Private Equity in Africa: An Evolving Market

Derick Appia-Kubi
Johnson MBA ’13
5/22/2013
- Evolution of Private Equity in Africa
- Why Africa?
- Deal Flow
- Market Players
- Fundraising
- Transactions
- Investment Value
- Exits
- Success Stories
- Challenges & Risks
The Africa of today is the beginning transformation of…

- **54** African sovereign countries
- **1 billion** People in Africa
- **52** The number of African cities with more than 1 million people each
- **60%** Africa’s share of the world’s total amount of uncultivated arable land
- **860 billion** Africa’s combined consumer spending
- **20** The number of African companies with revenues of at least $3 billion

Source: McKinsey Report – Lions on the move, June 2010
$2.6 trillion  
Africa’s collective GDP in 2020

$1.4 trillion  
Africa’s consumer spending in 2020

1.1 billion  
The number of Africans of working age in 2040

128  
The number of African households with discretionary income in 2020

50%  
The portion of Africans living in cities by 2030

Source: McKinsey Report – Lions on the move, June 2010
The evolution of private equity in Africa started in South Africa and evolved to countries across Africa.

- History of private equity in Africa dates back to the late 1980s with the emergence of funds based and focused on South African.
- In the early 1990s Development Financial Institutions supported fund managers with a broader mandate to invest across Africa.
- The early 2000’s witnessed an increase of funds generated by western-educated African general partners with a Pan-African investment focus.
What makes private equity in Africa attractive?

- PE penetration lags behind increasing GDP growth
- Increase Foreign Direct Investment provides more access to capital
- Political stability and stricter governance
- Growing middle class indicates increase in purchasing power
- Regional cooperation among countries
- Great opportunities but limited capital input
Private equity firms invested $1.13 billion through 58 deals throughout Africa in 2012 but mostly in smaller deals.

- Private equity investment activity was spread across Africa but East Africa claimed the largest deals.
- 45% of 2012 PE deals in Africa occurred in Kenya, Nigeria, and South Africa versus 60% in 2011.
- Most deals reported existed within the $0 - $5 million range, representative of the focus on SME investing.
- Direct Foreign Investments remain strong but there is a lack of large PE-friendly deals.
Industry specific investments by private equity firms is the key to unlocking economic acceleration in Africa.

Deal activity in Africa reflects a focus on financial services, manufacturing & industrials, and agriculture: three key industries integral to the development of emerging market countries.
A range of established and new PE firms have raised funds focused on investing in Africa.

**Established:**
- Ethos
- Actis
- Kingdom Zephyr

**New:**
- Carlyle ($750M)
- BTG Pactual ($1B)
- Helios ($900M)

75+ Africa-focused private equity funds investing in Africa.

- 75+ PE firms launched Africa-specific funds to support PE activity in Africa.
- New PE players such as Carlyle, BTG Pactual, and Helios have penetrated a continent dominated by established player the likes of Ethos, Actis, and Kingdom Zephyr.
- Sub-Saharan, Southern, and Eastern Africa launched greater funds in 2012.

![Number and (Value US$) of Fund Launches in 2012 by Targeted Region](chart)
An increase of capital raised for Africa is targeting frontier markets outside of South Africa

- In the last five years PE firms targeting opportunities in Africa raised $9.3 billion
- For over decade capital was mostly directed to South Africa but now frontier markets outside of South Africa is gaining great attraction
- Currently South Africa makes up less than 10% of funds raised
PE transactions in Africa focus on hands-on value creation beyond simple financial engineering and severe cost-cutting

<table>
<thead>
<tr>
<th>Value Creation</th>
<th>Why? / How?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assemble the right team</td>
<td>Help portfolio company management by assembling dedicated internal portfolio teams to maximize the growth potential</td>
</tr>
<tr>
<td></td>
<td>Hire talent and resources to unlock value in the portfolio</td>
</tr>
<tr>
<td></td>
<td>Train executives within the portfolio company</td>
</tr>
<tr>
<td>Drive operational improvements</td>
<td>Achieving operational improvements is the key source of value creation so get involved in the day-to-day decisions</td>
</tr>
<tr>
<td></td>
<td>75% of firms get involved by strengthening standard financial and operating performance reporting</td>
</tr>
<tr>
<td></td>
<td>Chances of improving profit margins are greater if an industry expert is deployed to work with the portfolio company</td>
</tr>
<tr>
<td>Develop company vision and growth strategy</td>
<td>Hire an industry expert to help portfolio company develop a long-term vision and consult on key areas of the business</td>
</tr>
<tr>
<td></td>
<td>PE firm helps company to expand margins by increasing and revenue streams while applying strict processes to reduce cost</td>
</tr>
<tr>
<td>Provide a diverse network with strong relationships</td>
<td>Companies need the vast network and relationships provided by PE firms in order to create synergies and growth opportunities</td>
</tr>
<tr>
<td></td>
<td>Build scale by identifying M&amp;A targets, helping with regulators, introducing new clients or suppliers, and identifying strategic buyers and exit opportunities</td>
</tr>
</tbody>
</table>
Short-term investment in emerging markets returns 16% while investing in Africa returns double the public market rate.

Stagnant returns in markets of US and Europe, have influenced PE firms to invest in emerging markets but it is unclear if returns are substantial there.

Short-term investments (5yr horizon) outperformed public stocks and developed markets however a long-term outlook (10yr horizon) showed equal performance.

Relative to Africa, PE in Africa has returned almost double to investors what they might have achieved on public markets due to PE’s strategic and operational improvement.

The IFC reports its Africa portfolio has historically outperformed their entire emerging market portfolio between 2000 – 2010 at 21.7% return given 42 Sub-Saharan African funds.
Doubling returns stem from vetting management team, making governance changes, and giving access to their networks.

- Getting to know and backing the right management team is very vital for the success of returns in African deals so extensive management due diligence is important.
- Improving the environmental, social, and governance policies of portfolio companies improves company performance and give strategic buyers the confidence to buy.
- Providing access to networks more than generates double the returns.

Figure 8. PE firms’ knowledge of management teams prior to investing

- Extensive due diligence on management: 29%
- Limited/no due diligence on management: 13%
- Had a prior relationship with management team, entrepreneur or sponsor: 58%  

Relative returns

- Had a prior relationship with management team, entrepreneur or sponsor: 1
- Limited/no due diligence on management: 0.2
- Extensive due diligence on management: 2.5

Source: How do private equity investors create value?: 2013 Africa Study, Ernst & Young and AVCA, 2013

Figure 9. Governance changes in portfolio companies

- Governance changes: 15%
- Limited/no governance changes: 85%

Relative returns

Source: How do private equity investors create value?: 2013 Africa Study, Ernst & Young and AVCA, 2013

Figure 10. PE firms providing portfolio companies with access to their networks

- Access to PE firm’s networks: 33%
- No access to PE firm’s networks: 67%

Relative returns

Source: How do private equity investors create value?: 2013 Africa Study, Ernst & Young and AVCA, 2013
Africa private equity not only source deals but also have a focus on a variety of promising exit opportunities

- 118 exits by PE firms were recorded between 2007 – 2012, private sales are not included.
- High number of exits in 2007 attests to the resilience of Africa during global financial crisis.
- Sales to strategic buyers account for about half of all exits, strong involvement of regional and local buyers is evident of a strong pan-African market.
- An increase of PE buyouts signifies a mature African market as larger PE funds are raised.
Exits show momentum across all regions and various sectors with financial services leading

- 58% percent of exits were across Africa while 42% occurred in South Africa
- Large markets of South Africa, Nigeria, Egypt, Ghana, and Kenya accounted for 74% of exits
- Financial sector has the highest number of exits due to banking reforms in countries such as Ghana and Nigeria
- As disposable income increases, financial services are becoming an important part of the economic landscape prime for PE investors looking to penetrate the African market

Figure 2. Exits by region

Figure 3. Financial services most active sector, driven by growth in consumer
Success stories of private equity investments and exits have occurred throughout the years. The more successful PE deals occur, the more momentum is created for PE firms to invest in Africa.
Challenges and risks that exist for private equity firms interested in Africa are minimal and can be mitigated

<table>
<thead>
<tr>
<th>Risk</th>
<th>Description</th>
<th>Mitigation</th>
<th>Risk Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shallow Talent Pool</td>
<td>▪ Lack of experienced fund managers for investors to invest in&lt;br&gt;▪ Companies prime to invest lack management talent</td>
<td>▪ Increasing numbers of fund managers are establishing local team in Africa with and hiring Africans from the diaspora with proper education and training&lt;br&gt;▪ Fund managers can bring substantial value-add expertise to portfolio companies lacking talent</td>
<td>Shallow</td>
</tr>
<tr>
<td>Political Risk / Corruption</td>
<td>▪ Political risk once overshadowed Africa in the wake of dictators and civil wars&lt;br&gt;▪ Companies can be affected due to transition of governments</td>
<td>▪ Greater stability as democracies mature which creates a business friendly environment to the world&lt;br&gt;▪ Africa is shedding any perception of corruption, 67% of LP’s view Africa as attractive for investment&lt;br&gt;▪ Do not invest in government-backed companies</td>
<td>Shallow</td>
</tr>
<tr>
<td>Weak Exit Environments</td>
<td>▪ Exit opportunities is a hurdle to attracting capital&lt;br&gt;▪ IPOs are less frequent given liquidity in the public markets</td>
<td>▪ Many successful exits have occurred through sales to strategic buyers that are consolidating&lt;br&gt;▪ Regional centers such as Lagos, Johannesburg, Nairobi are developing pockets of liquidity</td>
<td>Shallow</td>
</tr>
<tr>
<td>Not enough scalable deals</td>
<td>▪ Lack of consolidation of businesses minimizes the number of big ticket deals</td>
<td>▪ Invest in companies with the vision to scale up through acquisitions and position for sale&lt;br&gt;▪ The expansion of banking sector across nations is being adopted by other industries</td>
<td>Shallow</td>
</tr>
</tbody>
</table>
Conclusion: Private Equity in Africa is a world of opportunity

- Africa is the fastest growing investment regions in the world today
- Maturing markets and rising opportunities has attracted established investors as Africa-focused funds are growing demonstrating successful exit landscape
- Traditional barriers to entry such as poor developed financial markets, political instability, and economic fragmentation are being broken by political reform and economic growth
- Private equity manager in Africa continue expand their track record of success and post impressive returns compared to global markets
### Figure 6. Selected deals in Africa 2010 and 2011

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Company</th>
<th>Deal value (US$m)</th>
<th>Country</th>
<th>Firm</th>
</tr>
</thead>
<tbody>
<tr>
<td>3-Oct-11</td>
<td>Tracker Network Ltd.</td>
<td>434</td>
<td>South Africa</td>
<td>Actis Capital LLP, RMB Ventures Ltd.</td>
</tr>
<tr>
<td>30-Aug-11</td>
<td>Universal Industries Corporation Ltd.</td>
<td>184</td>
<td>South Africa</td>
<td>Ethos Private Equity Ltd.</td>
</tr>
<tr>
<td>6-Jan-11</td>
<td>InterSwitch Ltd.</td>
<td>110</td>
<td>Nigeria</td>
<td>Helios Investment Partners LLP, Adlevo Capital Managers LLC</td>
</tr>
<tr>
<td>11-Sep-11</td>
<td>Rift Valley Railways</td>
<td>110</td>
<td>Kenya</td>
<td>Citadel Capital, African Agriculture Fund, IFC</td>
</tr>
<tr>
<td>12-Jan-10</td>
<td>Seven Energy Nigeria Ltd. (minority %)</td>
<td>48</td>
<td>Nigeria</td>
<td>Capital International Inc., Standard Chartered Private Equity</td>
</tr>
<tr>
<td>13-Jul-11</td>
<td>Denny Mushrooms Ltd.</td>
<td>38</td>
<td>South Africa</td>
<td>RMB Ventures</td>
</tr>
<tr>
<td>27-Jul-10</td>
<td>Mediterranean Smart Cards Co.</td>
<td>30</td>
<td>Egypt</td>
<td>Actis Capital LLP</td>
</tr>
<tr>
<td>14-Mar-11</td>
<td>Metago International Holdings</td>
<td>11</td>
<td>South Africa</td>
<td>3i Group plc</td>
</tr>
<tr>
<td>8-Mar-10</td>
<td>C &amp; I Leasing plc</td>
<td>10</td>
<td>Nigeria</td>
<td>Aureos Capital Ltd.</td>
</tr>
</tbody>
</table>

Source: Dealogic, Thomson One, Bloomberg.com
New funds raised for investments in Africa

<table>
<thead>
<tr>
<th>Status</th>
<th>Fund</th>
<th>Manager</th>
<th>Fund type</th>
<th>Closed or target size (US$m)</th>
<th>Industry focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closed 30-Sep-10</td>
<td>African Global Capital II</td>
<td>Och-Ziff Capital Management</td>
<td>Balanced</td>
<td>400</td>
<td>Energy, mining, natural resources</td>
</tr>
<tr>
<td>Closed 13-Oct-11</td>
<td>African infrastructure investment Fund II</td>
<td>African infrastructure investment Managers</td>
<td>Infrastructure</td>
<td>500</td>
<td>Infrastructure</td>
</tr>
<tr>
<td>Closed 26-Jul-10</td>
<td>ECP Africa Fund III</td>
<td>Emerging Capital Partners</td>
<td>Growth</td>
<td>613</td>
<td>Telecoms, consumer products, financial services, oil &amp; gas, mining, insurance</td>
</tr>
<tr>
<td>Closed 13-Jun-11</td>
<td>Helios Investors II</td>
<td>Helios Investment Partners</td>
<td>Buyout</td>
<td>900</td>
<td>Telecoms, health care, consumer products, financial services, agriculture, infrastructure</td>
</tr>
<tr>
<td>Closed 27-May-11</td>
<td>Capital Alliance Private Equity III</td>
<td>African Capital Alliance</td>
<td>Growth</td>
<td>450</td>
<td>Diversified</td>
</tr>
<tr>
<td>Closed 11-Feb-10</td>
<td>Pan African Investment Partners II</td>
<td>Kingdom Zephyr</td>
<td>Growth</td>
<td>492</td>
<td>Telecoms, consumer products, financial services, energy, insurance, property</td>
</tr>
<tr>
<td>Raising</td>
<td>Carlyle Africa Fund</td>
<td>Carlyle Group</td>
<td>Buyout</td>
<td>750</td>
<td>Consumer products, financial services, agriculture, energy, infrastructure</td>
</tr>
<tr>
<td>Raising</td>
<td>Ethos Private Equity Fund VI</td>
<td>Ethos Private Equity</td>
<td>Buyout</td>
<td>750</td>
<td>Technology, consumer products, retail, manufacturing, financial services, diversified, infrastructure, telecom media</td>
</tr>
<tr>
<td>Raising</td>
<td>8 Miles Fund I</td>
<td>8 Miles</td>
<td>Buyout</td>
<td>450</td>
<td>Diversified</td>
</tr>
<tr>
<td>Raising</td>
<td>EVI Capital Buyout Fund</td>
<td>EVI Capital</td>
<td>Buyout</td>
<td>400</td>
<td>Diversified</td>
</tr>
</tbody>
</table>

Source: EMPEA Industry Statistics, Q3 2011 release
Sectors with opportunities for PE investments across Africa

**Central Africa**

- Green Energy/Clean Tech: 13
- Other: 10
- Support Services: 9
- Financial Services: 8
- Agriculture/Agribusiness: 6
- Travel/Hospitality/Leisure: 6
- Retail: 6
- Education: 4
- Technology, Media & Telecommunication: 4
- Manufacturing & Industrials: 4
- Healthcare & Pharmaceuticals: 3
- Food & Beverage: 3

**Eastern Africa**

- Real Estate & Construction: 63
- Infrastructure: 63
- Retail: 63
- Education: 61
- Manufacturing & Industrials: 57
- Power/Oil & Gas/Utilities: 57
- Financial Services: 55
- Travel, Hospitality & Leisure: 54
- Healthcare & Pharmaceuticals: 54
- Technology, Media & Telecommunication: 53
- Food & Beverage: 52
- Support Services: 50
- Agriculture/Agribusiness: 50
- Green Energy/Clean Tech: 30
- Other: 30

**Southern Africa**

- Other: 40
- Travel/Hospitality/Leisure: 31
- Support Services: 30
- Manufacturing & Industrials: 29
- Agriculture/Agribusiness: 27
- Food & Beverage: 26
- Retail: 25
- Infrastructure: 25
- Green Energy/Clean Tech: 25
- Healthcare & Pharmaceuticals: 24
- Real Estate & Construction: 22
- Financial Services: 22
- Education: 21
- Technology, Media & Telecommunication: 21
- Power/Oil & Gas/Utilities: 14

**Western Africa**

- Other: 29
- Power/Oil & Gas/Utilities: 20
- Food & Beverage: 19
- Healthcare & Pharmaceuticals: 18
- Technology, Media & Telecommunication: 18
- Agriculture/Agribusiness: 14
- Financial Services: 14
- Infrastructure: 13
- Real Estate & Construction: 13
- Green Energy/Clean Tech: 13
- Education: 11
- Manufacturing & Industrials: 11
- Support Services: 10
- Travel/Hospitality/Leisure: 8
- Retail: 5
Resources

Publications:
- Private Equity Roundup – Africa, Ernst & Young, Feb. 2012
- Harvesting growth: How do private equity investors create value, Ernst & Young, 2013
- Global Private Equity Report 2012, Bain & Company
- Building Bridges: 2012 Africa attractiveness survey, Ernst & Young, 2012
- Private Equity Climate in Africa: Embracing The Lion, Avanz Capital, 2012

Websites:
- http://www.privateequityafrica.com/
- http://www.empea.org/regions/sub-saharan-africa/
- http://vc4africa.biz/blog/2013/05/14/private-equity-in-sub-saharan-africa-seeing-beyond-the-waves/