The Way Forward for Private Equity in Egypt

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Since the removal of the Morsi-led government from power in July 3, 2013, Egypt has started on a path of *istikrar, istismar* and *istilam*—stability, enhancement of entrepreneurship, and safety and security of the state—that should bolster Egypt's economy. The EGX30, Egypt's key share index, hit a three-year high in early November, with the market up 20% over the previous two months. Private equity activity continues and local private equity players formed the Egyptian Private Equity Association (EPEA) in 2011. In the background of this economic activity, most Egyptians have been focused on the draft Constitution, which was overwhelmingly approved in a two-day vote on January 14 and 15, 2014. The approval of the draft Constitution will set the stage for Egypt to undertake further reforms to create a more favorable environment for private equity and venture capital.

The scope of the economic section of the Constitution is intended to better regulate and liberalize Egypt's economy. Article 27 of the draft Constitution states that the new economic system will aim at achieving prosperity and economic growth through sustainable development and social justice. If passed, it will commit Egypt's economic system to transparency, competitiveness, the promotion of investment, and the prevention of monopolies. Article 28 emphasizes that economic production and service- and information-based activities shall be considered the key components of the national economy. The state will commit to protecting them, increasing their competitiveness, and providing an environment that attracts investment. It also outlines the state's responsibility to work on increasing production, encouraging exports and regulating imports. The Central Bank of Egypt took an important first step in the

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Notable Private Equity Deals in Egypt

1. June 2013: Actis invested US$102 million to acquire a 30% stake in Edita Food Industries

2. February 2013: Swicorp invested US$10 million in Orchidia Pharmaceutical Industries

3. September 2012: Beltone Private Equity invested US$2 million in Bio Pharma Egypt, a manufacturer of nutritional supplements

4. August 2012: Capital Trust Group acquired a minority stake in Sakson Oil & Gas Group

5. April 2012: Capital Trust Group, structured through its fund Euromena II, acquired 51% of Al Oyoun al Dawli Hospital

6. March 2012: Venture capital firm Ideavelopers invested US$1.3 million in DrBridge, a healthcare IT firm

direction of a freer market when it issued a circular on January 6, 2014 lifting some of the restrictions on repatriation of foreign currency established in early 2011 and thereby making it easier for companies and individuals to transfer euros and US dollars out of Egypt. A critical next step for Egypt will be the reform of Egypt's Company Law, which is no longer suited to the needs of domestic or foreign investors.

Egypt’s Company Law

Problems with Egypt's Company Law and the weaknesses of local courts cause most private equity and venture capital investors who make investments in Egyptian company to do so through vehicles incorporated outside Egypt[1], choose foreign law to govern their contracts, and provide that disputes will be resolved through international arbitration outside Egypt. To create a more welcoming environment for foreign direct investment, among other things, Egypt's Company Law must be updated to reflect international norms.

Company Law n. 159 of 1981 is one provision of the Company Law that requires urgent amendment. As currently in force, Company Law n. 159 of 1981 requires that joint stock companies intending to offer shares to the public must offer at least 49% of the shares to Egyptian underwriters for a period of one month, unless an Egyptian founding shareholder has already acquired such percentage of shares prior to the public offering. In addition, a minimum of three shareholders are required at all times and employee participation in company management is mandatory through board membership, share ownership or the establishment of an administrative committee selected from among the employees. Limited liability companies must have a majority partner (at least 51%) who is an Egyptian national or a legal entity incorporated under Egyptian law and fully owned by a local citizen, a minimum of two shareholders at all times, and at least one manager must be an Egyptian national. In all cases, the path to obtaining licenses and authorizations is neither linear nor rapid: ministerial authorizations are often required and bureaucrats can attempt to extort money from license applicants.

Investment Incentives & Guarantees Law

Another law that is due for an update is the Investment Incentives and Guarantees Law n. 8 of 1997, which is often referred to as providing exceptions to Company Law n. 8 of 1981. This law was intended to encourage foreign direct investments in Egypt in specific sectors: manufacturing and mining, logistics, tourism, medical facilities, oil services, infrastructure, and, interestingly, venture capital. At a minimum, the scope of its application should now be expanded to cover foreign direct investment in all sectors. The most important feature of the law is that it allows non-Egyptians to own 100% of Egyptian companies in the relevant sectors, as well as to nominate boards of administrators that do not include an Egyptian citizen. Licenses and permits required by foreign investors are also intended to be easier to obtain, and the General Authority for Investments has established a one-stop shop fully dedicated to assisting foreign investors in obtaining the required permits promptly. Companies falling within Law n. 8 of 1997 can purchase properties, land and construct buildings and plants anywhere (with the exception of the Sinai region) as long as those assets are needed to implement the company's business in Egypt. The law also provides that in no cases can those companies be confiscated or nationalized and their assets cannot be subject to sequester, seizure or expropriation by any administrative order. The Investment Incentives and Guarantees Law provides something of a blueprint for Company Law reform in Egypt generally, begging the question of why the protections and benefits currently granted by the law to foreign investors in specific sectors are not available to all investors —both foreign and domestic.

1. Egypt is a signatory to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the Egyptian Arbitration Law n. 27 of 1994 is closely modelled on the UNCITRAL model arbitration law.

Corporate Governance Code

Egypt's Corporate Governance Code of 2005 also deserves particular attention. Over the years, there have been several attempts at corporate governance reform in Egypt that led to the current version of Code of Corporate Governance. The Code is mainly based on OECD principles and has been firmly endorsed by the Ministry of Investments and the General Authority for Investments and Free Zones. The Code was incorporated into the Code of Corporate Governance for Listed Companies issued in February 2011. The Code for Listed Companies reflects international best practices and corporate governance standards. However, compliance with its rules, as with the Code of Corporate Governance, is voluntary, with the consequence that many companies do not follow either Code and there is no enforcement of the rules. Furthermore, the Code for Listed Companies is lacking a few key provisions even though it has been drafted with a view to adherence to international conventions. It does not contain sufficient measures to grant shareholders the right to timely and complete disclosure of company information, there are no provisions requiring the mandatory involvement of minority shareholders in important corporate decisions, and the rules governing related party transactions do not precisely describe the scope of their application or regulate related party transactions sufficiently.

> "Egypt has an opportunity to build a market in which PE can flourish, but it will only succeed if it amends the Company Law, revises the Code of Corporate Governance, and takes further steps to encourage domestic & foreign investment"

Local Advocacy Priorities

The Egyptian Private Equity Association (EPEA) is advocating for amendment of the Egyptian company and capital market laws in order to create a better environment for private equity deals. Among other things, EPEA is focused on amendments to the Egyptian Capital Markets Law (Law n. 95 for 1992) and its Executive Regulations, including (i) a new chapter in the Executive Regulations of the Capital Markets Law specifically regulating the establishment, registration and operation of private equity funds, asset managers and other fund management vehicles, (ii) a set of rules that amend the regulatory framework for investors' subscription in funds and the transfer of rights and shares between investors, (iii) the simplification of the regulatory framework in connection with the evaluation and pricing of the underlying assets of a fund, (iv) a clearer set of rules for the duties of fund managers, and (v) a simplification of the formation process for new Egyptian funds. EPEA is also focused on supporting amendments to the Company Law that would establish the recognition of common provisions in private equity transactions, including drag-along and tag-along rights, senior ranking for debt and senior equity holders in liquidations, step-in rights, and rights of first offer.

Taxation remains an important positive feature of investing in Egypt. The maximum tax rate applied to corporate profits is 25%. The Investment Incentives and Guarantees Law provides some additional benefits to foreign investors falling within its scope: custom duties can be discounted to a rate of 5%, and corporate profits can be nearly exempt from taxes if a company is based in a free trade area.

In 2007, Goldman Sachs named Egypt one of the N-11, which are eleven countries that have a high potential of joining the ranks of the world's largest economies in the 21st century, and in 2009, the Economist Intelligence Unit ranked Egypt as a member of the CIVETS, the six most favored emerging markets. Egypt now has an opportunity to fulfill that promise and to build a market in which private equity and venture capital can flourish, but it will only succeed if the government applies itself to amending the Company Law, revising the Code of Corporate Governance and taking the other steps required to encourage domestic and foreign investment.

About the Author

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