Freshfields Bruckhaus Deringer

Into Africa: the rise of private equity

Into Africa:
the rise of private equity

Private equity is a growing force in Africa. Last year the number of PE deals as a proportion of total M&A was higher than ever before.

The biggest global firms are also more active than in years past, closing deals in the first half of 2014 worth more than twice as much as during the same period in 2013. And the value of private equity exits in Africa is four times higher this year than last.

Several factors have combined to make the continent more attractive to investors. Africa is becoming more politically stable, with fewer conflicts today than at any point in the last 50 years. It is increasingly integrated into the global economy, and with trade comes more robust regulation. Standards of governance are rising and local managers and investment professionals are becoming more sophisticated. Add Africa's wealth of natural resources, rising population and its expanding middle class, and the conditions for growth are evident. A recent report from McKinsey predicts demand for capital on the continent will rise by 8 per cent a year between now and 2018.

Despite this, a number of risks remain. While Africa's urbanised areas are more peaceful than in the past, conflict and terrorism remain real risks in various parts of the continent. Corruption in some areas is rife, and the global reach of anti-bribery laws demands constant vigilance from investors.

Freshfields Bruckhaus Deringer studied deal data from Preqin and Thomson Reuters covering the period from 2004 to the present day, and identified a series of trends in the African PE market. We analysed transaction values, deal volumes and investment destinations, breaking the PE firms responsible for those deals into three groups:

- domestic African funds (managers that invest only in Africa);
- global African funds (firms with Africa-specific funds that also manage funds investing outside the continent); and
- global funds (global players managing funds that do not have an Africa-only mandate).

This report examines what the data tell us about Africa, while our private equity and Africa-focused teams give their views on what the future holds. We hope you find our opinions insightful.

84 deals
closed by global funds 2009–2014

44 deals
closed by global funds 2004–2009

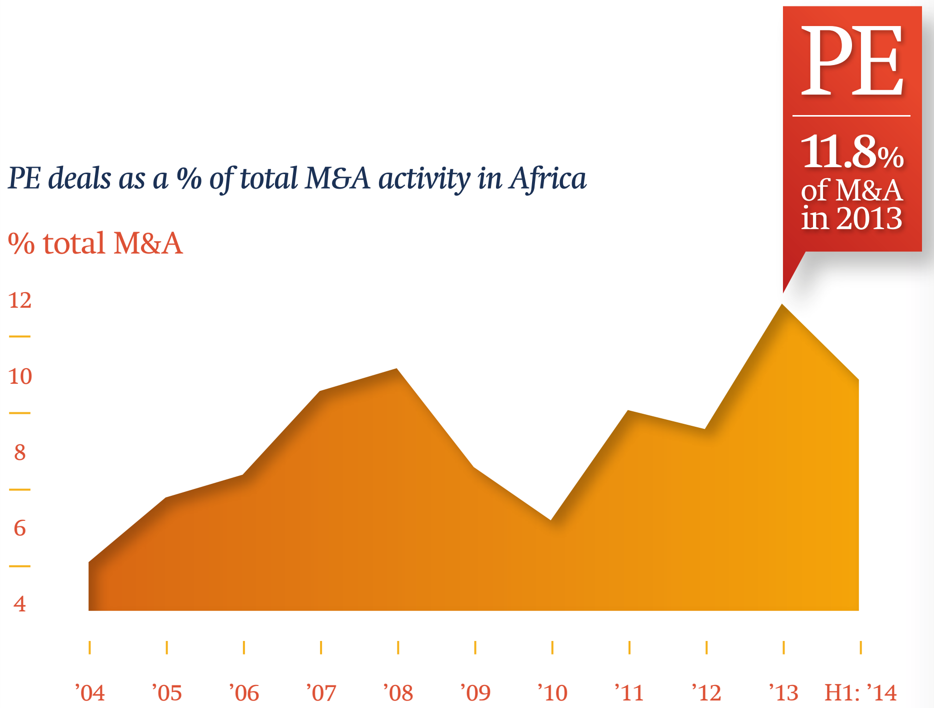
The analysis reveals:

- global funds completed 15 deals worth almost US$1.5bn between 1 January and 30 June 2014, up from 10 deals totalling US$621m in the first half of 2013;
- they are responsible for a greater proportion of total African PE deal value (83 per cent) and deal volume (44 per cent) this year than ever before;
- 11.8 per cent of African M&A transactions in 2013 were private equity investments – a new high. Although slightly lower this year, the figure is still strong (9.8 per cent);
- private equity firms invested US$4.26bn in African assets in 2013, more than at any time since 2007;
- the number of deals closed by global funds nearly doubled between 2009 and 2014 compared to the preceding five-year period;
- by value, almost half the deals closed by Africa-specific global funds since 2004 have come in the past two years; and
- global funds have shifted their geographic focus. Between 2004 and 2009, 75 per cent of their investment was in South Africa – between 2009 and H1 2014, this figure was 10 per cent.

Private equity

is a growing force in Africa

PE deals as a % of total M&A activity in Africa



Private equity in Africa – *a decade of deals*

As investors search for yield and risk appetites grow, emerging market assets become increasingly attractive. In terms of both deal volume and deal value, the biggest global players are becoming increasingly influential in Africa.

Freshfields' research reveals that private equity investments comprised 11.8 per cent of African M&A deals in 2013, their highest level to date. PE investors also completed 69 deals on the continent last year, more than in any other year in the past decade bar 2008 (71). The first half of 2014 has followed a similar pattern, with PE investments comprising almost 10 per cent of Africa's total M&A deals.

Volumes – and value – on the rise

The number of PE deals is rising – but their combined value is rising faster. Private equity firms invested more in Africa last year (US$4.26bn) than at any point since before the global financial crisis. The previous high was in 2007, when PE firms poured more than US$7.6bn into assets on the continent.

The total for 2013 was more than three-and-a-half times the US$1.18bn spent in 2012, and twice the average for the past nine years. Breaking the data into five-year blocks reveals PE investors spent more in Africa between 2009 and 2014 than during the previous half-decade.

Exits up – and fund-raising is bouyant

This year's exit figures are equally strong, with US$1.3bn in private equity exits reported in the year to mid-September according to data from Preqin. This is a significant increase on the total for the whole of 2013, when just US$0.3bn of sales was reported, the second lowest return since 2006. This year's numbers have been boosted by some very large deals, including Actis' two-stage sale of its 9.1 per cent stake in Egypt's Commercial International Bank which realised more than US$400m.

'This is a very exciting time'

Commenting on the study, Freshfields' corporate partner ***Shawn der Kinderen***, co-head of the firm's Africa group, says: 'The rise of private equity in Africa is evident from the figures, and it's also apparent from our conversations with clients. Two years ago the global firms I work with seemed much less interested in going into Africa – it was too risky. Now, some funds are looking at what the competition is doing and thinking they should do the same, or even considering building an Africa team if they don't already have one.'

Fellow corporate partner ***David Higgins***, co-head of the firm's Global Financial Investors group, adds: 'It's a very exciting time, with lots of funds looking at opportunities in Africa. However, this has led to an increase in relative prices and there are of course other issues to be overcome such as foreign exchange controls. But for funds that are willing to invest the time and effort to understand the local markets, there are real opportunities available.'

> *The number of PE deals is rising – but their combined value is rising faster.*

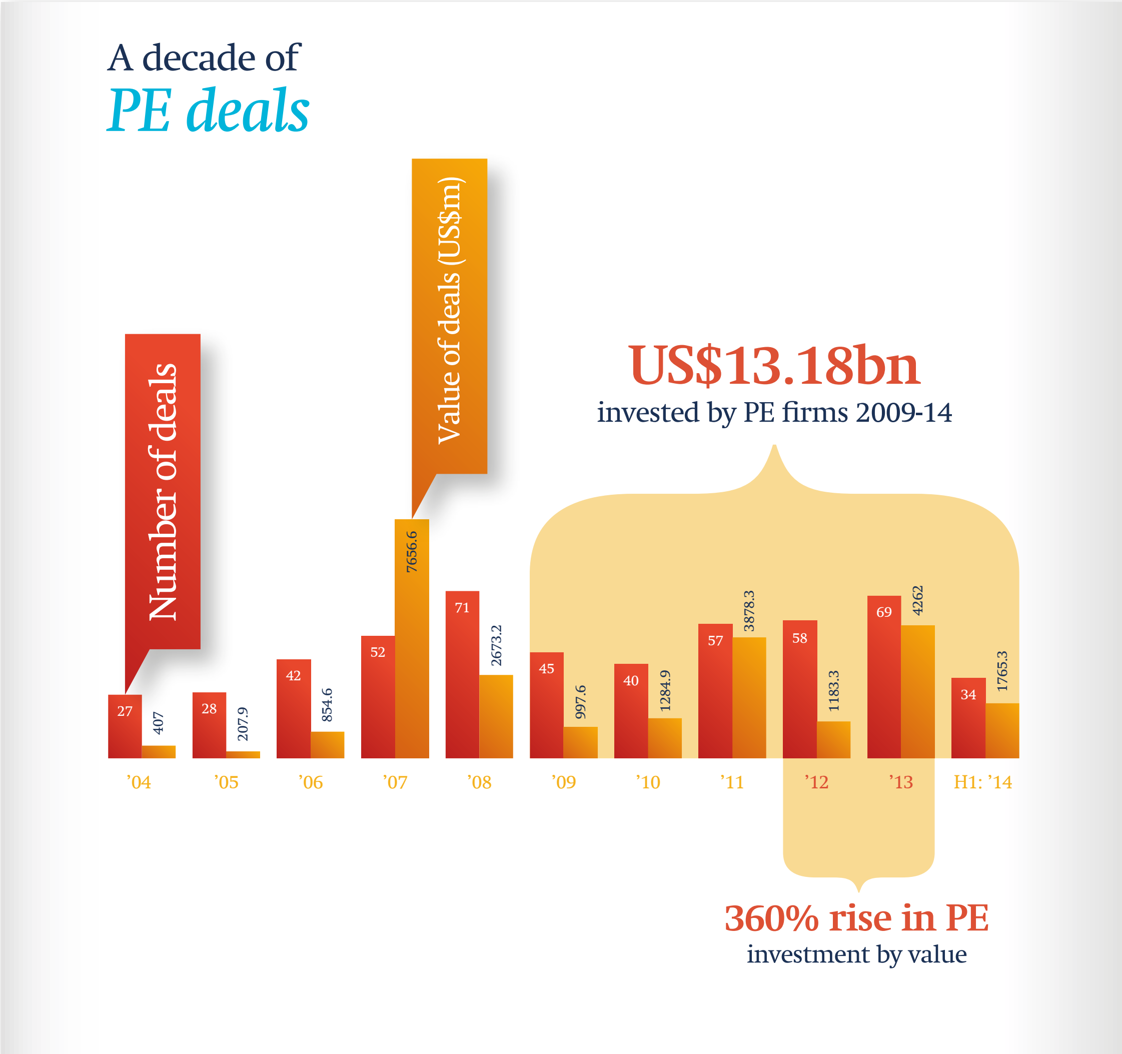
Into Africa: the rise of PE

Contacts

Corporate partner ***Pervez Akhtar***, head of Freshfields' MENA practice, advised The Abraaj Group last year on its acquisition of west African dairy giant Fan Milk International, one of the biggest ever private equity FMCG deals in Africa and reportedly the largest outside South Africa at the time. He says: 'As we move on from the financial crisis, private equity firms are back doing what they do for a living, which is investing. The PE market quietened down significantly during the downturn but is now picking up, because many firms have funds that have not been deployed.

They are looking for new markets that give them a growth story, and some of the returns we see in Africa are staggering compared to those in developed market economies. In Nigeria the government is privatising some banking assets which offers PE investors a clear opportunity. In other countries the prospects come as a result of Africa's need for capital. Companies and entrepreneurs understand that if they want to develop a business and give it a greater platform for success, they may need to bring in money and financial expertise from outside.'

> *The prospects come as a result of Africa's need for capital. Its companies and entrepreneurs understand that if they want to develop a business and give it a greater platform for success, they need to bring in money and financial expertise from outside.*



Global funds
– a growing influence

The biggest PE firms in the world are beginning to take a more strategic approach to their investments in Africa. Deal values and volumes are rising – and the latest figures reveal a very strong start to 2014.

“

As global players start to get more involved in the African market they'll understand more about local management teams and do more deals.

Global players exercise their power

Global PE funds completed 15 deals worth US$1.5bn between 1 January and 30 June 2014, up from 10 deals totalling US$621m in the first half of 2013. As a proportion of total PE deal value (83 per cent) and deal volume (44 per cent) global firms have been more active on the continent this year than ever before.

Over the past decade, domestic African funds completed 61 per cent of all PE transactions on the continent, with global funds registering 25 per cent and global African funds 14 per cent. Despite the financial crisis, the number of deals closed by global funds in Africa nearly doubled between 2009 and 2014 compared to the preceding five years.

Although the data for reported deal values is patchy, figures from Preqin suggest that almost US$25bn has been invested in African assets by private equity firms since 2004. To put this into context, the two biggest PE transactions of 2013 were Berkshire Hathaway/3G Capital's US$28bn acquisition of Heinz, and Silver Lake's US$25bn deal for Dell. But the available numbers reveal just how important global managers are to the African market, showing that global funds were responsible for 62 per cent of total PE investment between 2004–14. In addition almost half the deals (48.5 per cent) closed by global African funds since 2004 have come in the past two years.

Freshfields' analysis of the African private equity market categories the data according to three types of investor:

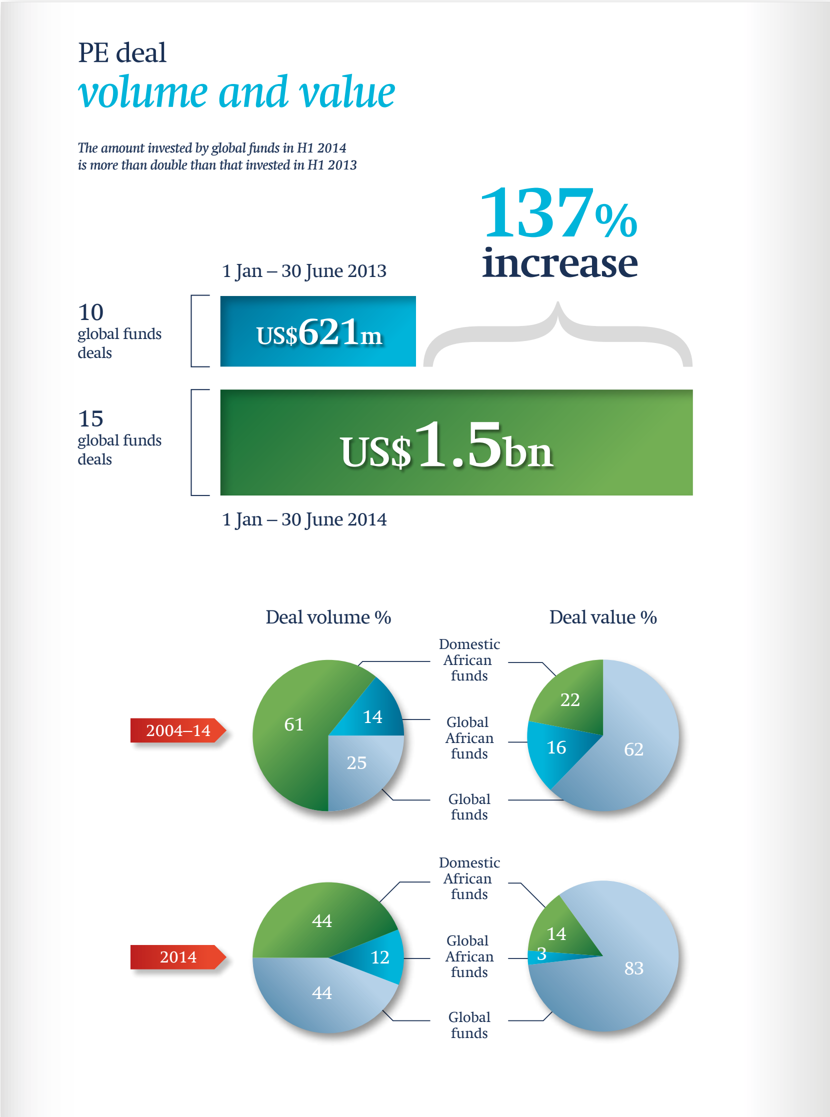
- domestic African funds: PE managers that only invest in African assets. These firms generally do the most deals with the lowest relative values;
- global African funds: firms that manage both Africa-specific funds as well as at least one fund that invests outside the continent. When they invest in African assets they are able to leverage their international footprint and experience to enhance value; and
- global funds: typically the bigger players. They have no particular focus on Africa, but will invest if assets with the right profile become available.

By breaking the data down in this way, we are able to identify more specific trends and draw more accurate conclusions about Africa's growth as an investment destination and its attractiveness to the world's most sophisticated private equity investors.

The snowball effect

Freshfields' corporate partner ***Adrian Maguire***, who works with some of the world's leading PE investors, including Advent, Cinven and Warburg Pincus, believes that the success of global funds will lead to further deals in the future. He says: 'The increasing interest from the biggest funds is partly as a result of increased risk tolerance, and partly because they're seeing others do deals in Africa. Sellers are now aware that global funds are willing to transact on the continent and are getting more comfortable selling to them. Limited partners are also asking for something different, and acquiring these types of businesses offers that.'

Rob Cant, a senior associate in Freshfields' Global Financial Investor group, who regularly advises on private equity transactions, says: 'It's clear that the biggest global firms will become more prominent in Africa in the future. The fact that firms like Blackstone, Carlyle, KKR and Warburg Pincus – whose LPs have invested in their funds based on global mandates – have all made sizeable investments on the continent shows that assets can be found that meet the investment profile of the world's most sophisticated financial investors.'



Sovereign wealth funds reveal confidence in the market

Our data also shows a broader interest in the African market from foreign sovereign wealth funds (SWFs). A decade ago, it was the Middle Eastern SWFs from the Gulf who were most active in Africa, largely investing in the north.

During the financial crisis, starting in 2008, we saw a pause from the Middle Eastern investors, at which point the Asian SWFs (specifically from China and Singapore) started to make direct investments of their own. More recently, the Gulf investors have returned (the Investment Corporation of Dubai's US$300m investment in Nigeria's Dangote Cement being a good example), but the Asian investors remain active (particularly the Singaporeans who have invested over US$1.4bn in Nigeria and Tanzania in the last 12 months).

Demand for capital predicted to rise by

8% a year

between now and 2008 (McKinsey).

Private equity in Africa – *a brief history*

PE firms operate a variety of models when investing on the continent. Some have local offices, others rely on sector-specific knowledge – while two of this year's biggest moves involved global funds joining forces with the same Nigerian billionaire.

Several of the biggest private equity firms in the world have turned their focus to Africa in recent years.

Several of the biggest private equity firms in the world have turned their focus to Africa in recent years. In June US giant KKR invested a reported US$200m in Ethiopian rose-grower Afriflora, while Warburg Pincus has completed a number of oil and gas deals on the continent in the past five years. Fellow US firms Blackstone and Carlyle both announced their own partnerships this year with Dangote Industries, the leviathan African conglomerate founded by Aliko Dangote – Africa's richest man – to invest in energy infrastructure. Blackstone, which has a history of investing in African energy assets, is set to commit US$2.5bn over the next five years, with a matching investment from Dangote Industries. Carlyle this year closed its first sub-Saharan fund after raising US$698m (almost 40 per cent more than it initially targeted), arguably making it the most high profile of the global African funds. The fund, which launched in 2011 and is managed from offices in Johannesburg and Lagos, has already closed three significant deals since its inception.

Some of the biggest and most active of the domestic African funds include Helios Investment Partners and Emerging Capital Partners, each of which has raised over US$2bn to invest in Africa over the last 10 years. A number of specialist investors have also emerged, such as Atlas Mara, the investment vehicle established by former Barclays CEO Bob Diamond and billionaire investor Ashish Thakkar which raised over US$300m through an IPO on the London Stock Exchange to invest in African financial institutions.

Elsewhere, growth market investors such as The Abraaj Group and Actis are among the more active firms on the continent. Last year Freshfields advised Abraaj, which has offices across the continent, on its acquisition of west African dairy giant Fan Milk International – one of the biggest ever private equity investments in an African FMCG business. The investment took the group's commitments in Africa beyond the US$2bn mark.

Co-investment arrangements are a recurring theme in the African PE market. Some of the biggest investors in Africa-specific funds are development finance institutions (DFI) like IFC and the African Development Bank. The DFIs are not only a rich source of LP investment in Africa – as they are in many other emerging markets – but they regularly co-invest (or at least have the option to do so) with the general partners and are increasingly looking at making their own direct equity investments.

The benefits of local knowledge

Carlyle and Blackstone's partnerships with Dangote Industries reveal the importance to global funds of local knowledge. Some PE firms such as Abraaj and Emerging Capital Partners operate a network of African offices, but the global funds have so far shown limited interest in building similar structures.

Freshfields' corporate partner ***Adrian Maguire*** adds: 'One of the key factors for a PE firm when acquiring a business is trust in the management team. Those with offices in-country can either get to know the management team of an asset they're considering or will already know them by reputation. As soon as they've done their first deal in the region, they'll start spending even more time in these markets and getting to know the management teams better and better. This will create momentum for more private equity investment as a whole.'

Shawn der Kinderen adds: 'Carlyle has opened offices in Johannesburg and Lagos, and Blackstone and KKR have launched their own Africa teams. Global private equity firms are increasingly hiring investment professionals who used to work for domestic or Africa-focused funds. All this shows how serious they are about investing there.'

US$200m

KKR's investment in Ethiopian rose-grower Afriflora, its first African deal.

US$5bn

The amount committed by Blackstone and Dangote Industries to African energy assets.

50+

The number of investments made by Emerging Capital Partners since 2004.

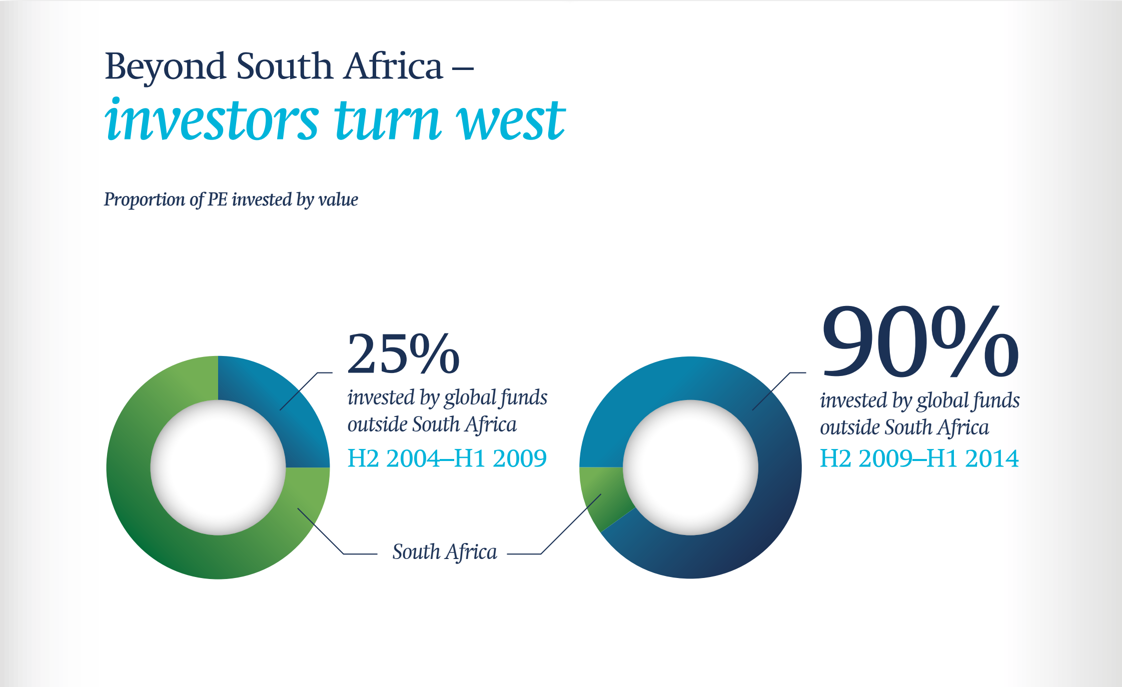
Contacts

Beyond South Africa – *investors turn west*

For the past decade South Africa has been the most popular destination for private equity investors in Africa. But in recent years the focus has shifted north and west to the continent's new economic powerhouse, Nigeria.

PE firms invested more than US$11bn in South Africa between 2004 and 2014, closing 223 deals. These figures represent 44.5 per cent of the US$25.2bn invested on the continent, and 42.6 per cent of Africa's 523 PE transactions.

Over the past five years South Africa has been the most popular African destination in terms of deal volume, attracting 38.7 per cent of all transactions. But domestic African funds are now doing a greater proportion of their business outside the country, closing just 27 per cent of their deals in South Africa over the past two years compared to more than half in the past five years. Deal values have also dramatically shifted, with South Africa's share of total investment falling from 75 per cent between 2004 and 2009 to just 10 per cent in the five years since.



Nigeria – Africa's 'colossus'

This reduction in investment in South Africa has coincided with the spectacular growth in Nigeria's share of PE investment on the continent. On 12 April this year Nigeria declared itself Africa's biggest economy, announcing that its GDP had grown 89 per cent to US$510bn – 38 per cent bigger than South Africa's. It did so by 'rebasing' its GDP figures, the first time it had done so since 1990. The process of calculating GDP involves referencing a base year, measuring how fast certain sectors are growing and then weighting each sector on its importance to the economy in the base year. Because Nigeria had waited so long to update its figures it was significantly undervaluing sectors such as telecoms and manufacturing, which now account for 25 and 7 per cent of GDP respectively.

The Economist reported that the revision 'provides a truer picture of Nigeria's size by giving due weight to the bits of the economy… that have been growing fast in recent years… The new numbers confirm that it really is the colossus of the continent'. Economic growth has averaged around 7 per cent a year for the past 10 years, it is rich in natural resources, has a coterie of dynamic entrepreneurs and twice as many citizens as Africa's second-biggest country, Ethiopia.

Nigeria's rise is reflected in the private equity data we analysed. It has topped the table for PE deal value in Africa every year since 2012, attracting almost a third (31.4 per cent) of the total private equity investment on the continent over the past five years. The figures this year are equally strong, with PE firms investing US$925m in the country to and including July – 52.4 per cent of the total.

PE firms invested
US$925m
in Nigeria
between January and July 2014.

Global players shift their focus

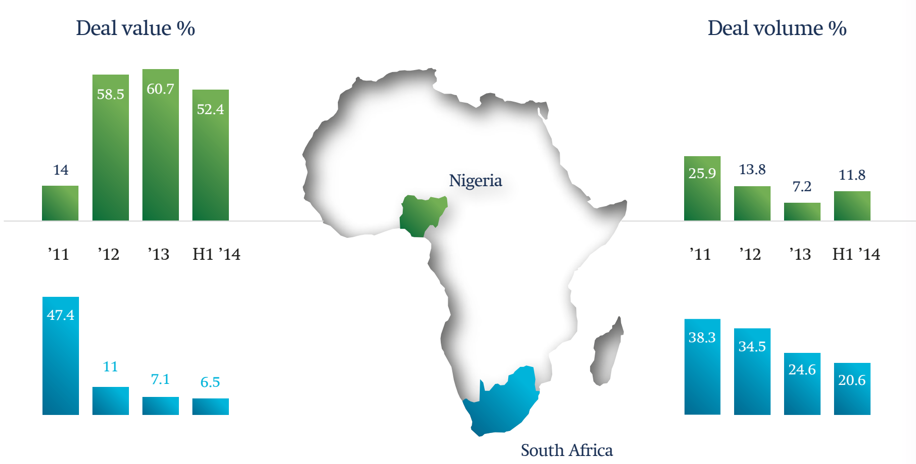
Analysing the data by fund type reveals a greater geographic spread of investments from both global Africa funds and global funds in recent years. More than four-fifths (84 per cent) of the money they have invested in west Africa since 2004 has come in the past two years. Global investors are also beginning to show significantly more interest in east African assets, with 41 per cent of their deals in the region since 2004 coming in the past two years. Despite the conflicts that have scarred north Africa's recent history, one-sixth of Africa's PE transactions over the past decade have been made in the region.

David Higgins says: 'North Africa, west Africa, southern Africa and east Africa contain very different markets. Investors need to take the regional and jurisdictional diversity into account. There is greater political risk in particular sectors such as energy or natural resources, where having a local partner is often critical. But if the asset is an FMCG business, you don't necessarily need a local partner because the target isn't strategic and may not be subject to regulatory scrutiny or governmental interest.'

Target *nations*

Between 2004–11, South Africa was the top PE destination by value in all but two years.

But since then the focus has shifted...



Managing *risks*

As deal volumes and values grow, so the scope and potential impact of global regulation is acting as a brake on deal-making. With the UK Bribery Act, US Foreign Corrupt Practices Act and international sanctions the perception from international investors is that it is harder to do deals in emerging markets, while the emergence of new regional antitrust and merger control regimes such as COMESA has added uncertainty to the M&A process. Currency and exchange controls can be used to stop the repatriation of funds, while in many African countries foreign investments are subject to restrictions and regulations on local employment and ownership rights. There may also be sector-specific rules in certain industries such as telecoms, energy or financial services.

Mitchell Presser, head of Freshfields' US M&A group – who came to the firm following seven years as founding partner of private equity firm Paine + Partners – believes that risk profile is an important driver for many PE firms. He says: 'Global private equity investors will typically invest a smaller proportion of their funds in higher-yielding assets to spread their risk. Africa still carries political risk, the potential for expropriation and uncertain regulatory regimes. Often the tipping point for PE investors is on the risk curve – if their advisers can make them feel comfortable investing in a new market then they'll do it.'

Pervez Akhtar says: 'Compliance, money laundering and bribery are serious concerns for PE firms. They don't want to be investing in businesses that are doing those sort of things now, or may be doing them in the future. We do a lot of work guiding businesses into emerging markets, and often help them focus on corruption or bribery issues so they know what to look out for.'

Adrian Maguire adds: 'PE funds have zero risk appetite for businesses that may be subject to criminal sanctions, including concerns around the Bribery Act and FCPA. Their LPs would be equally concerned – there are always other things they can spend their money on after all. Although the economic drivers are very much in favour of Africa as an investment destination, such regulatory issues can temper this.'

> “
>
> *There will be a few bumps in the road, like there always are in emerging markets. But while political risk in Africa remains, the situation gets easier as more deals are done. The lending banks begin to understand the market, and regulators and tax authorities become more familiar with private equity investors.*

Freshfields *in Africa*

We have been helping clients invest in Africa for more than 150 years since being engaged to advise on the building of the Suez Canal in the 1860s.

We are acting on the largest M&A transaction involving a listed company in Africa (Etisalat's acquisition of a stake in Maroc Telecom), and our international arbitration team has experience in more than 25 African jurisdictions. We are advising MTN on its landmark mobile tower sale and leaseback agreement with IHS in Nigeria, one of the biggest infrastructure transactions in the continent's history. Our project finance team is advising on the biggest project financing ever to close in Africa (Egypt's Mostorod refinery) and we also acted on one of South Africa's largest PPP projects (the Gautrain rail project).

Freshfields' Africa group comprises more than 100 lawyers spread across the firm. We also have relationships with Africa's best law firms, so we can build the right team for any matter – wherever it arises.

We've spent decades building our network and know who to recommend by name for any transactions or dispute. Our approach minimises the possibility of conflict and ensures our clients get a team they can trust in the shortest time possible.

> *Our global financial investors group has one of the most active teams on the continent, regularly advising private equity investors and sovereign wealth funds on their strategic investments in Africa.*

20+
African transactions
for global financial investor clients that Freshfields has advised on in the first nine months of 2014.

10 major
global investigations and compliance mandates
with an African focus we've handled in the past two years.

Contacts

Pervez Akhtar
Partner

T +971 4 5099 191
E pervez.akhtar@freshfields.com

Rob Cant
Senior Associate

T +971 4 5099 195
E rob.cant@freshfields.com

Bruce Embley
Partner

T +44 20 7832 7426
E bruce.embley@freshfields.com

David Higgins
Partner

T +44 20 7832 7353
E david.higgins@freshfields.com

Shawn der Kinderen
Partner

T +31 20 485 7624
E shawn.derkinderen@freshfields.com

Adrian Maguire
Partner

T +44 20 7716 4270
E adrian.maguire@freshfields.com

Alan Mason
Partner

T +33 1 44 56 44 51/ +44 20 7427 3628
E alan.mason@freshfields.com

Mitchell Presser
Partner

T +1 212 230 4650
E mitchell.presser@freshfields.com

Patrick Tardivy
Partner

T +33 1 44 56 33 22
E patrick.tardivy@freshfields.com