



Bright Africa

**A guide to equity investing
on the continent**

2014



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1 Introduction



In 2000, Africa began the long process of catching up to global living standards and economic output. Evidence of this change can be seen in the continent's share of global GDP, which has grown from 4.2% in 2008 to 4.5% in 2013. This may not seem like much, but increasing the global share of GDP requires countries to outperform global growth levels consistently over time. In Africa this has been achieved through sustained growth rates across the continent of more than 6% per annum for ten years. It has further seen Nigeria show the world's third highest growth in share of global GDP, behind only the phenomenal growth stories of China and India.

These impressive changes, paired with slowdowns in some other emerging markets, have resulted in a higher level of attention to Africa from around the world. Investors now need to understand whether Africa has a place in their portfolios, and if so, how they will access what the continent has to offer.

The first Bright Africa report was launched in 2013 as an initial response to these questions. We are pleased to launch the 2014 edition with improved coverage of both listed and unlisted equity markets. This 2014 edition has detailed coverage of listed markets on the continent, including an analysis of transaction costs on various exchanges, the truly investible universe of the exchanges (free-float adjusted), and sector pricing across major countries. We have further added analysis of Africa's mergers and acquisitions (M&A) activity, which gives a broader sense of transactional activity, both in terms of where the acquirers are coming from and which sectors are receiving investment. M&A activity is also important as an exit route for private equity, as trade sales account for the majority of exit transactions.

We have extended the work done previously on private equity transaction multiples, and now have more than 240 transactions in our database. The analysis of these transactions shows that African deals continue to be more attractively priced than those globally, and use significantly less debt than other parts of the world.

In order to generate the report, RisCura has used public data from a number of sources, as well as data gathered from our internal databases and network within the African investment community. RisCura would like to thank all of those who contributed time and data to the authors.

We hope that the analysis contained in the report serves as a useful starting point for those looking at Africa for the first time, or provides more detail for those more familiar with investing on the continent. We continue to be excited by the development, growth and potential of Africa and look forward to reporting on its on-going development.

Yours sincerely

Rory Ord
Head of Private Equity
RisCura



2 Key themes

Increased capital flows to Africa are financing strong growth

Since the financial crisis global flows of capital have been re-directed to emerging markets on concerns over developed market growth. Africa has benefitted from these flows as improved capital availability has helped to fund high levels of growth through FDI and portfolio flows into listed and private equity. There are now 8 African economies with GDP of over USD100 billion and more than 1000 mergers and acquisitions reported each year at a value of around USD35 billion.

African markets are accessible at reasonable multiples

Listed market price to earnings multiple (P/E) average a little below the emerging markets average and are significantly below the developed market average. The consumer staples sector is the highest priced sector on the continent on a P/E basis across most markets while other sectors are at lower levels. Private equity transaction multiples are still below global levels, and are well below multiples observed in the BRICs. Private equity deal multiples are fairly consistent across major sectors in the 5-7x EBITDA range.

Nigeria has been a global star since the turn of the century

Nigeria's GDP was re-based in 2014 for the first time in two decades resulting in a markedly improved picture of the economy. In particular, the country's services sectors were included for the first time providing a truer picture of Africa's largest economy, and one of the fastest growing countries on the continent. This revealed that Nigeria has been one of the world's faster growing economies since the turn of the century behind only China and India in its increase in share of global GDP.

Private equity investments are happening in all major markets

Private equity is becoming established in large markets such as South Africa, Nigeria, Kenya and through North Africa. Countries with large GDP, but difficult business conditions are finding it harder to attract private equity investment than other more investor friendly countries. South Africa is still the leader in private equity on the continent, but West Africa in particular and East Africa to a lesser degree are attracting capital and investment and more transactions are happening in those regions.

Africa's capital markets are developing and have shown excellent returns

Africa has 23 stock exchanges representing all of the continent's major economies. South Africa's JSE remains a model exchange and has been named the world's best regulated exchange for the fourth year running. The developing nature of the continent's other exchanges means that most markets have relatively low general liquidity and relatively high transaction costs. However, when trading the main shares on each exchange, there is better liquidity and often lower transaction costs. Returns have been strong across major exchanges due to strong earnings and improved capital flows.

Africa's growth sectors are accessible through a number of channels

While African markets develop, investors are using several channels to access African growth equity. Local listed markets give good access to financials, telecoms and consumer staples in certain countries. Private equity allows stronger exposure to consumer discretionary as well as industrials and materials, and niche sectors such as healthcare and education. Certain other sectors such as some resources can further be accessed through foreign listed Africa focused companies.

3 The story of investment in Africa

Africa as an investment destination

According to UNCTAD, global Foreign Direct Investment (FDI) flows increased by 11% in 2013, but are only now equivalent to the levels seen on average in the years leading up to the global financial crisis (GFC), at just under USD 1.5 trillion.

Yet the world is fundamentally different in terms of its distribution of capital,
with flows to developed markets now at only 44% of their pre-crisis highs.

Conversely, FDI flows to developing economies reached a new high of USD 759 billion in 2013 (53% of total flows). According to UNCTAD, developing Asia was the largest recipient of FDI in 2013, with Latin America and Africa both increasing their respective shares.

In 2013, Africa attracted USD 56 billion of FDI inflows, approximately 3.8% of the global FDI for the year. The increase from the prior year was largely driven by Southern Africa, with Mozambique the standout recipient at USD 7 billion of FDI compared to GDP of only USD 14.7 billion (UNCTAD).

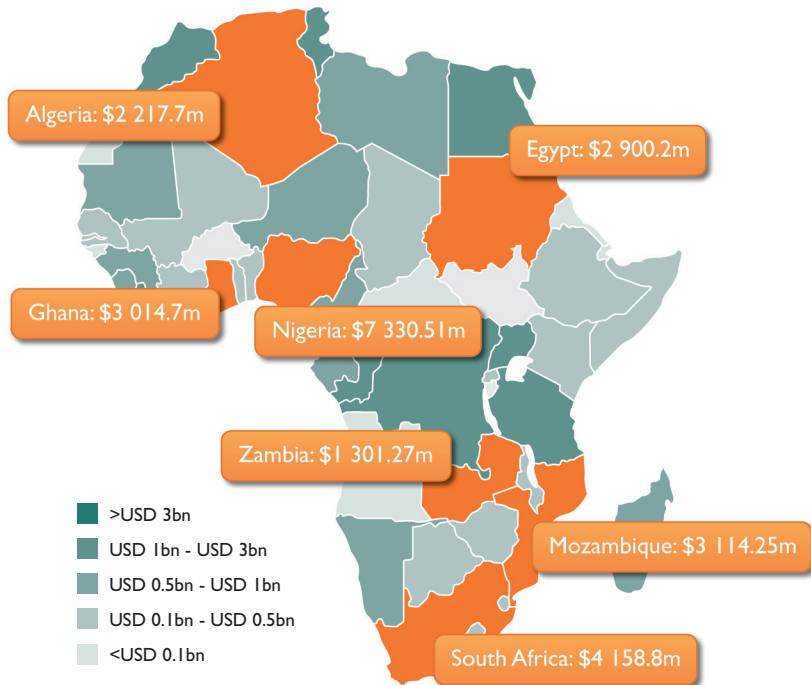
Net portfolio flows have been much more volatile, and have been strongly linked to developed market monetary policy. Inflows in recent years in many African countries have led to strong stock market performances in countries such as Ghana, Nigeria and Kenya, but have also played havoc with some currencies, most notably the South African Rand.

Notwithstanding the relatively low levels of investment in global terms, there is some evidence that investors are beginning to pay more attention to African economies. The continent's fast-growing communications industry has initiated the expansion of many international, South African and Pan African technology companies into Africa. The consumer sector has also attracted capital as the demographics and broad urbanisation trend support the strengthening of the middle class. Behind the development of these, and many other industries across the continent, is the expansion of the financial sector through banking, insurance and in some cases micro lenders in many African countries.

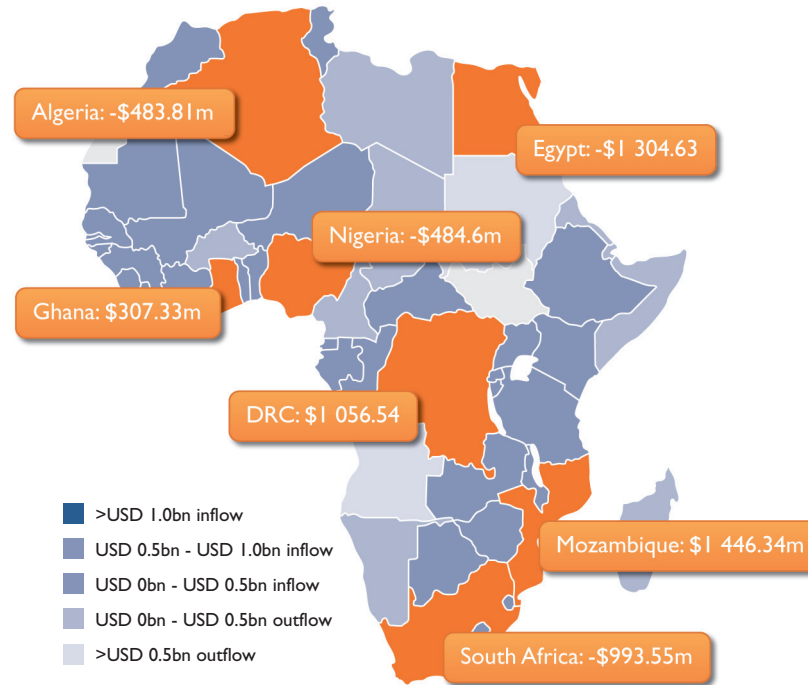


A more detailed look at FDI inflows, as shown below, gives an indication of which countries have recently managed to attract the most investment.

3-Year average net FDI inflow



3-Year rolling average net FDI inflow



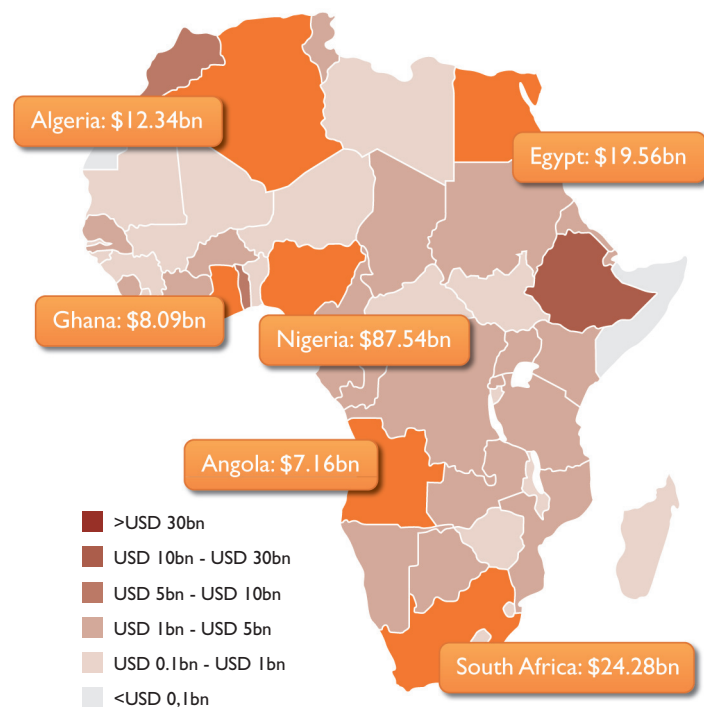
Source: World Bank, RisCura analysis

The main beneficiaries of FDI reported are Nigeria, Mozambique, South Africa and Ghana. The Democratic Republic of the Congo (DRC), Morocco, Egypt and the Congo all received over USD 2 billion net FDI inflow on average annually, over the 3-year period. Egypt saw a significant increase in 2012, recovering from a net FDI outflow position due to the ousting of Hosni Mubarak in 2011 and the political instability that followed. Egypt's net FDI inflow in 2012 was approximately a third of the levels seen in 2010. Other significant increases in FDI from the previous period include Mozambique, as investment in coal and gas continue to drive growth; and the DRC, with its rich untapped mineral reserves and agriculture opportunities.

GDP growth in Africa

GDP growth across the continent shows a region continuing its rapid development, albeit off a low base in many cases. The figures below display data published by the IMF, illustrating average growth in GDP over the three years from 2011 to 2013.

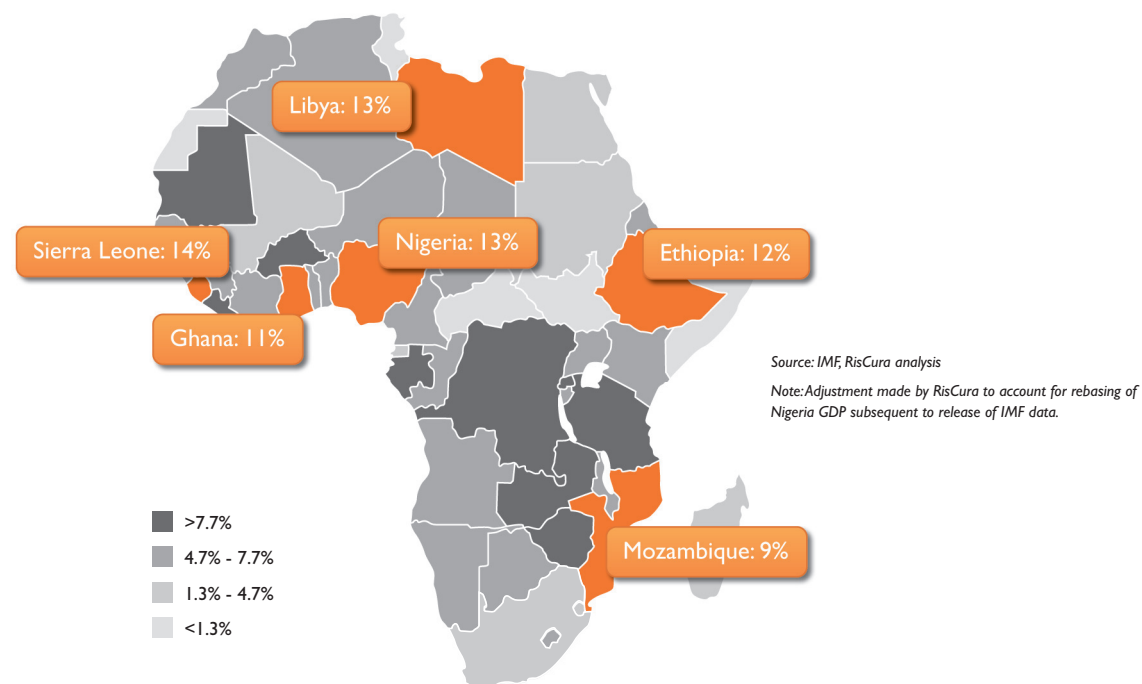
3-Year average GDP growth



The FDI situation described above closely supports the GDP growth experienced over the past three years, in dollar terms. The largest dollar growth, on a purchasing power parity (PPP) basis, is found in the largest economies on the continent, namely South Africa, Nigeria, Egypt and Algeria.

Nigeria's growth of USD 72 billion from 2012 to 2013, the largest on the continent, was in line with those of the United Kingdom, Russia and Korea, on a PPP basis. (It is important to note that approximately half of this growth is due to Nigeria's rebasing.)

3-Year average GDP growth (%)



In percentage terms, growth in GDP is quite different, as several new economies are experiencing rapid growth, often fuelled by the exploitation of mineral resources, and the resultant improvements in infrastructure.

GDP growth of Africa as a whole has averaged around 6% in each of the last 3 years, resulting in nominal GDP in 2013 of approximately USD 2.2 trillion, roughly equivalent to the GDP of Italy and slightly above that of India. On a PPP basis, Africa's GDP is USD 3.9 trillion, approximately equivalent to Germany's GDP on this basis.

Size of GDP over time

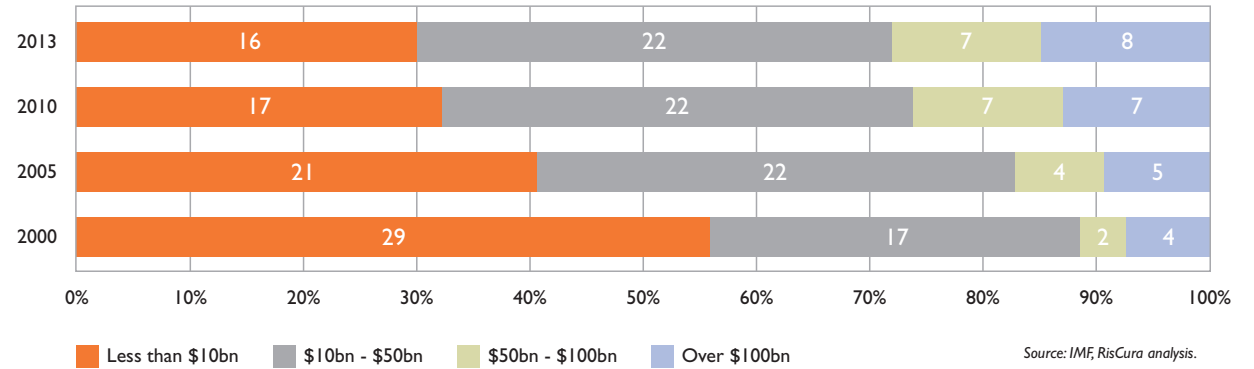
In order to get a better look at the overall increase in the size of African economies over time, the chart above displays the number of countries whose GDP fell into selected size buckets at 2000, 2005, 2010 and 2013. As a result of the strong economic growth over the 13-year period, there have been some profound changes in the size of African economies. In 2000, 55% (29 countries) of African countries had GDPs of less than USD 10 billion, while in 2013 this had fallen to 30% (16 countries). This growth has further resulted in 15 countries achieving GDPs of over USD 50 billion, up from only 6 at the turn of the century.

Over the same period, the median African country GDP has risen from USD 8.4 billion to USD 20 billion, an implied average growth rate of 6.9% per annum.

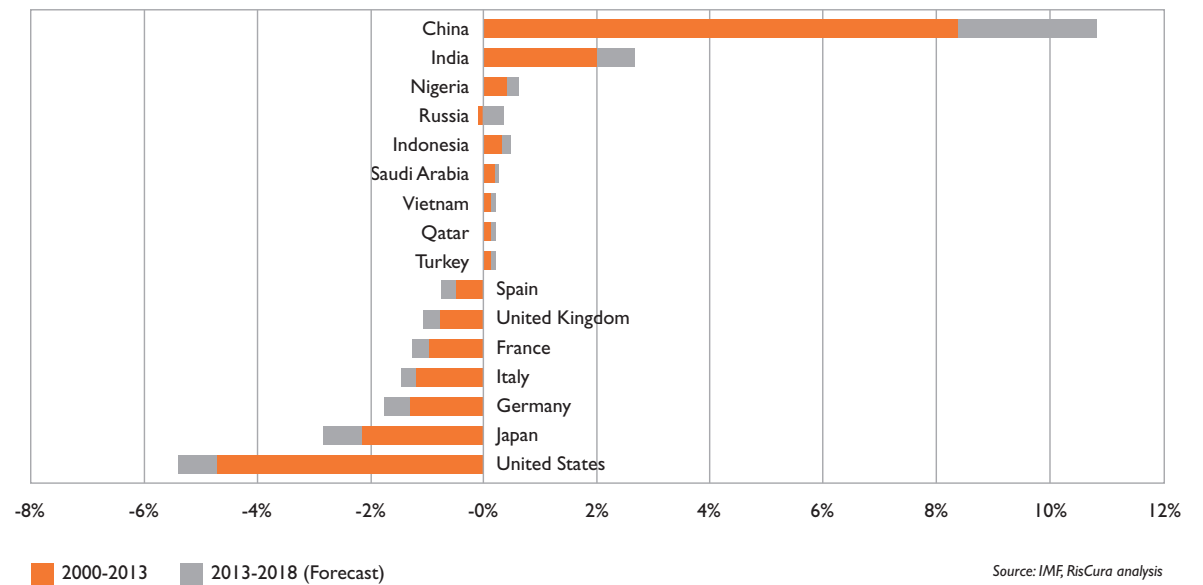
Change in share global GDP

The composition of global GDP has changed dramatically since the turn of the century, as the growth of emerging markets has significantly exceeded that of large developed economies. This change has resulted in China gaining more than 8% of global GDP to hold approximately 15% in 2013; while over the same period the US has lost around 5% of global GDP to fall to a share of below 20% in 2013.

African economies continue to grow
Number of African countries per GDP size bucket



Nigeria in the top 3
Change in share of global GDP (winners and losers)

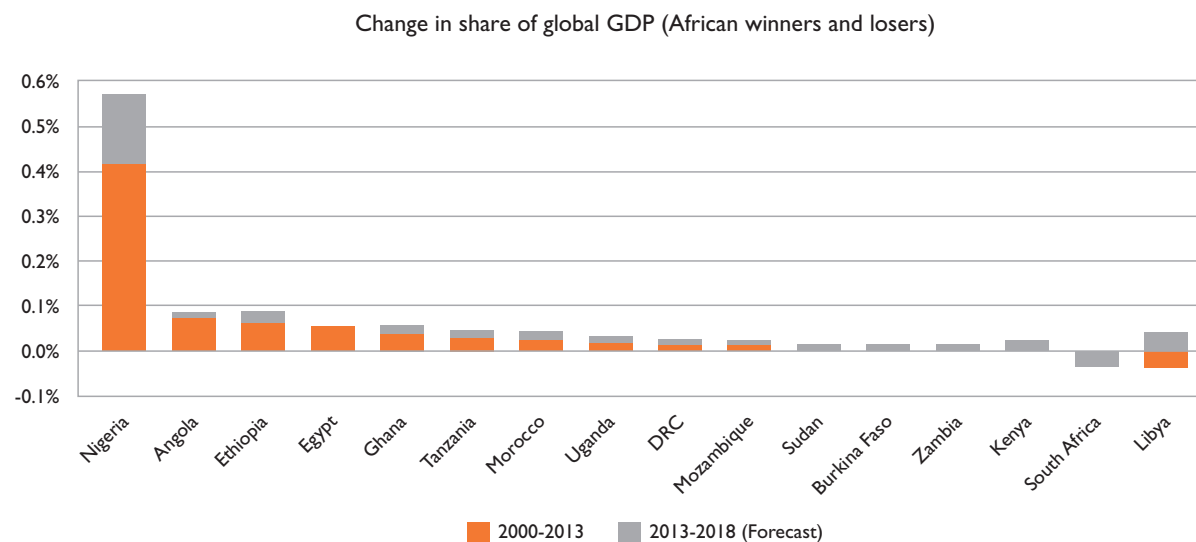


Nigeria the standout performer

Africa's rising star is Nigeria, being the third largest gainer globally over this 13-year period, almost doubling its share of global GDP by 0.42% to 0.97%. Nigeria has been included in the recently coined 'MINT' grouping referring to Mexico, Indonesia, Nigeria and Turkey all of which, with the exception of Mexico, feature strongly in the graph above.

Based on data reported by the IMF, with adjustments made by RisCura for the subsequent rebasing of the Nigerian GDP, Nigeria is expected to further increase its share by 0.16% over the next 5 years, as seen in the chart shown here.

This chart shows the greatest "winners" and "losers" of global GDP in Africa. On the "winners" side, it reiterates the positive story discussed above. It also demonstrates the relatively slow growth in South Africa compared to other large African economies. This raises the question of what impact low growth has had, and will continue to have, on South Africa's share in the world economy going forward should it not improve on expected growth figures.



Source: IMF, RisCura analysis.

Note: Adjustment made by RisCura to account for rebasing of Nigeria GDP subsequent to release of IMF data. All GDP numbers are quoted on a PPP basis.

According to the IMF's World Economic Outlook, in 2000, African GDP was roughly equivalent to that of France, Italy or the UK. By 2018, African GDP is expected to reach the size of approximately double the GDP's of France or the UK, and about 2.6 times the GDP of Italy.

Since 2000, Africa has created additional purchasing power of around the current size of the UK or Brazil, and the continent is expected to create further GDP of USD 1.6 trillion, roughly equivalent to adding GDP the size of Korea, over the next five years.

In 2013, the combined GDP of African countries represented only 4.5% of global GDP. 60% of all African countries experienced an increase in share of global GDP over the period 2008 to 2013, while 65% are expected to increase their share over the 2013 to 2018 period.

Comparing Africa to other emerging markets

Individual African markets remain small in comparison to the large emerging markets making up the BRICs, a grouping that refers to Brazil, Russia, India and China. However, when aggregated, Africa's place alongside these fast-developing large countries is better understood. While the individual African economies are certainly not homogenous, grouping the 54 individual countries is useful for comparative purposes to some of the world's large, fast-growing countries.

The population of the whole of Africa is close to 1.1 billion people, not far from the 1.4 and 1.2 billion of China and India respectively.

On a GDP per capita basis, India may be used as the nearest comparator to Africa.

African GDP compared to BRIC countries (PPP USDtrn)

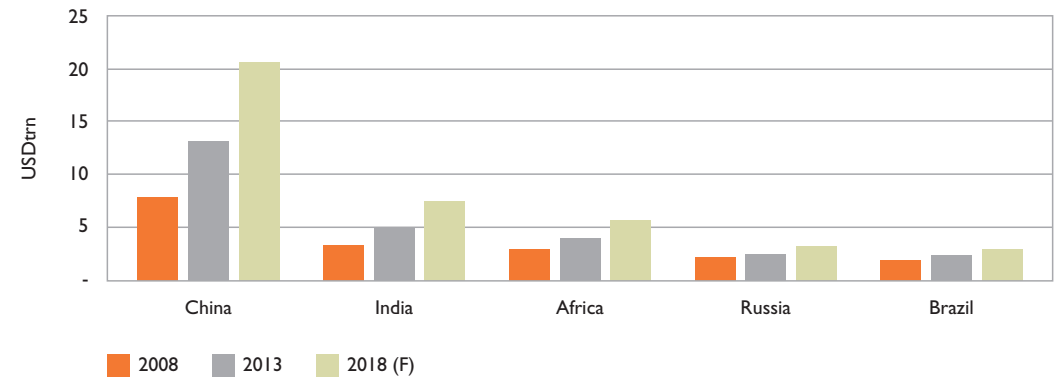
During the post financial crisis period from 2008 to 2013, Africa's GDP grew by 31% (CAGR: 5.6%) on a PPP basis, ahead of Brazil (22%) and Russia (13%), but behind China and India which grew at 64% (CAGR: 10.4%) and 50% (CAGR: 8.4%) respectively over this period, as seen on the adjacent chart. According to IMF forecasts, this trend is set to continue over the next five years. Africa as a whole is expected to grow by 42% from 2013 to 2018, only slightly behind India (49%), while China's growth is expected to slow to 54% over the five-year period.

Percentage of global GDP (PPP)

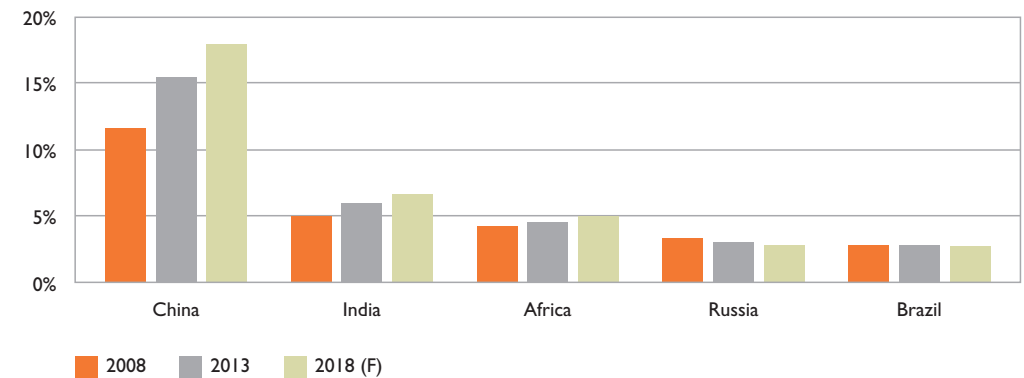
In terms of global GDP, Africa's share has increased to 4.5% from 4.2% in 2008 and is expected to increase to 4.9% by 2018. These may seem like incremental changes, but they are the result of a compounded annual growth rate (CAGR) of 5.6% for the continent since 2008 and anticipated CAGR to 2018 of 7.3%. This forward-looking growth again outweighs both Russia and Brazil, both of which are expected to experience a marginal decline in their share of global GDP over the period.

Africa's attractiveness as an investment destination continues to increase on the back of the growth highlighted above. The continent is well placed amongst peers such as the BRIC countries.

Africa splits the BRICS
African GDP compared to BRIC countries (PPP USDtrn)



Africa gaining
Percentage of global GDP (PPP)



Source: IMF, RisCura analysis.

Note: Adjustment made by RisCura to account for rebasing of Nigeria GDP subsequent to release of IMF data. All GDP numbers are quoted on a PPP basis.

4 The attractiveness of listed markets in Africa

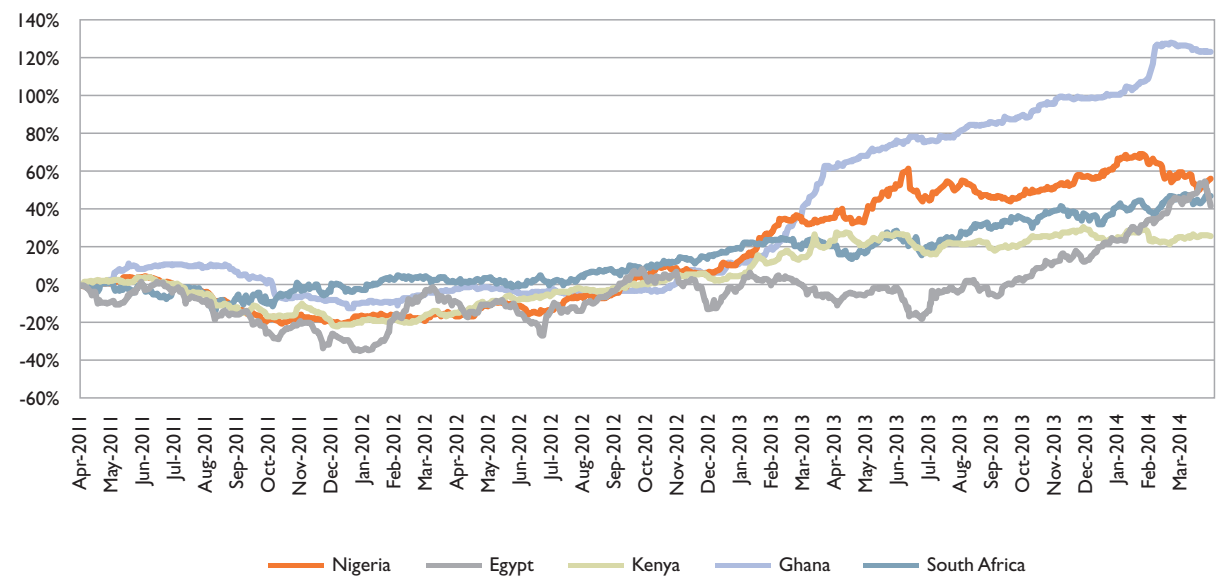
The most common way for institutional investors to access equity exposure in a region is through local listed equity markets. Some of the factors that affect the attractiveness of listed markets are the quality of exchanges, cost of trading, listed market valuations and sector access. While African listed equity markets are developing and certainly face challenges, strong returns and continuing growth expectations have encouraged investment.

Returns of major African exchanges

African exchanges have shown strong returns over the past three years as capital has flowed into frontier markets to access the higher growth expected. Post the financial crisis and the decline in performance of African markets along with the rest of the world, it is encouraging to see the improvement of the largest markets on the continent.

Average growth over the last three years has been 16% (CAGR), outperforming developed markets by 4% annually (S&P 500 CAGR: 12%). The last year in particular has been strong, with Egypt and Ghana growing at over 50% and 35% respectively.

African indices show strong performance
3 year relative index performance



The quality of African stock exchanges

High liquidity, low transaction costs, good availability of information and strong governance are the most frequently stated attributes of high calibre stock exchanges. While returns have been strong, most African equity markets are developing, and careful attention must be paid to these criteria in order to invest appropriately and mitigate risks.

This review of the quality of African stock exchanges builds on the factors mentioned above and also takes into account regulation, openness to foreign ownership, ease of capital in/outflows, as well as operational framework. The cost of trading on African exchanges is discussed in detail later in the report.

The results show the strength of South Africa's Johannesburg Stock Exchange (JSE), which for the fourth year running was ranked number one globally in the World Economic Forum (WEF) Global Competitiveness Report for regulation of securities exchanges. With the JSE's move to the international standard of T+3 settlement cycle already underway, this is expected to further strengthen the exchange's reign as Africa's leading securities exchange.

After the JSE, Egypt's exchange (EGX) ranks as Africa's second best.

Relatively lower regulation, operational efficiency and ease of foreign investment scores have resulted in a greater divide between the EGX and the JSE compared to last year's analysis. In global terms, the Egyptian exchange is similar in quality to Russia's (MOEX), Mexico's (BMV) and Indonesia's (IDX) exchanges. Despite having the largest GDP in Africa, Nigeria's exchange ranks currently only in category E, alongside Kenya and Tunisia, as a result of relatively poor liquidity, regulation and operational efficiency compared to global standards. Liquidity does vary by share, however, and there are marked differences between those shares that are well covered and traded, and those that have relatively lower levels of trade.

Looking at some of the exchanges in the F and G categories, a common trend of significantly lower values traded, as well as lack of information on efficiency, ease of capital flows and openness to foreign ownership were observed. To put this into context, the combined value traded for the 15 exchanges in categories F and G is approximately 0.57% of that of the JSE. The BRIC and MINT countries list relatively high on the analysis above, outranking most of the African countries in the sample, driven by higher trading volumes. Taking into account the BRIC and MINT countries, South Africa still remains the only exchange that ranks in category A, outscoring its fellow developing country exchanges due to high scores on regulation and openness to foreign ownership.

Quality of Equity Exchanges

Quality of Exchanges	Africa	BRIC	MINT
A	South Africa		
B		Brazil, India, China (Shanghai)	Turkey
C	Egypt	Russia	Indonesia, Mexico
D	Morocco, Mauritius		
E	Nigeria, Tunisia, Kenya		Nigeria
F	Zimbabwe, Namibia, Zambia, Botswana, Ghana		
G	Sudan, Tanzania, Uganda, Cape Verde, BRVM, Malawi, Rwanda, Cameroon, Sierra Leone, Mozambique		

Note: A description of the factors considered and sources used in determining the quality of each exchange can be found in Appendix A.

Market capitalisation and liquidity

Market capitalisation across African exchanges has grown by approximately 15% in 2012. This was ahead of the Eurozone's growth of 14% but behind the United States, which grew by 17%. Despite this growth, the total market capitalisation of all African exchanges reviewed still only makes up approximately 80% of what the NYSE trades in a single day.

Based on 2012 market capitalisation numbers as seen in the figure above, South Africa easily remains the largest African exchange. The market capitalisations of the Namibia, Botswana and Ghana exchanges also require interpretation, as they include some large dual listings that increase the reported values.

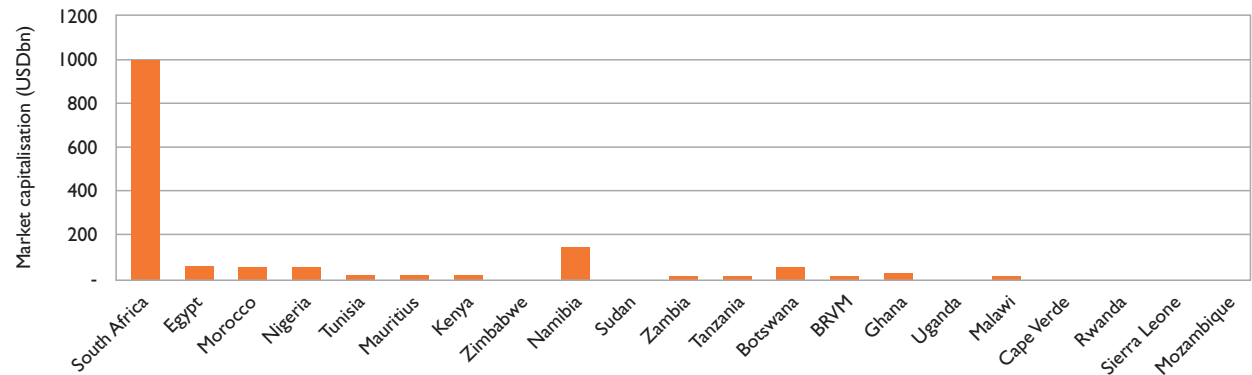
The figure below right shows that most African exchanges still suffer from low liquidity compared to developed market norms.

A fair estimation of a global average of more developed markets, based on the WFE member universe, would be around 43% turnover; therefore, indicating that only South Africa and Egypt achieved global average levels of liquidity. Among other emerging markets, China, Brazil and Turkey show much higher than average turnover, indicating high levels of liquidity for the period.

While many of the African exchanges require further development in order to be competitive internationally, progress has been made in a number of areas.

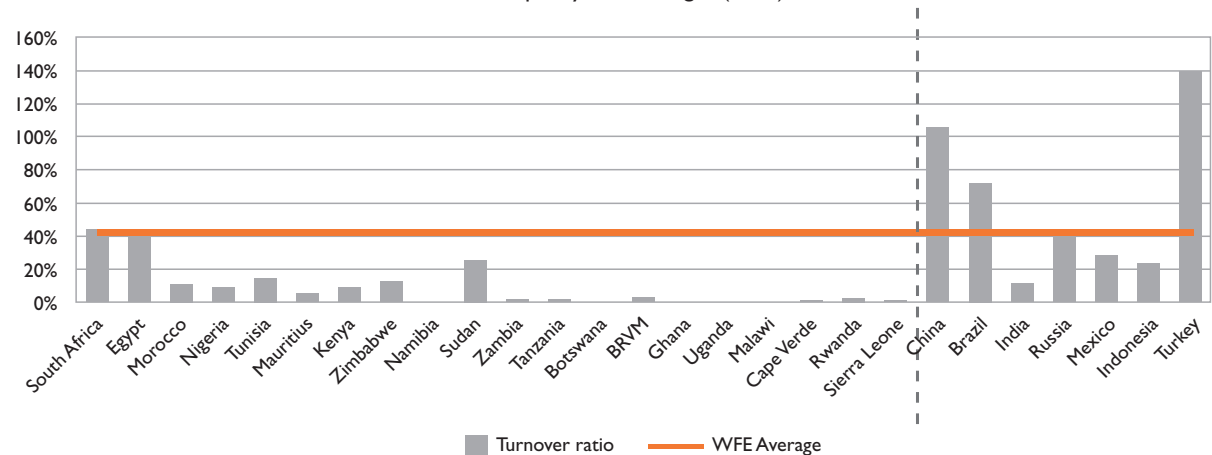
Regional integration has been relatively successful in the Western and Eastern blocks, allowing for more relaxed regulation and increased capital mobility. This has led to a decrease in costs and, therefore, an increase in liquidity. Many of the stock exchanges are currently in the process of demutualisation, which would further improve governance structures and incentivise an increase in efficiencies across the board.

South Africa, the continent's driving force
Market capitalisation of exchanges (2012)



Source: ASEA Newsletter 2013, WFE website, RisCura analysis.

African liquidity similar to India, Russia, Mexico and Indonesia
Liquidity of exchanges (2012)



Source: ASEA Newsletter 2013, WFE website, RisCura analysis.

The cost of trading in Africa

The costs involved in transacting can be either explicit, which are relatively straightforward to measure, or implicit. Implicit costs are not immediately apparent and as a result sophisticated calculations and methodologies are required to accurately quantify these costs.

Explicit costs

The range of the explicit costs of trading, which include brokerage charges, fees and taxes, remains relatively wide between African exchanges. The total cost of a 'round trip' (buying and then selling a share) can vary from as much as 3.30% (BRVM) to as low as 0.59% (South Africa) of value traded.

Explicit costs have been decreasing in some of the larger African markets such as Nigeria and Kenya. Comparatively, in the lower volume markets, costs have remained fairly static for some time as a result of the specific economics of these markets. However, as these markets develop and deepen, costs are expected to tend closer toward world trends, as increased transaction volumes allow for lower costs.

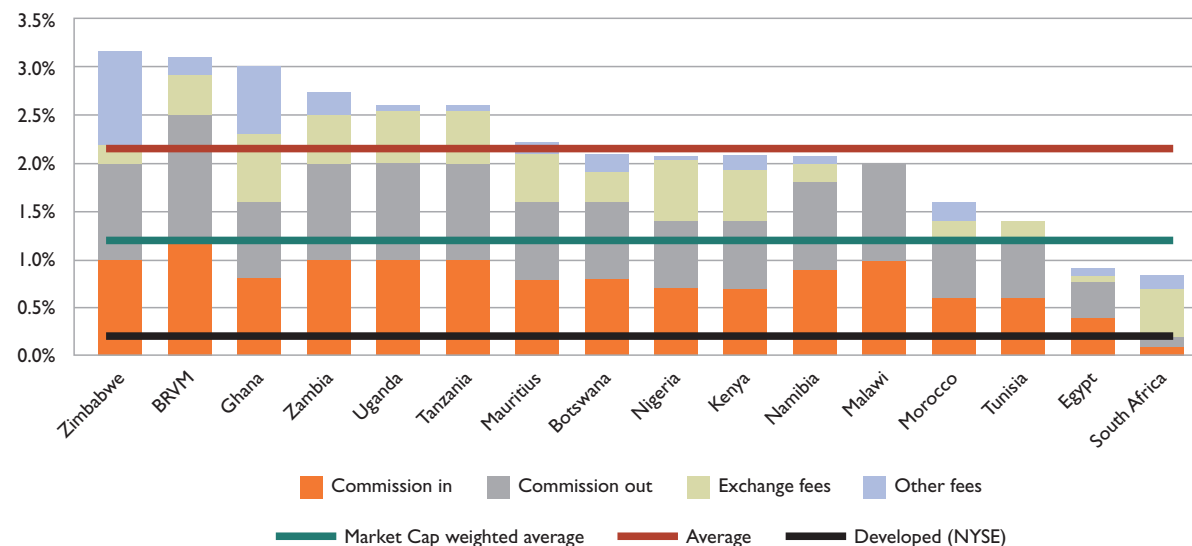
Implicit costs

Implicit or hidden costs, although harder to measure, often make up the majority of trading costs and are primarily driven by liquidity. Implicit costs are initially incurred when crossing the bid-offer spread to actively participate in the market. If the volume of the trade exceeds the amount offered or bid for, then market impact comes into play, compromising price to secure sufficient volume.

With the exception of South Africa and Egypt, the liquidity on African exchanges is low, which may result in high implicit costs of trading depending on the particular shares involved. However, it follows that as markets continue to deepen and liquidity improves, these costs should reduce at a similar rate.

Large differences in the cost of trading

Explicit costs - total cost of round trip



Source: Imara African Securities, RisCura analysis.
Note: The above costs are reflected exclusive of VAT.

Impact of currency translation

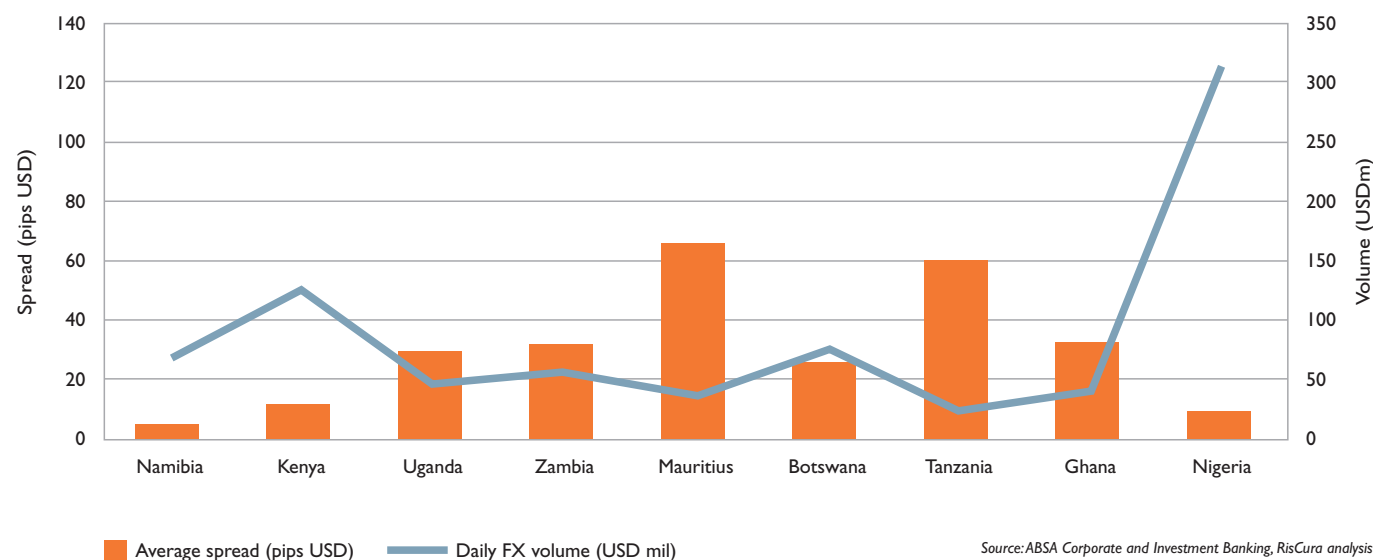
Access to domestic currencies should be a significant consideration when investing directly in African markets.

Trading in and out of these currencies has historically proven to be onerous as they tend to be characterised by liquidity limitations and large spreads. Although the proliferation of African foreign exchange (FX) platforms has provided increased access to these currencies, the associated costs can still fall.

FX is commonly traded in a manner where the costs are included in the spread (differential between the buying and selling price). Consequently a wider spread implies a higher cost of trading in and out of that currency. This is, however, dependent on the transaction size and can vary markedly, with larger deal sizes allowing for narrower spreads (not considering liquidity constraints). As both the volume of trading and the typical deal sizes increase these spreads should narrow, resulting in lower inherent costs.

The absence of sufficient liquidity in FX markets can also lead to increased costs if deal sizes are sufficiently large to outstrip supply. In terms of FX liquidity, Nigeria far exceeds its peers with an average daily volume of over USD 300 million, inferring superior access to the domestic currency. However, when trading in markets such as Tanzania, with average daily volume of less than USD 30 million, one should be cognisant of such restraints when implementing FX trading strategies.

Nigerian FX expensive despite high volumes
FX volumes and spreads

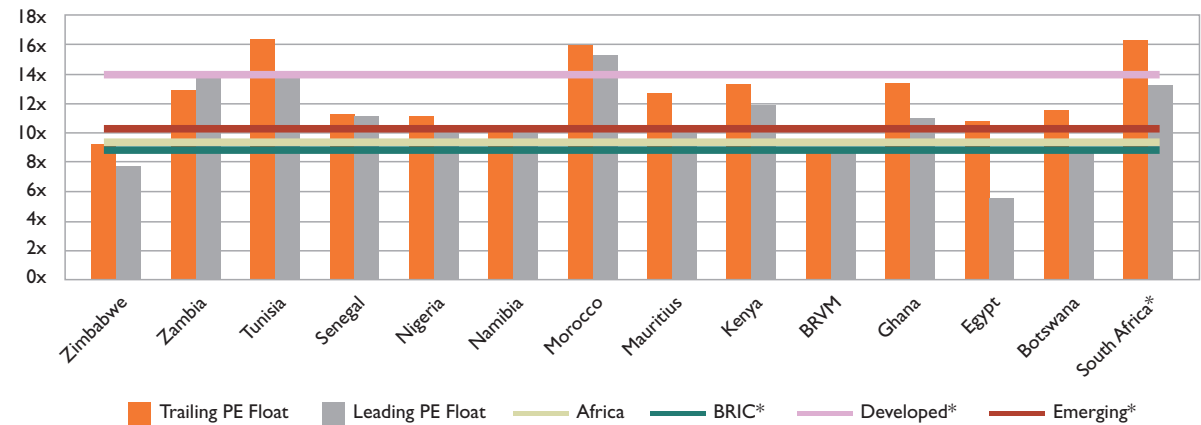


Source: ABSA Corporate and Investment Banking, RisCura analysis.

Valuations of Africa's listed markets

Valuations across African listed markets are varied and highlight the diverse nature of the continent. From a forward-looking perspective, investible-based valuations look attractive at a leading price to earnings multiple (P/E) of 9.3x for the continent, compared to over 10x for other emerging markets, and close to 14x for the developed markets as shown by the adjacent graph. (See an introduction to market multiples on pg27) Individually the countries that show relatively low valuations are Zimbabwe, the BRVM and Egypt. Although with the exception of Morocco, Tunisia and South Africa, all valuations are below developed markets and relatively in line with emerging markets.

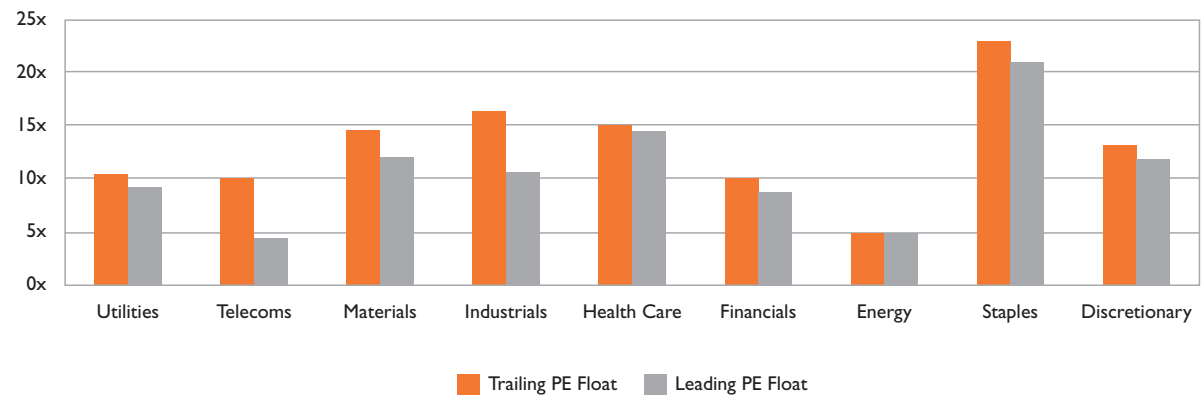
African valuations in line with other emerging markets
Investible representation of the listed P/E ratios for African countries



From a sectorial perspective, the breakdown in the chart to the right reveals strong contrasts in valuations.

From a sectorial perspective, the breakdown in the chart to the right reveals strong contrasts in valuations. Consumer staples are highly valued by the market at a P/E greater than 20x, while financials and energy appear somewhat cheaper coming in around the 10x and 5x levels respectively. On a forward-looking basis, valuations are favourable continent wide. Telecoms appear to carry the highest earnings growth expectations at a forward P/E of less than half the historic level.

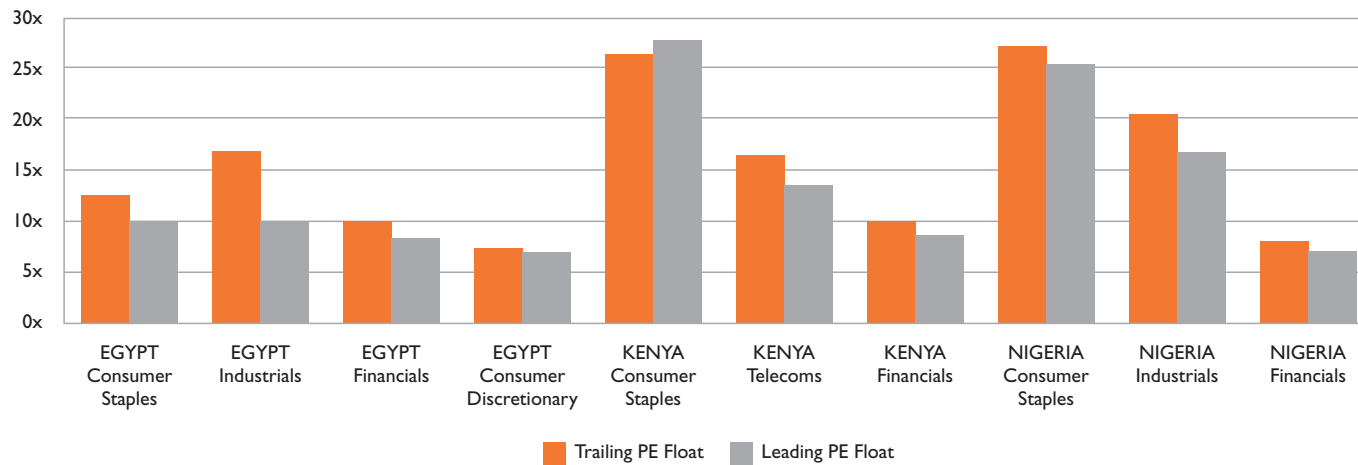
Consumer staples highly rated by investors
Aggregated investible sector representation of listed P/E ratios for African countries excluding SA



Source for both charts on this page: Bloomberg, S&P Capital IQ, FactSet, RisCura analysis.
Note: *MSCI Valuation utilised for South Africa, BRIC, Emerging and Developed Markets.

In order to understand where the sector valuations obtain their characteristic values, we delve further into sectors within the specific markets of Nigeria, Kenya and Egypt. These markets are regarded as the leaders in their respective regional blocks (West, East and North) and we would expect other countries within these regions to show similar characteristics. This disaggregated perspective illustrates the contrast in valuations to an even greater extent.

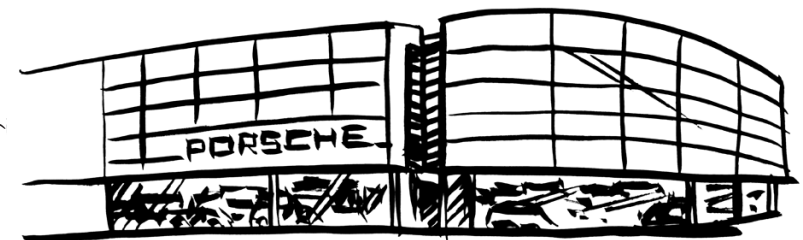
Financials indicate value going forward
 Aggrigated investible sector representation of Listed P/E ratios for Egypt, Kenya and Nigeria



Source: Bloomberg, S&P Capital IQ, FactSet, RisCura analysis.

Kenyan and Nigerian staples continue to be highly valued by the market on an absolute, leading basis, with financials in all three markets showing significant value on a forward looking basis.

Porsche Dealership, Lagos, Niger



Sector coverage in Africa's listed markets

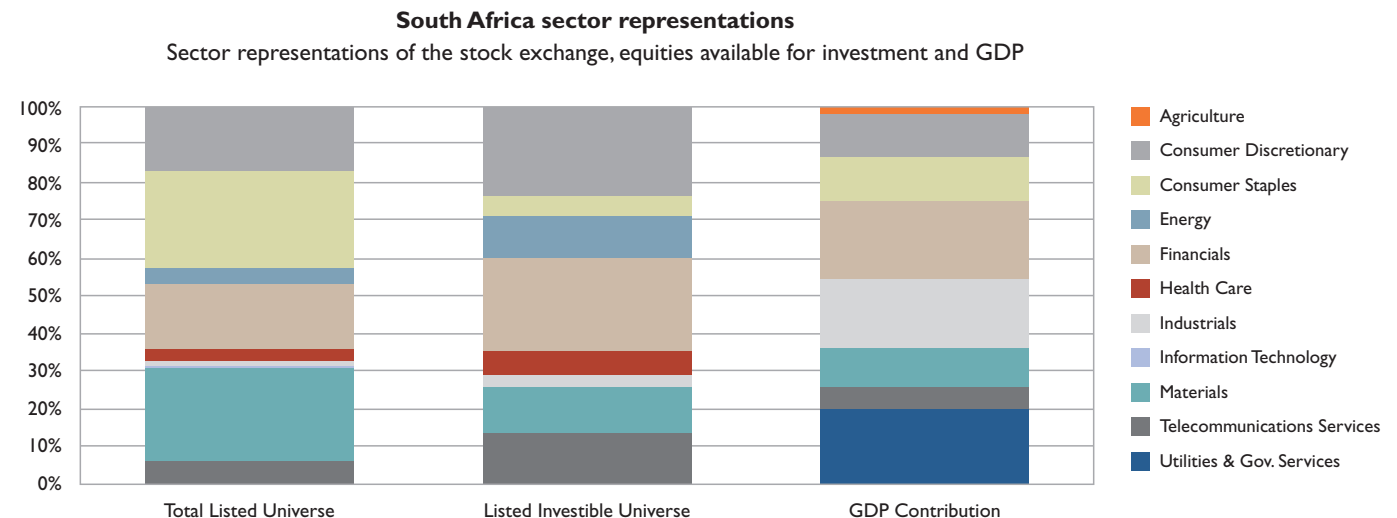
Investors looking to tap into the growing GDP of African countries will be interested in the apparent disconnect between each country's economic activity and the associated sectorial representation on the stock market. The smaller, less developed countries suffer to a greater extent, due to the concentration of their stock exchanges. This has not changed over the past year, but the rebasing of Nigeria's GDP has provided a more accurate picture of economic activity in that country.

As with many countries the full market cap
of the exchange is not completely accessible
to the typical investor.

This is due to a portion of certain listings being privately owned by, for example, board or family members. As these shares are not available for public trading, we get a truer representation of the investible universe in each country and sector by excluding the unavailable portions. The portion that remains is known as the market free float.

To get a more accurate representation of Africa's exchanges, the investible sector representation of each exchange has been included in the charts below. The representation of float in the charts below is in accordance with global index providers' guidelines.

The JSE, while providing the best sector representation between GDP and investible companies, bears its own eccentricities due to the number of dual listed and foreign operationally exposed companies. Of the top 40 shares by market cap listed on the JSE, 40% of the revenue is derived from outside of the borders of South Africa. The SWIX (Shareholder Weighted Index) was created to mitigate this effect by down-weighting those large dual-listed counters to account for only the float held in local custody.



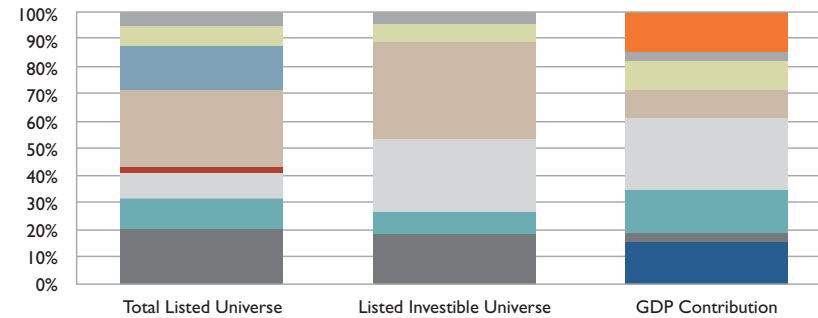
Source: FactSet, MSCI, BMI International, country specific statistical and economic ministries, RisCura analysis.

Egypt and South Africa are the only markets in Africa classified by MSCI as part of the emerging markets group. However, there is a large discrepancy between the exchange market cap representation and GDP generation, seen in the two charts showing South Africa and Egypt respectively. This is also the case when focusing on the truly investible portion of the exchange, where materials and agriculture are poorly represented, and financials and telecommunications are overstated, when compared to GDP contribution.

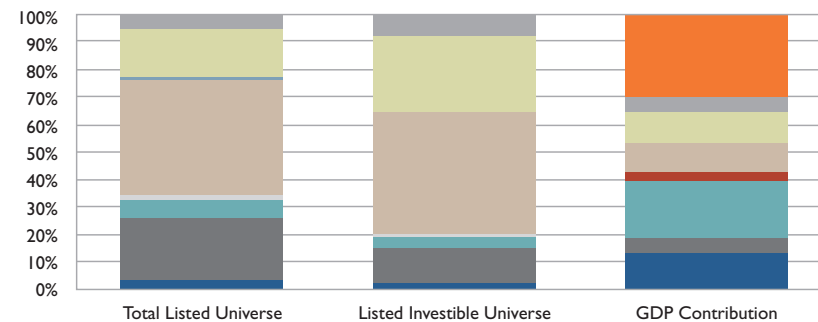
The graph middle right shows that the agricultural sector is an important factor in GDP generation for Kenya; however, accessing this is difficult from a listed standpoint. Tertiary level sectors such as financial services and telecommunications dominate the Nairobi exchange, with the primary and secondary sectors obtaining capital privately.

Nigeria suffers the most when translating GDP sectors onto the NSE. Oil and agriculture are the largest drivers of the Nigerian economy and, as is the case in Kenya, these sectors are poorly represented, with the tertiary sectors dominating the stock exchange. It is important to note that this has changed subsequent to the rebasing of the GDP figures this year. Previously the biases of agriculture and energy were even more significant. Some of the foreign oil extraction and refining companies have locally listed subsidiaries but these are small in comparison to the size of the energy industry within each country. It is encouraging to see the strong translation of total market cap to investible market cap with the exception of materials, which is a sign of the improving liquidity in the Nigerian exchange.

Egypt sector representations

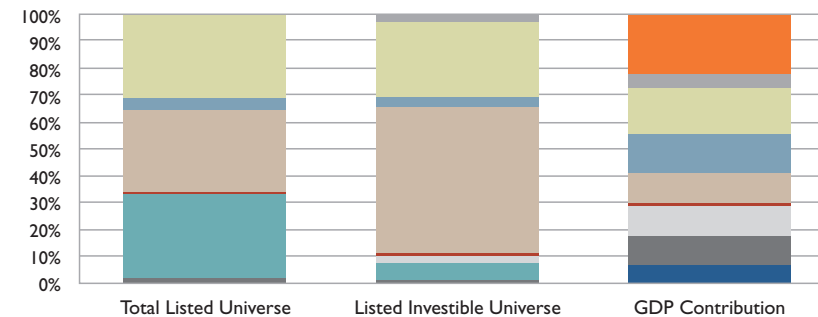


Kenya sector representations



- Agriculture
- Consumer Discretionary
- Consumer Staples
- Energy
- Financials
- Health Care
- Industrials
- Information Technology
- Materials
- Telecommunications Services
- Utilities & Gov. Services

Nigeria sector representations



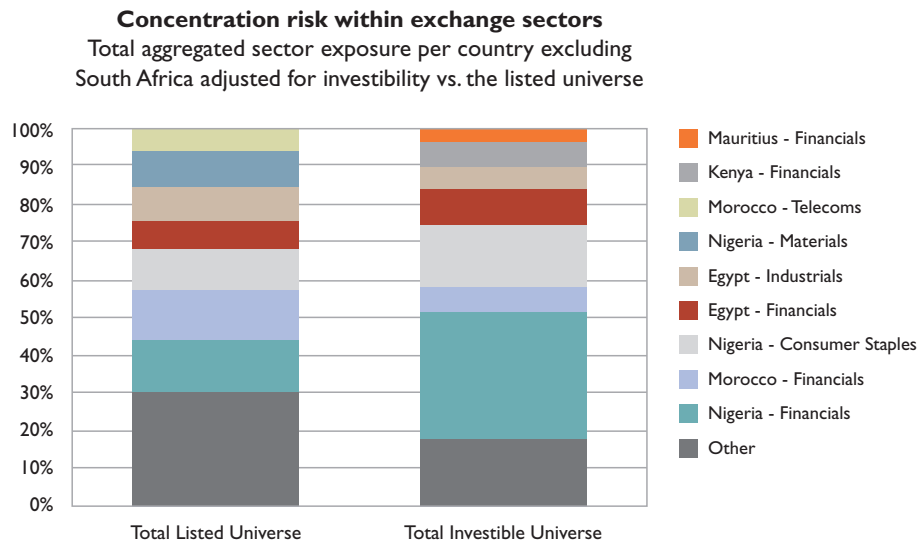
All sources on this page: FactSet, MSCI, BMI International, country specific statistical and economic ministries, RisCura analysis.

Listed sector concentration

As noted above, there is a lack of translation from country GDP generation by sector to the listed markets sector representations in Africa.

When looking purely at the listed markets excluding South Africa, it is apparent that there is also a large element of concentration risk within specific 'exchange sectors' across the continent; 70% of the available market cap is covered by 7 sectors within their respective countries.

This means that investors investing widely across the continent may still face concentration risk relating to specific sectors in certain countries.

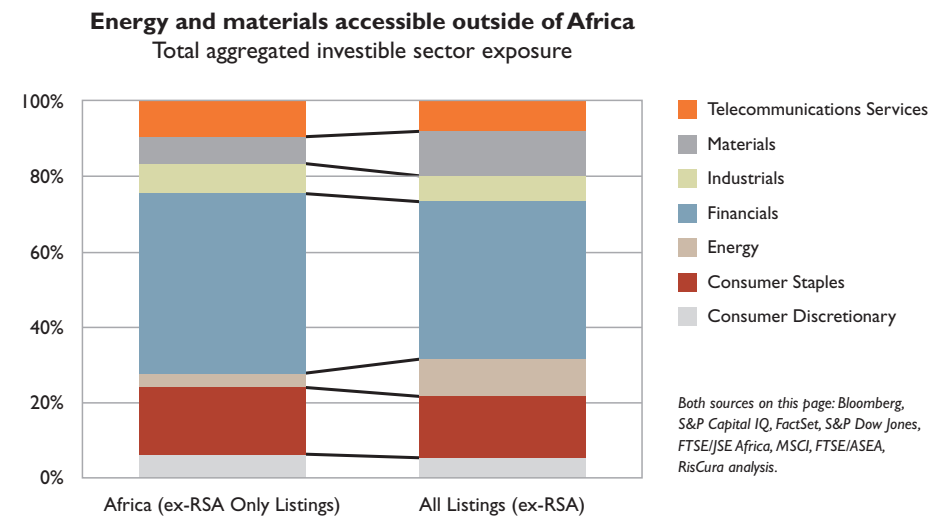


For example, if an investor decided to invest across the continent (excluding South Africa) based on the investibility of the markets as seen above, this would result in a third of capital being invested into the Nigerian financial sector, and a further 17% in Nigerian consumer staples. Finding methods to diversify this concentration risk is an important consideration for an investor looking at the listed markets in Africa.

Accessing Africa from abroad

Energy and materials play a significant role in the African development story and still offer the value that investors into Africa seek. Unfortunately, outside of South Africa, resources are poorly represented on the African exchanges, where financial and consumer sectors dominate. However African energy and materials may be accessed on exchanges outside Africa. Often the motivation behind this is that, as mineral and energy extraction is highly capital-intensive, these listings take place on the more efficient and larger capital markets in order to raise funds.

It may be that by looking beyond the borders of the African continent, diversification and alignment with GDP sector generation may begin to be achievable.



Long-only asset managers focused on African markets realise this and usually attribute a portion of their portfolios to foreign listings of Africa focused companies. These listings, other than improving the exposure to resources, also increase the exposure to countries with underdeveloped bourses. They also introduce countries previously excluded, as they do not, in fact, have a bourse such as Mali and Angola.

5 The attractiveness of private equity markets in Africa

A country's GDP alone does not determine the attractiveness of that country to private equity investment.

Factors such as investor protection and corporate governance, the taxation environment, trading across borders and access to credit are important factors to consider; among others, when making investment decisions.

Markets Attractive to PE in Africa

The IFC Ease of Doing Business ranking and the IESE VC&PE Attractiveness Index ranking ('Attractiveness Index'), plotted on the right, are measures already in place that are useful in assessing the attractiveness of a country to investment. It is important to note that a lower ranking is more attractive on both of these measures.

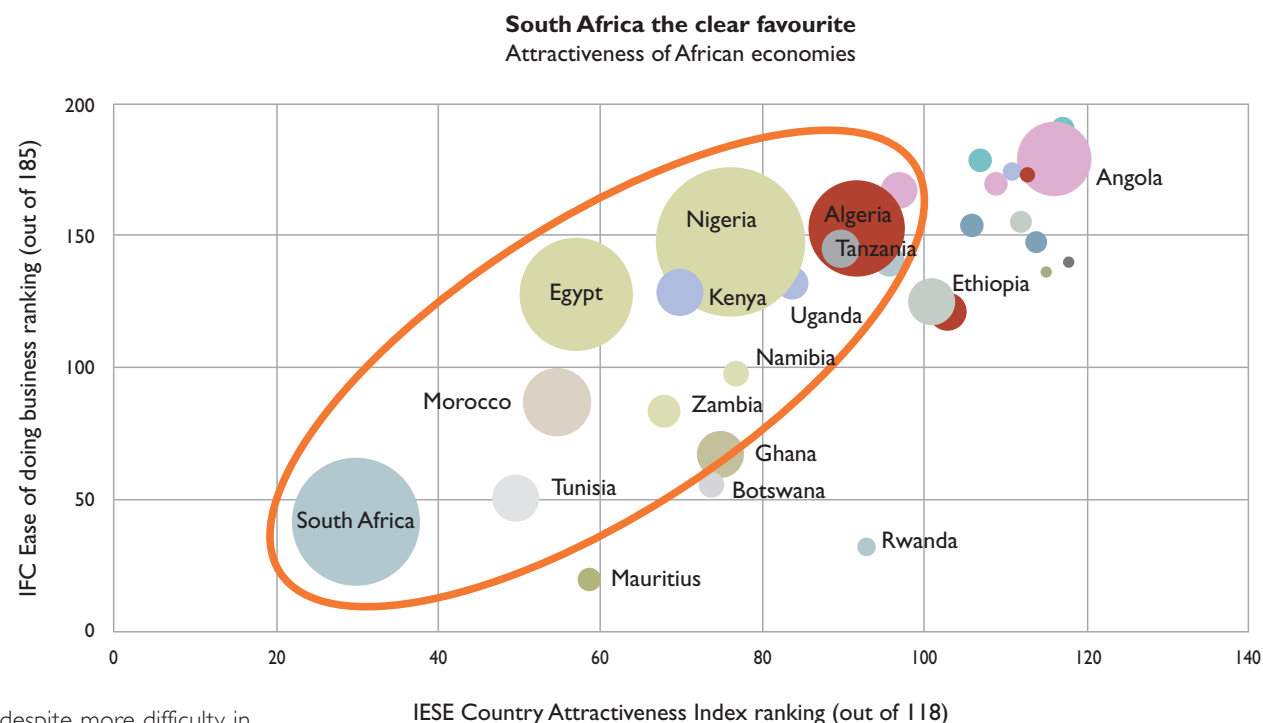
Ease of doing business alone is not sufficient to create the necessary conditions for successful private equity investment, although this is an important consideration. Factors such as economic growth, depth of capital markets, taxation and investor protections are all important considerations and are included in the Attractiveness Index. Countries like Mauritius and Rwanda have scored well on the Ease of Doing Business ranking, but are relatively small and score lower on the other considerations necessary for private equity.

Despite scoring lower on the ease of doing business scale, countries such as Nigeria, Egypt and Algeria are more attractive despite more difficulty in doing business.

Of the 31 African countries ranked by the Attractiveness Index, 16 have achieved improved rankings over the 2009 to 2013 period, the most impressive of which were Rwanda and Mauritius (11 places each). Mauritius, South Africa, Tunisia, Morocco and Egypt feature in the top 60 countries out of the 118 ranked on the Attractiveness Index worldwide, while Rwanda sits at 93.

Of the 185 countries ranked by the IFC Ease of Doing Business ranking, 10 African countries fall in the top 100 with Egypt falling marginally outside at 109.

The countries that feature closer to the lower left area of the graph offer a combination of the favourable factors mentioned above, with the larger economies identifiable by the size of the bubble. It is clear from the graph that when combining the size, attractiveness and ease of doing business factors, South Africa is still the clear leader on the continent due to its relatively advanced economy, financial institutions and good governance practices.



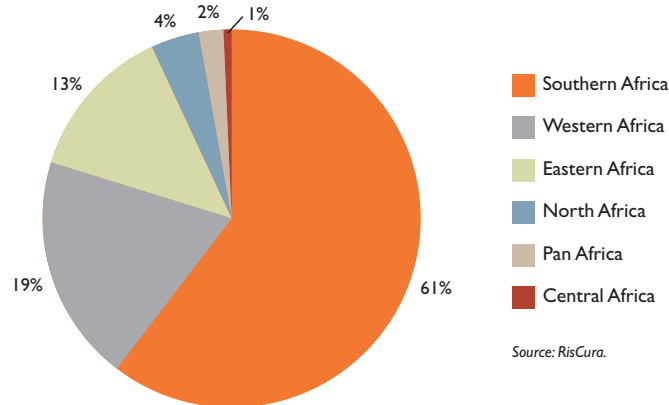
Source: IFC, IESE, RisCura analysis.
Note: The size of the bubble represents the size of the economy (nominal GDP).

Africa's private equity geographic focus

Private equity is fairly well developed in South Africa and in certain parts of North Africa, but it is just beginning in many parts of the continent. Although there are a number of transactions happening in North Africa, particularly Egypt, Tunisia and Morocco, it is more difficult to access data in that region. More than half of the continent's private equity activity takes place in South Africa, where the private equity ecosystem of dealmakers, bankers, lawyers and accountants is well established.

African PE deals by region

Southern Africa dominates transaction activity
Number of PE deals by region



Continued excitement around the growing population and economy of Nigeria attracts large amounts of capital to the West African region. A further significant portion of investments in West Africa is made up by those in Ghana, particularly in the financial sector.

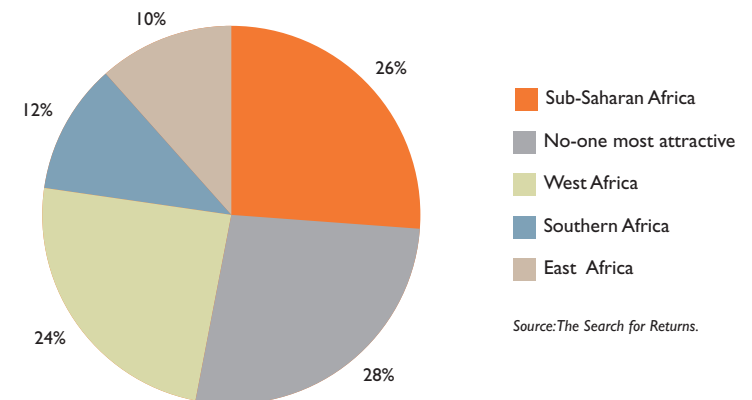
North Africa is the second most developed private equity region on the continent, but private equity fund managers in that region have been reluctant to provide data for inclusion in this report, underrepresenting this region.

In East Africa, the majority of deals are taking place in Kenya, the regional leader. Private equity investment has historically been taking place at fairly low levels given the importance of the region on the continent. However, increased investment is expected in the region, with the recent establishment of new fund managers with an East African focus.

Investor opinions

A recent survey conducted by RisCura, AVCA and SAVCA, The Search for Returns, found that while 26% and 24% of investors found sub-Saharan Africa and West Africa the most attractive regions on the continent; 28% of investors showed no bias toward any particular region.

No-one most attractive region on the continent
Attractiveness of different regions within Africa



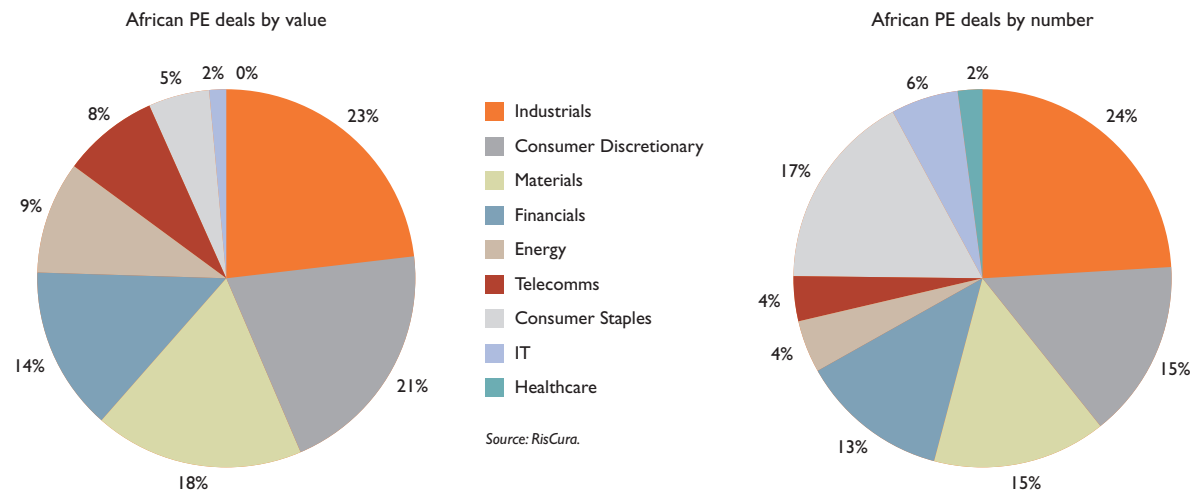
Africa's private equity sector focus

African private equity, like listed equity, is by no means perfectly diversified. Private capital will follow the most attractive deals, and this tends to favour certain sectors at certain times, as opportunities arise.

The value of private equity deals in Africa is weighted towards industrials, consumer discretionary, energy and materials, which make up three-quarters of deal value and two-thirds by number in our data set.

The charts below display the number of private equity deals, as well as the Enterprise Value of investee companies, which were the focus of private equity deals that took place in Africa between 2006 and 2013.

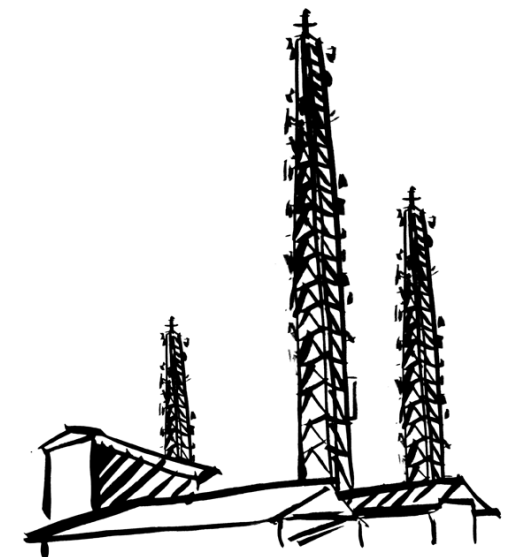
Sector focus differs from listed equity



Although Energy makes up 9% in value of deals that occurred over the period, the sector appears to be characterised by a small number of deals with large value. The telecoms sector exhibits similar characteristics, although not to the same extent. On the other hand, the consumer staples industry makes up a very small portion of the total value of transactions while contributing 17% by number of transactions.

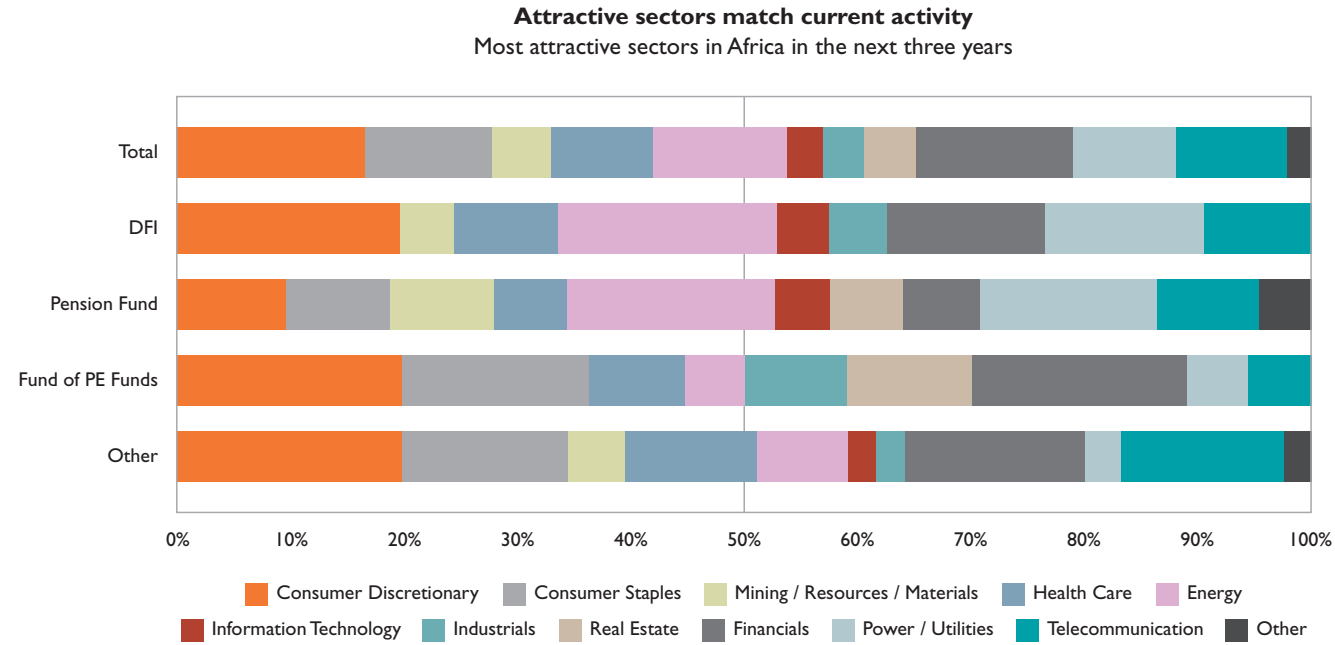
Based on this sample of deals, it appears that African private equity offers a different sector focus to listed equity, and may complement listed equity to create a more diversified African equity exposure.

Cellular Network Towers, Lagos, Nigeria.



Investor opinions

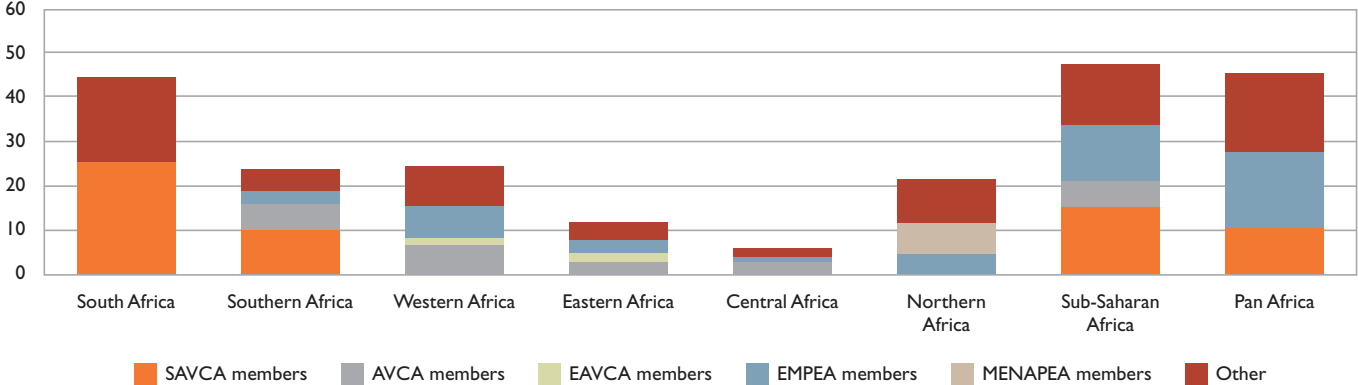
The results of the recent survey, *The Search for Returns*, are complementary to the sector analysis above; with the consumer discretionary, financial and consumer staples sectors considered the most attractive sectors in the next three years, according to limited partners (LPs).



Number of private equity managers by region

The graph below depicts the number of PE managers investing in the respective African regions according to their investment mandate or preference. Out of the total 223 managers considered, 52% had headquarters in South Africa, 13% were based in West Africa and a further 15% in Europe. Roughly half of managers have a sub-Saharan African or Pan African focus, reiterating the sentiment that there is no one most attractive region on the continent.

No-one most attractive region on the continent
African managers by investment region



Source: AVCA, SAVCA, RisCura analysis

Approximately half of the managers considered are regional PE managers, meaning that they are based in the region or country in which they are investing. According to the recent survey, *The Search for Returns*, 58% of LPs prefer regional funds as their route to accessing private equity in Africa.



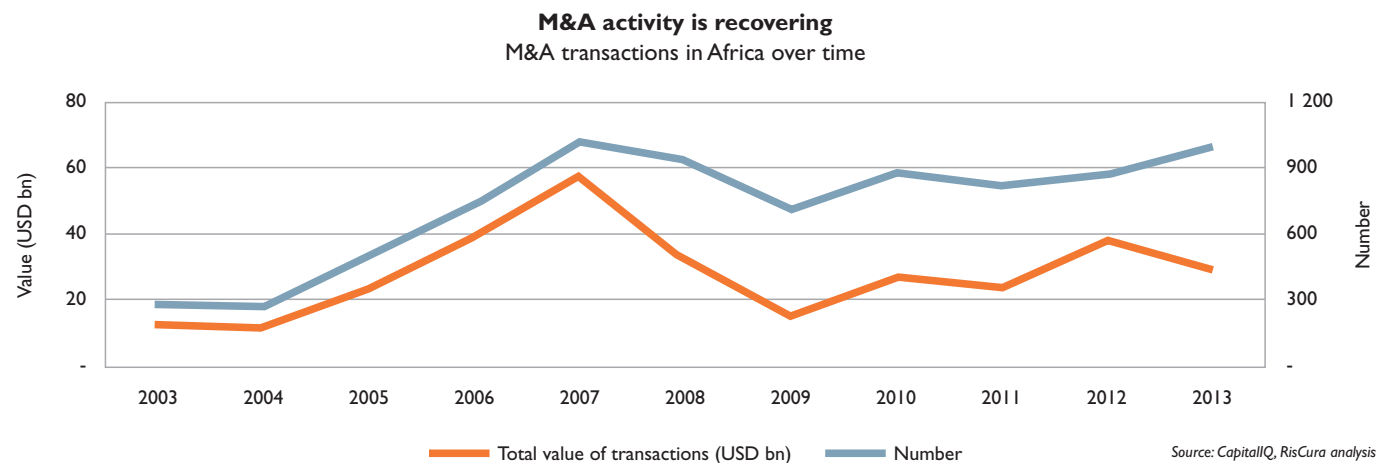
Merger & acquisition activity in Africa

Corporate mergers and acquisitions (M&A) play an important role in private equity markets, both as an indicator of activity and as an exit route for PE firms.

While not all M&A activity is recorded, those transactions that are reported provide some insight into the activity in this area. There was a sharp decline in M&A activity during the global financial crisis and the subsequent recovery thereafter. Data up to 2013 indicates that although a full recovery had not yet transpired, the number of transactions has risen to levels close to those in 2007.

M&A transaction activity over time

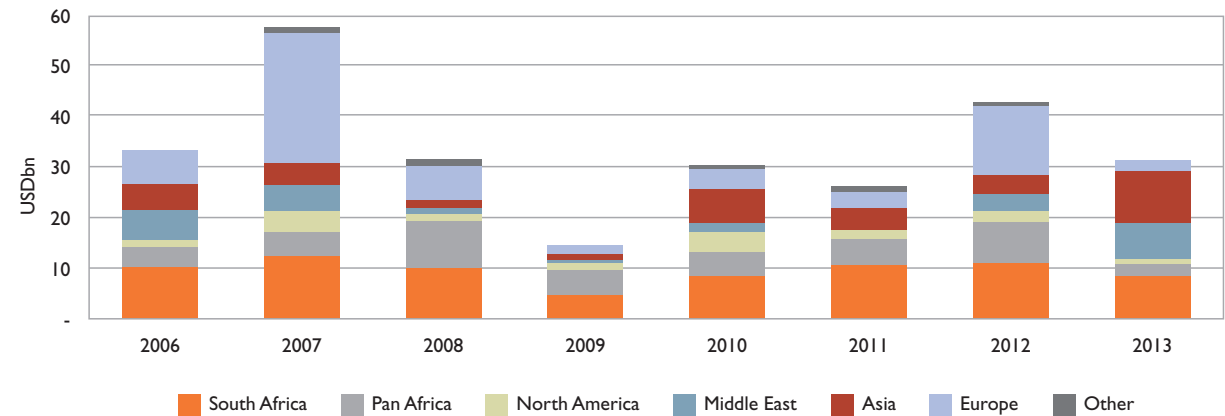
On average, Africa generates around USD 30 billion of M&A activity each year. As seen in the graph below, while Europe's activity in Africa declined substantially over 2009-2011 compared to the period before the global financial crisis. South Africa and the Pan African region experienced only slightly diminished activity over the same period. 2012 shows a major uptick in international investor confidence in the continent, apparent in the increased activity by European investors. The surge in investment from Europe in 2012 was led by investment from the UK, France and Switzerland into the continent. In 2013, Asian investment increased, but not enough to offset dips in investment from other regions.



Value of transactions by acquirer region

Increased activity from Asia in 2013 is due to large investments coming from India, China and Hong Kong while Middle East activity has been driven by the United Arab Emirates.

Value dips in 2013 despite uptick in Asian confidence
Value of M&A transactions by acquirer region



Source: Capital IQ, RisCura analysis.

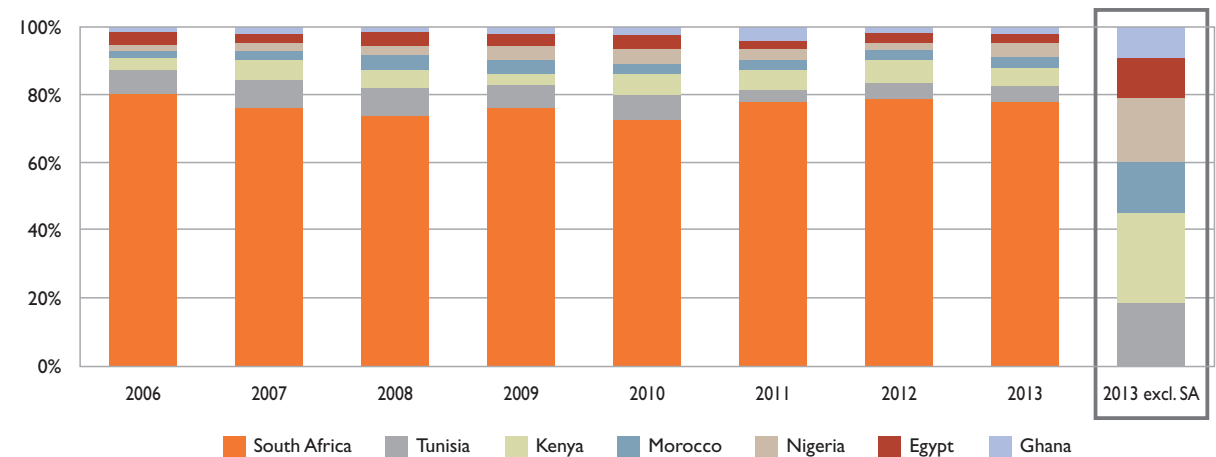
Number of M&A transactions

Considering the data by investee region, the target of M&A transactions has not changed significantly over the period. As is consistent with previous articles discussing the placement of investments in Africa, the majority of reported M&A activity occurs in South Africa. However, this still leaves around 200 reported M&A transactions per year taking place around the rest of the continent. It is very likely that transactions around the continent outside of South Africa are under-reported and are only a sample of the actual activity.

The number of transactions in Nigeria in 2013 was close to the level of activity seen in 2007/2008 representing a good recovery since the global economic downturn.

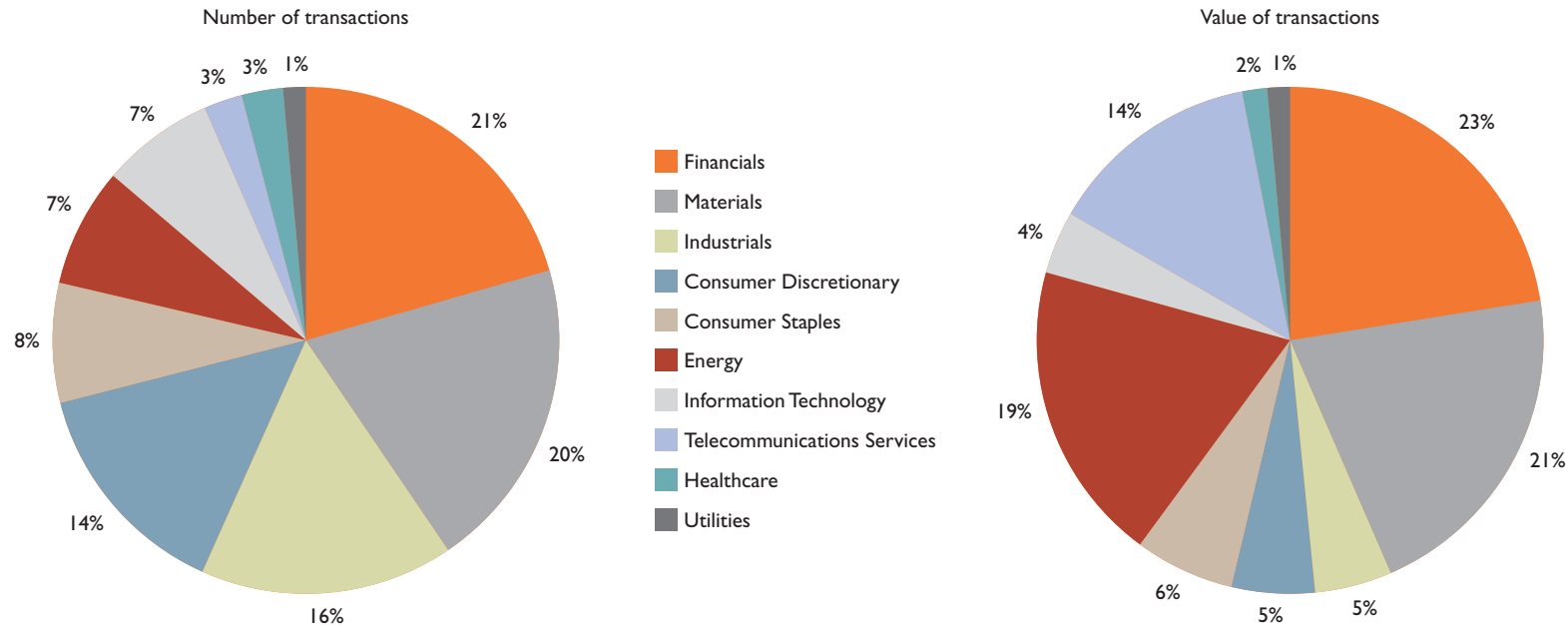
Over the last three years, growth in transactions activity in Nigeria has been in line with SA (CAGR 10%) and marginally above that in Kenya (CAGR 8%).

Steady exposure across the continent
Number of M&A transactions by target country



Source: Capital IQ, RisCura analysis.

Financials and materials dominate the market



Source: Capital IQ, RisCura analysis.

The pie charts above highlight that on a sector basis, financials and materials have been both the subject of the most deals, and the highest value deals.

Given the large amounts of capital required in the energy sector, it is expected that the 7% of deals that took place in this sector made up 19% of the value.

This was very similar to the telecoms sector; where 3% of the number of deals represented 14% of the deal value. Conversely, industrials and consumer discretionary deals made up 16% and 14% of the number of deals respectively, while each accounted for only 5% of the value.

Protea Hotel, Accra, Ghana.



6 Market multiples

An introduction to market multiples

An earnings multiple is a measure of the price of an investment, relative to the earnings of that investment. There are several different earnings multiples that are used by investors, but a common one is the ratio of the total value of an enterprise (Enterprise Value or EV) to the operating profit of the entity, proxied by EBITDA.

This EV/EBITDA ratio is a useful measure of the relative cheapness or expensiveness of different assets or markets, and is broadly comparable across sectors and geographies.

The Enterprise Value of a company is the sum of the market value of the debt and equity in the company. While this ratio is more commonly used in private equity rather than listed equity analysis, this multiple has been chosen for its flexibility for use across both kinds of equity investment.

The EV/EBITDA multiple represents a balance of growth expectations of an asset and the risk to the earnings. For example, an investor will pay less for an asset with a higher perceived risk but the same earnings as another asset, resulting in a lower EV/EBITDA multiple for the riskier asset. However, if that same riskier asset is expected to produce higher growth than another asset, this expectation of growth may outweigh the additional risk resulting in a higher multiple.

Multiples tend to revert to average levels over time for particular markets as expectations of growth and risk fluctuate. This can be seen in the developed market multiples chart below where multiples increased with confidence and optimism ahead of the global financial crisis of 2008. Once the financial crisis hit, multiples fell sharply as investors re-evaluated these expectations before multiples returned to 10-year average levels.

The Palms Shopping Mall, Lagos, Nigeria.



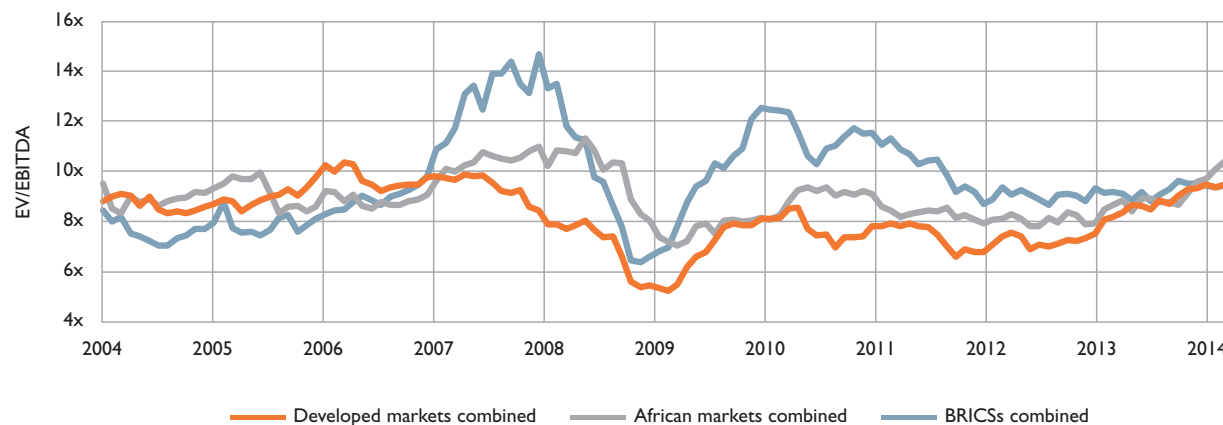
Listed multiples in Africa

In African listed markets, the multiples traded followed the global trend up to and through the financial crisis in 2008.

EV/EBITDA multiples comparison to African markets*

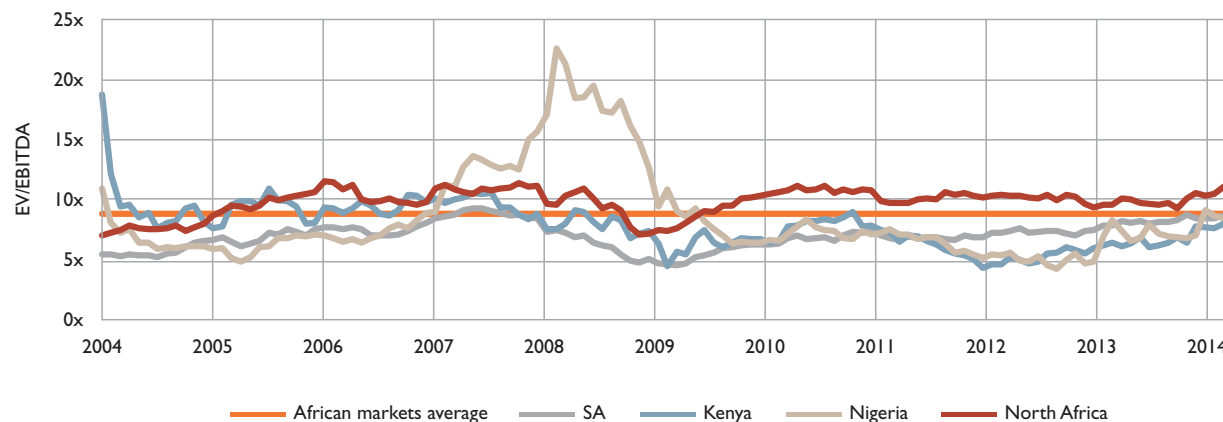
It is clear that all markets were negatively affected by the 2008 global financial crisis, with similar trends in the level of multiples. Africa was no exception to this, with multiples dipping sharply in 2008 and then partially recovering. Over the past 18 months, however, African markets have improved convincingly and were priced at 10.7x at 31 March 2014, increasing from 8.8x the previous year and above the ten-year average of 8.9x.

African multiples on the rise
Listed EV/EBITDA multiples over time



The crisis saw a dramatic dip in Nigerian multiples (illustrated adjacent), in particular from highs of more than 20x in early 2008. The recovery in African listed multiples after the financial crisis has been slow; however 2012 and 2013 have seen some improvement in multiples in Kenya and Nigeria particularly, as well as South Africa to a lesser extent.

Slow recovery of African markets
Listed EV/EBITDA multiples over time



Nile shipping, Egypt.



Source for both charts on this page: S&P Capital IQ RisCura analysis.

*Note: "African markets" refers to South Africa, Kenya, Nigeria, Ghana, Egypt, Morocco, Tunisia
Note: "North African" refers to Egypt, Morocco and Tunisia

Private equity multiples in Africa

RisCura has compiled a database of African private equity entry transaction multiples to determine the levels at which transactions are occurring, compared to other parts of the world. This database is a compilation of the multiples paid by African private equity funds to enter into private equity deals only. It does not include exit transactions. The graph below plots these multiples for a period from 2006 to 2013.

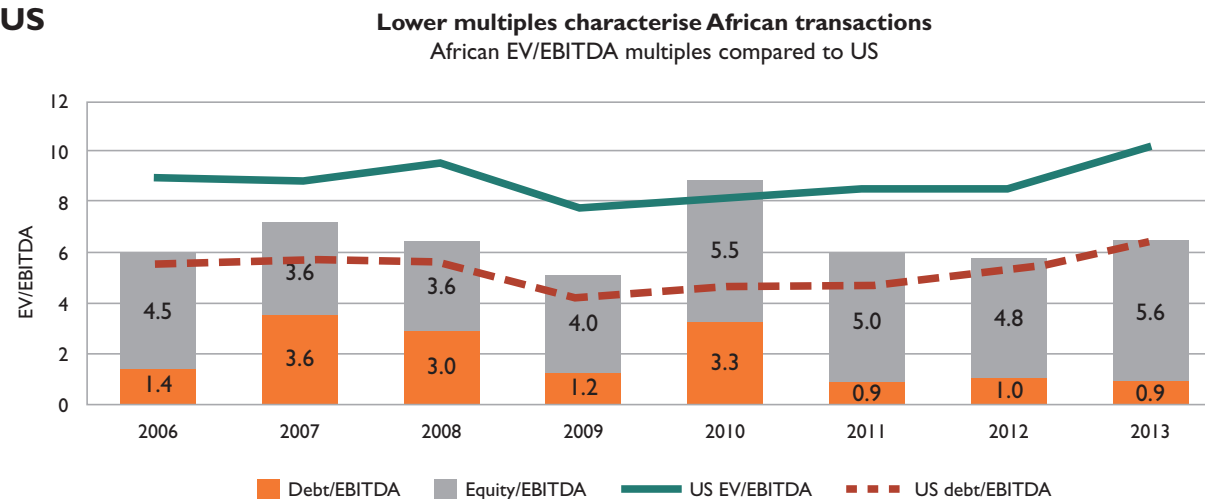
African private equity multiples compared to US

The adjacent information shows that, in general, African private equity deal multiples have been lower than those in other parts of the world, although there have been some exceptions to this rule.

In 2010, several large deals took place on the continent where fairly high multiples were paid to secure these investments. The sample includes an average of 30 African private equity deals per year for the 2006 to 2013 period and is considered indicative of the level of transaction multiples paid over time.

The area where African deals differ markedly from other parts of the world is the use of debt as part of the financing of deals. African debt markets are relatively undeveloped, with the exception of South Africa, which results in difficulty sourcing debt funding for deals. Consequently, African private equity deals have used an average of approximately 1x EBITDA in debt financing over the past three years, compared to approximately 5.5x in the US. This very low level of debt means that these deals take on little extra risk through leverage and, therefore, do not rely on leverage for returns.

The use of debt in Africa was higher in 2007 when large deals were still being done with debt in South Africa. Since then, however, debt levels have declined and have not fully recovered. In contrast, debt multiples in the US have recovered significantly since the dip in 2009, and appear to be the main driver behind increased purchase price multiples to 2013.



Source: RisCura, Pitchbook.

Note: Debt/EBITDA refers to the portion of the EV/EBITDA multiple funded by debt. Equity/EBITDA refers to the portion of the EV/EBITDA multiple funded by equity.

Analysis of private equity multiples in Africa

Deal multiples by count

An analysis of the number of deals falling into deal multiple groupings is plotted to the right, which shows interesting results when compared to global private equity deals.

African transactions are evenly spread across price categories above 2.5x EBITDA. Approximately one third of African PE deals take place between 2.5-5x EBITDA, twice the global average for this price group. In general it can be seen that African deals are more common in lower price groupings than globally where 40% of deals are priced in excess of 7.5x EBITDA.

This lower pricing of African deals is the result of many factors including higher risk perceptions and lower debt availability in African markets.

Deal multiples by company size

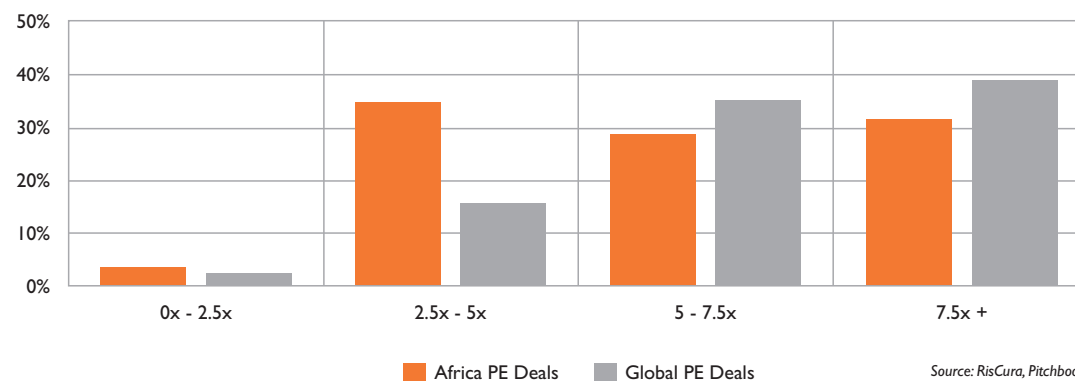
When deals are split by the size of the investee company, it is clear that the global trend of higher multiples and more debt on larger deals also holds true in Africa. Small and medium sized transactions are priced similarly to global levels when looked at through the economic cycle, while large transactions are priced lower in Africa.

When looking at debt multiples only, it is clear that much lower levels of debt are used across all deal sizes in Africa, with the largest deals averaging only 3.12x. While there is certainly an upward trend in debt use as deals become larger, the rate of increase is far lower than in global deals. Even deals involving companies with Enterprise Values of over USD 250 million are only 35% debt-financed compared to the global average of 61%.

This is due to a number of factors including poor access to debt markets in parts of the continent, the relative risk aversion of South African banks and generally high interest rates across the continent. The average debt use includes a number of deals that do not utilise any debt in the capital structure. When these all-equity deals are excluded from the data set, the Debt/EBITDA ratio moves up to approximately 2.8x. This is consistent with the levels at which South African banks say they will provide debt to deals.

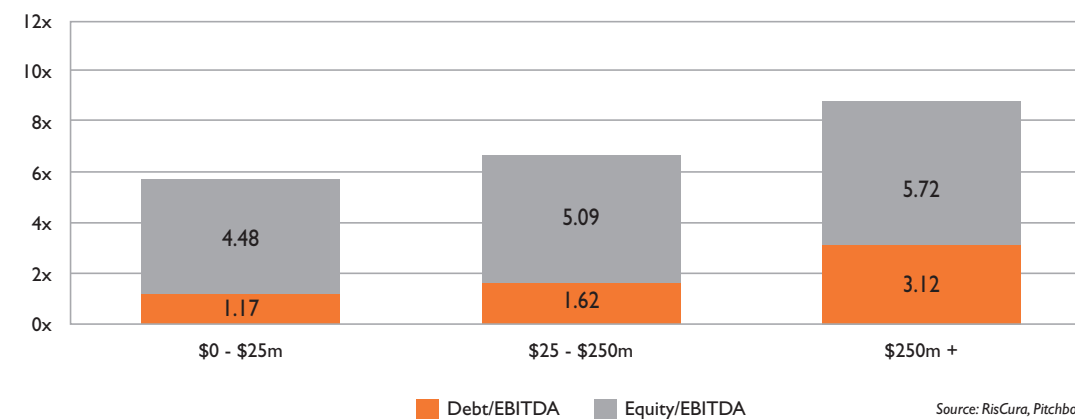
African deal making occurs over a large price range

Count of deal EV/EBITDA multiples by price categories



Leverage in Africa is low

African EV/EBITDA multiples by enterprise value

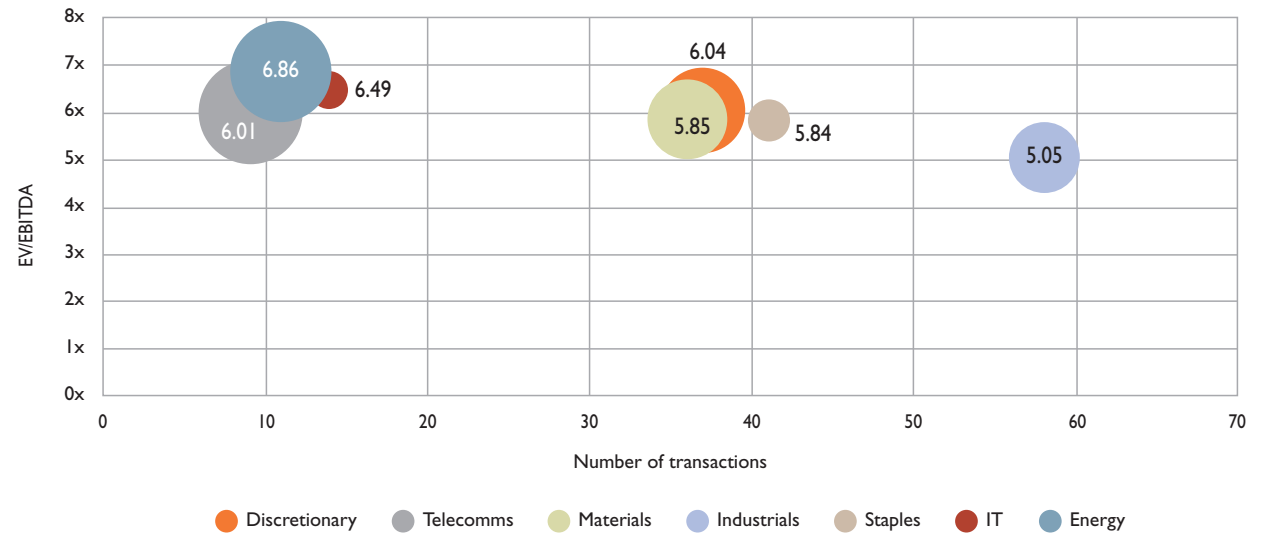


Deal multiples by sector

The adjacent graph depicts the median multiples of transactions occurring in each sector. The horizontal axis displays the number of transactions and the size of the bubble shows the average size of transactions in that sector. Interestingly there is a relatively small range of multiples between sectors, from the industrials sector with a multiple of 5.05x to the energy sector with a multiple of 6.86x.

As is consistent with previously illustrated data, the chart shows the relatively small average size of transactions that are executed in the consumer staples and information technology sectors, in contrast to large transactions in the energy and telecoms industries.

Range of multiples across sectors is small
Deal multiples by sector



Deal multiples by deal type

This section looks at the multiples that have been paid for different types of deals over the sample period. The results show that higher multiples and larger amount of debt are common in buyout/replacement deals, which would be expected due to the fact that a large portion of these deals would be leveraged, allowing for a higher multiple to be paid.

Debt pushes buyout prices up
Entry EV/EBITDA multiples by deal type

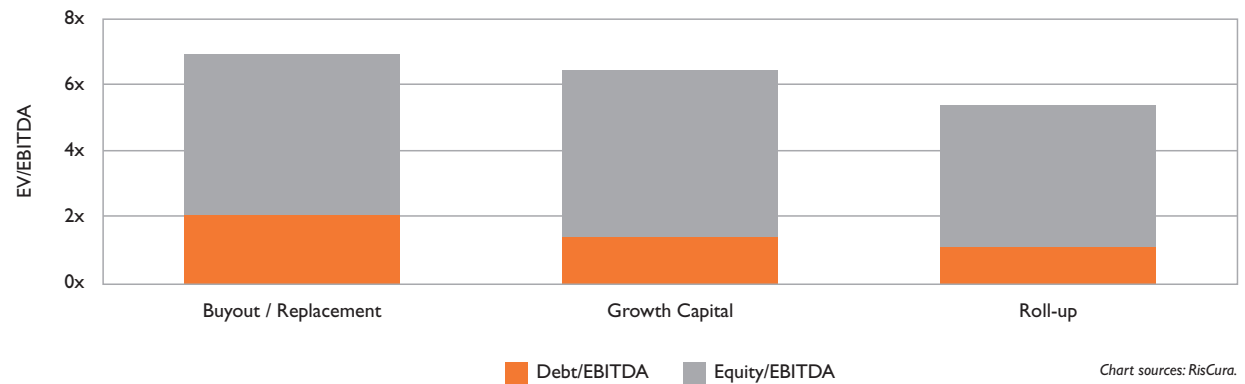


Chart sources: RisCura.

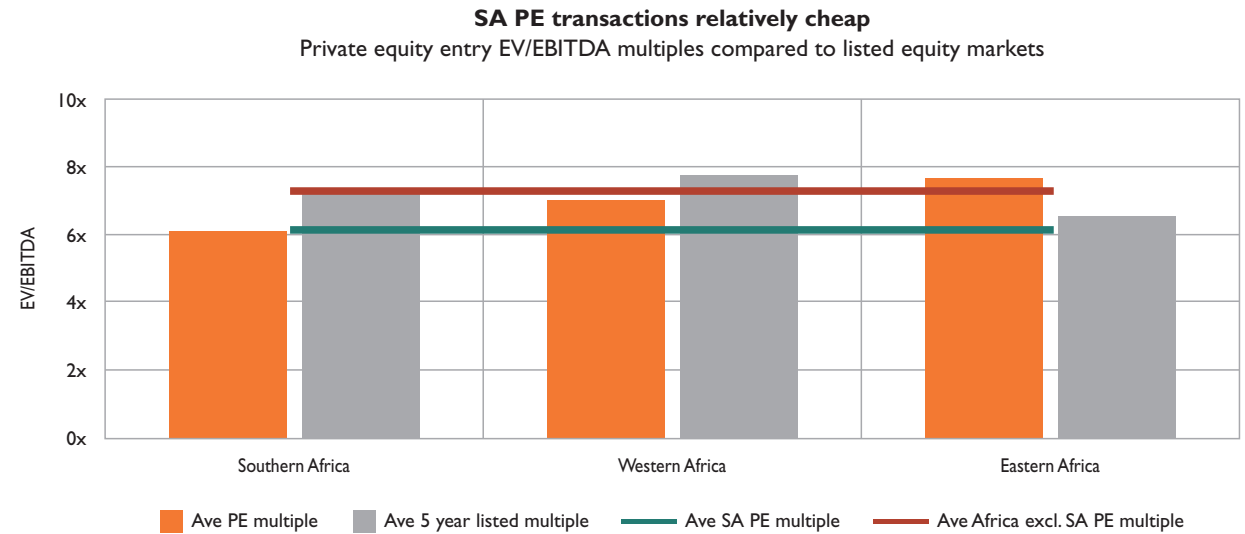


Deal multiples by company region

When multiples are broken down by region (shown in the graph below), it is interesting to note that those paid in South Africa are the lowest on the continent, both in listed and private equity markets. One explanation for this is the lower growth expectations for South Africa as a significantly more developed economy than those in the other regions.

West African listed and private equity multiples are comparatively high, reflecting the growth expectations for the region compared to other parts of the continent. East Africa, too, reflects relatively high private equity multiples. Overall, private equity multiples in South Africa averaged 6.2x, while those in the rest of the continent were 7.3x.

As noted previously in this report, North African fund managers have been reluctant to provide data for use in this report and therefore are under-represented. Therefore, the report does not show the region as the data set is relatively small and inconsistent.



Source: RisCura.

Terminology

AVCA	African Venture Capital Association
BRIC	Brazil, Russia, India, China
BRVM	Bourse Régionale des Valeurs Mobilières SA. The regional stock exchange serving Benin, Burkina Faso, Guinea Bissau, Ivory Coast, Mali, Niger, Senegal and Togo.
CAGR	Compound annual growth rate
Demutualisation	When a mutual company owned by its users/members converts into a company owned by shareholders.
DRC	Democratic Republic of the Congo
EBITDA	A proxy for operating income [Earnings before interest, tax, depreciation and amortisation]
Enterprise value, EV	A measure of a company's value [Market cap plus debt, minority interest and preference shares]
EV/EBITDA	Earning multiple calculated as Enterprise Value divided by EBITDA
FDI	Foreign direct investment
Free-float-adjusted	Market capitalisation of a company, adjusted to reflect the number of shares readily available in the market.
FX	Foreign exchange
GDP	Gross domestic product <ul style="list-style-type: none"> - PPP basis: Purchasing power parity basis, taking into account the relative costs of a basket of goods in each country, reported in current international dollars. - Nominal basis: GDP at current prices
GFC	Global financial crisis
IESEVC&PE	Refers to the IESE Business School Venture Capital and Private Equity
IFC	International Finance Corporation
IMF	International Monetary Fund
LP	Limited partners
M&A	Mergers and Acquisitions
Market capitalisation	Total dollar market value of all of a company's outstanding shares
MINT	Mexico, Indonesia, Nigeria, Turkey
MSCI	A US-based provider of equity, fixed income and hedge fund stock market indexes, and equity portfolio analysis tools
PE	Private Equity
P/E	Price to Earnings multiple
Rebasing of Nigeria GDP	The Nigerian GDP was recently rebased to a base year of 2010. This means that the National Bureau of Statistics recalculated GDP using a base year of 2010 (previously 1990), taking into account the production structure and prices in that year.
Sample period	RisCura private equity deal database covering transactions from 2003 to 2013.
SAVCA	South African Venture Capital Association
SWIX	Shareholder weighted index
Turnover ratio	A measure of stock liquidity calculated by dividing the total number of shares traded over a period by the average number of shares outstanding for the period.
UNCTAD	United Nations Conference on Trade and Development
WFE	World Federation of Exchanges

Appendix A

Criteria for Quality of Exchange Ranking

For each criteria below, the higher the score the better an exchange fared in that criteria.

Criteria 1 [Complete Data]

A point allocated based on whether all countries have market capitalisation, value traded and number of companies listed information available.

Criteria 2 [Number of Companies Listed]

3 point rating based on the number of companies listed.

Criteria 3 [Value Traded]

6 point rating system based on the size of value traded.

Criteria 4 [WFE Membership]

A score of two awarded to all WFE members.

Criteria 5 [Regulation]

7 point rating system testing strength of an exchange's regulation, scores were obtained from the World Economic Forum Global Competitive Report.

Criteria 6 [Financing through stock exchange]

7 point rating system testing the ease in which companies are able to raise money by issuing shares on the stock market, scores were obtained from the World Economic Forum Global Competitive Report.

Criteria 7 [Openness to foreign ownership]; Criteria 8 [Ease of capital inflows/outflows] and Criteria 9 [Efficiency of the operational framework]

All three criteria were sourced from the MSCI Global Market Accessibility Review and carried a maximum score of 0.5 per criterion.



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