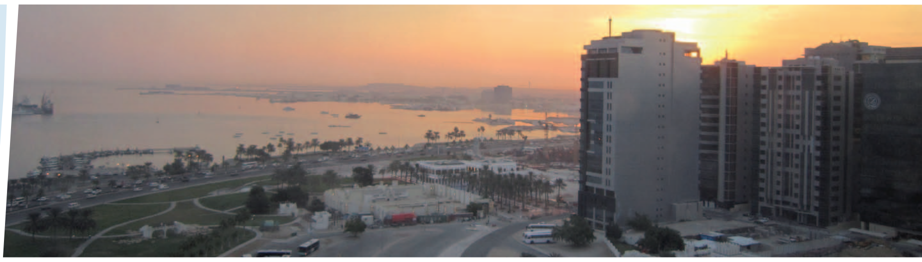

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FEMIP

An Overview

Mobilizing the potential of
GCC Sovereign Wealth Funds for
Mediterranean Partner Countries

European
Investment
Bank

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An Overview

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Mobilizing the potential of GCC Sovereign Wealth Funds for the Mediterranean Partner Countries - Overview

European Investment Bank (supervision)

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This study is financed under the Facility for Euro-Mediterranean Investment and Partnership Trust Fund. The FEMIP Trust Fund which was established in 2004, and has been financed – to date – by 16 EU Member States and the European Commission, is intended to support the development of the private sector via the financing of studies and technical assistance measures and the provision of private equity. It focuses on seven priority sectors financial sector and MSMEs; water and environment; energy; transport; research, development and innovation; urban development and human capital.

The authors take full responsibility for the content of this report. The opinions expressed do not necessarily reflect the view of the European Investment Bank

This document is the executive summary of a larger study and does not necessarily reflect its full content.

1. Abbreviations and acronyms

- **ADIA:** Abu Dhabi Investment Authority
- **ADIC:** Abu Dhabi Investment Council
- **AfDB:** African Development Bank
- **ALAC:** Africa Latin America and Caribbean
- **AuM:** Assets under Management
- **DF:** Development Fund
- **FDI:** Foreign Direct Investments
- **FEMIP:** Facility for Euro-Mediterranean Investment and Partnership
- **GCC:** Gulf Cooperation Council
- **GDP:** Gross Domestic Product
- **HKMA:** Hong Kong Monetary Agency
- **ICD:** Investment Corporation Dubai
- **IDB:** Inter-American Development Bank
- **IFC:** International Finance Corporation
- **IPIC:** International Petroleum Financial
- **JBIC:** Japan Bank for International Cooperation
- **KEXIM**: Export Import Bank of Korea
- **KIA**: Kuwait Investment Authority
- **MASEN**: Moroccan Agency for Solar Energy
- **MDB**: Multilateral Development Banks
- **MENA**: Middle East and North Africa
- **OIF**: Oman Investment Fund
- **PF:** Pension Fund
- **PIF**: Public Investment Fund
- **PPP**: Public Private Partnership
- **QH**: Qatar Holding
- **QIA**: Qatar Investment Authority
- **RAKIA**: Ras Al Khaimah Investment Authority
- **SAFE**: State Administration of Foreign Exchange
- **SAMA**: Saudi Arabia Monetary Agency
- **SGRF**: State General Reserve Fund
- **SWF**: Sovereign Wealth Fund

Over the last five years, Sovereign Wealth Funds (SWFs) have played an increasingly important role in providing capital globally. By attempting to maximize investment returns, SWFs have enhanced their traditional investment approaches by increasing direct investments, increasing their exposure to selective emerging markets and diversifying their portfolio across industries. Hand in hand with these developments the SWFs have built up in-house investment capabilities.

The GCC SWFs are among the largest SWFs in the world with an appetite for direct investments, including infrastructure investments. However, three challenges limit infrastructure investments by GCC SWFs in the FEMIP region. Firstly, SWFs seek to invest with equity (instead of debt). Secondly, SWFs favour investments in mature markets and selective emerging markets which provide more stable cash flows with lower regulatory and political liability (e.g. Asia and Latin America). Thirdly, most GCC SWFs require an internal return rate (IRR) of 15% and a minimum equity stake of at least USD 50 million. Despite a healthy pipeline of infrastructure-related projects in Egypt, Jordan, Tunisia and Morocco, only a handful match GCC SWF requirements. This third challenge is even more important as there are investment opportunities in mature markets and in emerging markets (e.g. Asia and Latin America) offering similar yields, while having more stable investment environments.

1. Introduction to Sovereign Wealth Funds

1.1 Overview of Sovereign Wealth Funds

A SWF is a state-owned investment fund composed of financial assets such as stocks and bonds and to a smaller extent real estate, private equity and other financial instruments. These government funds emerged as far back as the 1950s in oil rich countries to sustain savings for the future. The Arabian Gulf countries, Russia and Norway are typical examples of countries with oil-revenue-funded SWFs. In the 1970s and 1980s Asian SWFs emerged, which derived their funds from the foreign currencies resulting from massive exports to the Western world. Today China, Hong Kong and Singapore are in the top 10 largest SWFs in the world. In recent years, developed countries have also started their own SWFs like Australia, South Korea or France, but with fund sizes 10 to 20 times smaller than the Arabian Gulf or Asian funds.

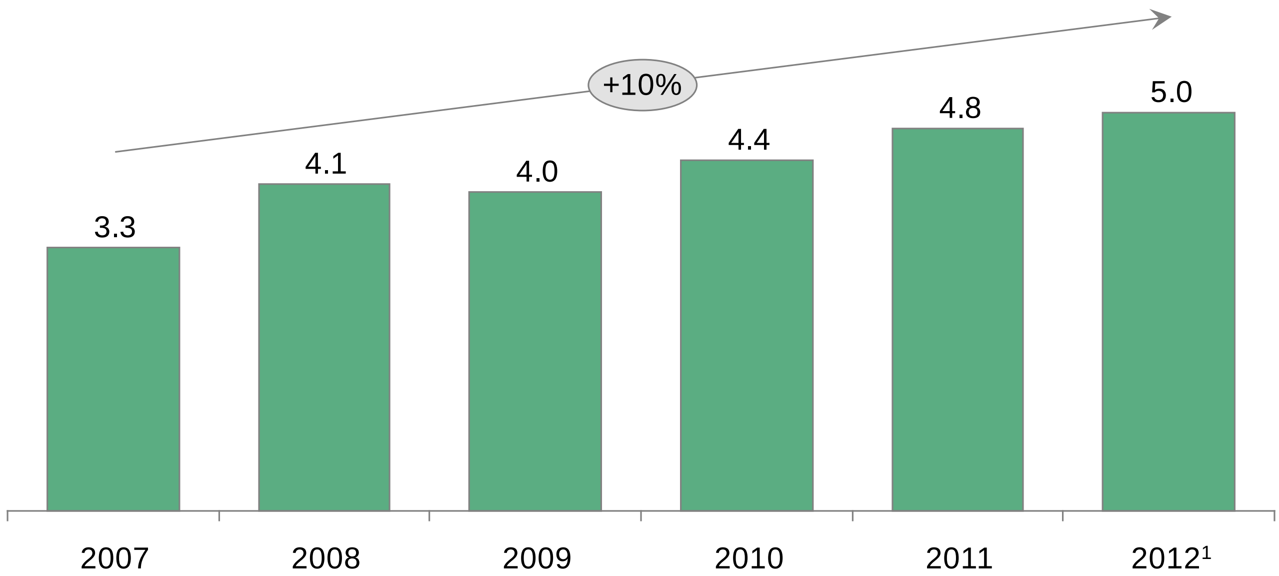
The SWFs have been established for three main motives or sometimes a combination of them:

- Stabilization: protect and stabilize the economy from excess volatility in revenues or exports;
- Future generation fund: increase savings for future generations;
- Government investment arm: fund social and economical development and diversification in the country.

The vast majority of SWFs structure their holdings to maximize investment returns.

Over the last decade, the size and number of SWFs have increased dramatically. Table 1 shows that as of 2012, SWFs in the world collectively manage around USD 5 trillion which corresponds to an annual growth of 10% since 2007. Table 2 illustrates that nearly half the SWFs in the global top 20 are from Gulf States. The rise in oil prices provided these Gulf States with massive amounts of wealth invested through SWFs.

Table 1: assets held by SWFs (in USD Trillion)



1. Assets managed as of May 2012

Table 2: top-20 SWFs by total assets

20 largest SWFs (inception year)	AuM per May 2012 (USD B)	Countries
1.Abu Dhabi Investment Authority (1976)	627	UAE
2.Government Pension Fund - Global (1990)	611	Norway
3.SAFE Investment Company (1997)	568	China
4.SAMA Foreign Holdings (n/a)	533	KSA
5.China Investment Corporation (2007)	440	China
6.Kuwait Investment Authority (1953)	296	Kuwait
7.HKMA Investment Portfolio (1993)	293	Hong Kong
8.Govt of Singapore Investment Corp (1981)	248	Singapore
9.Mubadala Development Company (2002)	177	UAE
10.Temasek Holdings (1974)	157	Singapore
11.National Wealth Fund (2008)	150	Russia
12.National Social Security Fund (2000)	135	China
13.Qatar Investment Authority (2005)	100	Qatar
14.Australian Future Fund (2006)	80	Australia
15.Investment Corp of Dubai (2006)	70	UAE
16.Libyan Investment Authority (2006)	65	Libya
17.Kazakhstan National Fund (2000)	58	Kazakhstan
18.Int'l Petroleum Investment Co (1984)	58	UAE
19.Revenue Regulation Fund (2000)	57	Algeria
20.Korea Investment Corporation (2005)	43	S. Korea

Gulf SWF

Source: SWF institute, BCG analysis

1.2 Sovereign Wealth Funds' direct investment trends and strategy

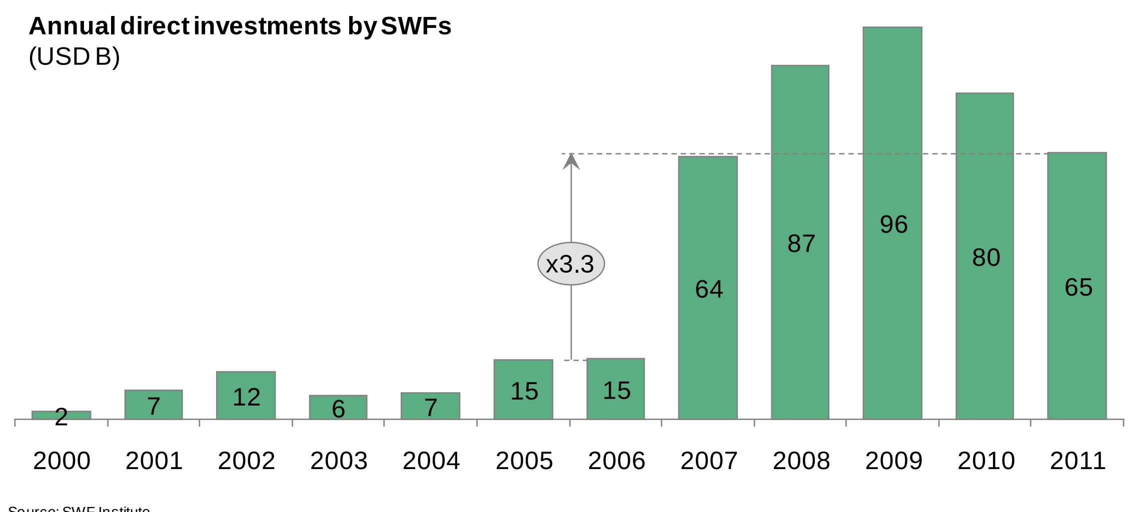
SWFs typically function somewhere in between a Mutual Fund (risk-averse passive investor) and a Private Equity firm (higher risk-tolerance investor). More specifically, SWFs cover a large spectrum of investment strategies, from a more classical passive asset management approach (with few, selected active investments) like Abu Dhabi Investment Authority (ADIA) to an active management of companies in the portfolio like Singapore's SWF Temasek.

SWFs have played a critical role in recent years, notably during the global financial crisis where they acted for many as "white knights", shoring up big companies and banks in the EU and the US with long-term capital. Interestingly though, whereas in the 2000s they were ill-perceived by the public for acquiring "trophy" assets in the Western economies, they are now sought-after in a general context of liquidity drought. However, the post-crisis era has seen SWF investments stall in 2010 and 2011, due mainly to excessive exposure to under-performing European markets. **The financial crisis has also accelerated four trends that can be observed in the direct investment strategies of SWFs.**

Trend 1: Increase in direct investments

As SWFs seek returns beyond benchmarks (Alpha generation) with growing capabilities, they have increased their direct investments significantly since early 2007 as shown in table 3. The financial services sector was a large recipient of SWF direct investments between 2007 and 2011 as it provided a steady source of investment capital that helped stabilize the markets. Secondly the energy, utilities and infrastructure sectors were also significant recipients as these industries became increasingly attractive to SWFs due to the long-term stable returns and the low risks.

Table 3: Annual direct SWF investments between 2000 and 2011



Trend 2: Stronger focus on emerging markets

SWFs investments from the pre-crisis period to 2012 still show a predominant focus on the developed economies, with the US and the UK leading, as shown in table 4. This reflects their predominantly conservative investment philosophy. In addition it is a reflection of the amount and quality of available assets with suitable returns in mature markets (with the exception of China).

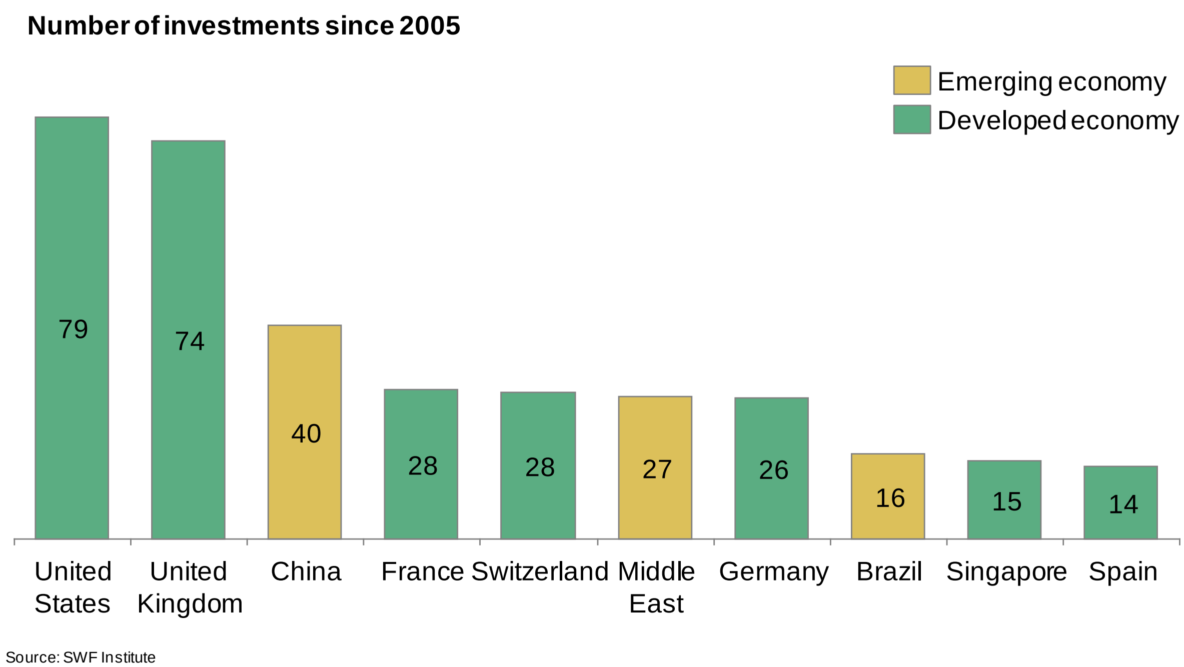


Table 4: SWF investments by geography since 2005

As the crisis in Europe and North America continues and investment returns remain particularly low, SWFs have started increasing their focus on emerging markets (e.g. Asia and Eastern Europe) which offer investment opportunities with higher yields. As an example, Temasek (Singapore SWF) has been increasingly investing in emerging and frontier markets since 2009/2010. In the last two years Temasek started to explore India, Pakistan, Latin America and South Africa. Whereas Temasek used to invest significantly in its home country, in 2010 it carried out 80% of its investments outside Singapore and for the most part in emerging markets.

Trend 3: Industry diversification

The financial services industry has been the largest direct investment recipient sector from SWFs for years, representing one third of total investments. The next three equally large investments are real estate, energy and infrastructure, each at 12% of the total investments. Since 2008 the share of SWF investment into financial services has been gradually declining and the proportion of investments in industrials, materials, telecoms and consumer goods has been increasing. SWFs' sector focus strategy is changing from a few "industry bets" to a broad industry diversification including sectors like retail, healthcare and semi-conductor technology.

Trend 4: Shift from third party managers to in-house management of assets

Many SWFs have emerged in the last decade. The first significant wave of SWF creation is no older than the 1980s. In their early stages, SWFs outsourced most of their asset management to established third party managers. However, in the wake of the financial crisis SWFs have been dissatisfied with the third party managers' performance, the misaligned incentives and high fees. As a result, SWFs are increasingly deploying their capital through in-house teams.

2. GCC Sovereign Wealth Funds

Since the early 2000s the number of SWFs in the Gulf region has grown substantially. The rise in oil prices provided the GCC countries with substantial wealth. At the same time, the relatively small size of their economies and concerns about fuelling inflation meant a large proportion of their revenue had to be invested abroad and managed through SWFs.

Out of the sixteen SWFs operating in the GCC, eight have been selected to assess the potential for investments in infrastructure projects in the Mediterranean partner countries. As shown in table 5, these eight funds were selected as they are investing directly in infrastructure projects and they are investing beyond their home country.

Table 5: Selected GCC SWFs

Fund	Country	Inception year	AuM USD B	In scope of study?
Abu Dhabi Investment Authority (ADIA)	**UAE**	**1976**	**627**	✓
Mubadala	**UAE**	**2002**	**177**	✓
Investment Corporation of Dubai (ICD)	UAE	2006	70	✘
Int'l Petroleum Investment Co	**UAE**	**1984**	**58**	✓
Abu Dhabi Investment Council (ADIC)	UAE	2007	10	✘
Aabar	UAE	2005	10	✘
RAK Investment Authority (RAKIA)	UAE	2005	1.2	✘
Invest AD	**UAE**	**1977**	**0.6**	✓
SAMA Foreign Holdings	KSA	N/A	533	✘
Public Investment Fund (PIF)	KSA	1971[1]	5.3[2]	✘
Kuwait Investment Authority (KIA)	**Kuwait**	**1953**	**296**	✓
Qatar Investment Authority (QIA)	**Qatar**	**2003**	**100**	✓
Qatar Holding	**Qatar**	**2006**	**N/A**	✓
Mumtalakat Holding Company	Bahrain	2006	9	✘
State General Reserve Fund (SGRF)	Oman	1980	8.2	✘
Oman Investment Fund (OIF)	**Oman**	**2006**	**8.2**	✓

1. Initially established 1971 but mandate changed in 2008 2. Actual AUM is much higher as it is a vehicle for MoF to invest in KSA economy
Source: Various public sources, company websites, SWF institute, BCG analysis

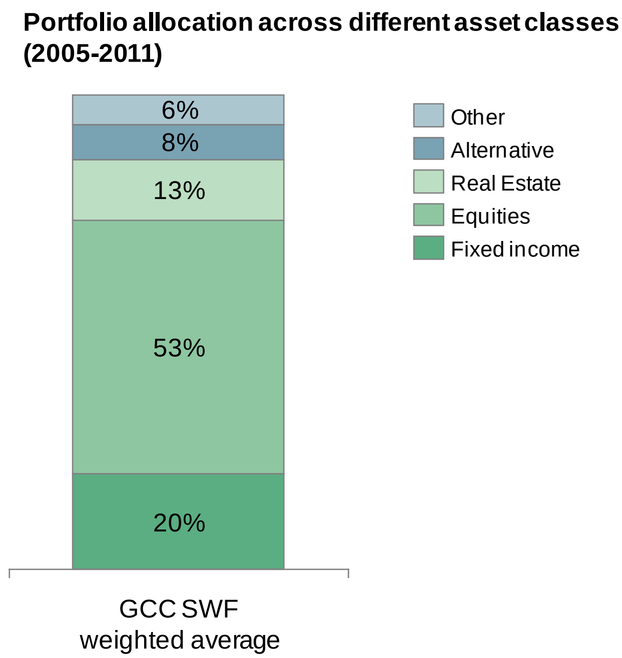
✓ **In scope**
✘ Not in scope

Please note: the financials for SWF used in this report are publicly reported figures and/or figures from various industry reports. They may not reflect the size or composition of the portfolio of an individual SWF correctly. However, we believe that overall they give a fair representation of the SWF investment landscape.

2.1 Current investment strategy

The investment strategy of the GCC SWFs is to maximize returns on investment and in some cases perform synergies and/or acquire capabilities that can be deployed in the home country for building new industry capabilities. Mubadala and the International Petroleum Investment Company (IPIC) typically consider this cross-country portfolio synergy as a criterion next to the investment return and risk.

Table 6: GCC SWF portfolio sector breakdown



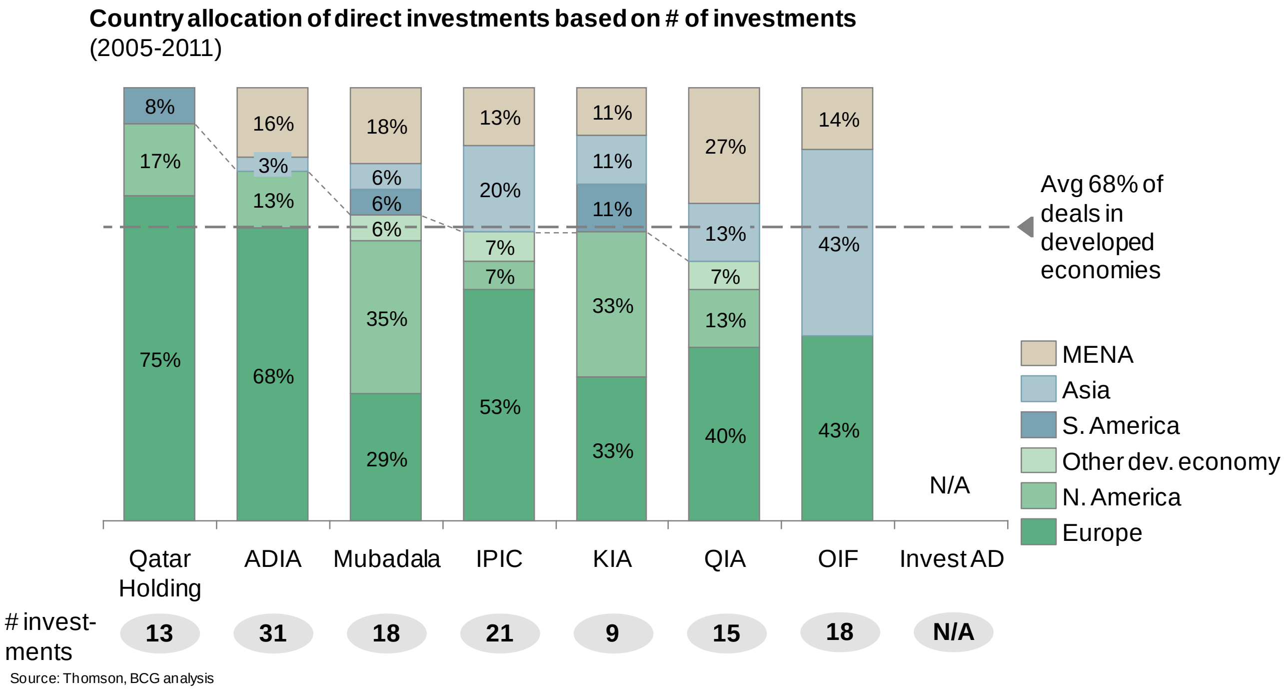
Source: company websites, Sovereign Wealth Fund Institute, JP Morgan Sovereign Wealth Fund Primer 2008

The portfolio structure of GCC SWFs is heavily focused on equity and fixed income, which together represent 70% of total funds allocated on average. As shown on table 6, real estate is the third largest asset class, sometimes up to one third of the portfolio as is the case for QIA. Finally the alternative investments – which include private equity fund participations, investments in hedge funds, commodities and infrastructure – represent a growing share, just below 10% of the total portfolio.

The sector breakdown reveals that financial services remain a core part of the investments, amounting to 30% of total asset allocation on average. QIA is again the GCC SWF, amongst the eight selected, with the highest allocation to financial services (just below 50%). The infrastructure sector is covered by virtually all the GCC SWFs but only represent a small share of their investments, between 5 to 10% of the total portfolio.

About 68% of the GCC SWFs' direct investments are in the developed economies with Qatar Holding as high as 92% as shown on table 7. GCC SWFs have also started increasing their focus on emerging markets, in line with other global SWFs, in an effort to capture higher yields.

Table 7: Selected GCC SWFs' investments per region between 2005 and 2011



2.2 Demand and constraints for investments in target countries

The GCC governments, often through their SWFs, have been active in the target countries for a long time due to close Arab ties with the local governments. KIA was the first GCC SWF to establish a joint-fund with Morocco, a non-GCC Arab country back in 1976. The mandate of the Consortium Maroco Koweitien de Développement (CMKD), as it is known, was and still is to invest in Moroccan real estate, tourism and the financial sector. Nearly forty years later, the predominant GCC SWF investment sectors in the Arab target countries remain real estate, tourism and finance:

- **KIA** invested in three FEMIP markets with **local partnerships**:
  - Morocco: asset acquisition, fund investment and direct participations in tourism, real estate and finance;
  - Tunisia: predominately tourism and real estate;
  - Egypt: planned set up of a USD 1billion listed equity vehicle (financial services).

- **QIA** invested in the same three markets but through its **subsidiary** Qatari Diar:
  - Morocco: USD 600 million investment in a luxury housing and tourism complex;
  - Tunisia: several infrastructure projects in real estate and tourism (seaside resorts);
  - Egypt: real estate investments on the Nile and in Sharm el-Sheikh.

Qatar Holding, **Aabar Investments** (held by **IPIC**) and **KIA** set up a USD 3 billion **joint-fund** (Wessal Capital) with Morocco's Fund for the Development of Tourism. The fund will contribute to the "Morocco 2020" tourism sector ambitions.

Direct investments in the target countries by GCC SWFs have been limited as shown in table 8 and all these investments pre-date the Arab spring, which started in December 2010.

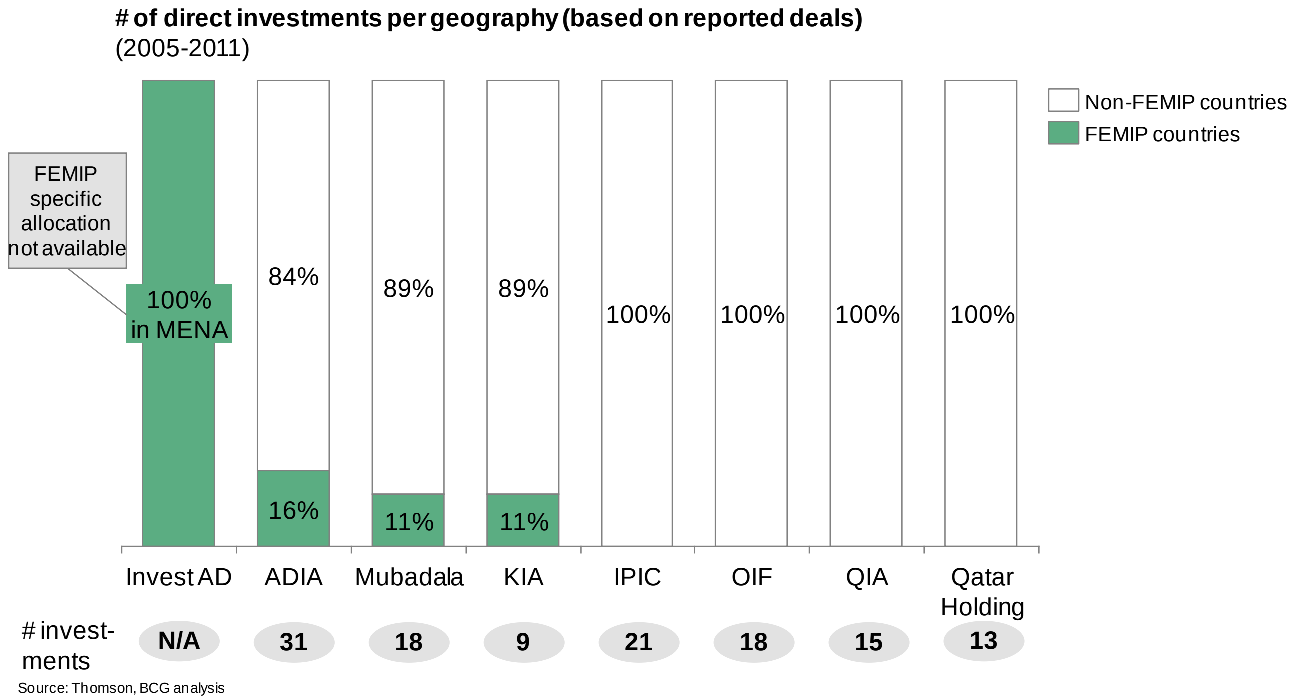


Table 8: Selected GCC SWFs' number of direct investments in FEMIP countries

There are only a few notable direct investments the GCC SWFs have achieved: ADIA has been the most active GCC SWF in the target countries with a strong focus on Egypt in 2007/2008. It invested in construction, financial services and power. Among the GCC SWF direct investments in the target countries, only a few are infrastructure investments. For example, Invest AD took part in the Queen Alia International Airport project in Jordan in 2007.

Two key constraints have limited GCC SWFs investments in infrastructure projects in the target countries:

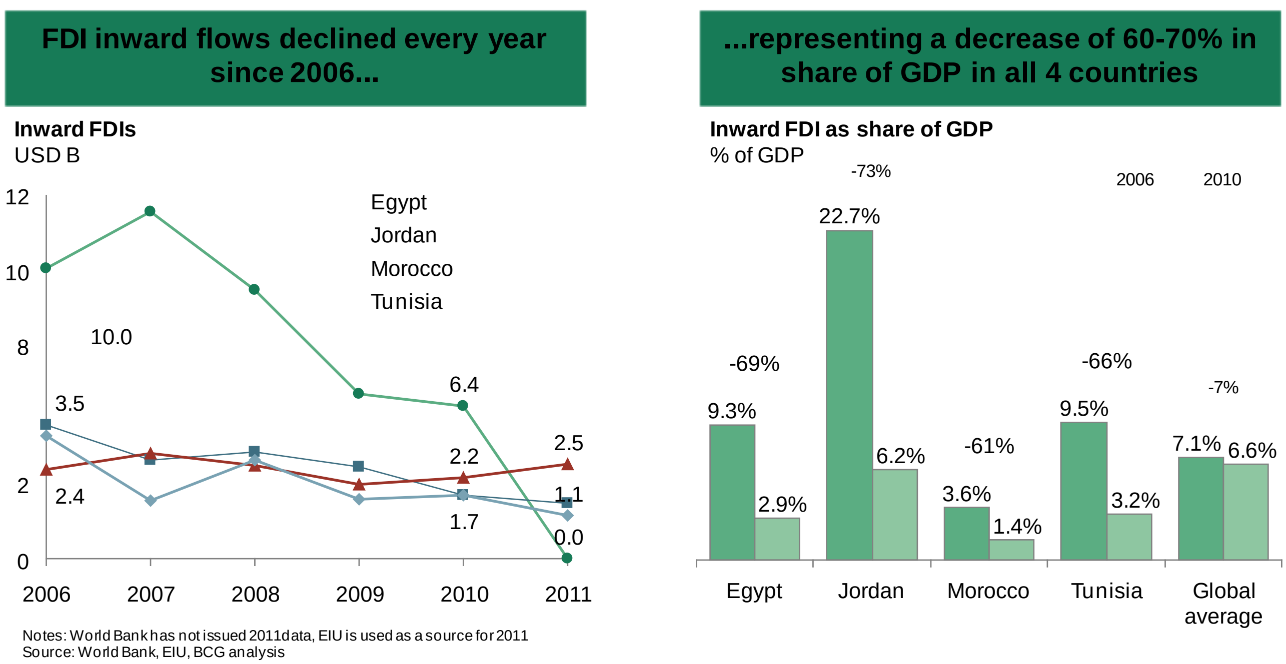
- GCC SWFs prefer mature markets for infrastructure investments. The main reasons are three-fold: Firstly, the availability of assets is higher. Secondly, infrastructure investments in mature markets offer more stable cash flows with less risk. Finally, the legal and economic environment is more stable and the political risk is lower compared to FEMIP countries (especially compared to Egypt and Libya);

- GCC SWFs prefer to invest with equity (and not debt) in infrastructure projects, as most SWFs have return benchmarks for infrastructure investments similar to equities.

3. Supply of projects in FEMIP countries

The last six years has seen Foreign Direct Investment (FDI) inflows into MENA steadily decline because of three major causes. Firstly, the 2007 crisis has seen international capital (and especially European capital) retract from emerging market economies where it supported many infrastructure investments. Secondly, slow progress in investment policy development has deterred investors, notably in those countries where Public Private Partnership (PPP) regulation is either non-existent or not up to international standards: Syria, Jordan, Lebanon and until recently (2010) Egypt. Finally, the Arab Spring has considerably weakened already decreasing FDI inflows into the region (cf. table 9). Investment into North Africa fell by an estimated 42% in 2011, which comes in addition to the 32% cumulative decrease between 2008 and 2010. Most investors are poised waiting for positive political evolution.

Table 9: FDI inward flows into Egypt, Jordan, Morocco and Tunisia between 2006 and 2011



Despite the challenging macroeconomic and political situation, there are a number of important infrastructure-related projects in the pipeline. Most infrastructure projects stem from Egypt, Morocco, Jordan and Tunisia. Table 10 below provides the breakdown of all reported infrastructure-related projects currently planned or running in the four most active target countries.

Table 10: Project pipeline in Egypt, Jordan, Morocco and Tunisia in 2011/2012 based on public source

	Number of projects (within deal value in USD B)				Total number of projects	Total value of deals (USD B)
Sector	**(0.1 – 0.5)**	**(0.5 – 1.0)**	**(1.0 – 5.0)**	**(> 5.0)**		
Power & Water	11	4	6	2	23	**44**
Petrochemicals	3	3	5	0	11	**13**
Infrastructure	5	1	1	0	7	**5**
Oil & Gas	1	1	2	0	4	**5**
Industry	3	0	0	0	3	**0.5**
Total	23	9	14	2	48	**67**

Source: Zawya projects database, BCG analysis

Nearly half the projects in the target countries are below USD 500 million total project value, whereas the large GCC SWFs will typically only consider projects with value above USD 500 million. On the other hand, sixteen projects exceed USD 1 billion in value. Of those sixteen, only one project is infrastructure: the Cairo metro. Despite a good supply of infrastructure-related projects in the target countries, only a few meet SWFs' requirements.

The expansion of PPP's in the target countries may encourage FDI inflow. The main incitements for investment that PPP brings are government participation and enhanced regulation for foreign investments.

Out of the 48 reported projects, approximately one third are operated on a PPP basis. All FEMIP countries have engaged in PPP law design or PPP reforms in order to foster large infrastructure projects.

Egypt

Egypt is the largest FDI recipient in the FEMIP region and the country with the most active project pipeline. Egypt passed a new PPP law in July 2010, bringing the investment procedures closer to international standards and laying down the foundations for a very attractive PPP market.

One of the most important PPP infrastructure projects in Egypt currently is the Rod Al Farag highway with a USD 300 million equity size and an expected IRR of around 16%.

Tunisia

Tunisia has a slow project pipeline currently. No major investment has been started since the revolts started in 2011. Tunisia does not have a PPP law per se but only a "concession" law which is still favourable for PPP investment. However, a dedicated law to PPP would benefit capital entry into the country. The Ras Jedir highway project is one of the largest, currently running with a USD 600 million value.

Morocco

Likewise Morocco operates its large infrastructure projects on a "concession" law basis, leaving the market demand risk on the private sector. Even though this law has succeeded in keeping international investors, a PPP law would allow unification of different existing support initiatives. Several very large scale solar energy projects are planned in Morocco, sponsored by MASEN with combined project values exceeding USD 10 billion.

Jordan

The successful Queen Alia Airport project has shown its potential for PPP investments and the government is currently writing a PPP law to eventually substitute the current government institutions supporting PPP on a project by project basis. The new port at Aqaba is one of the major infrastructure projects to be executed in the next few years.

FEMIP for the Mediterranean

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Facility for Euro-Mediterranean Investment and Partnership

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