Unlocking the potential of the "Africa Rising" narrative through private equity

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The "why" for private equity and Africa

Private equity as an asset class has, for a number of years, been widely viewed as preferred over traditional asset classes. The removal of a large degree of the market risk and volatility created by market perception and macro-economic factors from private equity investments, and even sensationalism through the media, is likely to be behind this investor preference.

Returns in the private equity industry support this preference. In the March 2018 edition of the RisCura-SAVCA South African Private Equity Performance Report[1] (which tracks the performance of a representative basket of South African private equity funds with the aim of establishing and maintaining an authoritative benchmark for the measurement of private equity performance in the South African market), one of the most notable statistics reported was that, in the most recently measured period, the 5 and 10-year IRR returns were 13.6 percent and 12.9 percent respectively, outperforming listed metrics over a 3-year period, and earning positive direct alpha (i.e., active return on investment). This was despite the political uncertainty and corruption scandals that have unsettled the South African market over the past couple of years.

Statistics such as those in the RisCura-SAVCA report are not as readily available for the continent as a whole. This is coupled with South Africa not being the most accurate reflection of the picture painted by the African continent overall, given South Africa's maturity profile with respect to the private equity space compared to that of other countries in Africa, and its lesser degree of reliance on hard commodity prices such as oil, which slumped in recent years and brought some of the traditional African power houses (such as Nigeria) to their knees.

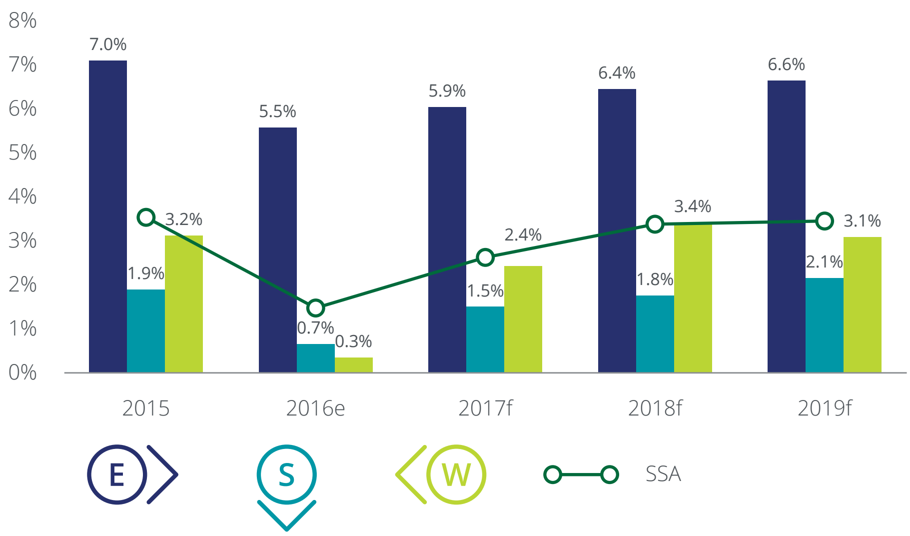
Nevertheless, the "Africa Rising" narrative is one that is familiar to investors around the world. Real GDP growth for sub-Saharan Africa as published by the IMF[2] slowed to below 2 percent in 2016 and was up to just below 3 percent in 2017. Forecasts for 2018 also show an increase, to between 3 and 4 percent, as oil prices are expected to continue on a recovery path from the 2016 slump. In the 2017 edition of the AVCA Annual Africa Private Equity Data Tracker[3], the UN was cited as expecting Africa to grow by 3.5 percent in 2018 and 3.7 percent in 2019, due to higher external demand, rising commodity prices, and improved domestic conditions.

1. http://savca.co.za/wp-content/uploads/2018/03/RisCura_SAVCA-PE-report_March2018.pdf
2. International Monetary Fund (IMF). 2017. World Economic Outlook (WEO) database, October update. Available [Online]: http://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx
3. https://www.avca-africa.org/research-publications/data-reports/2017-annual-african-private-equity-data-tracker-and-regional-spotlights/

Drivers of potential

Africa fits into many of the recent global trends that have been rapidly evolving. Demand for the most basic of services such as education and healthcare will continue to increase as the growing population of most African countries outweighs most developed economies. In the most recent World Population Prospects revision document published by the UN[4], Africa outweighed each of its continental counterparts in terms of population growth between 2017 and 2030, with a cumulative average growth rate per annum of 2.4 percent, compared to the second largest continent in terms of such growth (Oceania) at 1.2 percent.

Figure 1: Real GDP growth, 2015-19f (%)



Source: IMF, 2017

4. https://esa.un.org/unpd/wpp/Publications/Files/WPP2017_KeyFindings.pdf

Consumer-based services and sectors may be seen as secondary to services such as healthcare, education, and other social services; however, another global trend that is well documented is that of accelerated urbanization, and changes in economic power. Africa's poverty struggle has been widely considered to be its biggest challenge. Overcoming this challenge is very much dependent on FDI to create growth. The prospect of private and government collaboration continues to be debated, opening up further untapped opportunities, in light of the changing economic landscape of the African continent.

As the continent continues to battle and often partially overcome this challenge, albeit in pockets of areas, a consumer-based society will begin to become more prevalent. One of the trends noted in the 2017 Deloitte Africa PECS[5], highlighted hereafter, is the expected focus on consumer-based services in terms of private equity investment.

The 2017 Deloitte Africa PECS

To achieve and exceed the potential that for some has almost completely disappeared since the "Africa Rising" narrative was first coined, private equity most certainly should be considered as one of the strongest levers.

In the most recent edition of the Deloitte Africa Private Equity Confidence Survey (PECS), the overarching themes were the resilience and optimism of the private equity sector despite micro and macro economical challenges faced by the continent over the past three years. The survey collates the responses from practitioners across the three regions within sub-Saharan Africa (namely Southern, East, and West), and presents a summarized view of sentiment for the coming 12 months. Although there have been a number of key developments since the survey was completed (i.e. a new ruling party president in South Africa, renewed political stability in Kenya after the elections in December that had to be re-held, and the resignation of Robert Mugabe from his long tenure as president of Zimbabwe), these developments have not seemed to trouble investors globally and, if anything, have only heightened the opportunism that was once synonymous with Africa.

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Amongst the standout themes, the following have been summarized to best capture the prevailing optimism:

Country focus

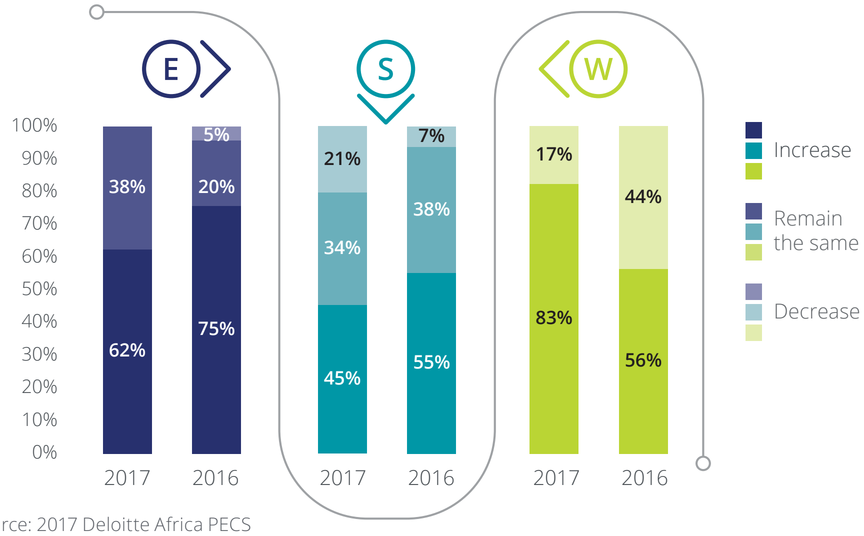
A key driver of continental growth for Africa is the rapid growth of countries within each region. Despite South Africa, Kenya, and Nigeria being the key regional powers in Southern, East and West Africa respectively, a number of other countries in the regions are beginning to show signs of maturity in developing their economies, which may start to attract more foreign investors. In West Africa, Ghana was considered a preferred investment destination over the traditional choice of Nigeria, as noted in the 2017 Deloitte Africa PECS. Similarly, East Africa, Tanzania and Rwanda were investment destinations that respondents viewed more positively when questioned about preferred investment destinations, compared to responses received in previous years. As economic conditions improve and political stability increasingly becomes the norm, the contribution to overall growth and positive sentiment for Africa is expected to become more widespread.

5. https://www2.deloitte.com/za/en/pages/finance/articles/2017-deloitte-africa-private-equity-confidence-survey.html

Deal activity
The majority of respondents to the survey across each region expected private equity activity to increase over the next 12-month period, with the highest level of optimism in this regard coming out of West Africa. Expectations that the region has bottomed out since the commodity price slump are quite bullish.

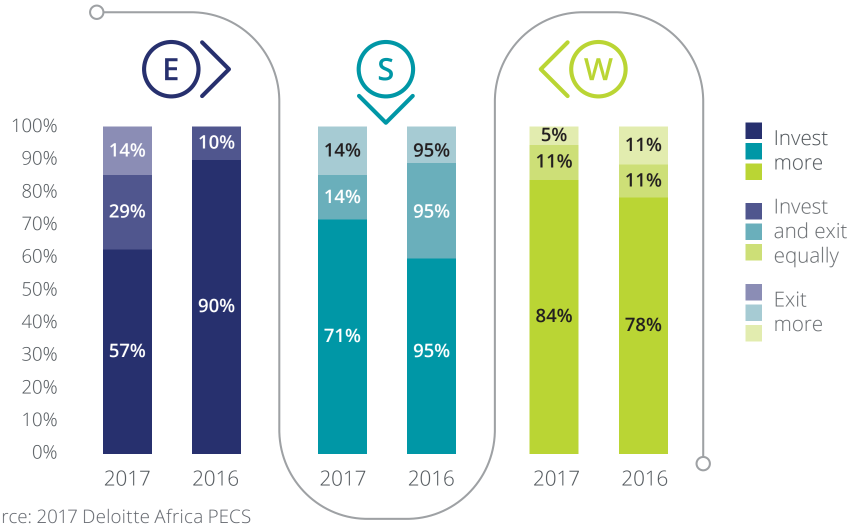
Respondents across each region also expected to invest more in the next 12 months, and this finding is underpinned by an increase in funds under management as reported in the AVCA Annual Africa PE Data Tracker[3].

Figure 2: Over the next 12 months we expect PE activity in the region to



Source: 2017 Deloitte Africa PECS

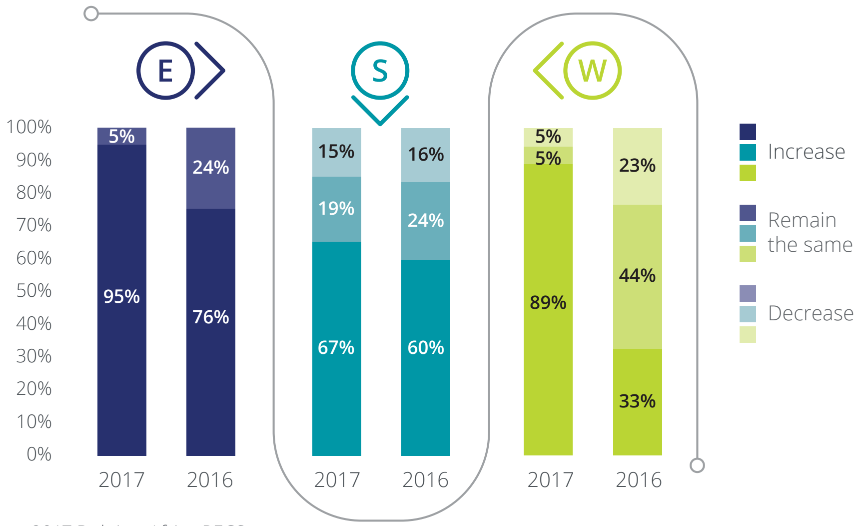
Figure 3: Over the next 12 months we expect to



Source: 2017 Deloitte Africa PECS

Competition
Competition was another metric that respondents to the survey expected to increase over the next 12 months, leading to an increase in entry multiples on transactions, particularly in East and West Africa.

Figure 4: We expect that competition for new investment in the region will



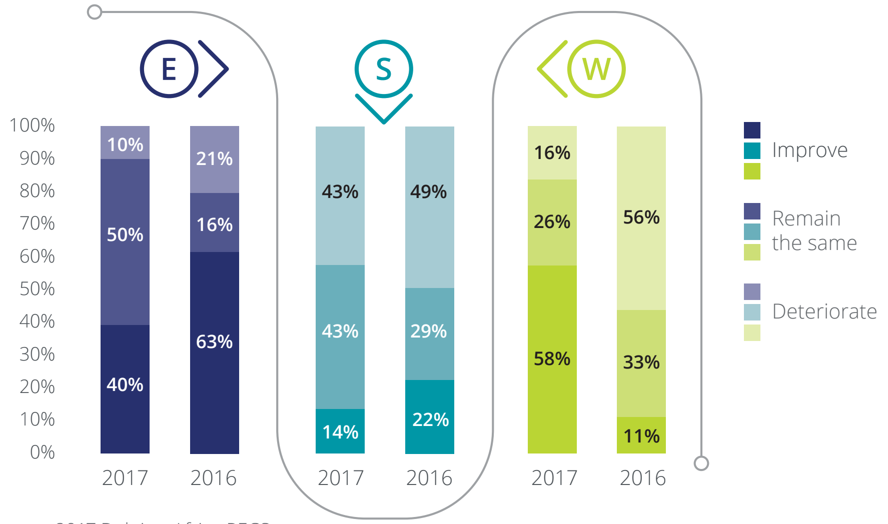
Source: 2017 Deloitte Africa PECS

Sector focus
Another standout observation from the survey was the sector focus component touched on earlier, which effectively required practitioners to provide a view on sectors that are expected to offer the most opportunities for returns and will therefore warrant increased focus. Food and beverages had the highest average focus, followed by agriculture and the healthcare industries, all seemingly driven by higher populations and a burgeoning middle class.

Fundraising environment
Expectations around the fundraising environment were mixed in each region, largely as a result of the factors mentioned earlier, the key factor being the political state of South Africa. West Africa had the most notable positivity in sentiment as the majority of respondents expected an improvement in the fundraising environment.

The last standout point to be highlighted is the source of funding on which practitioners provided their expectations. Europe and the USA were the two regions in which the most funds were expected to be raised, particularly for East and West Africa. With a more positive outlook on South Africa as a result of more perceived political stability, we expect the views of practitioners in Southern Africa to align with those of their East and West Africa counterparts, and fundraising to be sought across borders with more vigor and optimism.

Figure 5: Over the next 12 months, we expect the fundraising environment for private equity to



Source: 2017 Deloitte Africa PECS

Practitioner updates

Since the survey, which was launched in November 2017, SAVCA (Southern Africa Venture Capital and Private Equity Association, an industry body that serves to advocate private equity and venture capital as an asset class, amongst other purposes) hosted a private equity conference in February 2018 where practitioners were invited to share their views through a host of panel discussions.

The theme throughout the conference was the topic of fundraising and the benefit of using hindsight, insight, and foresight to better unlock the potential of the asset class and continent.

FDI is key for the industry and practitioners' views suggest that unlocking funds across borders has been a particular challenge. On a continent with such potential, but one that has been plagued with both huge market and country risk, building investor confidence in the team managing the funds being sought is critical. Getting creative in the means by which funds are raised, and utilizing impact and corporate social responsibility, by which all large organizations must demonstrate commitment, were key discussion points that were passionately debated. Investors often want to know that an investment will reap financial rewards first and foremost, and assess opportunities primarily on this basis, before considering the social impact that an investment may have. Africa allows for the achievement of social impact on most if not all investment decisions, given the high levels of unemployment and poverty, poor infrastructure across the board in most countries and political unrest that stunts the growth potential that the continent embodies.

Making an impact that matters is a key concept for every "Deloittian". It is the purpose for which we as a firm exist, and it is more readily achieved in Africa than in developed countries.

Common challenges are measuring the impact and deciding upon the desired effect. Various metrics do exist, but they are often too complex to track. Impact investments therefore require a conscious decision in the investment strategy of all practitioners. This needs to closely relate to the environment in which a business operates and an investor invests. Whatever one's view is on impact investments, practitioners are more often than not in unison about its importance and Africa certainly has plenty to offer in this regard.

Conclusion

The continent has suffered a whirlwind of political and market-based wounds over the past two years. Despite growth in pockets of areas across the continent, the overwhelming impact of low commodity prices and political instability have been the biggest contributors to slowed growth. Recent political developments and an upwards trajectory after hitting rock bottom have since renewed hopes of Africa realizing its potential in the medium to long term. Private equity has been a proven asset class in terms of returns, and practitioners in the industry have always been more positive than not with regards to unlocking returns on the continent. The future is always uncertain. With the hindsight of the lows experienced across the continent over the past few years, Africa is surely now better positioned than ever to continue its once obvious and envied growth trajectory.

To the point:

- The "African Rising" narrative has been subdued in recent years as a result of a slump in hard commodity prices and political instability in key economies on the continent, such as South Africa and Kenya.
- Private equity as an asset class for investment has outperformed traditional asset classes, particularly in South Africa.
- Key drivers of the potential that was captured by the narrative still exist and include many global trends such as technological advancement and increased urbanization, which continue to develop.
- The performance of the private equity industry coupled with the potential of the continent supported the optimism from the majority of practitioners across sub-Saharan Africa, which was demonstrated through the 2017 Deloitte Africa PECS.