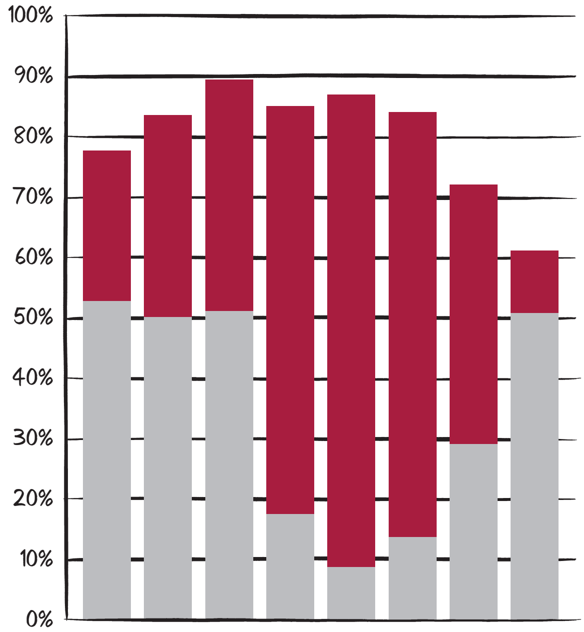

THE SEARCH FOR RETURNS

Investor views on private equity in Africa

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African Private Equity and Venture Capital Association

SOUTH AFRICAN VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION

RisCura good thinking

Contents

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Foreword

We are honoured to present the inaugural edition of ***The search for returns: Investor views on private equity in Africa*** report, the first dedicated appraisal of global limited partners' views on private equity in Africa.

As the private equity landscape has evolved in Africa, so too has its investor base. As an industry that was pioneered by the development finance institutions, today it includes a broad range of limited partners from pension funds, foundations and endowments, to sovereign wealth funds, fund of funds, family offices and beyond.

The search for returns is a practical assessment of investor sentiment and perception of the attractiveness of private equity in Africa relative to other emerging markets. It delves into the appeal of specific regions, sectors, and preferences for accessing opportunities, and highlights expected changes in investor decision-making with respect to the asset class over the short-to-medium term.

Our asset class, which in Africa chiefly provides growth equity to private companies, is uniquely positioned to be a catalyst for change. We are profoundly grateful to the survey participants, and to the members of AVCA and of SAVCA that supported this important initiative. Our thanks also go to RisCura, for providing valuable input to ***The search for returns***. We look forward to deepening this research in years to come and to continuing to track investors' evolving views towards private equity in Africa.

Best regards,

Michelle Kathryn Essomé
Chief Executive Officer, AVCA

Africa is perceived to be more attractive than other emerging markets.

Executive summary

RisCura, AVCA and SAVCA are pleased to present the first edition of ***The search for returns: Investor views on private equity in Africa*** report. The purpose of this report is to provide stakeholders with views on private equity in Africa from the Limited Partner's (LP's) perspective. This study examines future investment plans into African private equity, the region's relative attractiveness, expected return drivers, preferred investment vehicles, and the challenges to investing in the region.

The results of this survey are based on data collected from 48 LPs from Africa and around the world. These LPs range from endowments and family offices to pension funds and development finance institutions (DFIs). Collectively, the LPs have over US$ 150 billion in global private equity assets under management and undrawn commitments of US$ 50 billion.

Below are the key findings of the survey.

Africa is perceived to be more attractive than other emerging markets.

Africa's apparently unstoppable march to become one of the most popular destinations for investment is also reflected in the results of this survey. In line with the EMPEA Global Limited Partners Survey, released in May 2013, Africa is now perceived as a more attractive market than other emerging markets by 70% of respondents.

There is continued interest in emerging market private equity and growing interest in African private equity.

Most LPs, excluding DFIs and fund of funds whose mandate and focus is specifically African, have limited or no exposure to African private equity. However, in their search for returns in the current global investment landscape, they expect to extend their involvement with both emerging market private equity and African private equity - in a cautious fashion.

Earnings growth is expected to be the major driver of superior private equity returns for Africa in the long term.

In contrast to other more developed markets, the major driver of the expected performance is the underlying growth in earnings and the implicit underlying economic growth. In line with the current limited use of leverage in African private equity, LPs do not expect leverage to play a significant role in the return on capital achieved. This lack of leverage may contribute to lowering the perceived risk of private equity in Africa.

A limited number of established general partners (GPs) and perceived weak exit environments are the most significant barriers to investing.

The relative youth of Africa's private equity industry has resulted in a large number of funds currently raising money, but only a very limited number having an established track record. It is clear that this lack of demonstrated expertise is proving a significant stumbling block for LPs.

As noted in the recent AVCA and EY report on exits in Africa, the small and illiquid public market for equities in Africa has long created the perception that there is a weak exit environment. Even with the increased activity in this area and a strong market in trade sales, this risk is still high on investors' agendas.

Despite the degree of unease and caution that political risk normally evokes from investors, it is interesting to note that in line with the reduction in political risk in Africa in the last decade, investors now cite political risk as only the third-biggest barrier to investment.

Regional funds are the preferred route to accessing African private equity in the near term.

With the smaller scale and limited number of investment opportunities available in each sector, regional funds currently seem to be a preferred investment vehicle. With many pension funds being first-time entrants into the African private equity market, a preference is also shown for fund of funds, which allows these LPs to rely on the expertise of experienced investment professionals at the fund of fund level.

A strong track record and operational expertise by GPs are key to attracting African PE commitments.

The complex, opaque and unique nature of the business environment in Africa appears to result in LPs valuing both proven investment and operational expertise. Flowing from the concerns regarding the lack of established GPs, LPs also appear to value long-established relationships within the investment team.

LP preference is for African fund managers to be based in Africa.

In the past a large number of African investment funds have been based in the major financial centres around the world. The LPs surveyed however expressed a marked preference for managers based in their primary target market. This preference also resonates with the high value placed on operational expertise of GPs within the African environment.

Environmental, Social and Governance (ESG) factors are at least equally important in Africa compared to other emerging markets.

The notable exception to this is the higher importance placed by almost half of the LPs on governance considerations. This trend is especially notable under African LPs.

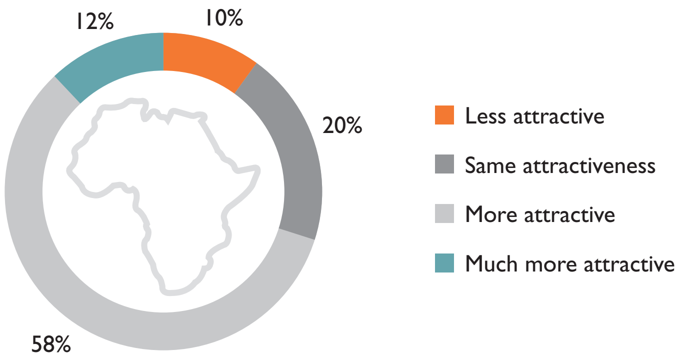
African private equity returns are generally expected to compare favourably to listed equity.

This expectation is very much in line with the risk profile of private equity and the historic returns received by investors. The worldwide trend to include a larger proportion of alternative assets in investor portfolios seems to be in response to the attractive returns associated with private equity.

Africa's attractiveness vs. other emerging markets

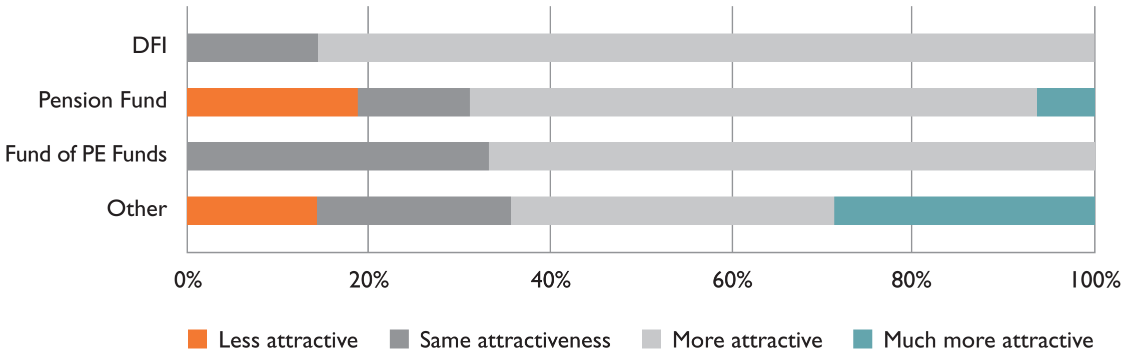
Over two thirds of the surveyed limited partners believe that Africa is more attractive compared to other emerging markets. One fifth of the respondents said that Africa's attractiveness is on par with other emerging markets, while 10% of surveyed limited partners feel that Africa lags other emerging markets in attractiveness due to the relatively nascent stage of the industry on the continent.

Attractiveness of Africa compared to other EMs



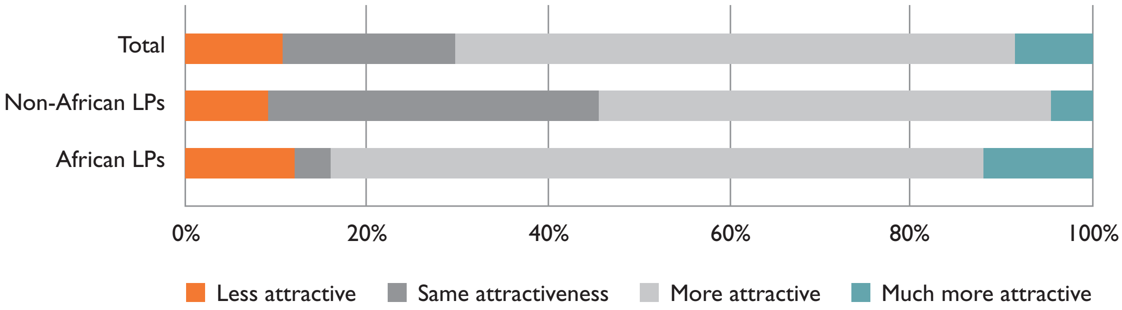
Within the limited partner categories, all FoFs and DFIs surveyed, as well as more than 80% of pension funds and other LPs, said African private equity was as attractive or more attractive than other emerging markets private equity.

Attractiveness of Africa compared to other EMs



Within the regional subgroups, African limited partners were the most bullish about their continent, with more than 80% of African limited partners stating that Africa was more attractive than other emerging markets. Global investors were more cautious, but still approximately 90% of these respondents said that African PE was at least as attractive as other emerging markets.

Attractiveness of Africa compared to other EMs



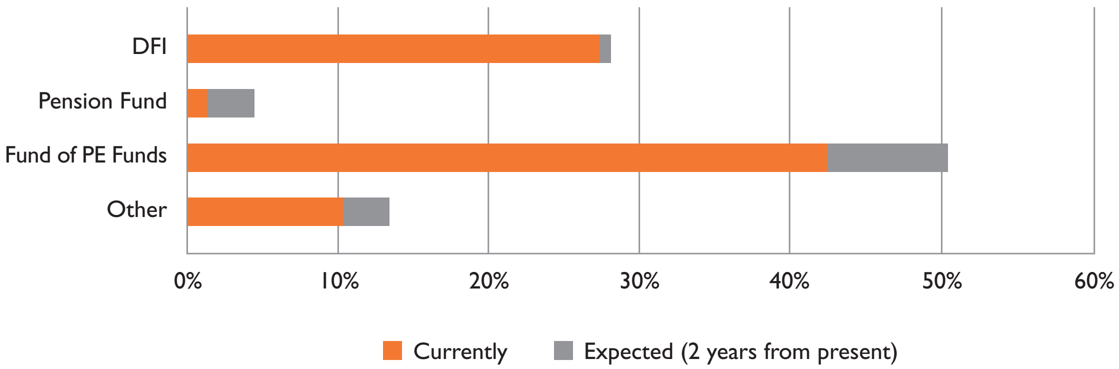
The majority of limited partners believe Africa is more attractive relative to other emerging markets. Limited partners' views are mixed when it comes to identifying the most attractive region within the continent. 26% of surveyed limited partners think Sub-Saharan Africa (as a whole) is the most attractive proposition, another 24% believe West Africa is the most attractive region, while 28% of limited partners are of the opinion that there is no single most attractive region.

Africa is perceived to be more attractive than other emerging markets.

An appetite for African private equity

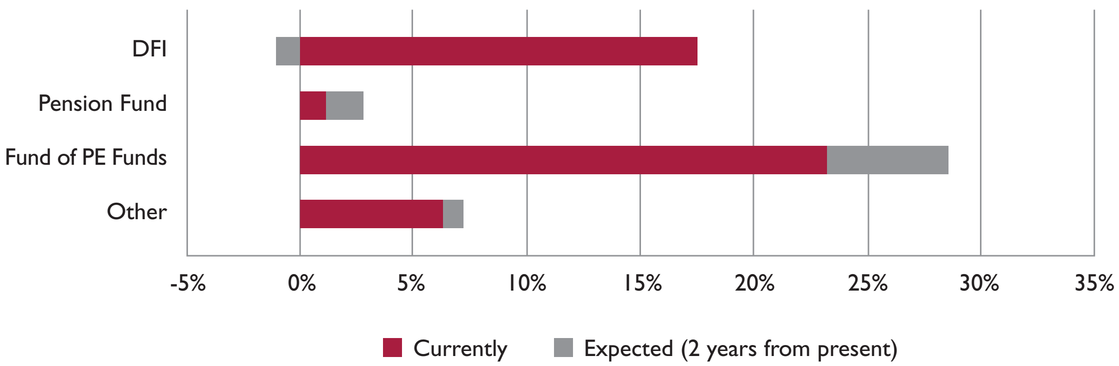
All of the surveyed LPs expect to increase their percentage exposure to emerging market private equity over the next 24 months. African and global fund of funds (FoFs) will spearhead the increase in exposure, and expect to have roughly half of their portfolios in emerging market private equity in the next 24 months (up from the current 42%). DFIs have expressed the least interest in increasing their emerging market private equity exposure (1% increase) suggesting that their current allocation (nearly 30%) may be nearing their allocation limits.

Emerging market PE (as % of total portfolio)



There is also growing interest in African private equity, with 85% of LPs indicating that they plan on increasing their percentage exposure to the continent's private equity over the next 24 months. As was the case with emerging market private equity, FoFs expect the largest increase in African private equity allocation (5%). This compares with an expected 2% increase in allocation from pension funds, which currently have the least exposure to African private equity (1% of portfolios). This is likely due to pension fund regulations and exchange controls.

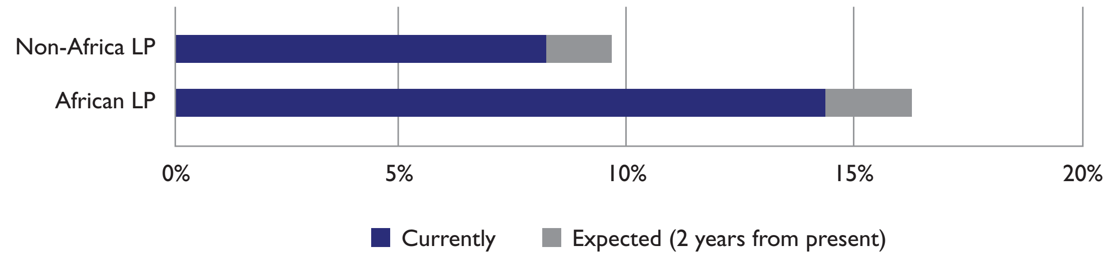
African PE (as % of total portfolio)



The slight decrease in DFI allocation is due to portfolio realignment by some DFIs to meet prescribed targets.

Within the regional subgroups, African investors are on average expected to have the largest increase in allocation to African private equity (2% increase).

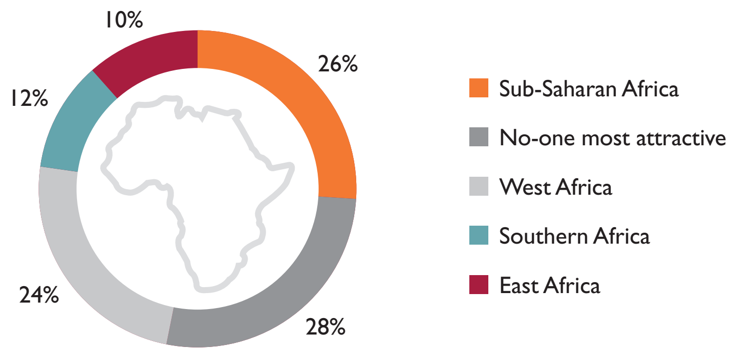
African PE (as % of total portfolio)



> "We believe Africa will outperform due to the scale of opportunity."

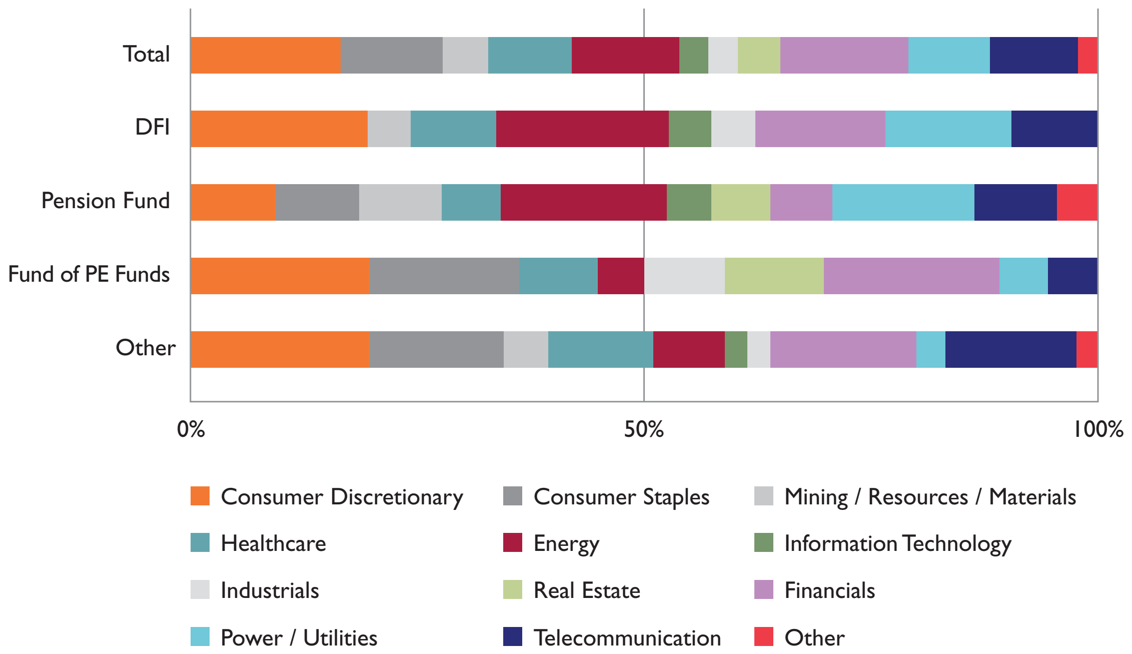
Regions and sectors within Africa that appeal to investors

Attractiveness of different regions within Africa



Africa's large population and growth of per capita income make it an attractive region for consumer-oriented businesses. The consumer discretionary, financial and consumer staples are seen as the most attractive sectors in the next three years. These three sectors were cited by limited partners as being the most attractive due to a combination of growth areas, capital needs and company valuations. The industrials sector, mining and real estate were considered to be the least attractive.

Most attractive sectors in Africa in the next three years

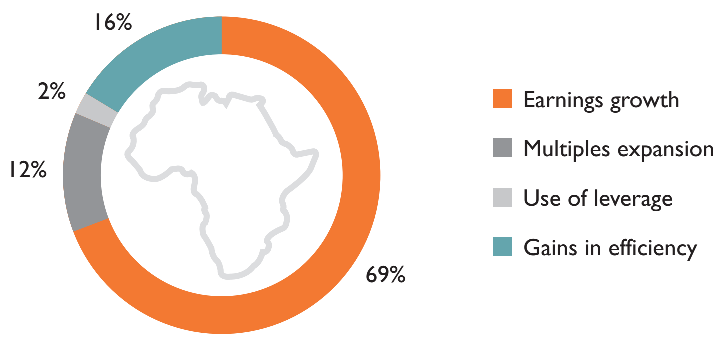


There are some striking differences when results are analysed according to limited partner categories. Although consumer discretionary still appears to be the most attractive sector, pension funds are of the view that the energy and power/utilities sectors will be the most attractive sectors over the next three years. Reasons cited for this view include on-going transformation in the energy and power utilities sectors, which will make them appealing for long-term investors. In addition, typical bank financing is not currently available for these sectors. DFIs rank the energy sector as the most attractive, equally attractive as consumer discretionary over the 3-year period.

Perceived future performance of African private equity

When asked to identify the main drivers of private equity returns in Africa over the next 10 years, an overwhelming 69% of limited partners identified earnings growth as the primary driver of private equity returns, in line with high GDP growth rates forecasted for most African countries. Limited partners indicated that the majority of businesses that can grow quickly and scale, would achieve this via organic revenue growth.

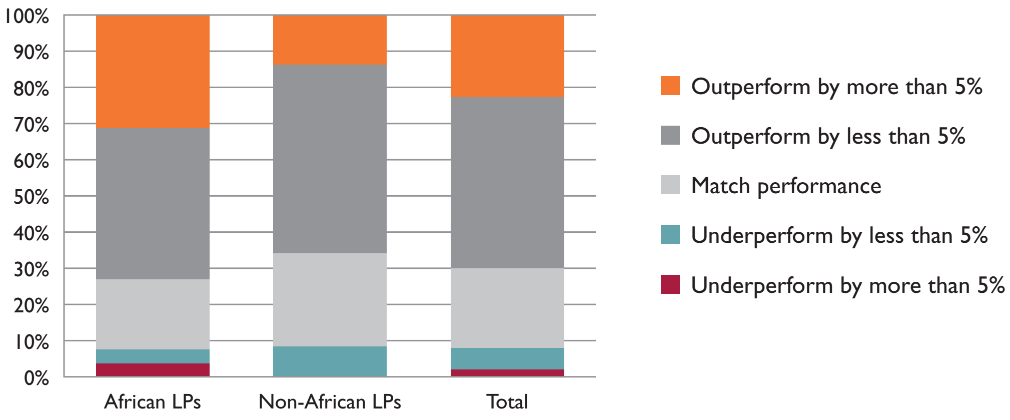
Perceived drivers of performance



Overall, more than 70% of limited partners surveyed expect African private equity returns to outperform emerging market private equity returns over the next 10 years, with 24% of limited partners expecting an outperformance of 5% or more from their African private equity investments; the limited partners in this category cited the scale of opportunity as a key reason for their choice. The limited partners expecting African private equity to outperform emerging market private equity by less than 5%, cited the increased competition for deals on the larger end as one reason. On the other hand, 22% of LPs believe that African private equity will match the performance of emerging market private equity, while 8% of respondents think that African PE returns will lag those of emerging market private equity in 10 years.

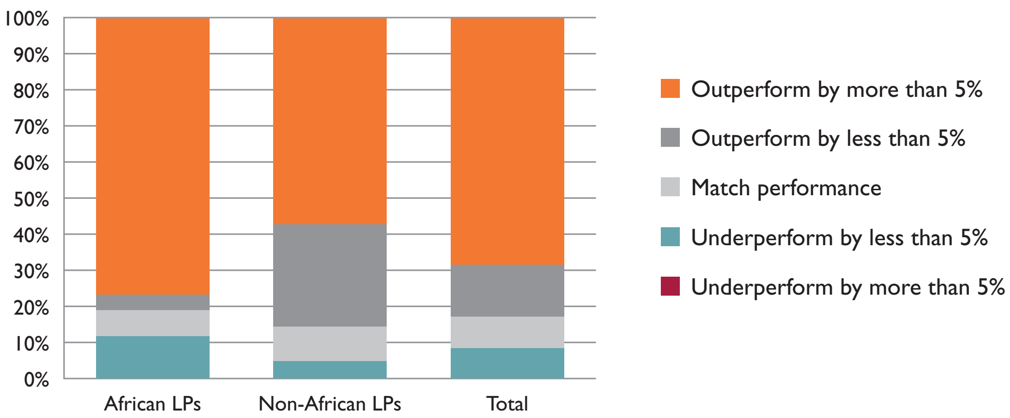
> "We would focus primarily on funds that make growth equity investments, which will use very little if any leverage. As such, we expect that there would be operational improvement and enhanced market penetration of those companies, which will translate to earnings growth."

Expected African PE returns compared to other EMs



African private equity returns are also generally expected to compare favourably to listed equity. 80% of the surveyed LPs expect African private equity to outperform their local listed equity over the next 10 years. On the other hand, 15% have indicated that they expect African private equity returns to either match or underperform their local listed equity.

Expected African PE returns compared to listed equity



"We feel that the increased competition in the market, especially on the larger end of the scale, might affect returns."

Perceived barriers to investing in African private equity

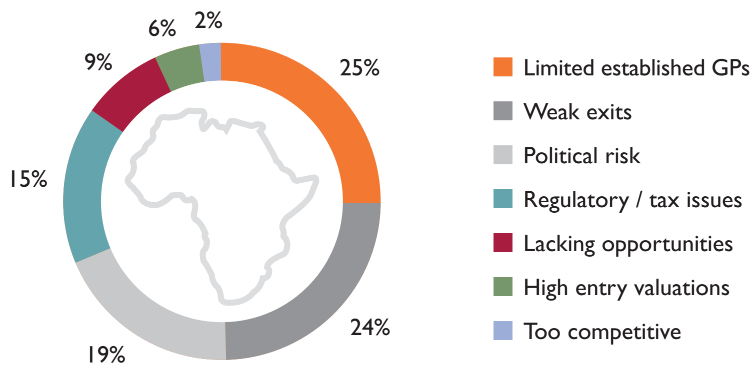
A limited number of established GPs and perceived weak exit environments were the most significant barriers to investing in African private equity.

Respondents believed that the biggest challenges to investing in private equity anywhere in the world were the lack of liquidity, long time horizons and perceived high fees.

When asked about the specific challenges facing African private equity, the relative youth of the African private equity industry was the main concern, resulting in relatively few established general partners and a perceived weak exit environment. The perception that Africa has political risk is present, and was also cited as the third-biggest challenge. African limited partners were, however, less concerned with political risk than non-African limited partners.

Concerns in some quarters that additional capital flowing into African private equity was causing increased competition and high entry valuations were reflected by a small minority of limited partners surveyed.

Biggest challenges to investing in African PE

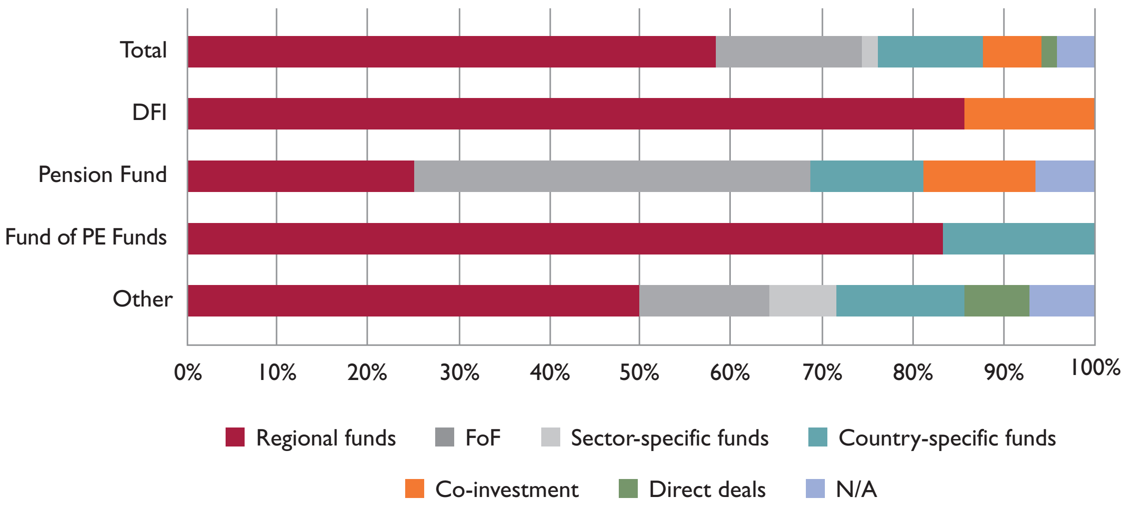


Political risk trails other factors as the biggest challenge.

The preferred route to accessing African private equity

58% of the surveyed limited partners listed regional funds as the preferred route in the near term, followed by FoFs (19%) and country-dedicated funds (12%). Co-investing with GPs and direct deals were consistently of little interest to LPs except for endowments and family offices, which did consider this a viable route.

Preferred route to accessing African PE

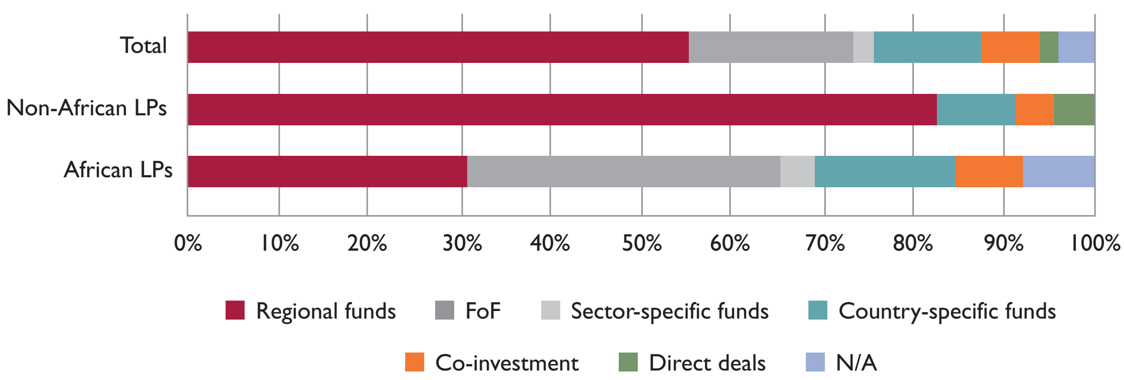


Results were mixed at the investor category and regional subgroups level.

FoFs have a clear preference for regional funds (83% of FoF LPs listed regional funds as the preferred primary route) followed by country-specific funds (17%). This compares to a 44% preference for FoFs as a primary route expressed by pension funds that also chose regional funds as the second preference (31%).

African LPs prefer regional funds to FoFs and country-specific funds. On the other hand, US and European LPs are likely to invest in African private equity via FoFs.

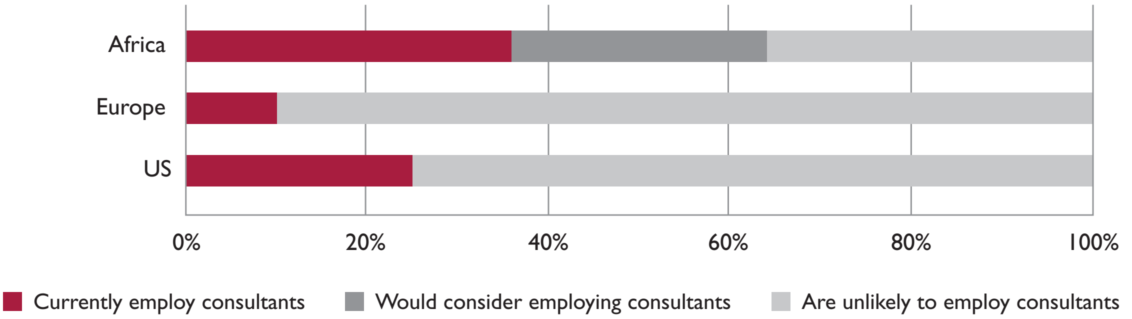
Preferred route to accessing African PE



About a quarter of the surveyed LPs currently use consultants for African private equity investments. This compares with approximately 14% of LPs who would consider using consultants, whereas 60% of the surveyed LPs are unlikely to employ consultants. Reasons cited by the latter group include sufficient in-house expertise and/or access to industry experts as advisers through their extensive network. In addition a few respondents mentioned that some consultants are still educating themselves on the asset class.

Within the group that remains open to the use of consultants, West and Southern African limited partners have the highest representation. However, European and US investors are clearly most likely not to employ consultants, in favour of indirect access via FoFs.

The use of consultants for African PE

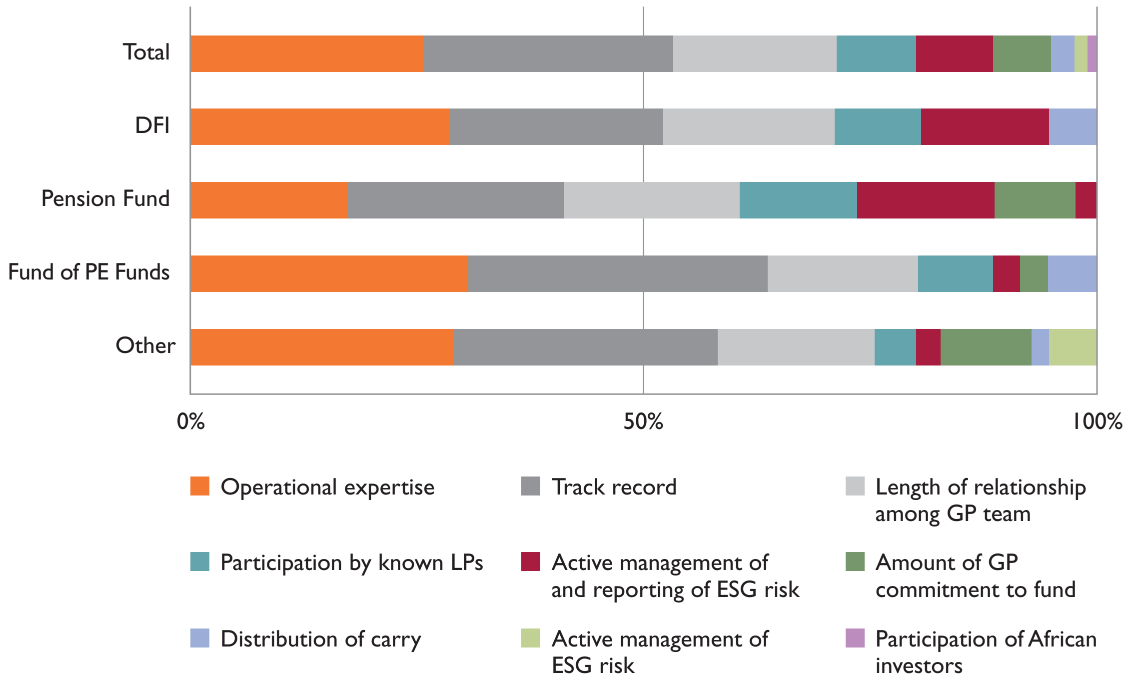


> "We have a preference for regional managers because they have the flexibility to deploy capital effectively across the continent in response to changing conditions."

The factors affecting the selection of GPs in Africa

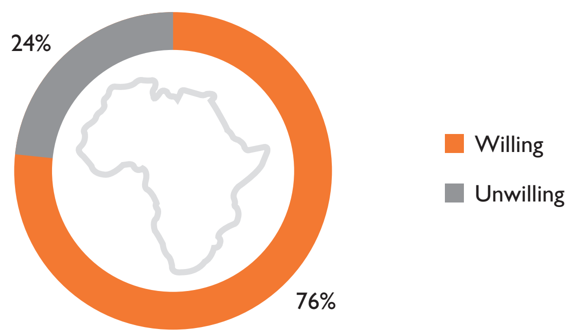
When evaluating an African private equity fund manager, limited partners consistently cited track record and operational expertise among the most important considerations. Further consideration is given to the length of the relationship of the core team of the general partner, as well as involvement of experienced limited partners in the fund.

Important factors when assessing African PE managers



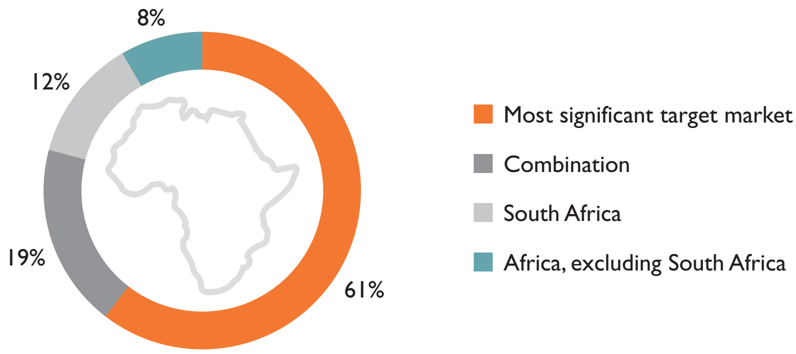
The majority of the respondents expressed willingness to consider investing in a first-time fund manager in Africa, particularly if the team had other experience to draw on from time at other general partners or if the team could show experience in executing transactions on a deal-by-deal basis from investment through to exit.

Willingness to invest in an African GP's first fund



60% of the respondents were of the opinion that African private equity fund managers should be based in the most significant target market in Africa, while a further 18% said that general partners should be based across different locations.

Preferred location for African GPs



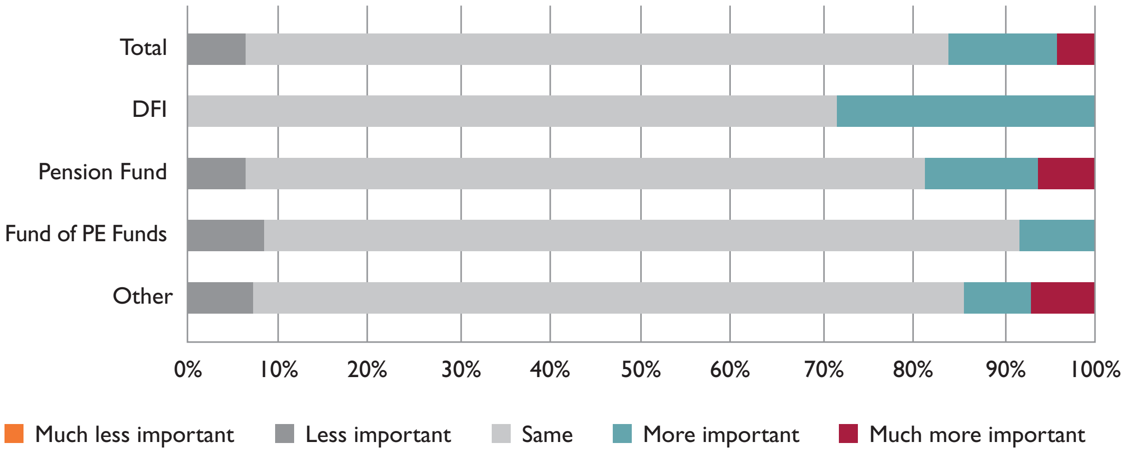
"We would invest in a first-time fund, however the management team would need to have previous African experience, and show a track record of successful investments from sourcing through to exit."

The perceived importance of ESG factors in Africa

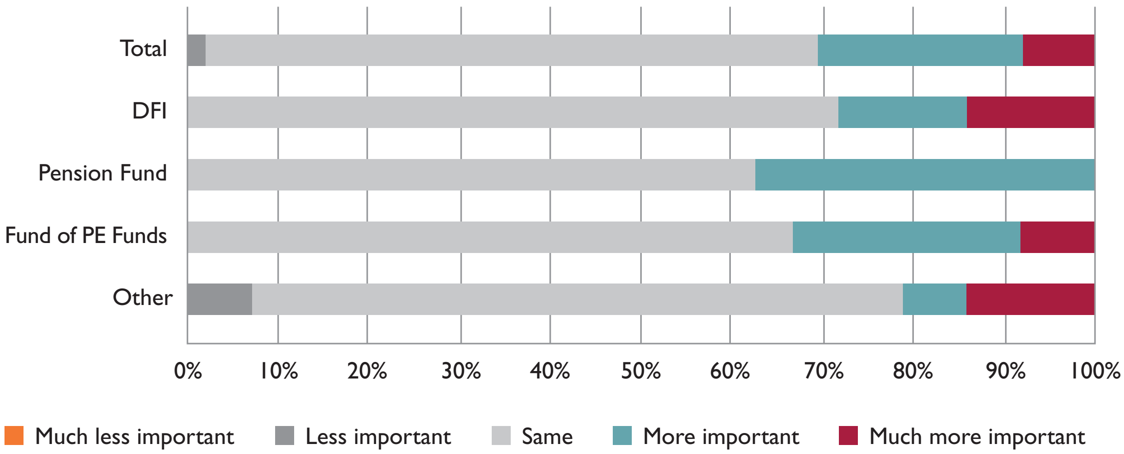
When asked to evaluate the importance of ESG factors in selecting African private equity managers compared to other emerging markets' private equity managers, limited partners were of the opinion that ESG factors were just as important in selecting general partners in Africa.

Limited partners place a higher importance on governance in Africa compared to other emerging markets, with around half of respondents saying a focus on governance was more important in Africa, and all respondents saying it was at least as important as in other emerging markets.

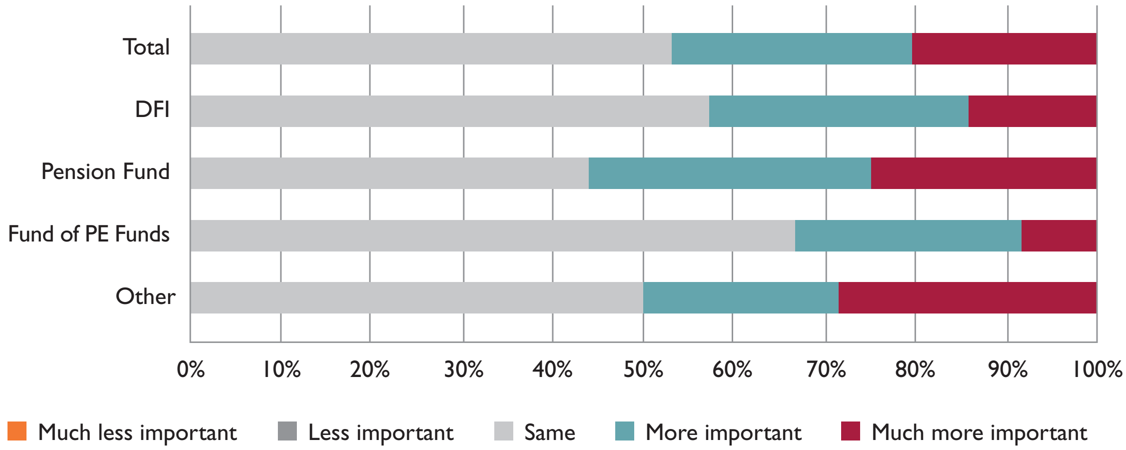
Environmental considerations in Africa vs. other EMs



Social considerations in Africa vs. other EMs



Governance considerations in Africa vs. other EMs

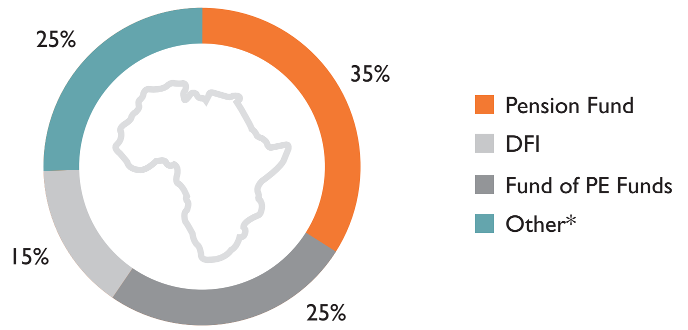


LPs place a higher importance on governance in Africa compared to other emerging markets.

Respondent profiles

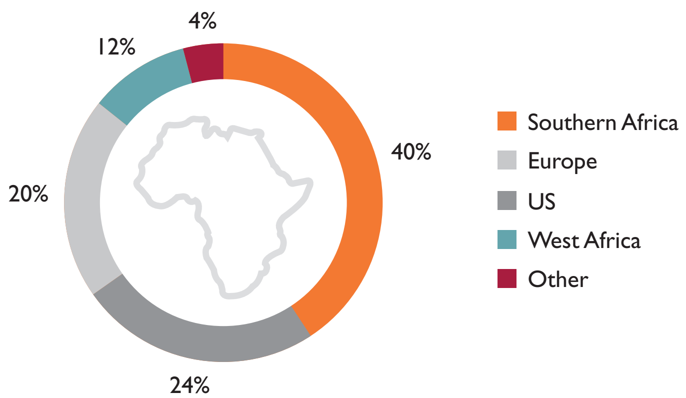
RisCura, AVCA and SAVCA surveyed 48 limited partners from across four continents, representing a diverse mix of pension funds, insurance companies, sovereign wealth funds, banks, asset managers, endowments, foundations, family offices, development finance institutions. These institutional investors collectively represent global private equity assets under management of nearly US$150 billion and undrawn commitments of over US$50 billion.

Type of organisation

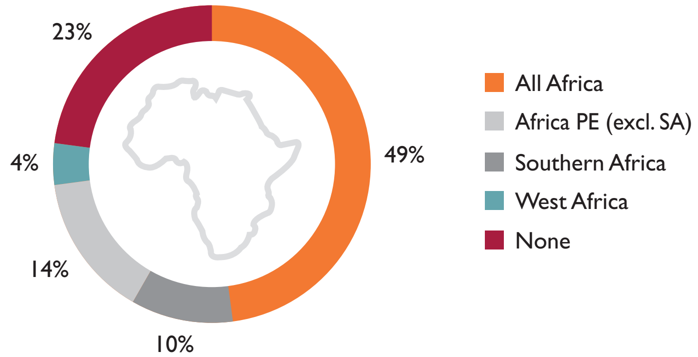


*Other includes endowments, family offices, multi asset managers, insurance companies, sovereign wealth funds and investment consultants.

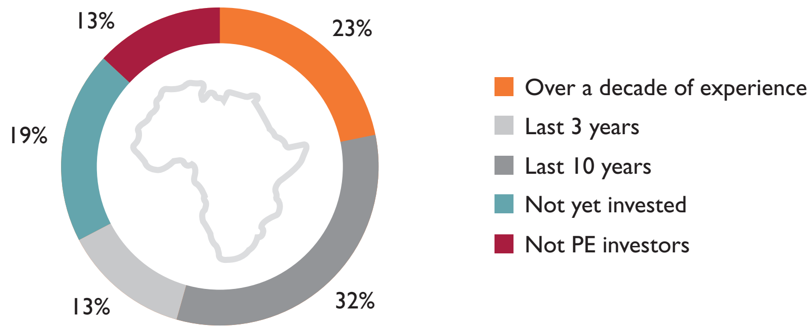
Head office location



Current investment position



Length of experience in PE (to date)



Research methodology

RisCura, AVCA and SAVCA surveyed 48 limited partners from across four continents. The respondents were selected to represent a cross section of all investors. The sample contains a diverse mix of pension funds, insurance companies, sovereign wealth funds, banks, asset managers, endowments, foundations, family offices, and development finance institutions. The survey incorporates the views of investors who were currently invested in private equity in Africa, as well as those who were not invested were surveyed. These institutional investors collectively represent global private equity assets under management of nearly US$150 billion and undrawn commitments of over US$50 billion.

The survey was conducted between November 2013 and January 2014. The survey initially asked a number of profiling questions, which provided the basis for future analysis of the information according to specific characteristics. The remainder of the questions then recorded the investor's view on African private equity. Copies of the survey were e-mailed to the recipients and a subsequent call was set up with all recipients who were available. During this call, further background regarding the survey responses was discussed.

Information was collated and reviewed during January 2014 and any discrepancies and anomalies followed up. Information has been presented split by both LP category and geography. LPs were subsequently categorised into four categories namely pension funds, fund of funds, DFIs and other in order to ensure sufficient coverage in each category. Geographically the respondents were split into African and Non-African respondents. Geographically the information was analysed inclusive of all LP types, as well as exclusive of DFIs and fund of funds. This was done as the needs and requirements of these specific investors differ from the rest and may thus obscure the trends being observed.

These additional breakdowns can be viewed online at **riscura.com/the-search-for-returns**.

Survey definitions

- **Emerging markets** (abbreviated to "EM") encompasses the private equity markets of all countries outside of the United States, Canada, Western Europe, Japan, Australia and New Zealand.
- **Funds of Private Equity Funds** abbreviated to "FoFs".
- **General Partners** abbreviated to "GPs".
- **Limited Partners** abbreviated to "LPs".
- **Development Finance Institutions** abbreviated to "DFIs".
- **Private Equity** (abbreviated to "PE") encompasses leveraged buyouts, growth capital, and venture capital and mezzanine investments.
- **Environmental, Social and Governance** abbreviated to "ESG".

"We believe that in the future, financial sector growth will resemble the growth seen in the telecoms sector."

About RisCura, AVCA and SAVCA

RisCura is a global independent investment adviser and financial analytics provider with specialist expertise in Africa. The company services institutional investors with over USD 200 billion in assets under consulting, as well as a significant number of asset management, hedge fund and private equity firms.

The company's strengths include independent valuation, risk and performance analysis services to investors, and an exceptional skill for understanding investments in emerging and frontier markets.

For more information, visit **www.riscura.com**, email **rord@riscura.com** or call **+27 (0) 21 673 6999**.

The African Private Equity and Venture Capital Association's (AVCA) mission is to promote and catalyse the private equity and venture capital industry in Africa.

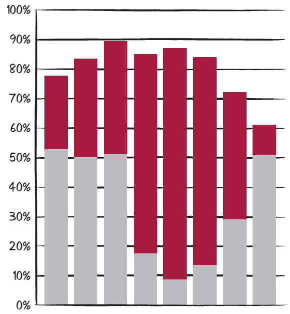
AVCA is a member-supported organisation, with members spanning private equity and venture capital firms, institutional investors, foundations and endowments, international development finance institutions, professional service firms and academia. They are all united by a common purpose: to be part of the African growth story.

Together with a network of experts and collaborators across Africa and beyond, AVCA represents the voice of the pan-African industry in discussions with governments, regulators, lawmakers and the media.

For more information, visit **www.avca-africa.org**, email **michelle.essome@avca-africa.org** or call **+44 (0) 203 632 0408**.

The South African Venture Capital and Private Equity Association (SAVCA) is the industry association representing around 90 private equity fund managers in the private equity and venture capital industry in Southern Africa. SAVCA was formed in 1998 and its mission is to play a meaningful role in the private equity and venture capital industry by promoting the interests of the industry, lobbying on behalf of the industry, disseminating information and providing research on the industry in South Africa.

For more information, visit **www.savca.co.za**, email **info@savca.co.za** or call **+27 (0) 11 268 0041**.



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