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# THE PRIVATE EQUITY CLIMATE IN AFRICA: EMBRACING THE LION

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*Connecting Investors Across the World*

**Avanz Capital Partners Ltd.** is an independent investment firm that specializes in private equity across the emerging and frontier markets. It has been established to invest in private equity funds in emerging and frontier markets, with complementary direct and secondary activities.

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*Prepared by Avanz Capital in association with the Africa Venture Capital Association*

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## **Summary**

### **Why is private equity in Africa an opportunity and how big is that market?**

Often referred to as the 'final frontier' market by private equity investors<sup>1</sup>, Africa is showing signs of promise due to its rapidly improving economic environment, favorable demographics and growing private sector business activities. Investors who are diligent in their research of investment opportunities have been able to realize outsized returns while minimizing perceived risks. Opportunities exist across the continent, which has been largely overshadowed as an emerging markets private equity destination by hot BRIC<sup>2</sup> markets. As BRICs become increasingly competitive and acquisition values are increasing, investors have begun to seek compelling opportunities for investment in frontier markets, where significantly lower entry prices exist compared to other emerging markets. In addition, the underpenetrated private equity industry offers substantial growth potential, given that Sub-Saharan Africa private equity represents only 0.09% of total GDP for the region. Further, the potential of the private equity market in Africa is substantial given the estimated 400,000<sup>3</sup> private companies compared to 388<sup>4</sup> publicly listed companies in South Africa alone. Public markets are concentrated on larger companies and they lack representation of many companies and industries that will benefit from future growth of the continent.

The African continent comprises 44 countries in Sub-Saharan Africa and 8 in North Africa and can be divided into five sub-regions – East, West, Southern, Middle and North. Of these five sub-regions, West Africa is divided into Anglophone and Francophone West Africa. Each of the sub-regions is typically dominated by one country that provides a larger hub market for many increasingly regional companies – Kenya in the east, Nigeria in the west, South Africa in the south, and Egypt in the north offer the most developed country-specific markets. A note of caution, as these countries are emerging, an assessment of the economic, political, and social risks associated with each is essential for determining investment opportunities.

## **I. Macroeconomic Overview**

*African GDP growth weathered the recession better than OECD countries and has recovered much more strongly.*

*World Bank Data*

The IMF estimates GDP growth in Africa will be 6.6% in 2012, compared to 3.7% for OECD countries. The economies of Africa are resilient, as demonstrated by the economic growth maintained through the heart of the financial crisis. According to IMF data, Sub-Saharan Africa's GDP grew at a high of 7.1% in 2007, slowing to 2.9% in 2009, compared to advanced economies' real GDP growth, which averaged 2.8% in 2007 and -3.6% in 2009<sup>5</sup>. Moving forward, there are high growth expectations for Africa. More specifically, growth is forecasted to average 5.5% in 2017, compared with advanced economies' expected average of 2.7%. The continent holds 16 of the top 30 economies that are expected to have the fastest growth rates over the next five years (2012-2017)<sup>5</sup>.

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<sup>1</sup> Emerging Markets Private Equity Association "EMPEA" Insight: Private Equity in Sub-Saharan Africa, November 2010

<sup>2</sup> Brazil, Russia, India and China

<sup>3</sup> Doing Business in South Africa - 2011 (by the US Department of State)

<sup>4</sup> World Federation of Stock Exchanges

<sup>5</sup> International Monetary Fund World Economic Outlook, April 2012 Edition

Avanz Capital believes GDP growth will continue to be driven by a combination of factors including: (1) relative political stability and increasing reform, which will support better management of resource extraction industries, and (2) investment in related services and development projects, particularly in the energy and infrastructure sectors.

A growing number of African economies are in very good macroeconomic shape. Successful investment in the continent requires an understanding of trends in sub-regional growth, as some countries are in much better position either by virtue of their natural resource abundance or by superior political governance (often an “either/or” situation).

As political reform and greater global integration open-up African markets, driven initially by the global increase in demand for natural resources, African economies that acknowledge and embrace these changes stand to grow. By diligent analysis of opportunities in select countries and regions, investment risk can be mitigated while still achieving excellent returns.

Such robust growth has given prudent governments a much wider range of macroeconomic policy options, which gives African markets flexibility against the worst pressures of the continuing global downturn. Many African governments have followed a reform agenda, with 78% of Sub-Saharan economies implementing some form of business regulation reforms in 2011, up from 59% in 2010, according to the *World Bank Doing Business Report 2012*. Recent commentary on the impact of the Euro Crisis on Africa's economies has painted a mixed picture. The African Development Bank Chief Economist, Mthuli Ncube, believes that the crisis damages trade, restricts African governments' abilities to borrow money on the international markets, and also reduces the level of tourism, which is having a big impact on more diversified economies that do not rely as heavily on commodity-based trade relations with China. Some investors, such as Hurley Doddy of Emerging Capital Partners (ECP), remain bullish on Africa's prospects, noting continuing demand from China, supporting Africa's middle-class driven domestic growth story.<sup>6</sup>

The continent has improved its macroeconomic stability bringing inflation down from an average of 114% in the 1990s to an average of 59% since 2000, according to the *World Bank Databank, 2011*. The average current account deficit too has dropped from -2.7% (of GDP) to -1.3%, signaling the growing strength of African economies in global markets. As a percentage of total GNI, the debt burden on the continent has fallen from an average of 115% in the 1990s to 84% since 2000. Having a lower debt burden does allow governments in Africa more options to combat domestic economic pressures.

As in other emerging markets, the growth of the middle class is an important driver of investment opportunities. Three major demographic shifts are evident: (1) a growing formal labor force, (2) increasingly urbanized population, and (3) dramatically falling dependency ratios on the continent. Africa is currently

*In comparison to other emerging economies, Africa is still a largely underserved market of nearly 1 billion people (14% of the world's population) and is hugely diverse. It is easily forgotten that the Continent spans 20% of the world's land mass – more than Europe, India, US and China combined.*

*- Hurley Doddy,  
Managing Director and  
Founding Partner of  
Emerging Capital  
Partners (ECP)*

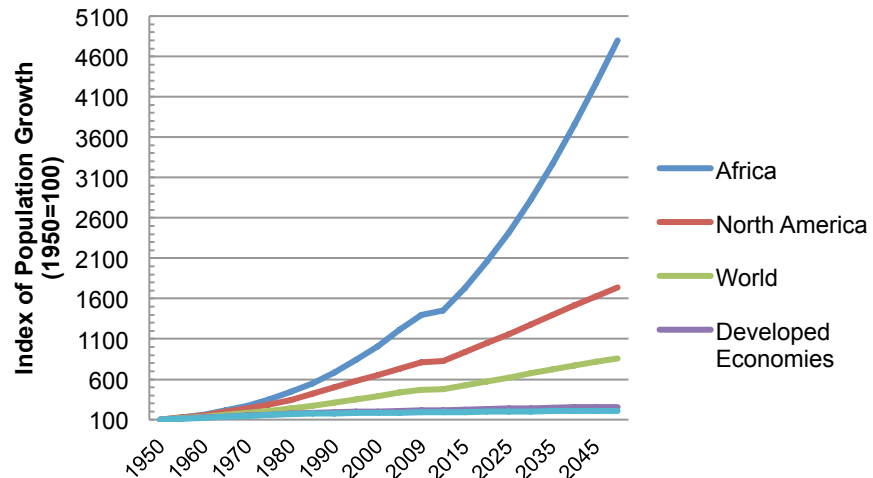
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<sup>6</sup> <http://www.bbc.co.uk/news/business-17039701>

leading the world in these positive trends and stands to benefit from this demographic shift in the coming decades.

The urban population in Africa is rising. Between 1990 and 2009, the urban population expanded by 102% to 408 million people, as compared globally, where urbanization growth was 54% over the same period, reaching 3.5 billion people. Since 1950, Africa has seen a staggering rise in urban growth, which is forecast to continue in the coming decades (see figure 1). The impact of urban development has been a mutually reinforcing cycle of economic growth and development within urban economic hubs. As more people flock to take advantage of superior opportunities, this virtuous circle pushes increasing numbers of the population into a higher economic layer as businesses expand and mature, which results in higher wages and more disposable income with which to further spur economic growth.

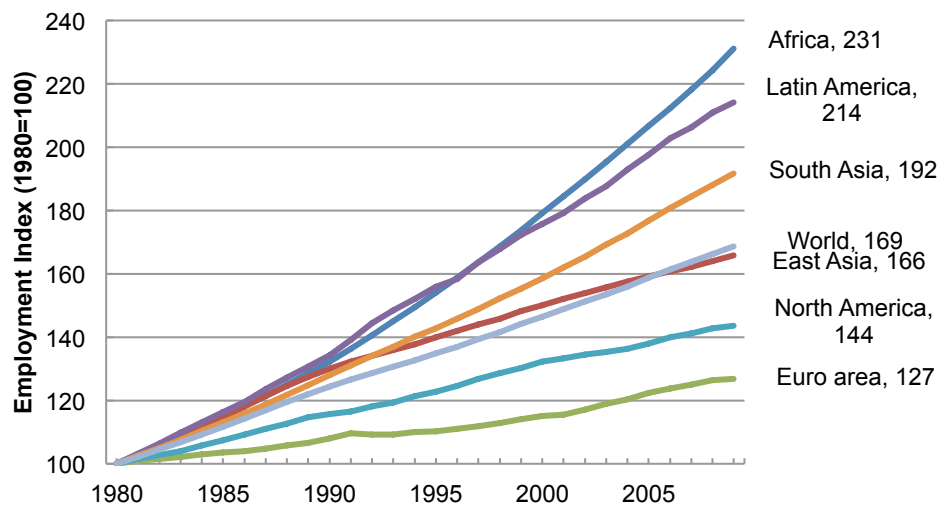
**Figure 1: Global Urban Growth Index, 1950-2050**



Source: UN Population Division (1950-100)

Not only is the urban population growing, it is reinforced by a rapidly expanding labor force. As figure 2 shows, Africa has outpaced the world on this front since 1980. Increasing the supply of labor can be a blessing or a curse depending on the macroeconomic context, as well as how it is managed, but the exceptional growth in many parts of Africa should create a virtuous cycle as companies seek increasing amounts of both skilled and unskilled labor to manage their growth needs. As long as there is economic momentum and it is appropriately managed, the labor boom will continue to develop opportunities in African economies for growth companies. In turn, developing domestic companies stands to propel millions of people into the middle class in the coming decades as Africa and Africans seek a brighter economic future.

Figure 2: Labor Force Growth Index, 1980-2009



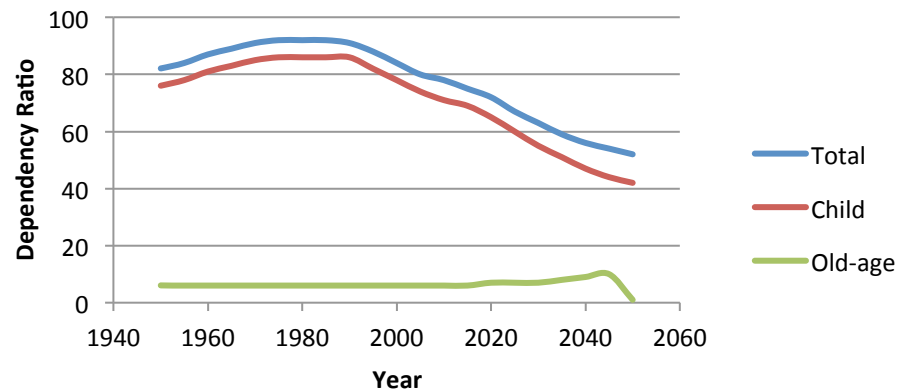
Source: IMF World Development Indicators (1980=100)

The dependency ratio shows the relation between the working age ‘productive’ population (typically 15-64) and those who are ‘dependent’ (under 15 and over 65) excluding unemployment variations. The measurement has major policy implications, depending on whether the country is facing a demographic surplus (high productive, low dependent population) or deficit (low productive, high dependent population).

In Africa, dependency ratios for children have already fallen dramatically since the 1970s as greater education and the slow but steady improvement in living and health standards (for example, child mortality has fallen by 28% since 1990) have led on average to reduced family size and extended life expectancies. Sub-Saharan Africa still has a dependency ratio 1.6 times the world average (85% vs. 64%)<sup>7</sup>, but as figure 3 shows, the trend in Africa is towards a declining ratio. This decline is also linked into the rise in both urban population and labor force growth. Africa has a very large young population due to demographic trends, and has had traditionally one of the shortest average life expectancies of any continent. This is changing, however, as more stable social and economic conditions and increasing access to high quality healthcare are supporting productive demographic shifts. As one result, child dependency is set to continue its decline as more people live longer and more productive lives, which will reduce the child dependency ratio. These factors will lead to ideal demographic conditions to foster the growth of the nascent African middle class, who will drive the next generation of African economic growth.

<sup>7</sup> Africa Development Indicators 2011: Factoids [http://siteresources.worldbank.org/INTAFRICA/Resources/Africa-factoids\\_hires\\_FINAL\\_Sept\\_9-2011\\_11.pdf](http://siteresources.worldbank.org/INTAFRICA/Resources/Africa-factoids_hires_FINAL_Sept_9-2011_11.pdf)

Figure 3: Africa Dependency Ratios, 1950-2050



World Bank Database, 2009

Foreign direct investment (“FDI”) inflows in Africa for 2010 reached \$55 billion, eclipsing the \$7 billion in 2000, and are expected to continue at an upward trend, which should help Africa to attract further investments as it builds a stronger track record and provides investors with better investment opportunities.

The current outlook is positive as growth rates remain strong relative to the global economy. Further, investment in private equity has shown both return potential and diversification benefits on portfolios, thereby continuing to drive growing emerging market investor interest in the region.

## II. The African Private Equity Opportunity

The potential for the private equity market is significant. In South Africa alone there are an estimated 400,000<sup>8</sup> private companies compared to 388<sup>9</sup> publicly listed companies. Investors pursuing private equity strategies can target attractive and diversified sectors that are under-represented in the public markets. Private equity investors are also able to invest in small and medium sized enterprises, while public markets generally are comprised of only the largest companies.

In contrast, one of the perceived advantages of public company investments over private equity investing is the availability of liquidity in the public markets for exits. However, the major risk in investing in listed equity in Africa is the level of volatility. This volatility is due in part to the limited number of actively traded companies on the stock exchanges. Because of the restriction of supply, there is a lot more demand for a limited number of stocks, and they rise more sharply. On the other hand, when investors retreat, due to the relatively illiquid

<sup>8</sup> Doing Business in South Africa - 2011 (by the US Department of State)

<sup>9</sup> World Federation of Stock Exchanges

*Africa is currently under-funded, but shows considerable potential. The IFC's Africa portfolio saw a 21.73% [per annum] return between 2000 and March 2010.*

*- EMPEA Insight: Sub-Saharan Africa 2010*

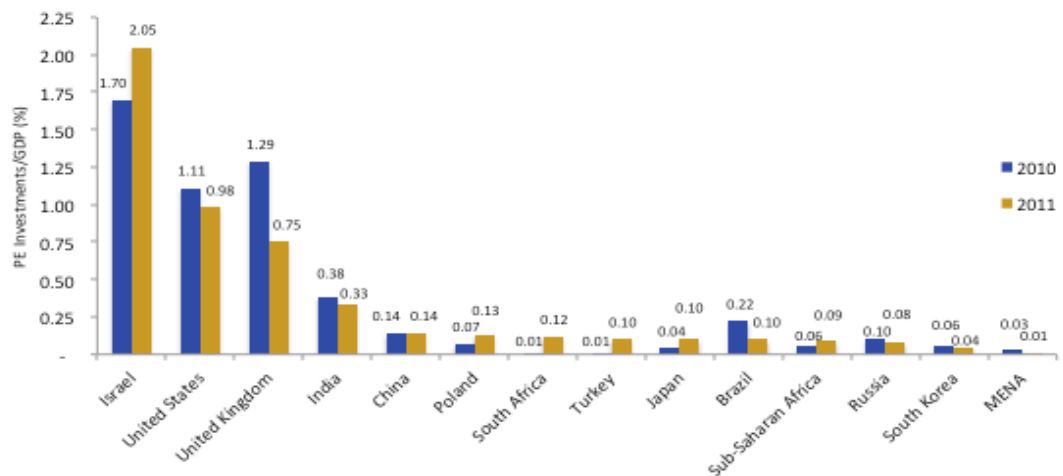
nature of stock markets, valuations drop more sharply than for companies who are in deeper, more liquid, and interlinked developed markets stock exchanges.

According to the Avanz Capital database, there are 158 private equity funds (115 fund managers) in Africa with a total of \$32.9 billion in capital closed since 2002 or currently being raised (avg. fund size is \$216.5 million). Of the 158 funds, 60% have a fund size below \$200 million, 32% are in the middle market (\$200-800 million) and only six have fund sizes above \$800 million.

The landscape of private equity funds in Africa is small compared to emerging Asia (excludes the developed countries) where there are 427 funds (286 fund managers) with a total of \$184.3 billion in capital closed since 2002 or currently being raised (avg. fund size is \$475 million). Latin America has a similar number of funds to Africa at 165 and number of fund managers at 110 but the total capital closed since 2002 or being raised currently at \$54.0 billion and the average fund size of \$330 million are nearly double that of Africa<sup>10</sup>.

Africa's private equity industry is at an early stage of development, but it is growing steadily, providing a solid case for investment. The ratio of private equity investments to GDP in Sub-Saharan Africa stood at 0.09% compared to 0.98% in the US and 0.14% in China in 2011 as shown in figure 4.

**Figure 4: Private Equity Penetration – 2010 & 2011 (Percent of GDP)**



*Source: EMPEA EM PE Annual Fundraising and Investment Review, 2011, Spring 2012, p. 24 (data from EMPEA, IMF, Centre for Management Buy-out Research, Pitchbook, Israel Venture Capital Research, Asia Private Equity Review). Methodology: Annual PE investment divided by annual GDP.*

The region has only attracted between 3% and 6% of total funds raised in emerging markets between 2005 and 2011. Africa stands to prosper if capital is committed to support growth businesses amid the improving regulatory, political and market climates. The African market has shown an early track record of success, based on the explosive growth potential for African companies, as was the case with Helios Towers (see box below).

<sup>10</sup> Avanz Capital database



**Helios Towers**

Helios Towers Nigeria Limited was established in 2005 to provide GSM and fixed wireless operators in Nigeria with an economically viable and environmentally friendlier outsourced alternative to in-house construction, maintenance and ownership of telecommunication tower sites. The company builds and maintains a network of telecommunications towers, and leases space on the towers to multiple GSM, fixed wireless and other providers of wireless services under long-term lease agreements.

The company was supported by an initially modest investment by the IFC of \$50 million of mezzanine debt, plus a second tranche of \$50 million of senior debt, and syndicated a further \$150 million from other development banks (AFDB, DEG, FMO, PROPARCO) and private investors, including Soros Strategic Partners, RIT Capital Management (Lord Rothschild’s investment firm) and Albright Capital Management. In conjunction with DFI involvement, established investment firms joined the investment, providing a deeper source of funds to an investment opportunity with strong potential.

The IFC has since returned to invest a further \$250 million in Helios Towers’ expansion plans into Ghana and East Africa. Private investors returned heavily too, taking advantage of an early track record of success. A number of initial investors returned from Global Investor Group, an investment vehicle comprised of Soros Strategic Partners LP, RIT Capital, Albright Capital Management LLC and Helios III Fund, investing \$350 million in equity to support the rollout of services to other African countries.

*We’ve seen the emergence of more large GPs, but we expect to see more fund managers entering the market. We expect that pension fund regulation reform, enabling local institutional investors to invest in private equity will also help catalyze the emergence of more fund managers.*

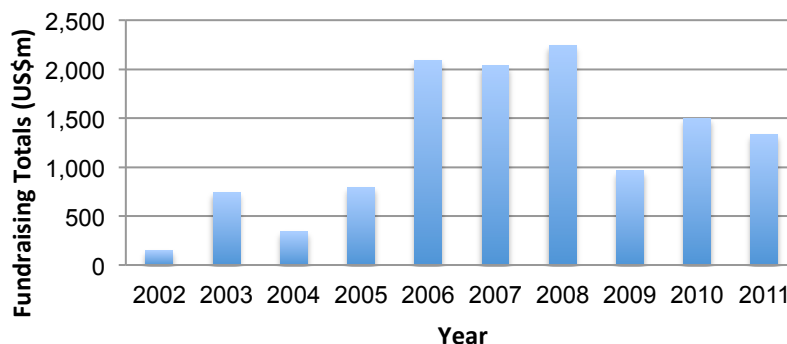
*- Okechukwu Enelamah, CEO of African Capital Alliance (ACA)*

**Fundraising**

According to Preqin statistics, by October 2010, 73% of fund managers on the road were raising either their first (23%) or second fund (50%). These figures are significant, reinforcing the strength and stability of the continent’s private equity markets in light of continued global financial uncertainty.

There is increasing interest among investors for Africa-focused private equity funds. In 2011, private equity funds in Sub-Saharan Africa raised over \$1.3 billion, a significant increase from \$964 million raised in 2009 but still below the record \$2.2 billion raised in 2008 (see figure 5). Recently renewed global concerns have suppressed a smooth upward rebound.

**Figure 5: Sub-Saharan Africa Fundraising Totals, 2002-2011**



Source: EMPEA. Data as of 31 December 2011. Published 15 March 2012.

While investors maintain long-term expectations of significant growth in emerging and frontier markets, fundraising totals have been spiky, and Africa is no different. Year-on-year change in fundraising totals was 133% for 2004-2005 and 164% for 2005-2006, as investors looked to invest in perceived high-risk, high-return environments. After the global financial crisis in 2008-2009, Africa rebounded faster than the emerging markets as a whole. Africa showed its robustness by attracting 56% growth in fundraising commitments for 2009-2010, outpacing the emerging markets fundraising totals of 4% for 2009-2010.

The fundraising landscape in Africa has been driven over the last few years by pan-African funds, many launched by established fund managers. In 2010, the EMPEA-reported \$1.5 billion fundraising total was largely composed of the February closes of Kingdom Zephyr Africa Management's second Pan African Investment Partners Fund at \$492 million and Aureos Capital's \$381 million. These were followed in July by Emerging Capital Partners' third fund at \$613 million.

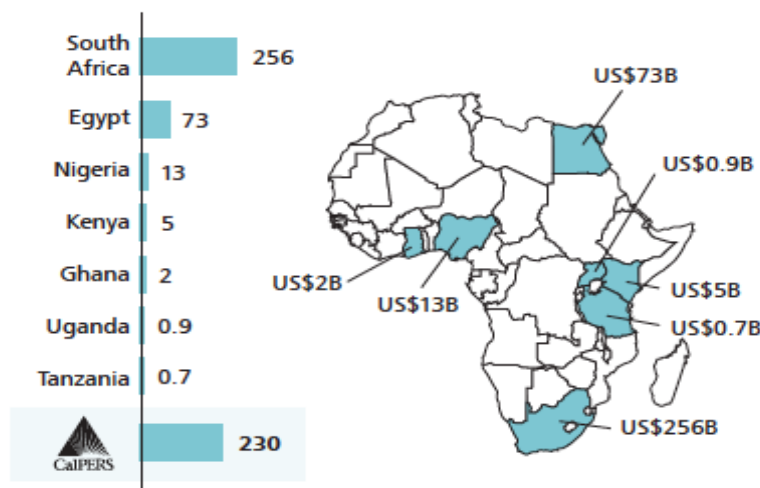
The trend continued in 2011 with Helios Investment Partners' \$900 million fund that closed in June that year, accounting for the lion's share of the \$1,056 million raised in the half year. On the near horizon is a \$500 million fund announced by The Carlyle Group in 2Q, while proven South Africa fund manager Ethos is nearing a final close on a \$750 million fund, showing that Africa can already rival, and is on course to beat, its own pre-crisis fundraising.

While fundraising in Africa has been dominated over the past two years by a handful of managers that provide investors with excellent track records, there are many smaller, often first- or second-time funds, emerging with more nimble portfolio targets. These funds allow investors to select from a deeper fund manager pool as the number of funds operating in Africa has grown fivefold in the past decade. The number of fund managers investing in Africa for the first time has more than doubled since 2004, according to Preqin statistics. In 2004, 6 first-time fund managers held a close on their fund. The number of first time funds closing rose to 13 in 2008, before dropping during the global recession. As of September 2011 however, 14 first time managers had seen their funds close, signaling a promising rebound. This trend of new managers entering will continue to flesh out the talent pool of managers operating in Africa, and as these fund managers go on to establish later funds, will lay down solid data to chart future performance.

African private equity markets are also underfunded. Sub-Saharan Africa private equity funds raised \$11.0 billion, while they invested \$12.3 billion between 2005 and 2011 according to EMPEA statistics. By comparison, Asia private equity funds raised \$26.3 billion and invested \$18.7 billion during the same period. The difference is that Sub-Saharan Africa has more investment opportunities for capital than capital raised, leaving the market underfunded; this statistic simply highlights Africa's potential as an investment destination. Whereas in emerging Asia, interest in deals has led to well-funded investment vehicles, but increased competition which has driven higher valuations.

Increasingly, African fund managers are looking to tap local pools of capital. With the rise of the middle class leading to growing pension pools, Nigeria and South Africa are increasingly allowing local pension funds to invest in private equity on a much larger scale. Domestic institutional capital in Africa is starting to play a role in private equity, increasingly outside of the home country of the institutions. The large and growing size of domestic institutional capital is a significant opportunity for private equity on the continent. For instance, in Nigeria, the Contributory Pension Scheme (CPS) has grown to \$13 billion assets under management (AUM), exceeded in size on the continent by South Africa (\$256 billion) and Egypt (\$73 billion) (see figure 6). In a further sign of growing support for private equity investments, South Africa’s Regulation 28 (governing pension fund investments) was amended in early 2011 to boost the private equity allocation from 5% to 10%. According to SAVCA, over \$13.5 billion was invested in private equity in South Africa by domestic pension funds, hitting the 5% private equity cap, at the end of 2010, however commitments are expected to double, given the higher cap<sup>11</sup>.

**Figure 6: Estimated Total Pension Assets, US\$B\*<sup>12</sup>**



Source: Local regulators.  
\* Most recent statistics available.

Given the continued uncertainty in global markets and the long-term horizon of young African pension funds, private equity offers an attractive investment destination. According to one EMPEA observer, “...long-term savings vehicles such as pension funds are uniquely positioned to manage the long investment term and limited liquidity of private equity investment to capture what appears to be a significant performance premium and diversification benefits.”<sup>13</sup>

<sup>11</sup> EMPEA Special Insight: Sub-Saharan Africa 2010

<sup>12</sup> Africa 2Q2011 EMPEA Review

<sup>13</sup> EMPEA 2Q2011 Review

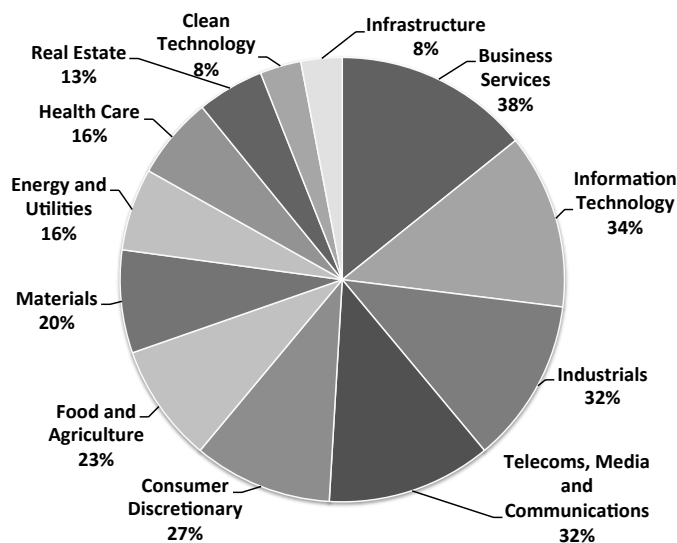
While the total amounts remain relatively small, countries are increasingly looking to tap into the growing prosperity of their citizens as well as to benefit from the demographic surplus that much of Africa is experiencing. It is a trend worth watching closely as the biggest economies on the continent mature and begin to assert themselves increasingly on a global scale.

**Private Equity Fund Investment Strategy in Africa**

Half of the private equity funds Avanz Capital is tracking in Africa are generalists and the other half has a single focus on a particular industry<sup>14</sup>. The majority of funds are in the mid-market targeting fast growing mid-and small-sized companies.

Overall the strategies for Africa funds have largely targeted investment opportunities in business services (38%), information technology (34%) and telecoms (32%), supported by big-ticket industrial and mining projects (see figure 7).

**Figure 7: Africa-Based Fund Manager Industry Preferences**



Source: Preqin Private Equity Spotlight Datapack, September 2011

Note: Fund Managers may have multiple industry preferences and therefore the total does not add to 100%.

Fund managers can build an investment strategy based on connecting promising investment links between complimentary sectors. By tailoring investments across industries in Africa, fund managers can create ‘ecosystems’ of complimentary investments on the continent that support each other physically – the ‘field to port’ strategy that allows an investor to more closely control the outcome of its investments from multiple angles. In markets that are fully developed companies tend to specialize in a sector, but in Africa companies

<sup>14</sup> Avanz Capital database

often find a need to build their own logistics or supply channels, for example. There are many synergies across industries.

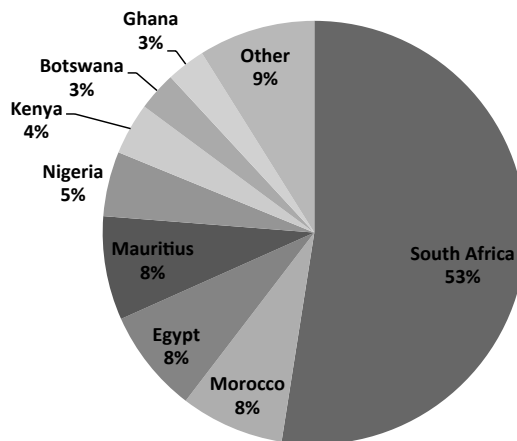
One notable example is the potential to build on the mobile networks in Africa. The continent has experienced heavy growth in the use of mobile phones due to the prohibitive costs of extending the wired infrastructure. It is quite feasible that the same will happen with Internet growth, driven by the growth of the 4G and “Long-Term Evolution” (LTE) mobile technologies. With wired data networks too expensive to install, existing wireless networks will look to upgrade. Complimentary to that is the challenge of creating internet-capable devices that are cheap enough to become widely adopted, in the same way as the last generation of phones was. By investing in complimentary industries, it becomes possible to reap the interwoven benefits of two (or more) industries simultaneously, and with the young age of the African markets, these opportunities are prevalent.

What sets Africa apart for private equity investors is the robustness of the recovery of many of the economies, especially in regional leaders such as South Africa, Nigeria and Kenya. This has encouraged a significant number of fund managers, chiefly those with a strategic focus on growth and expansion investments, to target opportunities in African companies.

### **Geographic Distribution of Funds**

Of Africa-based fund managers, 53% operate out of South Africa, while Egypt, Mauritius and Morocco are home to 8% each and Nigeria and Kenya hold 5% and 4% respectively, according to September 2011 data from Preqin (see figure 8). All of these countries are home to regional ‘capital capitals’ for East, West, Southern and North Africa sub-regions, while Mauritius offers easy access to the continent for international investors.

**Figure 8: Geographic Distribution of Africa-Based Fund Managers**



Source: Preqin Private Equity Spotlight Datapack, September 2011

South Africa in particular is becoming known as an emerging market leader and is increasingly being styled as Africa's contribution to the BRIC bloc, allowing it to weigh in internationally. It is the most developed single national economy in Africa and it is therefore an effective entry point for many fund managers looking to expand their presence. Additionally, it is the country in Africa most capable of supporting multiple single-country-focused funds and it also has the most developed financial environment for supporting private equity investments.

A historically stable region (recent troubles aside), North Africa has been able to support single country funds for some time, including in Egypt and Morocco. As the North Africa region recovers and democratizes, Avanz Capital believes there will be significant investment potential.

The rest of the African economies are quickly growing to support regional fund managers with the development of effective trading blocs, which allow rapidly expanding companies excellent opportunities to grow and take advantage of new markets and legislation.

### **Track Record of Funds in Africa**

The short track record of the majority of fund managers might be considered a risk, however with close analysis of the organizations, there is an opportunity for savvy investors to take advantage of the explosion in the depth of talent seeking to invest in Africa's compelling markets. Given that over 77% of actively raising managers are raising at least their second fund, most are on track to establish a track record. However, of those managers, 50% have only raised one fund previously, and so there are a number of private equity organizations that have yet to establish what may be deemed a sufficient track record by western standards.

While the track record for all of Africa is still relatively short, South Africa has been steadily building out data to meet growing investor interest in the country. Riscura Q42011 data on private equity funds shows promising performance in South Africa – pooled private equity IRR over a 10-year term is 23.1% when compared to the Johannesburg All Share Total Return Index's 14.0% return over the same time period. South African private equity also offers favorable returns against emerging markets equities more broadly. By comparison, 3Q 2011 10-year data from the Cambridge Associates Global Emerging Markets Private Equity & Venture Capital Index show returns of 10.6%<sup>15</sup>. South Africa could well be a lead indicator for the African continent, as many of the largest countries, economically and demographically, begin to realize the impact that better governance and global integration can have on their economic prospects.

*The number of teams created to fundraise and invest in Africa has grown. The ability of fund managers to attract international investors is an important indicator of how perception is shifting in the right direction.*

*- Papa Madiaw Ndiaye, CEO and Founding Partner of Advanced Finance and Investment Group (AFIG)*

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<sup>15</sup> Data was provided by Cambridge Associates to Avanz Capital at no cost

Emerging market investors with exposure to Sub-Saharan Africa in particular, have come to expect higher returns than those without, according to the 2011 EMPEA/Collier Survey, suggesting that these investors are confident in the abilities of experienced fund managers to anticipate and manage the risks of investing in Africa's young private equity markets.

To date, Development Finance Institutions (DFIs) have invested roughly \$7 billion in Sub-Saharan Africa alone, which amounts to between 60% and 75% of investment in private equity funds.<sup>16</sup> The IFC reports that its Africa portfolio has historically outperformed their entire emerging markets portfolio. Between 2000 and March 2010, the Africa funds portfolio posted a 21.7% return from 42 Sub-Saharan African private equity funds.<sup>17</sup>

### **Exits**

African exits by private equity funds in 2011 surpassed \$1.2 billion<sup>18</sup>, a significant rise from the \$79 million that was disposed of in all of 2010. Recent exits include:

- Paradise Capital's \$410 million sale of its Egypt-based manufacturing company, Olympic Group, to Electrolux
- Ethos sold a majority of its shares during an IPO of sporting goods retailer, Holdsport, on the Johannesburg Stock Exchange, in July 2011 and the remaining shares in April 2012
- The sale of Aureos Capital's stake in Nigerian biscuit manufacturer Deli Foods to South Africa's Tiger Brands after 3 years, reaping what Aureos called "solid" returns
- HBD Venture Capital selling its stake in mobile payment company Fundamo to Visa in a \$110 million deal
- Blackstar announcing that it had reaped a 72% IRR and 4x returns on its sale of Ferro Industrial Products, after less than three years of holding the asset, selling its 54% stake in the company to Investec and Ferro management for \$27.6 million
- China Investment Corporation purchased Shanduka Group for \$245m in November 2011 from Old Mutual Private Equity and Investec
- Citadel exited National Petroleum Company Egypt for \$147.5m in January 2012

Through May 2012, there have been a total of 10 exits announced – 4 in South Africa, 2 in Cote d'Ivoire, 1 in each of DRC, Ghana, Zambia and Zimbabwe. Aureos, ECP and Ethos each exited 2 companies.

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<sup>16</sup> AVCA Africa Institutional Investor Training, April 2012

<sup>17</sup> EMPEA Special Insight: Sub-Saharan Africa 2010

<sup>18</sup> <http://www.privateequityafrica.com/analysis/africa-pe-exits-hit-1-2billion/>

***III. What are the main risks associated with private equity in Africa and how can these particular risks be effectively managed?***

**Shallow talent pool**

Investors without exposure to the region indicated in both the 2010 and 2011 EMPEA/Collier surveys that a shortage of experienced fund managers inhibited their willingness to invest in Africa. Even investors who have spent time in Africa have remarked on the difficulty of finding private equity fund managers with sufficient experience. While competition remains relatively thin, the past decade has seen a number of private equity firms in Africa steadily developing their track records. As a result of the steady increase in FDI on the continent as well as support from DFIs, an increasing number of fund managers are establishing local teams in various countries to expand their local knowledge and cultivate business networks. The talent pool is also increasing as more experienced fund managers are being drawn to the opportunity in Africa.

The shortage of talent is also evident at the company level, giving investors such as private equity fund managers, an opportunity to bring substantial value-added to their investments. Increasingly, the presence of the Africa diaspora, educated and trained in the more advanced economies, helps build connections for local entrepreneurs to the rest of the world; investors that bring global networks can be very valuable. Global integration and the importance of Africa as a resource base to the world also attract managerial talent to the region.

**Political risk/corruption**

Many economies in Africa have been working hard in the wake of the financial crisis to showcase their greater political stability and increasingly business-friendly environments to the world. Political risks that once overshadowed any thoughts of institutional investing are being overhauled as democracies mature and long-running civil wars are fading into history. This “renaissance” political freedom and civil liberties over the past 10 years has been led by Southern and East Africa. Both regions have worked tirelessly to establish regional trade zones, which in turn have spurred the growth of companies operating across national boundaries within these regions. The political environment isn't perfect, but as with other emerging markets, the momentum of further investment has extracted varying degrees of democratic reforms from governments eager to nurture foreign interest in their country.

In *Transparency International's* most recent Corruption Perceptions Index (CPI), South Africa (rank: 64), Namibia (57) and Ghana (62) were found to be less corrupt than Brazil (73), India (95) and China (75), although the DRC (168), Angola (168) and Sudan (177) remain at the bottom of the table. Africa remains a continent with danger as well as opportunity, but a careful approach to investment, incorporating solid know-your-customer practices and extensive due diligence, can ferret out the most promising opportunities.



The continent has made very constructive moves to shed any perception of corruption, and it appears to be paying off. EMPEA's most recent research<sup>19</sup> on Limited Partner (LP) appetite gives evidence of the region's brand improvement, with 67% of LPs surveyed viewing Africa as attractive in 2011 and 39% planning to begin or expand their investments in sub-Saharan African funds. This response to Africa's growing institutional capacity has the potential to be a virtuous circle, encouraging more emerging markets investors to take a longer and harder look at the continent.

### **Weak exit environments**

The exit environment is another hurdle to attracting more capital. IPOs are much less frequent in Africa given the relative lack of liquidity in the public markets. However past investor performance has shown the possibility for trade sales as a means of exit from successful investments, accounting for the bulk of exits made in 2009 and 2010. While the continent's markets remain weak, the development of regional economic centers such as Johannesburg, Lagos or Nairobi, are creating pockets of liquidity that can be utilized successfully by investors.

The perception among LPs that China and India are the best destinations for emerging market investment due to size of their markets and experience of their GPs, obscures the fact that the brightest African economies are surprisingly ranked higher than BRIC countries by the *World Bank Doing Business Report 2012*. China, the highest scoring BRIC country at 91, still lags behind such African trailblazers as Mauritius (23), South Africa (35), Botswana (54) and Rwanda (45), while India (132) keeps company with Tanzania (128), Sudan (135), and Nigeria (133). Brazil sits at 126 and Russia at 120. What Africa lacks to become a mainstream private equity destination relative to more established emerging markets is an extended track record of deep performance data. For many fund managers, this has proved to be the greatest stumbling block. However, for those who grasp the importance of less quantitative measures in analyzing emerging markets, the opportunity for superior returns is significant. Africa's greatest weakness is also the greatest opportunity for investors. The current misperception that Africa presents a poor opportunity for private equity investment due to outsized risks means competition for deals is still very limited and valuations are still quite cheap. While it is true that the continent has not grown in a uniform manner, investment portfolios that are managed with an emphasis on intensive research, diversification, and the selection of the best fund managers, stand to offer the diligent investor outsized returns. Assets in sub-Saharan Africa – with multiples in the high single digits (compared with double-digit multiples in markets such as China and Brazil) are considered bargains by many investors. Prices are expected to rise; yet most fund managers believe that good deals will continue to abound.

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<sup>19</sup> EMPEA LP Survey 2012

#### ***IV. Conclusion***

Africa is one of the fastest growing investment regions in the world today. As the continent's markets mature and investment grade opportunities arise, the benefits of investing in Africa-focused funds are a growing consideration even for established investors. In several countries, traditional barriers to entry, such as poorly developed financial markets, political instability and the fragmentation of the economy are gradually being broken down by political reform and economic growth. South Africa in particular has led the rise of the rest of Africa by developing its national financial markets to near global standards. It is expected that North Africa will soon follow suit as it seeks to reestablish strong commercial credentials and geographic advantages in the wake of the dual shocks of regional uprising and European financial crisis.

Perhaps not all investors are ready for Africa, but Africa is ready for investors. Contrary to popular belief, the political and economic environment continues to improve dramatically, which has created a significant opportunity to cultivate a myriad of industries. The proof is becoming more evident as African private equity managers expand their track records of success and continue to post impressive returns on capital. Indeed, we believe that African managers are now sufficiently established and have the potential to offer compelling returns.

Private equity offers a unique and stable investment opportunity in Africa. As mentioned earlier, the South African private equity pooled market performance IRR at 23.1% for the ten-year period ending December 2011 compares favorably to most global markets. Carefully selected fund management teams with the appropriate strategy for the markets they target, demonstrable past performance, and solid experience would provide the opportunity to take advantage of the growth and diversity found in Africa. A well-constructed Africa private equity funds portfolio is expected to provide financial investors with strong returns, balanced risks through diversification and appropriate exposure to the most promising industries and companies across the region.

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***About the Authors***

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Ms. Celaya is a co-founder of Avanz Capital where she is Chief Investment Officer and leads product development, portfolio construction, fund selection, and investor relations. She is an accomplished investment manager with 30 years of Emerging Markets expertise, including as the head of the International Finance Corporation's (IFC's) Private Equity and Investment Funds Group and Chairperson of the IFC Global Funds Investment Committee for six years. While at IFC, Ms. Celaya oversaw one of the largest emerging markets funds portfolios in the world, with 176 funds and approximately \$3.2 billion in committed capital. Ms. Celaya set IFC's strategy and led an annual investment program averaging 20 funds per year and \$400 million in committed capital per year. She is a former Regional Director for the IFC in Sub-Saharan Africa and headed the Latin America Financial Institutions Group. During her tenure at the IFC, Ms. Celaya was responsible for numerous direct investment transactions. Ms. Celaya served on several advisory committees for IFC's portfolio funds, including Advent Latin America, Carlyle Mexico, Ethos in South Africa and PAIP/PACP in the African region.



Ms. Celaya helped establish the Emerging Markets Private Equity Association (EMPEA) and served on its Advisory Committee from 2004-2010. Ms. Celaya was also responsible for cementing IFC's reputation as a leading global emerging markets fund investor and promoter of the asset class through its premier annual conference ([www.globalpeconference.com](http://www.globalpeconference.com)). Prior to joining IFC in 1991, she worked in international banking for ten years.

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Mr. Assaad is a co-founder of Avanz Capital where he is Chief Portfolio, Risk & Compliance Officer managing the sourcing, screening and negotiating of investments, as well as risk management. He is a respected senior investment and finance professional with over 26 years of experience, including serving as CIO in IFC's Private Equity Funds Group and as investment manager for IFC's sector-specific funds, such as clean energy, extractive industries, infrastructure and healthcare. He held various positions across IFC with regional responsibilities in companies, financial institutions and funds covering the Middle East & North Africa, South & Southeast Asia and Emerging Europe, with transactional experience in Latin America and Africa.



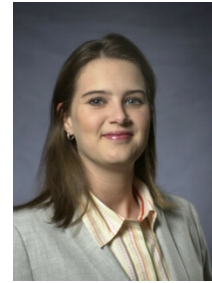
Prior to joining IFC in 1987, Mr. Assaad was for three years the Director of Management Advisory Services at Environmental Quality International in Cairo, Egypt, a large private Egyptian consulting firm.

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**About AVCA**

AVCA is a not-for-profit association, founded to promote, develop and stimulate private equity and venture capital in Africa through programs, which include research, advocacy, training, and industry gatherings. For more information about AVCA, please contact [avca@avca-africa.org](mailto:avca@avca-africa.org).

