CLOUDS OVER AFRICA

This year has already proven to be a challenging one for private equity investors in Africa, with dramatic currency fluctuations, depressed oil and copper prices and sluggish demand from China and Europe, the continent's largest trade partners. We spoke to **Alex-Handrah Aimé**, Managing Director of **Emerging Capital Partners Johannesburg**, about ECP's approach to investing given the current realities.

What challenges are you seeing in the African market?
Prolonged low commodity prices have had a significant impact on countries like South Africa while low oil prices have hurt Nigeria's and Angola's economies because their hard currency reserves are driven by oil. With lower growth in key emerging markets, particularly China, and volatility because of the strengthening US dollar, investors have become more cautious across global markets. That's likely to have implications for deal flow because of valuation gaps between buyers and sellers.

That said, people often miss that Africa is actually a net importer of oil, so having low oil prices should be an overall positive for the continent. Large economies like Nigeria have also diversified in recent years into sectors like telecoms and financial services so the drop in oil prices should only be a short-term shock.

How have these economic trends impacted ECP's investments?
From ECP's perspective, the region is still ripe with opportunity. In fact from 2014 to 2015, the total value of private equity funds in Africa rose from US$1.9 billion to US$4.3 billion, according to research by the African Private Equity & Venture Capital Association. During this period of volatility, it's more important than ever for investors to work with teams with deep local knowledge and experience across multiple cycles. That experience enables firms like ECP to distinguish near-term market-driven challenges from the fundamental performance of the underlying businesses. It allows us to continue to take calculated risks on new investments where we see strong management teams and longer-term potential.

Do you think the economic downturn and lower commodity prices will create value-driven opportunities for sponsors in the African market?
For those investing in new jurisdictions such as Mozambique gas and Uganda or Kenya oil, it is a timing issue. It's difficult from a private equity perspective when you have a narrow window to identify whether you are already hitting bottom or whether you will have to wait another two to three years for a cycle to run its course. On the other hand, financial investors to Africa have

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historically over-invested in commodity and oil-driven sectors rather than in infrastructure, logistics, and other consumer sectors that support a more diversified economy. So more domestic sectors are now getting more attention and private equity firms such as ECP are leading that trend.

You mentioned volatility because of the strengthening US dollar. How are foreign exchange fluctuations impacting investment?
It's definitely impacting investment in Africa, but you need to look at it over a three- to five-year period and ask whether the underlying growth of the business is such that you can outrun the impact of the currency depreciation. If you are investing in businesses that are truly domestic and have some level of natural hedging or hard-currency-driven revenue, you're more insulated from the volatility.

How does ECP try to manage foreign exchange risk?
There are three ways to address forex risk. You can manage it at the fund level, the portfolio level, or you can remain unhedged. We try to build a geographically diversified portfolio so that, for example, fluctuations in the Nigerian Naira or South African Rand don't impact our investments in the east Africa market. You don't want to be over-exposed in any one region. And because African currencies are not easy to hedge, you also have to focus on the fundamentals of the business to ensure there is natural hedging.

What is the exit environment in Africa?
Many prospective investors still query the feasibility and number of exit routes available to private equity firms, but I think some of this nervousness is misplaced. ECP

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has achieved more than 34 exits in the past 15 years through a range of trade sales, public market IPOs and structured exits, which shows that with the proper strategy, strong exits are possible. 2014 was a standout year for exits on the continent, with private equity firms announcing a total of 40 exits.

The deepening of Africa's economies and the emergence of a sizable middle class has also caught the attention of international strategic investors in sectors beyond natural resources. We see large corporations setting up offices in hub economies like Kenya where they can find high-growth companies to add to their portfolios. More than 40% of our exits since 2012 have been to strategic investors, such as our sale of Continental Reinsurance, a Nigerian reinsurance company, to a multinational Moroccan insurance company in 2014. These strategic sales are likely to continue.

What other ways can investors exit their investments in Africa?

Listings on local exchanges have also become a more viable exit strategy. Although IPOs in Africa remain challenging, over the last few years we have seen the local capital markets deepen. ECP has fully exited nine companies through listings on African stock exchanges, including a leading Nigerian mobile telecommunications operator via the Nigerian Stock Exchange, the first listing of a telecom company on the NSE.

The global investment world's increasing interest in African high-growth companies has also provided opportunities to exit through international equity markets. For example, ECP fully exited Société Internationale de Plantations d'Hévéas, a leading natural rubber producer and exporter, through block sales on the NYSE Euronext Paris. An increasing number of Sub-Saharan African stocks are listed on international exchanges. We expect these types of exit opportunities to continue to grow.

Trends

Do you see a developing trend of strategics taking an equity position with a sponsor at the outset of an investment?

Absolutely. This allows strategics to partner with private equity firms that have local teams with local knowledge, so if they don't have a lot of on-the-ground experience it's a great way to gain comfort with the environment and to take control later. The pairing also works well for private equity firms because strategics often have deep industry knowledge that can positively impact the return on investment. There is a lot of low-hanging fruit and your eyes are often bigger than your stomach when you work in African private equity. But ultimately, it's really about finding the right management team with whom you can partner to execute a shared vision.