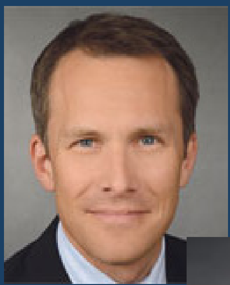
AVCA Member Profile: DEG



DEG is one of the Development Finance Institutions (DFI) that has been leading investments in Africa since the 1960s. Today it is part of KfW, the German government-owned development bank. DEG's mission is to create sustainable growth in developing and emerging market countries by promoting business initiatives. Of the 100 emerging and developing market private equity (PE) funds in its portfolio, 25 are African.

DEG's PE investment group works out of Accra, Johannesburg, Lagos and Nairobi as well as the organisation's headquarters in Cologne. Gunnar Stork, Director - Equity & Mezzanine, Africa and Latin America based in Cologne, and Anne Kellper, Vice President - Equity & Mezzanine Africa based in Johannesburg, talk to AVCA about where and how they are finding investment opportunities in Africa.

Q: What sorts of PE funds are appealing to DEG?

A: ANNE: Our regional focus is north of South Africa. We support first-time teams, some small and mid-sized regional funds and larger players too. We are a long term investor and don't have to adhere to specific time frames for exits.

GUNNAR: We like a well-diversified portfolio and we focus on transactions that we understand. There are 500 DEG employees worldwide and so we can only do so many deals. The core team focusing on PE, is made up of around 10-12 people, with the support of the wider DEG organisation, looks at a lot of funds and deals. But currently we are committing to only 4 or 5 PE funds in Africa each year.

Q: Do you worry that a fund could fail to get raised just because DEG has declined to invest?

A: ANNE: If we say 'no' to a GP we are happy to openly explain our decision. If, for example, a GP has a specific country focus and they don't want to look outside of this, then that would distort our diversification strategy.

However, we do offer an open door; it is part of our role. We stay in touch with a lot of the managers we don't invest in. On the fund side we have limited resources so we have to be very selective.

Q: Origionally DEG predominantly offered loans but has moved into equity. Is this the way things will stay?

A: ANNE: We are a bank in the wider sense; 60% of what we do is loans. We are slowly migrating into an equity business. Today roughly 50% of the portfolio is in risk capital.

GUNNAR: In the future, risk capital should rise to 60%. It will be 45 - 50% over the medium term, although in Africa we are at 50% already. There are both developmental and return reasons for this. One part of our mandate is to discover and develop new markets and another part is to support new instruments. The larger markets have long term debt available in their local currency and some are trying to fulfil the next funding gap; that is equity and mezzanine. Based on returns alone, the PE programme has been successful.

After 15 years of investing in Africa, we feel that mezzanine will definitely find its way into the continent. Mezzanine poses a more complex set of risks and questions surrounding the legal rights and ranking of mezzanine investors within a company. Companies need educating that mezzanine can be structured like cheap equity by combining the advantages of equity and debt.

Q: Could selling into the secondaries market be a good route to expanding Africa's PE institutional investor base?

A: GUNNAR: Over the last two years we have had quite a bit of interest in our portfolio or for us to buy secondary portfolio positions from various sources. Sometimes these are introduced by fund managers, sometimes by placement agents or direct from an investor seeking an exit. We don't have to sell portfolios so we are not a very active secondary player.

ANNE: We are seeking to expand Africa's PE institutional investor base in other ways. Last year, with EKK Bank, we launched the €150mn Renewable Energy Fund for Emerging Markets, known as the EKK Fund. It is managed by Universal Investment, a German investment company. DEG sources the investments and offers them to the EKK Fund as a co-investment opportunity. This allows German investors to learn from DEG's emerging markets experience, as opposed to selling secondary positions without any ongoing support from DEG.

Q: Everyone knows who DEG are and where to find you. How do you source good deals?

A: GUNNAR: I was based in Mexico for four years until the autumn of 2014. This taught me a number of things. Firstly, know as many people as you can and build a very strong network to source deals. Secondly, know who you should do business with. Finally, know which transactions you should not touch. You can only source deals if you do deals. We have been very active in Africa for over three years now. The more business we do, the more we build our pipeline.

ANNE: We also go to conferences. The investor community meets up two or three times a year at these conferences. We find AVCA's annual conference very useful. We have very close relationships with other DFIs and we discuss pipelines and various issues, so fund managers should never expect that we are not going to talk to each other!

Q: US$4.1bn was raised for PE in Africa in 2014, according to AVCA's recent statistics. What do you make of all this capital and interest in Africa?

A: GUNNAR: In the last 12 to 18 months the number of large funds in the US$500mn - US$1bn range has increased dramatically. Three years ago there were not many US$100mn transactions on the continent. We are curious to see if there are enough deals for so many large funds. In the US$100mn - US$500mn fund size bracket there are still enough deals for the number of funds in the market.

Q: How does DEG keep its talent from disappearing into PE funds?

A: ANNE: We don't have any equity upside but we have a stable team and not a lot of churn. Gunnar has been with DEG for 14 years and I have been here almost 10. Most of us really like what we do; we get to combine the challenges of development and returns and we work with people with similar mindset.