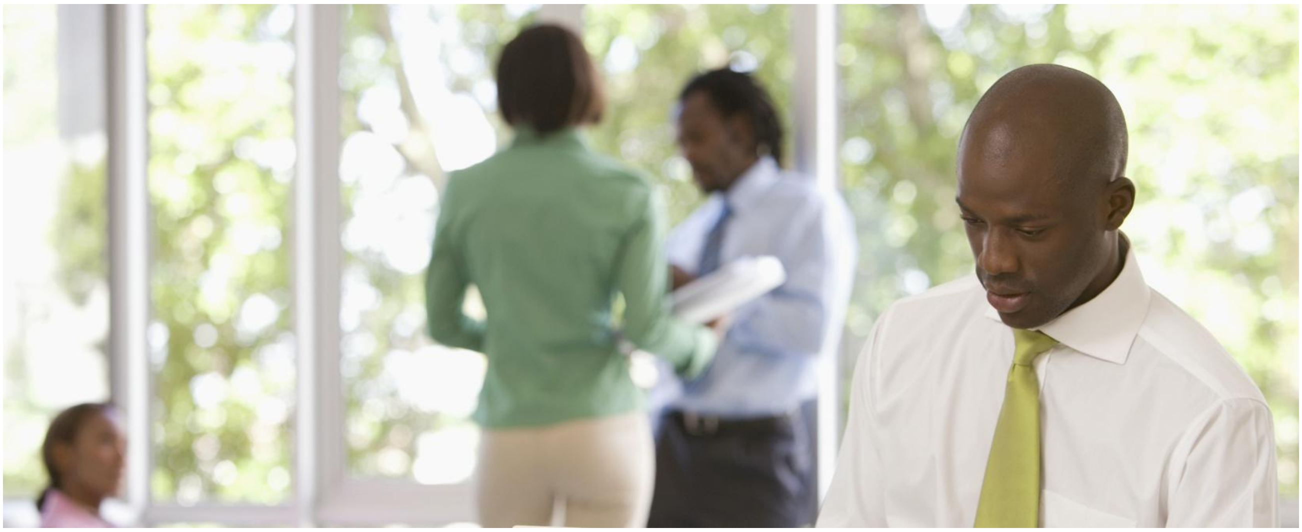
Africa – an emerging destination for SWF and PE investment

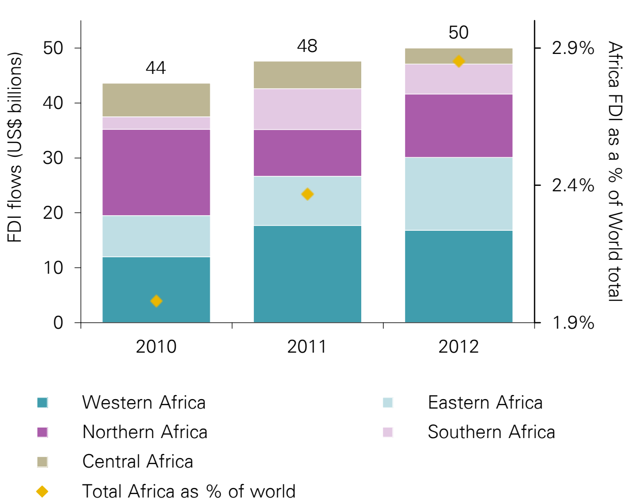
TRANSACTIONS & RESTRUCTURING



Introduction

According to UNCTAD's annual survey on investment trends, foreign direct investment (FDI) flows into African nations increased 5% during 2013, surpassing US$50 billion p.a. It is interesting to note that this growth took place at a time when global FDIs reduced by approximately 18% over the same period. In the wake of decelerating growth in China, Brazil and India, global investors are warming up to the prospect of investing into Africa. Not surprisingly, we have seen Private Equity firms and SWFs, both globally and in the MENA region, increasing their focus on Africa (particularly Sub Saharan Africa) which is increasingly viewed as a destination of growth and value. While we refer to Africa as "one" in this article, it is easy to forget that the continent comprises of five regions and over 55 countries, each with its unique opportunities and challenges.

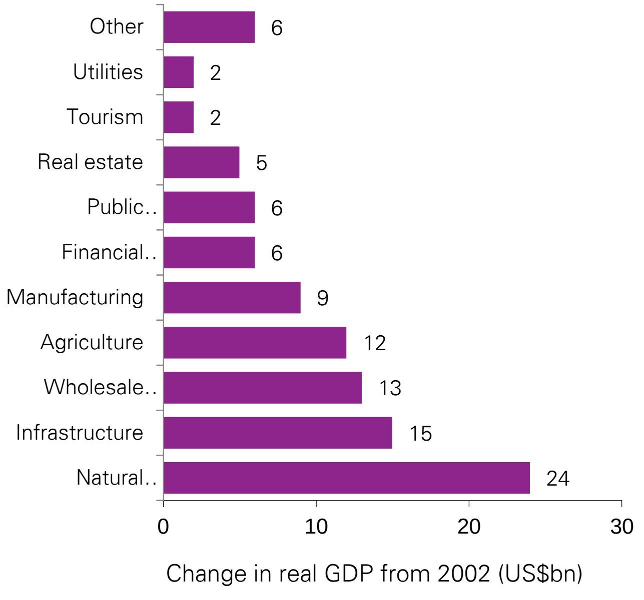
Africa's Foreign Direct Investment flows



- **Eastern Africa:** Energy resources, such as the recently discovered gas reserves in Tanzania and oil fields in Uganda, have driven increased FDI.
- **Western Africa:** FDI continue to be primarily channelled to Nigeria and Ghana for oil and gas related investments.
- **North Africa:** FDIs during 2012 increased 50% on prior year following improvement in political stability across a number of key economies.
- **Southern Africa**: FDI has increased, driven primarily by Mozambique where inflows have more than doubled owing to the nation's large off-shore gas reserves.
- **Central Africa:** FDI have historically been attracted by natural resources, in particular mining opportunities in the Democratic Republic of Congo.

While there appears to be many factors at play, this article discusses some of the key factors driving investment into Africa and the key challenges which remain for investors. Although this article looks at Africa as a whole, we acknowledge that the continent is diverse and, therefore, the investment drivers and challenges discussed may vary between countries and regions.

Africa's GDP growth since 2002 - by sector



Key sectors of growth

Given Africa is amongst the world's richest continents in terms of known mineral wealth, it is only appropriate that natural resources are the largest contributors of GDP growth, contributing US$24 billion in real GDP since 2002.

In view of Africa's annual infrastructure spending needs of c.US$93 billion p.a. (Africa Infrastructure Country Diagnostic dated 2013), it is also unsurprising that infrastructure is the second largest contributor of GDP growth since 2002 (US$15 billion), representing Africa's increased focus on improving transport and telecommunication networks.

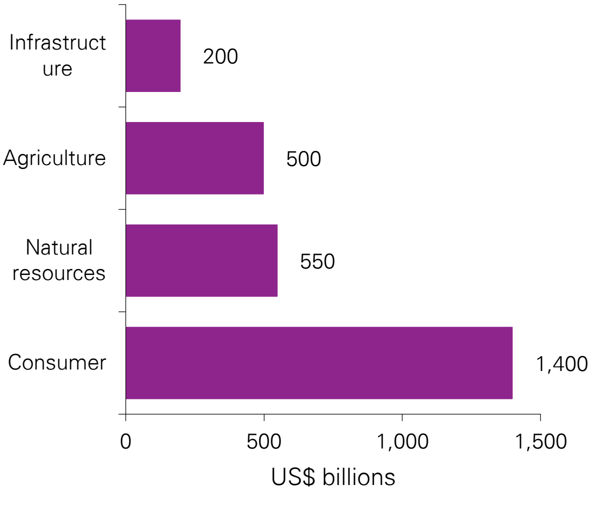
Amongst others, emerging sectors include wholesale and retail (driven by a growing middle class), agriculture (60% of global uncultivated arable land is found in Africa), manufacturing (a by product of improvements in human and IT capital) and financial services (follows a period of economic resilience and increased investment).

Economic resilience

The region's economic prosperity is complimented by an increasing 'middle class' which have more than tripled in population during the last 30 years. Defined as those earning between US$2 and US$20 a day, the World Bank predicts Africa's middle class to grow from 355 million (34% of Africa's population) in 2010 to 1.1 billion (42% of the population) by 2060, making it the world's fastest growing middle class. The continent's growing consumer class is central to its economic fabric and fuels Africa's strong appetite for basic infrastructure, natural resources, agriculture as well as consumer goods. The consumer goods sector in Africa is expected to experience a revenue growth of approximately US$1,500 billion from 2008 through to 2020, driven largely by a growing middle class.

At a time when Europe continues to implement austerity measures and the US economy comes to terms with rising national debt, the emerging African economy has demonstrated a certain level of resilience. Six of the world's ten most rapidly expanding economies are now located in Sub Saharan Africa, including South Africa, Nigeria and Kenya. With an average real GDP growth of 5% during the last three years and one-third of Africa's countries having real GDP growth rates of more than 6% during 2013, the size of the African economy has more than tripled since 2000 (Africa Attractiveness Survey 2013).

Projected revenue growth to 2020



Evolving legal and regulatory environment

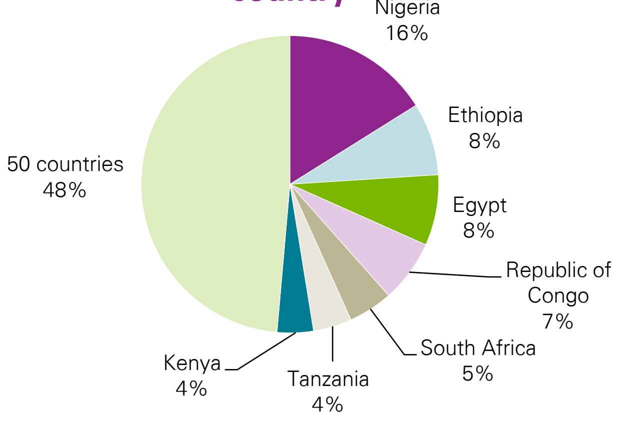
The continent's legal and regulatory environment is in the early stages of its development. That said, there has been a marked improvement in the establishment of necessary frameworks, particularly in the financial services sector. During the past decade, African policymakers have undergone a process of modernising legal and regulatory structures so as to establish more harmonised measures, encouraging greater inter-continental and international investments.

While differing regulations across African markets remain, regulators continue to align and strengthen measures across the continent in key sectors. This has created a platform for higher economic growth in Africa and is likely to pave the way for greater investments in the medium to long term.

Demographics and improving human capital

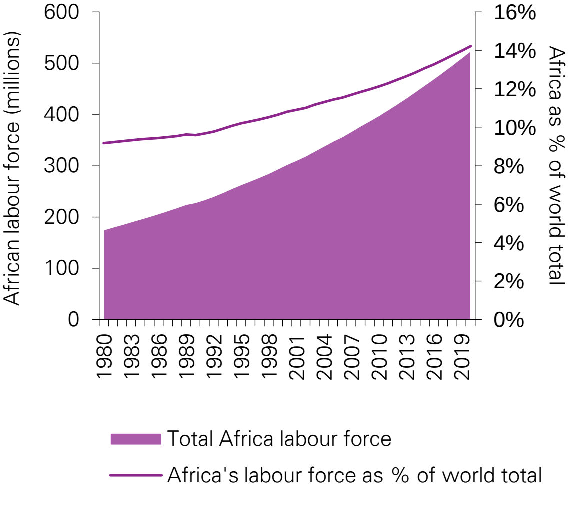
Traditionally Africa has been viewed as a geographic and economic link between Europe and the Middle East. However, owing to its strong demographics, large and growing population, and high growth potential, the continent is quickly gaining traction with large investors (SWFs and Private Equity alike) as the new emerging market and destination for investment. The abundance of natural resources as well as human capital bodes well for cash rich and opportunistic global investors given the relatively untapped disposition of Africa's resources. From our experience, a growing number of investors are keenly looking at countries with a large population (such as Nigeria and Egypt) due to the sheer market size, and therefore, opportunities it presents.

Africa - population snapshot by country



In our experience, not only is the African economy on the agenda for regional investors but so too is the hiring of African employees. Investment houses pride themselves on having a local reach and deep understanding of markets. The African human capital market remains nascent and is considered by many to be in the early phases of its development life cycle compared to regions like the Middle East. That said, there has been considerable improvement in the continent's offering as an increased number of Africans are becoming technically equipped through higher education and training at foreign institutions. Given Africa's rapid population growth and hence competitive job market, hiring costs and employee wages are far lower in the continent compared to financial hubs around the world, which can prove to be a significant competitive advantage.

Africa's labour force



Improved political environment and reforms

Unrest has paved the way for reform and cautious optimism. The region is gradually being opened up to PE investment. As politically volatile countries continue their transition to a relatively stable political environment, we are noticing a pick up in investment activity. The drop in investment and fund raising activity in response to the unrest was only ever likely to be a temporary position as the overall demographics of the region remain strong and robust.

Consumer markets are poised to grow as industries and regional businesses expand into new territories, both within and beyond Africa. By and large, in addition to natural resources and consumer goods, infrastructure is viewed as a key sector of growth. According to market estimates, there are US$93 billion of infrastructure investments required annually by 2020 for Africa to meet the UN's Millennium Development goals. This represents valuable opportunities for cash rich investors looking at medium to long term investment horizons.

Key challenges

While Africa certainly presents a significant opportunity to foreign investors, there remains a number of challenges which need to be appreciated before exploring the investment opportunities in the region:

- **Political environment.:** While generally improving and stabilising, political instability and volatility remains in a number of key economies which raises concerns over investor protection, enforcement of contractual terms, transparency and abidance to rules and regulations (the term "facilitation payments" is all too common). This increases the perceived political risk, making it more difficult for global investors to deploy funds.
- **Local relationships:** When investing into Africa, there appears to be no substitute for having skilled and experienced people on the ground. Building relationships and forging alliances with domestic investors and regulators is absolutely key for a successful execution. Foreign investors should be prepared to invest in their own local teams in order to capture this critical local expertise and contacts. Furthermore, quite often commercial interests have to be aligned with strategic interests of local players.
- **Information limitations:** Information asymmetry and lack of a proven track record in these geographies makes investor decisions more challenging. As with many emerging economies, quality data is hard to come by and therefore, difficult to get an accurate understanding of investment opportunities, markets and competitive landscape.

Once a presence has been established, an investor needs to be aware of the ongoing challenges:

- **Close and regular monitoring of investments**: Given the nature of the market and unique risks that businesses in Africa are subject to (from bribery/corruption to embezzlement), investments require close and regular monitoring before, during and after acquisition. Related to the point made above, having a trusted and experienced local presence and team on the ground is crucial.
- **Limited Successful exit strategies:** Some of the traditional exit avenues are not necessarily available or applicable to investments in Africa. Given the regional stock markets are small / nascent and IPOs not prevalent, investors will need to carefully assess, plan and execute exit strategies. Trade and strategic sales are most prevalent and the likely route to disposal across most industries.

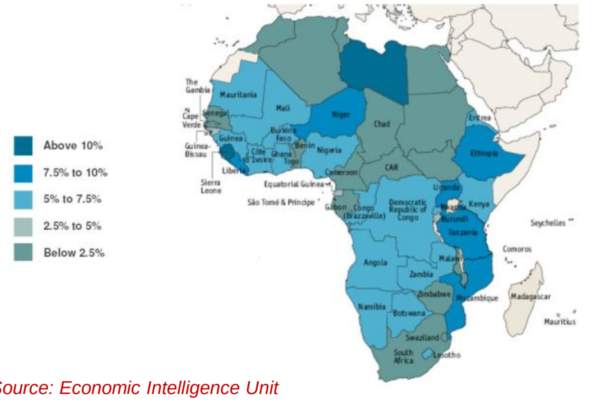
Conclusion

Africa is a large and diverse continent which offers a lot of opportunity and avenues for FDI. With mineral wealth, strong demographics, increasing middle / consumer class and improving political and regulatory environments, we expect Africa to continue to attract the interest of international investors.

However, with opportunity comes challenges and Africa is no exception to this. It is clear that there is no substitute for having expertise on the ground. Those looking to invest into the continent must be prepared to invest into their own teams and expertise. Relationships are particularly important and, therefore, an investor needs to demonstrate a commitment to creating and growing relationships which can take time (and investment holding periods may be longer as a result).

The continent does remain somewhat volatile. Once a presence has been established, an investment will require close and regular monitoring. In addition, some traditional exit avenues may not be open (eg IPO) and, therefore, there is a greater dependence on strategic exits which require careful planning and execution.

Real GDP growth (2012-2016 forecast)



Source: Economic Intelligence Unit

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