

Lebanon Taps into the Potential Lying in Innovation and Entrepreneurship



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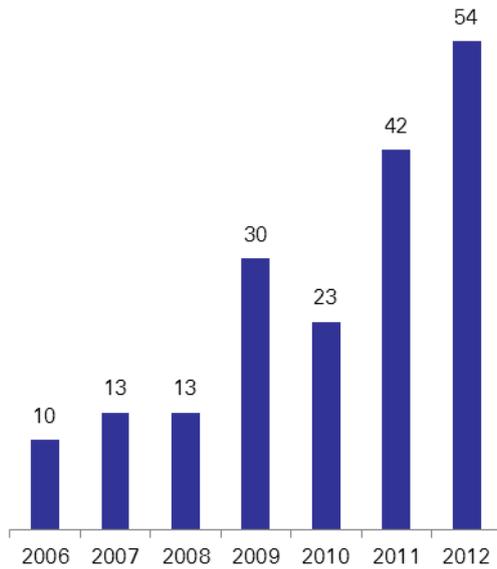
Number of VC Transactions in the MENA Region

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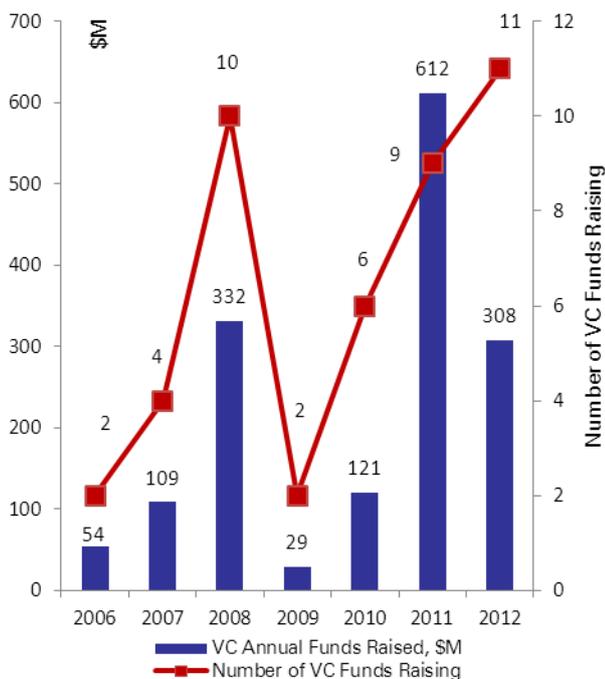
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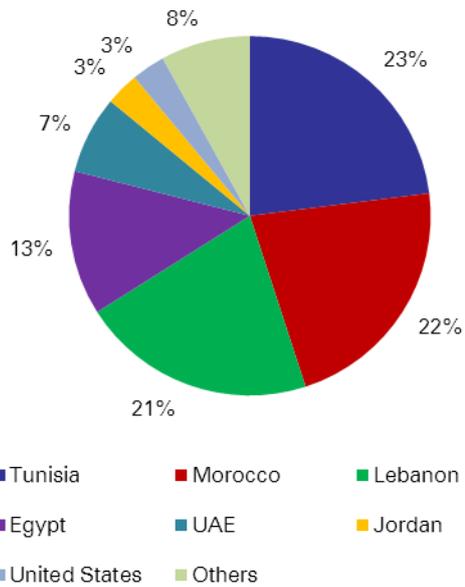
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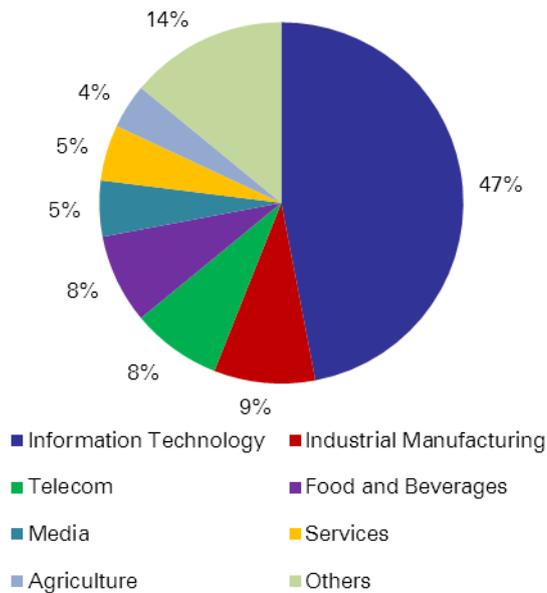
VC Annual Funds Raised in the MENA Region



Country Concentration of VC Deals by Volume, 2010-2012



Sector Concentration of VC Deals by Volume, 2010-2012



Source: Zawya Private Equity Monitor

Embracing Innovation and Venture Capitalism

Lebanon is now unlocking the potential economic benefits held in innovative entrepreneurship, a pillar of growth and development. This truly counts as a budding cultural shift, one that can only be successful if entrepreneurs with new-ideas believe Lebanon is an innovation hotbed and if angel investors, venture capitalists, and most recently commercial banks set the right backdrop to making it one, by rendering equity financing available.

The desire to promote and encourage innovation goes hand in hand with the growth of Venture Capitalism in Lebanon. Venture Capitalists' major role is scanning a large pool of start-ups, detecting the ones with the most solid business model and growth-potential, assisting them in their early-stage growth period and propelling them into long-term growth. VC assistance is not limited to financing but also entails sharing expertise and contact networks which allow the start-ups to adapt to the fast track business environment.

A start-up must be prepared before approaching venture capitalists. The first phase in the start-up's financing cycle is delicate since all there is on the table is a budding idea and financing is limited to "love money" i.e. Friends, family or angel investors providing seed capital to kick-start the business rather than reap high returns on their investment. At this stage, referred to as "the valley of death", there is no steady or significant revenue stream, the entrepreneur incurs many initial costs and the valuation is subjective and minimal. The challenge therefore lies in surviving until the start-up is ready to successfully approach a VC.

After VCs are approached, the entrepreneur often opts for several rounds of financing. As they gather funds through multiple rounds, entrepreneurs are fine-tuning their product/service and growing their structure while being in touch with the market. In this process, if the product/service is gaining traction, the value of the company is technically increasing and allowing the entrepreneur to gather more funds in the coming round with minimum dilution of ownership.

What VCs have to Offer...

A developed VC industry has the potential to generate a slew of positive effects on Lebanon's economy such as job creation and higher competitiveness across various industries, both leading to higher overall growth. Essentially, VC would give the economy a sense of rejuvenation. The fresh Lebanese graduates will be able to steer away from the traditional career paths of medicine, engineering, law or stable high-growth jobs and explore the idea of becoming innovative entrepreneurs. As the VC space grows stronger and more organized, accessing finance to turn an idea into a profitable and scalable business becomes more of an achievable goal.

VC activity also encourages entrepreneurs of all stages to invest in Research and Development (R&D). R&D allows the future entrepreneur to learn all there is to know on the sector he is looking to tap, and gives the established entrepreneur the ability to understand and even anticipate the dynamics at play in his/her market. Awareness in regard of the benefits of R&D is yet to be raised in Lebanon, which ranked 127th out of 144 countries in terms of company spending on R&D by the World Economic Forum (WEF).

What Lebanon has to Offer...

A robust educational system is essential for the innovation landscape as it molds the country's future entrepreneurs. Lebanon has no shortcomings on this front, ranking 28th out of 144 countries for the quality of the educational system and 5th for the quality of math and science education according to the World Economic Forum. However, Lebanon is not fully reaping the rewards of this qualified pool of labor and that due to the "brain-drain" phenomenon. The qualified men and women are being drawn to grow their business or career abroad. An essential infrastructure reform and enhancement, particularly electricity and internet, is required to keep the technical innovators interested in Lebanon.

Lebanon and VCs: Strong Match even in Tough Times

Lebanon has had a challenging economic landscape since 2011 till this day but still witnessed a steady growth in venture capitalism activity. An unstable local and regional security situation along with numerous political deadlocks have had wide-reaching consequences on the Lebanese economy, subduing the core sectors of construction, real estate, and tourism. In spite of this backdrop, Lebanon ranked 59th out of 144 countries in terms of venture capital availability in the 2014-2015 edition of the World Economic Forum's Global Competitiveness Index up from the 62nd place in the 2013-2014 edition. The rise of VC availability can be explained by the fact that venture capitalists are risk takers who back entrepreneurs in "sickness and in health". VC is even a gateway for a country to regain economic strength through higher competitiveness and reduced unemployment.

Central Bank Gives the Knowledge Economy a Boost

It's precisely because the economy is in need of a boost that the central bank (Banque du Liban, BDL) issued circular #331, allowing the banks to be not only lenders but also investors in the knowledge economy. One of a kind in Lebanon, this circular stipulates that commercial banks now have the chance to finance startups, venture capital firms, accelerators, incubators, all part of the knowledge economy, through equity.

The circular has already been perceived as promising by banks, VCs and startups alike. After concluding around 15 investments in technology startups, Berytech, aiming for an average of \$30M for its second fund Berytech Fund II, has already gathered funds from Lebanese commercial banks, including Blom Bank. Blom Bank, along with Bank Audi, Bank Med, Banque Libano-Francaise and a few others have also pledged funds for Middle East Venture Partners' (MEVP) new \$50M fund. Hala Fadel, fund manager at Comgest, along with entrepreneurs Henri Asseily and Herve Cuvilliez are also setting up a fund under Leap Ventures with a target of \$100M and an initial objective of \$50M, to be gathered from banks mostly and from some of the partners' own investments. Al-Mawarid Bank and Beirut Angels set the #331 circular in motion by offering more than \$300,000 to Presella, an online tickets and events reservation application. Beirut Angels is a local business angels' network launched in 2013 by former Minister of Telecom Nicolas Sehnaoui, Hala Fadel, Chairperson of the MIT Enterprise Forum and Louay Al Kadri, co-founder and CEO of Presella.

All stakeholders in the knowledge economy which are operating under the wing of BDL's circular must be careful not to over-supply the market. With new money coming in, equilibrium must be struck between supply and demand especially that new demand for money needs time to materialize. With all the VCs that have embarked on the #331 journey planning to invest over a span of around four years, pumping \$30M each year would be an acceptable deployment of funds that the market can absorb.

Different scenarios might play out when the new funds are deployed on the market. If VCs have too much money on their hands that they need to invest while the market has very few attractive opportunities, the startups might benefit from overvaluations.

However, if the new money creates a "VC oligopoly", the VCs get the upper hand. When only a few VCs control the market, startups might not have a vast array of choices and will find themselves compelled to select one of the key market players to access funding and technically lose ground in terms of negotiations.

The funds to be deployed under circular #331 might also incite other venture capital firms to enter the market or simply create a healthy competition amongst existing VCs which would then be a win-win situation for both parties. Prior to the circular, the market was characterized mostly by small funds and ticket-sizes, much co-investing and deal-sharing. This situation is likely to change once competition on the market heats up with larger funds and more proprietary deals emerging.

According to Mr. Omar Christidis, founder and CEO of ArabNet, an events and media company for the Arab digital industry, in order to gain a competitive edge, VCs must show that they can add value beyond money or/and seek to be the most visible and the most accessible on the market, which allows them to gather a substantial flow of deals. He also stressed on the fact that VCs must be keen on preserving a sound market reputation, as this element is a heavy-weight in the start-up community.

What Needs to be Done?

With large sums of money in the VC pipeline, a higher deal flow is needed. This deal flow needs to be generated by accelerators and incubators that foster the creation of start-ups. Accelerators and incubators offer early-stage entrepreneurs the mentorship and the training they need to transform a mere idea into a viable product that can garner success when it's launched and that can attract VCs. However, Lebanon needs more of these "start-up" generators today to increase the deal flow and allow the money in the VC pipeline to be utilized in worthy-investments. Hence, it goes without saying that the VC world and the accelerator and incubator ecosystem are complementary.

Setting the innovative entrepreneurship on a growth path requires better communication channels amongst all stakeholders. Entrepreneurs, Accelerators & Incubators, Venture capitalists and most recently Lebanese banks have to embrace the approach of continuous learning to keep up with the ever-evolving start-up world.

In order to foster innovation, efforts to enhance intellectual property protection must be on Lebanon's to-do-list. An innovator needs to make sure that his product is protected by the rule of law. Lebanon must increase efforts on this front as the World Economic Forum (WEF) ranked it 139th out of 144 countries in terms of intellectual property protection. However, in terms of capacity for innovation, Lebanon climbs in the ranking all the way up to the 54th spot, meaning that potential exists but simply needs to be nurtured.

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