

# Harvesting growth

How do private equity investors create value?

A joint study of private equity exits  
in Africa by AVCA and Ernst & Young



# Contents

01 **Foreword by African Venture  
Capital Association**

02 **Executive summary**

## **Key findings**

03 **PE exit activity and performance**

07 **Buying well: local networks are key**

10 **Growing companies well:  
ESG improvements drive growth**

13 **Realizing value: strategic buyers  
are a vital exit route**

16 **Outlook**

19 **About the study**

20 **Contacts**

In many regions of Africa, there's a long history of producing coffee and this is a key export for many countries. This photo shows an image of roasting coffee beans.



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# Foreword



We are honored to have partnered with Ernst & Young on this first study of private equity exits across Africa.

This collaboration with Ernst & Young represents a pivotal step in addressing the need for credible data

on the African private equity and venture capital landscape. This research will provide investors with key information on how fund managers create value, deliver commercial returns and, more importantly, debunk common myths about exits in Africa.

Africa is taking center stage on the back of exceptional economic growth, a rising middle class and relative political stability – themes that make the continent an increasingly attractive investment destination. Our industry, which provides development capital to private companies, is uniquely positioned to further support the growth of African economies.

We are profoundly grateful to our members and other organizations, including the Emerging Markets Private Equity Association (EMPEA), which supported this important initiative. We look forward to deepening this research and providing you with more data on value creation in Africa.

Best regards,

A handwritten signature in black ink that reads "Michelle Kathryn Essomé".

**Michelle Kathryn Essomé**  
Chief Executive  
African Venture Capital Association

# Executive summary

Africa's economic development over the last few years has been impressive, with many countries across the continent starting to see the benefits of government and economic reforms and increased foreign direct investment (FDI) flows. This, together with a steady rate of investment by, among others, development finance institutions (DFIs), has enabled the creation of a viable and vibrant private equity (PE) market as managers seek to capitalize on Africa's strong economic growth rates. Over the last 10 years, Africa's economic output has increased threefold to US\$2t, and 6 African countries have been among the 10 fastest-growing economies in the world.

In Africa, however, the PE industry is in a phase of relative infancy. The continent's stock markets, other than the Johannesburg Stock Exchange, are still very small and relatively illiquid, and the intermediary networks remain far from complete across the region. As a result, a widely held perception is that exits are hard to achieve and that therefore they are few in number. However, our analysis points to a higher level of exit activity than might be expected. Between 2007 and 2012, we recorded a total of 118 realizations by African private equity fund managers.

Africa's PE firms are clearly demonstrating a good capacity of finding ways to realize value. One of the key means of finding the right exit partner is through the PE firm's wide and varied contacts – a vital attribute in such a young market. The most significant form of exit is via strategic sales, with regional strategics becoming a particularly important exit route since 2009. Africa's markets are becoming increasingly pan-regional. The continent's PE houses are playing an important role in facilitating that process, often by building local companies with a compelling strategic logic to regional buyers looking to gain a foothold in Africa's fast-growth markets. At the larger end of the deal spectrum, some players are working with portfolio companies to help them build out a regional presence.

PE's strategic and operational improvements are generating returns of almost double the Johannesburg Stock Exchange ALSI.

In addition, Africa's PE houses are clearly working closely with the management teams they back to create value in investee companies. This partnership approach is particularly important, given the high incidence of minority stakes in the markets – 80% of our sample were minority stakes. A large part of value creation is implementing new procedures and processes to improve governance, but we have also found much evidence of PE houses using their networks to full effect to bring in the right expertise and to support portfolio companies in their growth plans.

Our research found that PE is focusing on organic revenue growth in African companies, a move that has accounted for approximately two-thirds of EBITDA growth. They are employing strategies familiar to other markets, such as building the right platform for growth and identifying product improvements.

These ingredients put together mean that Africa's PE firms are providing investors with outperformance relative to public markets. Our analysis of 62 exits for which we have returns information shows that PE's strategic and operational improvements are generating returns of almost double the Johannesburg Stock Exchange (JSE) ALSI. And while we may not have a comprehensive sample for this inaugural study, overall, our study demonstrates that Africa's PE houses are using all the levers at their disposal to find the right businesses and management to back, working in partnership with management teams to improve governance and performance and identifying the best available exit route.

# PE exit activity and performance

## PE exits show momentum across all regions

Between 2007 and 2012, we recorded a total of 118 exits by PE firms. This figure is very encouraging and likely to be higher than many prospective investors and other market participants may have expected. And we know there are many more than these because many sales are completed privately, making it difficult to collate complete data.

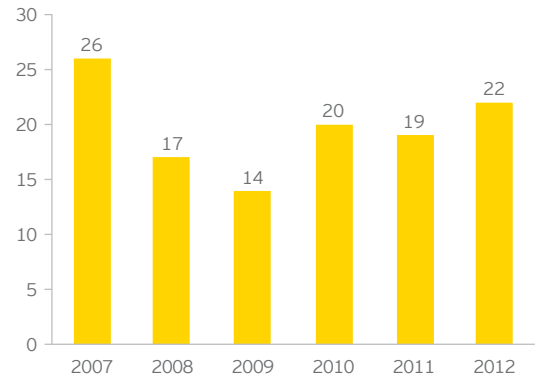
Also encouraging is the finding that these exits are not entirely centered around the more developed market in South Africa. These account for less than half of PE exits (42%). Instead, the remaining 58% of exits were spread across the different regions of Africa, where the industry is far younger than its South African counterpart. West Africa accounted for the second-highest proportion, with 25%, and the other regions – East Africa, North Africa and Southern Africa (excluding SA) – each accounting for 11% of exits. This is a highly positive finding as it demonstrates that PE houses across the continent not only can source good investment prospects but also have a focused eye on the exit.

Overall, as might be expected, the larger markets of South Africa, Nigeria, Egypt, Ghana and Kenya accounted for a large share of the exits, with 74%.

Last year proved to be a good year for exiting PE investments. It saw 22 realizations, up from 18 in 2011 and 20 in 2010. In fact, 2012 was the best year for exits by number since before the global crisis in 2007, attesting to the resilience of Africa at a time of global uncertainty.

PE houses across the continent not only can source good investment prospects but also have a focused eye on the exit.

Figure 1. Number of PE exits in Africa, 2007-12



Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

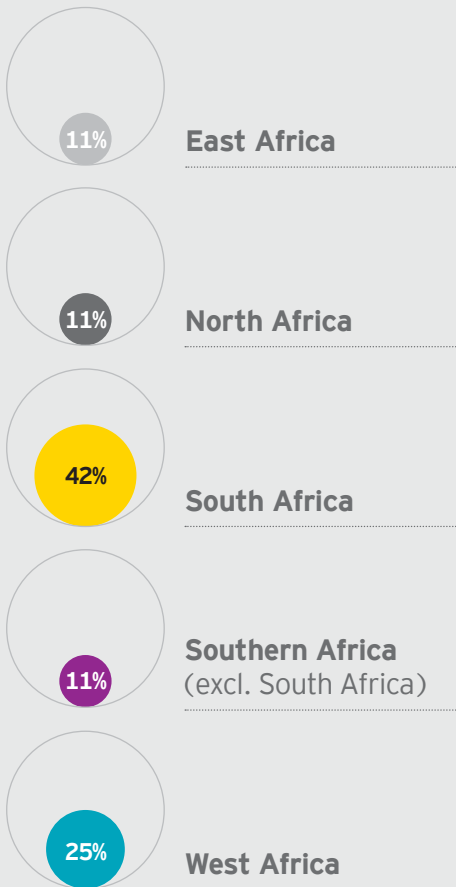
## Financial services exits lead, but other consumer-focused sectors important

By sector, financial services was the most active exit sector in Africa, accounting for 23% of realizations by number. This is largely the result of the high volume of financial services investments completed over the last few years as countries such as Nigeria and Ghana have undergone banking reforms. However, these exits also demonstrate the overriding investment theme in Africa – the rise of the consumer. As the region's economies grow and disposable incomes rise, financial services are becoming a more important part of the economic landscape and are therefore attractive not only to PE investors but also to strategic buyers looking for a foothold in new markets. The consumer theme is also reflected in some of the other active sectors by exit, such as food and beverage (9% of exits) and telecommunications (8%).

Figure 2. Exits by region



“The larger markets of South Africa, Nigeria, Egypt, Ghana and Kenya accounted for a large share of exits.”



Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

Figure 3. Financial services most active sector, driven by growth in consumer



Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

## Trade sales dominate, but secondary buyouts emerging

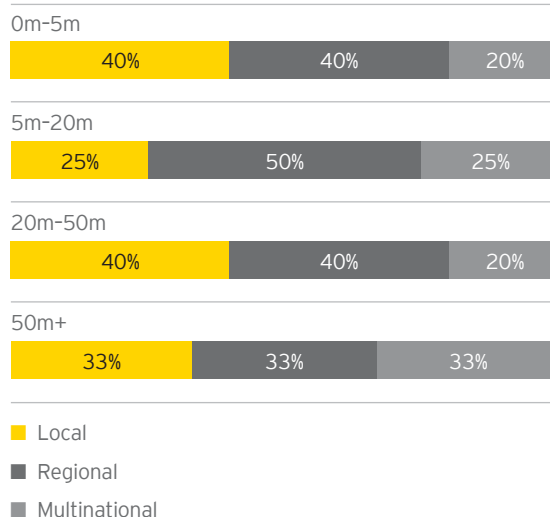
Sales to strategic buyers have been the most significant exit route in Africa, accounting for half of all exits. This type of exit accounted for over half of realizations in 2012. Of these buyers, regional and local companies have been the most active trade buyers from 2007 to 2012. However, between 2010 and 2012, regional buyers became the most prevalent type of strategic buyer, accounting for half of all trade sales. This points to an increasingly pan-African market that is being driven by local players consolidating fragmented industries across the continent. Our analysis suggests this trend is particularly notable in the financial services market.

Multinational companies, by contrast, make up a small proportion of trade sales – just 15% between 2010 and 2012, down from 31% between 2007 and 2009. This is perhaps a reflection of the cautious stance being adopted by global companies in their M&A strategies as economies in the rest of the world, including other key emerging markets, slowed in 2012. However, it may also be a function of the size of deals that PE currently targets in Africa. For those deals with an entry enterprise value (EV) of US\$50m or more, sales to multinational companies account for a third of exits to strategic buyers. As fund-raising numbers increase over time and deal sizes creep up, it seems likely that multinationals will become a more important source of exits in years to come.

Over half of the regional buyers were based in South Africa, with the rest evenly spread throughout the rest of Africa. This suggests that SA-based companies are becoming more active outside their domestic market and in other parts of Africa.

Sales to strategic buyers have been the most significant exit route in Africa, accounting for half of all exits.

Figure 4. Trade buyers – local, regional and multinational by entry enterprise value (US\$m)



Secondary buyouts were the second most important exit route in 2012, accounting for 23% of sales by PE. This is a significant development: in 2007, secondary buyouts were just 12% of exits by number. The increase is suggestive of a maturing market, as more PE funds become active in Africa and larger funds are raised. We would expect more PE-to-PE sales over the coming years.

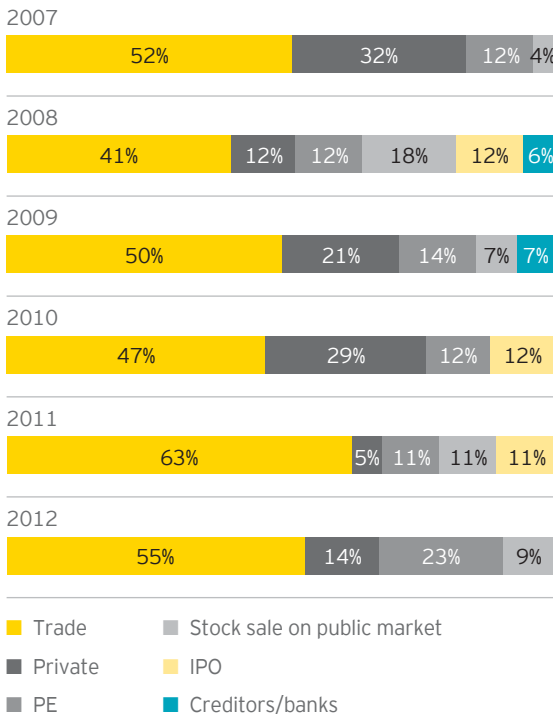
Africa-focused funds are also using stock markets as an entry and exit point for portfolio companies. While some are able to take advantage of IPO markets in the relatively liquid Johannesburg Stock Exchange, PE houses more commonly buy and sell minority positions in listed companies. In 2012, 9% of exits were via a stock sale on the public market.

Meanwhile, the low incidence of leveraged transactions means that exits to creditors are few. While there were some in 2008 and 2009 (6% and 7%, respectively), other years saw none.

# 91%

91% of deals in our sample were proprietary

**Figure 5. Exit route, by exit year and exit population**



Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

## Our exit sample shows African PE outperforming public markets

African PE firms are not just making excellent headway with generating exits, they are making strong returns in the process. This is highly encouraging for the future development of the industry in the region. DFIs, which have largely been responsible for the creation of PE in Africa, have clearly identified the PE players with potential for generating positive returns. A greater level of commercial sources of finance – both domestic and international – should follow.

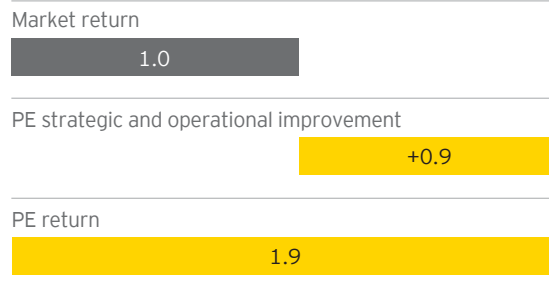
Our analysis of the 62 exits for which we have an equity multiple return shows that PE's strategic and operational improvement capability in Africa has led to a 0.9x multiple return over the JSE ALSI. In other

PE in Africa has returned almost double to investors what they might have achieved on the public markets.

words, PE in Africa has returned almost double to investors what they might have achieved on the public markets. This bears testament to African PE's ability to create value by sourcing good investments, working closely with management teams to improve companies and finding the best available realization route. (Unlike in many other markets, most of Africa's PE investments do not use leverage so there is no return from leverage in our data.) As the later parts of this report demonstrate, the PE model has been adapted by Africa's PE investors to suit local conditions; the returns they have generated show that these adaptations work well.

By region, those markets that are arguably least mature in PE terms – East and West Africa – generated the highest returns. This is possibly because PE is able to make more improvements to companies in these markets in addition to taking advantage of multiple expansion strategies.

**Figure 6. PE return relative to the market**



Note: Market return is based on returns to the JSE during the holding periods of exits in the study.

Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013



# Buying well: local networks are key

## Networks essential for origination in Africa

Finding the right opportunities to back is one of the key issues facing PE in Africa. There are few market studies or maps of local companies and opportunities, and the intermediary infrastructure is not yet well developed. As a result, Africa's PE firms must build and sustain healthy local networks to ensure successful deal origination.

Nearly half – 48% – of the deals were sourced via networks or relationships, while a third were identified through company and sector tracking. Just 14% of deals were opportunities brought to the PE firm. Once South African deals are removed from the figures, this falls to 11%. By region, half or more deals in West Africa, East Africa and Southern Africa (excluding SA) were originated through networks or relationships, while the more mature South African market saw fewer deals sourced this way.

As a result, 91% of deals in our sample were proprietary. Of the remaining 9% that went to auction or had some form of market testing, four-fifths were in SA, with the remainder in North Africa. This is because the auction market outside SA has been very limited, but also because of a preference among most respondents for proprietary deals, which can help save management's time and preserve confidentiality. The use of networks and relationships for transaction sourcing allows Africa's PE firms to uncover hidden gems and make investments at attractive entry prices – key ingredients for successful deals.

However, the prevalence of auctions is now starting to increase beyond SA. West Africa in particular is witnessing this trend, which indicates a maturing of the market in some countries. Unsurprisingly, these auctions are generally for the large assets, and competitors include not only PE houses but also regional and multinational strategics.

Almost half of deals sourced in Africa in our exit sample are through private sellers; this is higher than in Europe and the US, where only 13% and 32%, respectively, come from private sellers. However, the figure is not as high as in Latin America. In Africa, deals sourced through private sellers are particularly prevalent in the under US\$5m EV bracket, while a third come from corporates as carve-outs. Other PE houses were a relatively small (4%) source of deals for companies exited in 2007 to 2012, although we would expect these to increase as the market matures.

“A good local network is key for origination.”

“We found out about the deal from one of our LPs.”

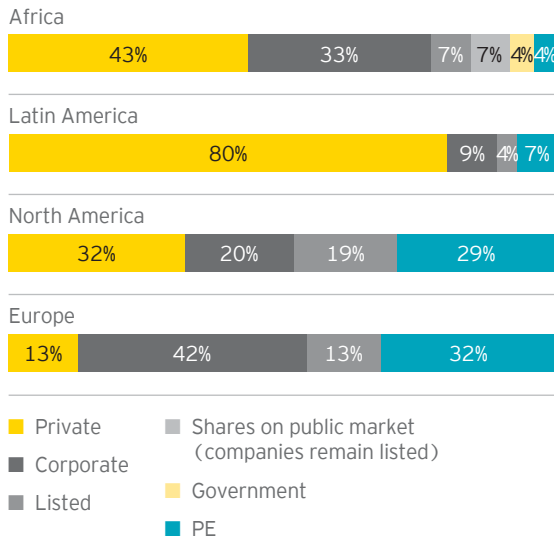
“Someone on our advisory board knew the CEO of the company.”

“Deals are generally proprietary, so we tend to get good prices.”

# 80%

Africa's PE firms tend to take minority stakes in the businesses they back (80% in our sample)

**Figure 7. Deal provenance, comparison across regions**



Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

## Backing the right management is vital

Africa's PE firms tend to take minority stakes in the businesses they back (80% in our sample). The prevalence of minority stakes means that African PE firms must ensure that they are adequately protected. Our analysis shows extensive use of minority protection rights as a key means of influencing management and the direction of a company. These include board seats, veto rights on major decisions, the right to change management where necessary and the right to change auditor.

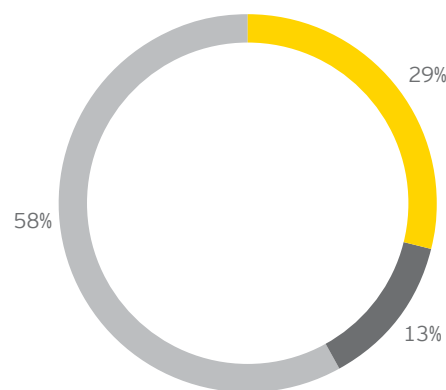
PE's emphasis on minority investment is centered on partnering with existing management teams to improve businesses. For this partnership to succeed, PE firms must be comfortable that they are working with the right people.

Africa's PE firms look to back incumbent management and either continue with an existing business plan (61%) or forge a new one (28%). Just 11% of exited deals involved bringing in new management. This is primarily because the management tends to be the majority owner of the business, but also because management talent is less prevalent in some markets. This feature is more pronounced in Africa than in some other emerging markets. For example, the CEO of a business was changed in just 26% of cases in Africa; a similar study we conducted in Latin America found that this happened in 37% of cases.

As a result, getting to know companies and their management teams well in advance of investing is vital for success in African deals. One of the most important elements of this is conducting extensive management due diligence. A third of deals in our sample that did this reported substantially higher returns than those that either conducted limited due diligence or simply relied on an existing relationship for knowledge of a team's capability.

**Figure 8. PE firms' knowledge of management teams prior to investing**

- Extensive due diligence on management
- Limited/no due diligence on management
- Had a prior relationship with management team, entrepreneur or sponsor



	Relative returns
Had a prior relationship with management team, entrepreneur or sponsor	1
Limited/no due diligence on management	0.2
Extensive due diligence on management	2.5

Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013



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“Looked at the company for years before investing. We got to know the management team, business plan and company financials. The long lead time enabled us to see that management could deliver on their business plan and targets.”

“It is critically important to have a broad knowledge base that covers not only the specifics of the company and/or sector but also the broader environment such as geopolitics and the macro picture.”

“Be careful who you partner with – do management checks and back a team with hands-on, relevant experience.”

In addition to understanding a management team's strengths and weaknesses, success in Africa is dependent on getting to know the country and sector macro story as well as thorough examining of the company's information. This is particularly the case where firms are operating in countries where they have less experience. Firms that spent one year or more looking at a company benefited from higher returns, according to our analysis.

All these factors – building strong networks and relationships, getting to know sellers and management teams, and gaining a detailed understanding of the company itself and the broader environment in which it operates – are time-intensive. However, as the results from our analysis of exits demonstrate, many African PE firms that have dedicated time and resource to buying well are now starting to see the results as good realizations are coming through.

# Growing companies well: ESG improvements drive growth

## ESG improvements key to driving growth in Africa

An important part of PE's value-add in Africa is improving the environmental, social and governance (ESG) policies of portfolio companies – possibly more so than in many other PE markets. Work in these core areas improves not only company performance, but also gives potential future buyers of these companies confidence as certain key risks are mitigated. In addition, it can also affect exit proceeds, particularly with regional or multinational strategic buyers, which are more likely to pay a premium for businesses they consider to be well run.

The DFIs, which have been the primary source of capital for many of Africa's PE funds, have been behind the drive for improvements in ESG practices in African companies. As government-owned or sponsored institutions, they have had a duty to report back to key stakeholders on where they have invested their capital and the developmental impact this has had. ESG has been core to this reporting, as governments, media and non-governmental organizations have maintained pressure on DFIs and their underlying investee funds to ensure not only that ethical best practices are adhered to, but also that sustainable development is achieved. This has resulted in many of Africa's PE funds and their investee companies now being at the forefront of emerging markets in setting the standards for ESG.

The ESG agenda is so important in some African firms that they report having dedicated coordinators or committees in-house to monitor companies' performance on ESG matters and oversee all elements of risk related to these areas.

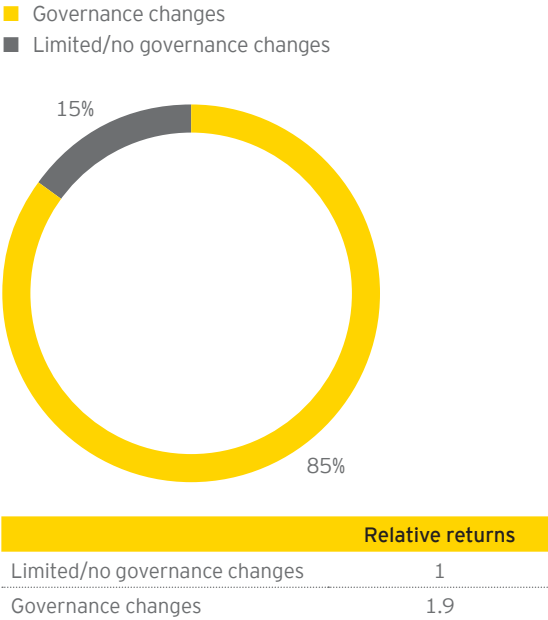
Governance is one of the most vital aspects of this. Our analysis shows that PE tends to make more governance improvements in family-run businesses and corporate carve-outs than in listed businesses, where its ability to execute change is more limited. Some of the governance initiatives are hygiene factors, such as bringing in independent non-executive directors, putting in place solid financial reporting and protocols, ensuring that accounts are audited and that monthly reports can be produced, and devising new incentive schemes for management

so their rewards are linked to performance. Others are more far-reaching. These include upgrading processes and hiring more qualified people to meet regulations or becoming approved/certified suppliers, implementing quality control systems and introducing corporate structures to family-run companies.

On the environmental and social side, Africa's PE firms work with portfolio companies to improve areas such as health and safety by introducing labor initiatives and establishing community projects like clinics. In South Africa, PE has been instrumental in bringing Black Economic Empowerment (BEE) shareholders into privately owned companies.

These kinds of ESG initiatives not only meet LP requirements, they have an impact on the returns PE is able to generate. Our analysis shows that, where significant governance changes are made, firms achieve almost two times the returns of companies where limited or no governance changes are implemented.

**Figure 9. Governance changes in portfolio companies**



Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013



## PE's networks provide growth opportunities

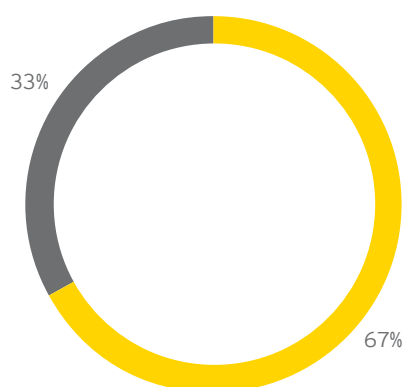
The relative immaturity of the African market means that PE firms are able to drive value by providing portfolio companies access to their networks. This support is helping investee companies grow profits and build scale.

There are a number of ways in which African PE houses are capitalizing on their networks to help build expertise within companies and support expansion strategies. These include identifying M&A targets to help companies expand, bringing in experienced board members (often with a particular industry expertise), expanding the management team, helping with regulators, introducing new client leads and providing support with identifying exit partners, particularly strategic buyers.

Providing access to networks is one of the key value-creation tools for African PE. Our analysis of exits where PE actively supported portfolio companies using this strategy shows that they generated much higher returns – well over double – than where it did not.

Figure 10. PE firms providing portfolio companies with access to their networks

■ Access to PE firm's networks  
■ No access to PE firm's networks



	Relative returns
No access to PE firm's networks	1
Access to PE firm's networks	2.4

Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

“We introduced potential acquisition targets.”

“We hired operational specialists to sit in the company at middle manager level to transfer expertise.”

“We provided the company with the right contacts – for example, in regulatory bodies – made sure they had the right partners, and helped them choose the right countries to expand into.”

## Value creation in action

**Company:** Société Internationale de Plantations d'Hévéas (NYSE Euronext: SIPH)

**PE investor:** Emerging Capital Partners (ECP)

**Sector:** Agriculture/forestry

**Entry date:** March 2005

**Exit date:** July 2007

**Returns:** 3.4x initial investment

### How PE helped the business

- ▶ ECP's investment allowed the company to expand production and implement cutting-edge techniques. The funding, combined with ECP's support in establishing the right partnerships and management team, resulted in revenue growth of 44 % annually over ECP's two-year holding period.
- ▶ ECP helped the company to become more attractive to investors by implementing standard financial reporting and identifying appropriate acquisition targets.
- ▶ In 2006, ECP played an instrumental role in negotiating the acquisition of Michelin's rubber plantations in Nigeria in exchange for a 20% stake in SIPH.

"We expanded into Algeria and Nigeria to take advantage of the huge potential demand. This accounted for approximately 20% of profit growth."

"25% of our profits growth came from producing a higher grade of product."

"Regional expansion accounted for around 80% of profit growth."

## PE is supporting organic revenue growth

Our study shows that the majority of profits growth in exited portfolio companies came from organic revenue growth. This accounted for two-thirds of EBITDA growth – far higher than in the US and Europe, where this accounts for just under half. African PE firms are helping companies capitalize on the continent's consumer boom by supporting their organic expansion strategies. With some portfolio companies, this means simply supporting the creation of the right platform to roll out in domestic and cross-border markets; with others,

PE is helping to identify product improvements that have more appeal to customers and/or improving margins.

Cost-reduction and restructuring strategies and M&A accounted for far less of the EBITDA growth seen in our exit sample. However, in some sectors where PE has recognized the need for scale, bolt-on acquisitions played a more important role in driving profits growth. Financial services was one such sector where financial institutions needed capital to consolidate and expand regionally to compete more effectively in the market.



# Realizing value: strategic buyers are a vital exit route

## Strategic buyers are key to successful exits

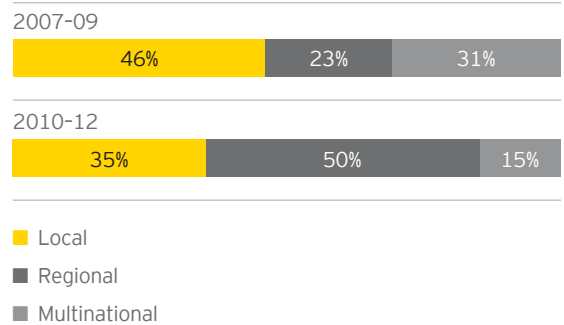
Understanding the needs and growth strategies of local and regional strategic buyers is at the heart of African PE's exit success story. Strategic buyers overall are the most active acquirers of PE portfolio companies, accounting for around half of all exits. And while local strategics continue to be an important exit route for many companies, our analysis suggests that returns are highest for PE when selling to regional corporates presumably because these buyers are looking for a valuable foothold in new markets.

Regional strategic buyers have been the most significant type of strategic buyer over more recent times. Between 2010 and 2012, they accounted for half of all strategic sales by PE. This is an increase over the 2007 to 2009 period, when local strategic buyers were more prominent by share. This indicates that markets on the continent are becoming more pan-African, aided possibly by the creation of intra-regional trade agreements. It is also possible that PE firms are increasingly seeking out the higher prize of exiting to regional players.

Of the regional strategic buyers, just over half came from South Africa (54%). The rest were spread evenly across Africa. SA-based strategics

are becoming more active across the rest of Africa over recent years, although they increasingly face competition from players in other markets looking to build scale across the region.

**Figure 11. Trade buyers – local, regional and multinational, by exit year**

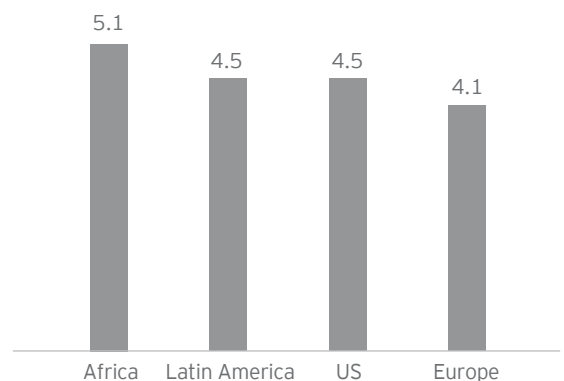


Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

## Hold periods are necessarily longer in Africa than elsewhere

Given the amount of transformation and support required by portfolio companies, it is hardly surprising that, as a general rule, holding periods are longer in African than in other regions of the world. Overall, the average holding period of African exits was 5.1 years between 2007 and 2011, higher than the Latin American and US figures of 4.5 years and much higher than the 4.1 years seen in Europe.

**Figure 12. Hold periods – Africa versus other regions**



Note: Latin America and US cover exits for 2007-11, Europe covers exits over 2006-12 and Africa covers exits for 2007-12

Source: *How do private equity investors create value?: 2013 Africa Study*, Ernst & Young and AVCA, 2013

“Africa is more about local and regional strategic buyers than multinational ones. For a sale to a multinational, you have to have a well-thought-through thesis as to why the asset should be of interest to them. Here, country risk comes more into play, too, so political risk and stability should be an important part of your investment thesis if you are targeting multinational buyers.”

Many of the value creation strategies African PE firms deploy take time as the focus is very much on supporting management teams and entrepreneurs in their growth plans. This has a clear effect on holding periods. For instance, firms will often work on resolving company governance issues before increasing their focus on growth. Identifying and getting to know the right buyer, too, may take longer in Africa in the absence of developed intermediation networks.

The fact that management often retains control of the company, with PE in a minority position, is another factor. However, PE firms in Africa emphasize the importance of having watertight shareholder agreements in place to smooth the exit process as the potential for disagreement over the value of a PE firm's stake in a business can be high.

Some African PE firms are also incorporating exit rights into the shareholder agreements, including "put" options that enable the backers to sell back to management teams.

### Value creation in action

**Company:** ABC Transport  
**PE investor:** African Capital Alliance (ACA)  
**Sector:** Transportation  
**Entry date:** August 2003  
**Exit date:** February 2008  
**Returns:** 4.7x initial investment

#### How PE helped the business

- ▶ ACA helped improve corporate governance and financial reporting and also assisted with recruiting senior management.
- ▶ ACA introduced some key corporate customers.
- ▶ ACA worked with management on expansion of the company's operations beyond Nigeria further into West Africa.
- ▶ ACA worked with management to prepare the company for and ensure a successful listing on the Nigerian Stock Exchange.

"The shareholder agreement was watertight and hard to wiggle out of."

"Agree the exit strategy at the point of entry and write it in the shareholder agreement."

## Exit enablers improve exit prospects

African PE firms are beginning to make effective use of the practices common in many other markets to enable exits. Key among these is ensuring the continuity of management teams or clear succession planning through the use of, for example, golden handcuffs for a defined period post-exit. These kinds of measures give potential buyers confidence that management talent and experience will remain with the company after it is sold, particularly in an environment where the pool of experienced teams is not deep.

Another important enabler of successful exits in Africa will be early exit preparation. This means PE firms and management agree to an exit plan from the outset and discuss alternatives as they arise. However, it also means careful positioning of the company within the market(s) in which the business operates to ensure that its strategic or other value is clear to potential buyers. Bringing in experienced advisors well in advance of a sale also helps to iron out any potential issues before negotiations start.

Finally, African PE's networks will continue to play a strong role at exit as well as at entry and during the period of investment. PE houses in Africa are leveraging their contacts and relationships to cast the net ever wider in the search for the right buyers for their businesses.

“At exit, a key selling point was that management was retaining a significant stake, which would help with retention – especially in a country with skills shortages.”

“We had lined up a partner for exit more than a year in advance.”



# Outlook

## Africa's PE industry will continue to grow from a strong base

Our study into African exits between 2007 and 2012 paints a picture of a young PE industry that has laid strong foundations for significant future growth.

PE is well positioned to take advantage of many of the favorable market conditions that Africa now displays. Overall, Sub-Saharan Africa has grown by over 5% a year, with many countries posting rates in excess of 6%. This rapid growth is set to continue as Ethiopia, Mozambique, Tanzania, the Democratic Republic of the Congo, Ghana, Zambia and Nigeria are expected to be 7 of the 10 fastest-growing countries in the world over the next 5 years (China, Vietnam and India make up the rest of the list). Indeed, economic growth for Sub-Saharan Africa is projected to be above 5% a year right through to 2020. These growth rates are attracting increasing PE interest as the industry is now casting its net far wider than the more developed (and slower growing) South African market.

One of the drivers of economic growth has been a concerted effort by many African governments to improve the environment in which businesses and investors operate. Key to this has been a focus on governance: 70% of African countries have improved in overall governance quality since 2006, according to the annual Ibrahim Index of African Governance. The Corruption Perceptions Index, compiled by Transparency International, backs this up. Africa now has 14 countries that rank higher than India and 35 higher than Russia.

In addition, many African countries have been undergoing a phase of rapid regulatory reform. This is strengthening the overall business environment. There are now 14 African countries ahead of Russia, 16 ahead of Brazil and 17 ahead of India in the World Bank's ranking of "ease of doing business." Mauritius, South Africa and Ghana are now considered by the World Bank as being easier markets in which to do business than China.

Africa's demographic profile is one of its key attractions as the continent shifts from being a commodities-led story to a consumer-led one, driven by the combined forces of growing urbanization, an increasing formal labor force and a declining dependency ratio (i.e., those aged below 15 and above 65).

And finally, FDI flows are increasing as the world's investors and businesses start to see continuing improvement in economic performance, governance standards and political stability across Africa. FDI is coming from the UK, the US, China and other emerging markets. Intra-African FDI flows have also been increasing, with a compound growth rate as high as 42% since 2007.

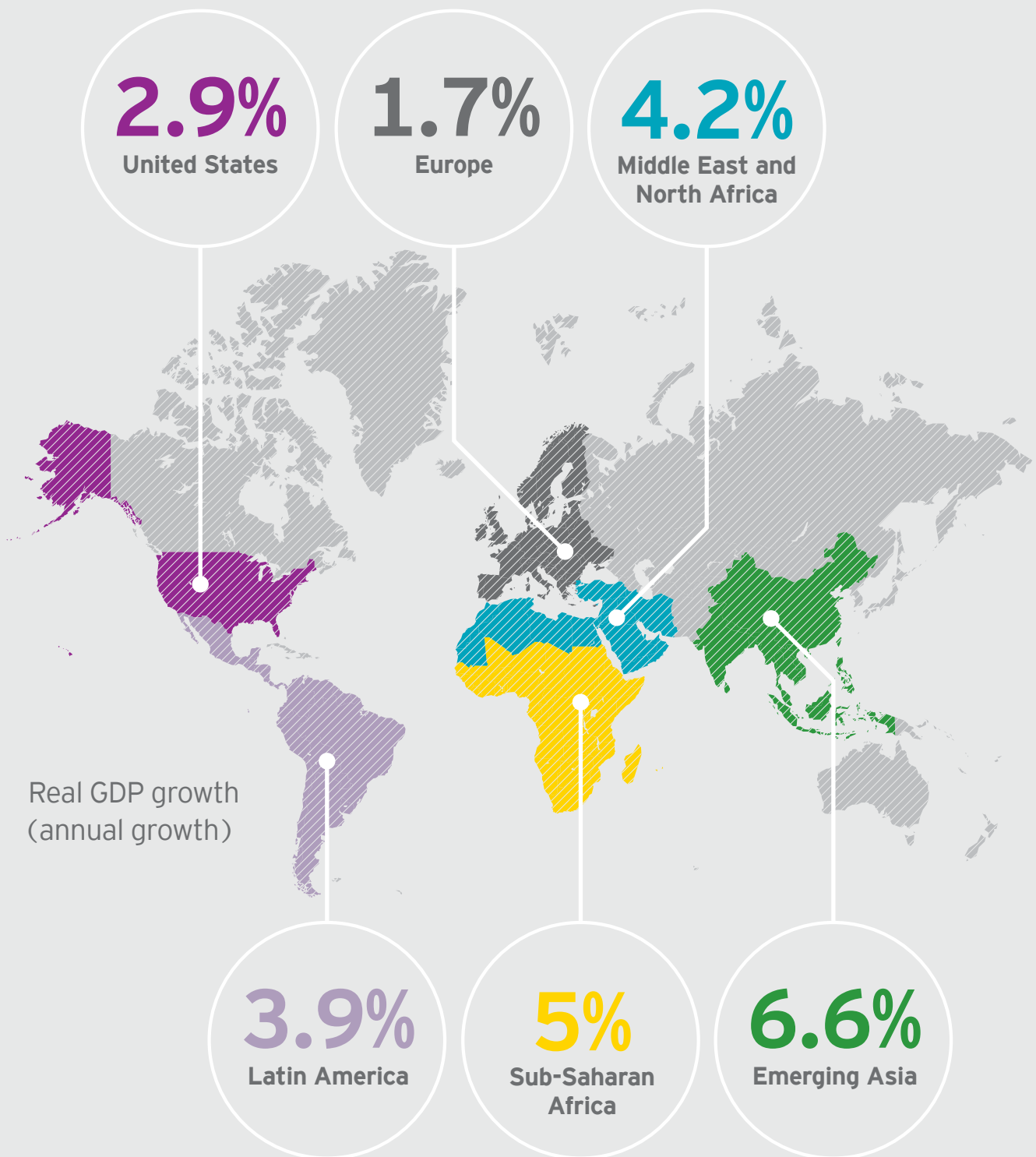
Historically, much of the focus among institutional investors on the region has centered on South Africa. However, there is an increasing desire among them and among South African PE houses to move beyond domestic borders to capture the growth rates projected for many African countries. There are also now a good number of experienced PE managers operating in specific markets or across the continent that are starting to be able to point to strong track records. So far, these funds have largely been supported by the DFIs. While these will continue to provide a significant amount of capital and support to Africa's funds, in recognition of the valuable development potential PE firms are able to unleash, more investors are needed if Africa's PE industry is to reach its full potential.

The relatively recent arrival of some of the global firms, in addition to the continued development of pan-African players, will help attract more international capital to the region. The onus on these players is to ensure they achieve continued success with their portfolio companies and generate outperformance for their investors.

The creation of local sovereign wealth funds and the continued development of pension funds in the region investing in PE are highly welcome. These institutions should provide further sources of capital for Africa's PE industry, particularly over the longer term. There is increasingly strong evidence to suggest that international LPs are looking more closely at Africa and are keen to gain exposure to the region's strong fundamentals.



Figure 13. Economic growth prospects: 2011-20 (annual growth, %)



Source: Oxford Economics

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This year will be a test as to whether that sentiment translates into real commitments. There are several funds currently on the market and some due to return to fund-raising over the coming months – some of them larger funds (US\$500m+) than we have seen over recent years. If these funds are successful in their fund-raising efforts, Africa's available dry powder will increase substantially.

However, LPs will need to be patient. Hold periods are generally longer in Africa than in other parts of the world. This is necessarily so. Value creation cannot be rushed in markets that are still young. Nevertheless, GPs in Africa need to have an eye on how they will realize value from the outset and prepare for exit early on, possibly more so than in many other markets, to ensure hold periods are no longer than they need to be.

African GPs must continue to build out and strengthen their local networks. As we've demonstrated in the report, these are vital for all three main stages of a deal – sourcing and buying, creating value and exiting. This, together with the predominance of minority stakes in the market outside South Africa, is one of the key distinguishing factors of the African market from most other economies. For those GPs venturing into markets that are new to them, ensuring they have the right local contact base as well as sound knowledge of local macroeconomic and political conditions will be essential.

The overall outlook is extremely positive. With a large number of private companies across Africa requiring growth capital and limited availability of alternative funding open to them, PE is extremely well placed to become a significant enabler of growth across the African continent. And, as the report demonstrates, it is also in a good position to provide its LPs with the outperformance they seek.

# About the study

The 2013 Africa study examined the results and methods of PE exits between 2007 and 2012 using similar methodology to the US, Europe, Latin America and Australasia studies. Data was drawn from various sources, including AVCA and EMPEA, and confidential, detailed interviews with former PE owners of the exited businesses. Initial research was performed into 118 transactions across the continent, with in-depth information obtained on 69 exits.

Our analysis entailed an examination of the decision to invest, value creation during ownership, the exit strategy and key lessons learned. We obtained good coverage of data in our sample relative to the population across a number of metrics such as exit year. However, as our exit population is not complete for the period 2007-12, our findings may not be fully representative.

Given the limitations of the data, our aim in this inaugural study was to produce an important but not necessarily statistically significant sample of deals, analysis of which would enhance the understanding of exit modalities and strategies in these markets and the underlying drivers of value creation.

The size of the sample is a function of the availability of data on exits in these markets – our primary motivation for embarking on this research – and the extent of participation from the PE community. We are tremendously grateful for the generosity of those participating in this study and appreciate both their time and input.

We look forward to continuing to bring you insights into private equity value creation in both developed and emerging economies in the coming months and years.

## **AVCA: delivering African excellence**

The African Venture Capital Association is a member-supported association whose sole mission is to promote private equity and venture capital investment in Africa.

Private equity and venture capital investment in Africa has the potential to have a profound catalytic impact on the development of African economies, companies and communities, and to provide strong commercial returns for investors.

Our members include private equity and venture capital firms, institutional investors, foundations and endowments, international development institutions, global professional service firms and academic institutions from around the globe that share a passion for Africa.

Our network of experts and collaborators support us in our ambition to represent the industry among regulators and lawmakers, and to navigate our members through these extraordinary times of increased regulation in the global private equity industry.

AVCA promotes the highest ethical standards in governance and transparency, provides unparalleled networking opportunities for fundraising and delivers ground-breaking intelligence and thought leadership on the Africa private equity and venture capital industry.

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# Contacts

## **AVCA**

**Michelle Kathryn Essomé**  
Chief Executive Officer  
michelle.essome@avca-africa.org

**Ponmile Osibo**  
Research Analyst  
ponmile.osibo@avca-africa.org

## **Ernst & Young**

**Sandile Hlophe**  
Africa Leader, Transaction Advisory Services  
sandile.hlophe@za.ey.com

**Graham Stokoe**  
Africa Private Equity Leader  
graham.stokoe@za.ey.com

**Jeff Bunder**  
Global Private Equity Leader  
jeffrey.bunder@ey.com

**Michael Rogers**  
Global Deputy Private Equity Leader  
michael.rogers@ey.com

**Sachin Date**  
EMEIA Private Equity Leader  
sdate@uk.ey.com

## **Special thanks to:**

**Philip Bass**  
Global Private Equity Partner, Ernst & Young

**Dorothy Kelso**  
Senior Private Equity Analyst, Ernst & Young

**Jennifer Choi**  
Acting Chief Executive Officer, EMPEA





### **A truly African footprint and focus**

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Our business focuses on a range of industry sectors that reflect the primary growth areas across Africa: government, infrastructure, mining and metals, oil and gas, telecommunications, power and utilities, retail and consumer products and financial services, including private equity.



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