging partnerships with healthcare operators. “The operators carry the burden of the operational risks while our firm carries the real estate risk,” he said. “And we secure returns through long-term rental agreements.”

The benefit of such a model is that it separates the real estate risk from the healthcare operations risk and hence assigns each to investors with different risk tolerances and appetites. Moreover, it allows healthcare operators to focus their liquidity on improving operations and scaling up the business, instead of pouring it into expensive real estate assets. In essence, such creative “slicing up” of the healthcare investments offers many benefits for all stakeholders involved.

While this model is still not popular in the region, it is common in the U.S. through vehicles called real estate investment trusts (REITs). Tanli of Methodist International agreed that separating the structure into two entities, an operating company and a property company, would make a deal more attractive to investors.

Understand the time horizons and potential returns
PE investors need to understand the particular parameters of healthcare deals. Dr. Stuart Bennett, an executive-in-residence at TVM Capital MENA, a regional healthcare PE house, suggested that PE firms communicate with their investor base in order to align their expectations with potential investment time lines (generally longer), especially when considering greenfield investments that, although more operationally complex, have the potential to offer a greater return than investment in an established business.

Similarly, Whitewater's Lefebvre emphasized the need to demystify the sector for investors to avoid scaring them off, and to foster a true understanding of the need for life sciences in the region. A more candid discussion about healthcare investments—and their long-term requirements, in contrast to the “quick buck” approach sought by some investors—could draw more PE firms to the sector, thus increasing the pool of investable capital and allowing PE to more directly help transform healthcare in the MENA region.

CONCLUSION
Participants in the discussion agreed that deal growth will be modest in the region this year and next, reflecting the many obstacles that PE investors need to overcome. However, given the growing scope of the region’s healthcare challenges over the coming decades, PE firms that choose their strategies and targets carefully—in markets where the government has established clear expectations—can find success. They have the potential to generate attractive returns for their firms and help build a stronger and healthier MENA region overall.
APPENDIX 1: LIST OF ROUNDTABLE PARTICIPANTS

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About the Middle East and North Africa Private Equity Association

The MENA Private Equity Association is a non-profit entity committed to supporting and developing the private equity and venture capital industry in the Middle East and North Africa.

The Association aims to foster greater communication within the region’s private equity and venture capital network and facilitate knowledge sharing in order to encourage overall economic growth; it actively promotes the industry’s successes to local stakeholders and builds trust with investors, regulators, and the public regionally and internationally.

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N2V
NBK Capital
New Silk Route Growth Capital
PineBridge Investments
Qatar First Bank
ReAya Holding
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Swicorp
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