African Private Markets

Attractive Return Opportunities with Economic, Social and Environmental Impact

Africa is a diversified continent of 54 countries, a number of which are among the fastest growing in the world. Countries such as Kenya, Cote d'Ivoire and Uganda have shown robust GDP growth through the commodity slump and are forecast to grow at 5-8% pa in 2017-19, according to the World Bank. These are net importers of oil and other commodities, and beneficiaries of lower commodity prices. Others, like Zambia and Ghana, have exhibited a sharp slowdown and currency devaluation, but are now forecast to regain growth momentum. Nigeria, Africa's largest economy and most populous country, has also seen a slowdown, owing to the decline in oil prices and exacerbated by currency restrictions. Growth is expected to improve and currency restrictions are gradually being relaxed. Universal across the continent is the scale of the opportunity: a growing middle class, high rates of urbanization, a young population of consumers, a massive demand for power, logistics, roads, commercial real estate and housing and an underserved mass market.

The Opportunity

Private markets (private equity, real estate and credit) provide the best way of accessing African growth. With increasing concerns[1] by developed market LPs about valuations and limited opportunities in the US and Europe, Africa provides a new opportunity set in high growth markets, with private equity acquisition multiples generally in the 6-8x EV/EBITDA, based on transactions seen by Mbuyu.

Private equity

Many African countries have a thriving private sector, with many family-owned SME and large cap companies, often operating for several generations. As with family businesses everywhere, succession issues or desire by the owners to institutionalize the business ahead of a sale provides an entry for private equity. Retail, FMCG, healthcare and education all benefit from the growing middle class and strong economic growth. Agribusiness, an important sector, as in a number of countries agriculture accounts for as much as 80% of GDP, benefits from urbanisation, formalisation of the economy and need for food security, leading to increasing demand the need to raise agricultural productivity. We steer clear of the oil & gas and mining sectors, as returns are correlated to global commodity prices, but also because there is a high risk of government interference and corruption. Ticket sizes for African SME private equity deals range between $10m and $50m for a large minority stake. Large deals range from $60m up to $150m. While popular perception is that too much capital has been raised for such deals, our view is that this is an oversimplification, driven partly by the lack of transparency in African markets about the companies which operate there. Many owners wish to be discrete about their level of wealth and therefore do not publicise the size or success of their businesses. This, and the challenging operating environment means that in our view private equity managers, especially in the SME sector, need to have a local presence and hands-on operating experience to be able to source and add value to companies. African private equity investment is almost exclusively growth capital, with loss ratios comparable to developed market buy-outs for $10m+ deals.[2]

Institutional investors can access the opportunity through private equity funds and co-investments. We track 78 private equity and 16 venture funds we consider investable, of which 50 private equity and 11 venture funds have commercial (20%+) net return objectives and 28 and 5, respectively, are focused primarily on impact, with less ambitious financial return targets. Commercial funds can be pan-African, regional or country-focused, invest in large caps or SMEs and some are focused on sectors, such as agribusiness or renewable energy.

Real estate

Retail, office and logistics infrastructure has been built for many years in Africa. However, build quality and scale have generally been modest. Over the last 10 years, rising middle class wealth and formalisation of the economy has created

[1] Argentius 2017 Annual Private Equity Survey.

[2] Source: Mbuyu Capital Partners deal database of 146 exited deals, sourced from 39 African private equity funds.

opportunities for the development of modern, western-style retail malls, with many comparable to the best malls in the US or Europe. The earliest A grade malls were built in major cities such as Nairobi and Lagos by foreign investors, and these markets are now becoming saturated, as local investors have followed suit, albeit often at lower quality. The original investors are now building in high growth, secondary markets, such as Senegal and Cote d'Ivoire, benefiting from a first mover advantage. Growth of domestic corporates and entry of developed market firms, such as the big four accountants has created demand for A grade offices. This has followed a similar trend to retail: high supply in major markets and a move of the leading developers to secondary, high growth countries, as well as exploiting more niche opportunities in the major cities. We are now seeing development of A grade logistics warehousing around major cities. Increasing retail volumes and growing economies are resulting in more movement of goods, with western companies such as DHL and Velogic as well as regional players and international FMCG companies needing modern logistics facilities. Increasing urbanisation is driving demand for housing all the way across the income range. However, the lack of availability of mortgage finance and credit for developers is holding back this market.

The bulk of real estate development in Africa is being financed and undertaken by local investors, including high net worth individuals and pension funds. Investment opportunities for US and European institutional investors without good local connections are primarily through funds and co-investments. We believe the opportunity is primarily in A grade assets, as there is strong demand for yielding assets with quality tenants from South African pension funds and sovereign wealth funds. There are only in our opinion around 10 investable real estate funds developing diversified A grade assets, although more are coming to market. However, more specialist opportunities exist, such as a recent investment made for a client by Mbuyu in a logistics warehousing business. For more impact-focused investors, there are also opportunities in low-cost housing for the urban mass market, which can deliver attractive returns while addressing a real social need.

Credit

Supply of credit to African companies varies substantially between countries. In many markets, only the highest quality corporates have access to bank credit, owing to limited competition and high yield local Treasury bills. More sophisticated markets such as Kenya and Nigeria provide credit for mid caps and selected small caps, but with high collateral requirements and generally for tenors of three years or less. However, even in these markets availability is highly cyclical and as the economy slows down and defaults rise, only the largest, most credit-worthy businesses retain access. In other markets such as Tanzania and Uganda supply is much more limited. Non-bank financial institutions, in particular microfinance institutions (MFIs) are present in most countries and address some of the needs of the poorest with micro loans at high interest rates. Nevertheless, the level of financial exclusion among individuals and small businesses in African countries is very high. Private equity and venture-backed businesses developing tech-enabled solutions, delivering credit at very low marginal cost, present interesting opportunities owing to the sheer number of potential customers. Other innovative players in this market are companies providing solar power and other off-grid energy solutions to the mass market, integrating asset finance into their business model. A key issue in providing credit to businesses with no US Dollar income is the associated local currency exposure, with African currencies generally depreciating against the US Dollar in the long run. This makes unhedged local currency credit unviable for most institutional investors seeking commercial returns.

The cyclicality and lack of credit to many corporates and individuals creates opportunities for non-bank lenders. This includes a number of funds providing, for example, mezzanine finance and credit to quality, but specialist businesses, in US Dollars. Credit also provides an opportunity to gain exposure to impact investment themes, such as financial inclusion, clean energy or healthcare, by lending to financial intermediaries lending on to mass market consumers and small businesses, such as MFIs and off-grid power companies. Returns can often be enhanced by equity-like kickers such as revenue participations. Hedging facilities are available for many African currencies, but are only economically viable for some countries.

About Mbuyu Capital

Mbuyu Capital is a specialist African investment manager, providing bespoke portfolios for institutional investors, focused on private market solutions.

Diversified, pan-Africa portfolio focused on the consumer and domestic growth

For example, a $70m portfolio currently being invested for a pension fund, seeking commercial returns, is allocating 75% in private equity and 25% in real estate, to deliver a diversified pan-African exposure to domestic growth, in order to provide diversification from the client's largely developed market investments. Sixty percent is being invested in primary and secondary funds and up to 30% in direct and co-investments, which substantially reduces fees and the J curve, as direct and co-investments attract no or low fees and capital is only drawn for investment.

Green energy portfolio

An alternative mandate could focus on delivery of power and clean energy, seeking to provide commercial returns, while also improving Africans' access to power, tackling greenhouse gas emissions and improving the environment. Depending on a client's risk-return appetite, such a portfolio might be invested in clean energy funds and co-investments, energy tech companies, as well as loans to allow off-grid power companies to provide asset finance to their customers.

The team has many years' experience institutional investing in private markets, in private equity, real estate and credit, through funds and co-investments, at large institutions, as well as corporate operational experience.

Michiel Timmerman, Mbuyu's founder and Managing Partner, was most recently MD & CIO of a $3.5bn alternative investment business at Ignis Asset Management. He also founded an SME-focused equipment financial leasing company in Tanzania, now with seven branches and 50 staff, which he continues to chair. He is also a co-founder, director and credit committee chairman of LAFCo, a specialist agribusiness SME lender, operating in seven countries in Africa and former NED and IC member of AgDevCo, a pan-African agriculture investment firm.

Marleen Groen, Senior Partner, is the founder and CEO of Greenpark Capital, a private equity fund investment firm, specializing in secondary markets, which she sold to StepStone Group in 2013. Following three years in an advisory capacity with StepStone, Marleen joined Mbuyu in 2017.

David Donahue, Partner, was responsible for $1bn of private equity and real estate investments at Ignis, as part of the alternatives business. Previously, he was a portfolio manager at APG, the largest Dutch pension fund, responsible for €1.2bn listed equity industrials and €0.7bn materials portfolios.

Afzal Amijee, Partner, is a former Operating Partner of Sun European Partners, a $10bn private equity investor. He has product development, operations, technology and financial management experience in private equity turnarounds and growth of fintech companies in Europe and the Middle East.

The team is supported by two internal staff for research, data management and administration and outsourced compliance, legal and IT staff.

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