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# The GCC and Its Influence in Future Private Capital Markets

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Recently, I returned from a trip to Bahrain, an island nation off the coast of Saudi Arabia in the Arabian (Persian) Gulf. I was hosted by Daniel Taylor, Head of Operations for First Bahrain a real estate investment and development group in the region. Bahrain and the other nations in the region have banded together under the heading of the Gulf Cooperation Council, or GCC as a means to dialogue on finance, trade and other regional issues. The GCC is a powerful influence in the world capital markets and includes Kuwait, Bahrain, Saudi Arabia, Oman, Qatar, and the United Arab Emirates.

This was my second trip to the Gulf region in the last 9 months with the first trip being in September of 2008 at the outset of the current crisis in capital markets. In September of last year I was in Dubai speaking at a conference on the topic of "Determining Shareholder Objectives." My message to the participants in the conference was that there were three reasons to raise capital; survival, growth in revenue, and growth in value.

*WHM Capital Advisors President, Bill McAfee (center), Abdul-Haq Mohammed of Trowers and Hamlins (left) and Dan Taylor of First Bahrain at the DTZ Money into Property Conference in Bahrain*

The third is the only legitimate reason for raising capital since growing revenue is no guarantee of producing returns, and surviving is not a long-term objective. Interestingly, when I was giving this talk in September 2008, global capital markets were disintegrating. One year later, capital is now scarcer than ever. Traditional risk measures and valuation techniques are coming into question in terms of their ability to reconcile adequate returns for investors with the risks they take.

Dan graciously facilitated 10 meetings in 4 days. The overarching theme was that capital decisions appear to have been made unsystematically in the past with little analysis of the quantitative costs of capital. In meetings with bankers and economic development officials, it became clear that the prior decisions on capital investment in the region were driven by either "intuition" or "average multiples". This is similar to what our firm regularly hears in the US about investment risk and return decisions in domestic capital markets.

There is no shortage of capital in the GCC, yet there is little appetite to aggressively deploy it. The significant bulk of regional investments went into Dubai real estate over the last five years. Purveyors of capital in the GCC region are adopting a wait–and-see approach to

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future investments. The skepticism is warranted and served as a main topic of conversation during the recent visit.

However, the GCC now has an interesting opportunity as the storehouse of a large supply of the world's private capital. In particular, the opportunity now exists to put capital to work in the US and Europe where banks are struggling to increase reserves for risks on their current balance sheets resulting from their over-aggressive posture in periods leading up to the meltdown. Private US businesses in particular, are dependent to a large extent on debt capital for growth. With banks unwilling or unable to lend to commercial ventures, these businesses will either sell, or look elsewhere for a broader capital market. The GCC is well-positioned to play a role as a source of capital.

US and Europe based real estate and private equity groups that have traditionally used leverage and counted on the ability to exit over a relatively short time period will continue to struggle to meet their shareholder objectives. These groups will be looking for exit opportunities on existing portfolio companies. Capital sources within the GCC can play the necessary role in this need for liquidity. This movement of world capital is a benefit to the whole global capital markets system as those private equity companies redeploy capital from these exits back into the viable private companies who are unable to get bank financing in the foreseeable future not because of their inability to amortize debt, but because banks are unable to make any new debt investments.

A more robust quantitative system for determining costs of capital is essential. The opportunities for the GCC are too important to make decisions based on intuition or basic industry analysis. The use of intuition and average multiples to determine investment suitability is proven flawed in the current environment. As I asked one banker in Bahrain, "If you smoke 20 cigarettes a day, and I smoke 0, does that mean the average is 10?" Unfortunately, this is the valuation methodology most used in private equity investments. Just because one company has sold for 6-times earnings does not necessarily mean that every member of the peer group should expect to sell for the same multiple. Dubai is the GCC's example of the phenomenon. Investors looked around and said, "If everyone else is doing it, I probably can't lose." In conversations, there was a high level of receptivity to our methods of statistical risk modeling for valuing assets on an independent basis using A.Q.U.A.®.

Fortunately, most of the capital sources in the GCC can withstand the downturn in Dubai real estate. What if Dubai based investors had deployed tools to help them identify some of the early warning signs of increasing risk and falling valuations? The opportunity now exists to invest capital in markets with depressed valuations. My meetings there showed that there is an interest to learn from past decisions and deploy improved decision modeling as these opportunities unfold.

*WHM Capital Advisors is a financial advisory firm providing research, analysis and advice to a diversified global client base that includes institutions, corporations and high-net-worth individuals. Founded in 2002, the firm's areas of expertise are valuation consulting, succession planning, mergers and acquisitions advice and investment management. In addition, the firm has a related technology company that designs applications to analyze complex financial issues for clients.*

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