Southern Africa

Leaving aside South Africa, Southern Africa is a relatively untapped private equity opportunity. But with some rich seams still to be mined, the question remains, who will take up the challenge?

Lisa Bushrod reports

South Africa's private equity professionals have long been expected to move beyond their local market. This has been an expectation in part borne out of the depth and breadth of South Africa's private equity market, and in part because it has been the norm for some time now for many of the country's institutionally structured private equity funds to include a potential allocation for deals outside of the country. Although, to date, these carve outs have been sparingly used. Mid to large buyout firm Ethos has gone beyond its home territory investing directly into non-South African entities as has Brait, although the latter has only done so via portfolio companies' that are headquartered in South Africa.

Part of the hesitation to move beyond home borders can be explained by risk. "It is the goal of most [South African PE funds] to conquer sub Saharan Africa, but if they misfire on their pan African expansion plans by moving too quickly to do deals north of the border, it will be a long time before their investors allow them a second chance, if at all. Anybody can execute a deal north of the border; there are many intermediaries in the major hubs in Africa, including South Africa, who are working on raising finance for pan African investment opportunities; but you have got to have active day-to-day control and if that is facilitated via a local partner in a joint venture, that adds an additional level of risk at the portfolio company level. Investors will typically look for their general partners to have a local presence, unless the fund documentation limits the percentage of capital that can be invested outside of South Africa, in which case the investors may be happy to accept that risk; implying that they can live with that small percentage of the fund being written off," says Warren Hibbert, partner of MVision.

Others attribute the hesitation to the fact that South Africa, with an economy of similar size to many developed European nations, an experienced private equity community and intermediary support network as well as a strong banking sector (largely untouched by the toxic assets emerging in the global credit crisis thanks to the National Credit Act that prevented investment in such instruments as well as the country's foreign exchange controls) consequently has enough rich pickings to offer investors.

Although throughout 2006 and 2007 as international players swarmed in, pricing rocketed and the availability of cheap debt appeared unending, even South Africa's most experienced private equity professionals were beginning to feel the days of rich pickings were over. The concern was that they might be squeezed out of segments of their own market and so forced to look beyond their borders in order to continue to achieve their past return profile.

But what a difference a few months make. The global credit crunch hit (most noticeably for those seeking significant leverage in South Africa through the loss of the Eurobond market by early 2008) and, although not subject to the toxic assets worries, South Africa has felt the immediate impact of the worsening global credit situation. Warren Watkins, partner KPMG South Africa, says: "There is still debt available to private equity, although more costly it's still available. Eighteen months ago we were looking at EBITDA multiples of 6x to 7x, now EBITDA is 3x and you are paying 1-2% more for debt." Despite international private equity investors having gone home to concentrate on under- and non-performing investments closer to home as the global developed world recession begins to bite into balance sheets, South Africa's private equity market has yet to return to equilibrium. This return to equilibrium is expected towards year-end as buyer and seller price expectations start to align with the current economic reality.

The move into Southern African private equity has not only been anticipated from South African professionals. Other regional players, such as Emerging Capital Partners (ECP), have made an impressive footprint across the whole of Africa, including Southern Africa. Renaissance Partners, the principal finance group part of the now troubled Russian financial conglomerate Renaissance Capital, had similar ambitions, as have groups like Delta Partners (telecoms investor), which is essentially a MENA investor with greater ambitions for Africa over the medium term, with offices split between Dubai and Johannesburg.

ECP as an infrastructure investor is a natural cross border play, where the fund sizes under management tend to mean opening several offices on the ground is still cost effective. Although how you achieve this is still a challenge; ECP has the brand and track record to have enabled it to subsume a lot of existing groups on the ground. It currently has five offices on the ground throughout Africa and operational support and back office functions managed out of a sixth office in Washington DC.

But for those not seeking a pan African but a regional Southern Africa (excluding South Africa) investment opportunity, the options remain limited. There are a number of reasons for this. "The markets are fairly fragmented; I think the only homogeneous region in Africa is the francophone region (UMOA & CEMAC), which have the same language and currency," says Mawuli Ababio, former managing director of the Africa Venture Capital Association.

Indeed defining Southern Africa can be a challenge in itself. There is COMESA (the Common Market for Eastern and Southern African states), which in essence aims to improve trade between the member countries (see boxed item) with the eventual aim (around 2020) of becoming a common market. Although, as examples like the ECC suggest, this will be fraught with obstacles and setbacks along the way. There is also the SADC grouping (see boxed item), which attempts to operate as a free trade area and is seeking to be a customs union by 2010 and have a common market in place by 2015 and monetary union by 2016 and a single currency two years after that. Limited partners note that when defining their Southern African geographies, funds will often talk in terms of either SADC or South Africa's frontier (border) states of Namibia (population 2.1 million), Botswana (1.9 million), Zimbabwe (11.4 million) and Mozambique (21.6 million.)

Not surprisingly, looking at the population breakdown, much of the private equity opportunity in Southern African hemisphere (excluding South Africa) is concentrated in the SME space. And on top of that, the frontier states present their own challenges in terms of private equity investment. Ababio says: "Botswana is leading [in terms of PE investment]. Zambia and Zimbabwe see very little and Mozambique is only beginning to tackle some of the legal obstacles like property rights and investor protections." Given the relatively small and fragmented economies making up much of Southern Africa it is easy to see why experienced practitioners quickly begin talking about the region's private equity opportunity in terms of sectors, and therefore regional, rather than country funds.

Barbara James, CEO of The Henshaw Fund, a pan African private equity fund-of-funds vehicle, says: "Basic industries that drive domestic growth are the industries that will be attractive in the short to medium term, such as financial services, telecoms, real estate, tourism, and ones not tied to commodities or to the extractive industries. Our next evolution of managers will be more sector focused including social sectors, such as health and education. Managers will have to be multi country managers to get the kind of geographic exposure we want from a PE fund."

There is a place for country funds (see IFC profile page 12) and long term prospects for those country funds investing with a view to creating regional rather than local champions. In the Southern hemisphere, Botswana is leading the way in terms of grass roots promotion of private equity as an asset class. Its pension funds, like those in Ghana, are now allowed to invest in private equity and it is expected that in time this will lead to the seeding of a number of Botswana focused private equity funds. South Africa's pension funds are by far the greatest supporters of its private equity industry and similarly this is how private equity funds have been seeded across developed Europe in previous decades. As well as promoting local industry, it makes sense for these local pension fund managers to experience and learn about the private equity asset class on familiar home turf before widening their portfolios at a later date.

Perhaps surprisingly, given a decade of increasingly hostile international headlines, Zimbabwe is creating a lot of excitement within the Southern regions private equity circles. Although it should be said that, despite bringing a once thriving Zimbabwe to its economic knees during the past decade, Robert Mugabe remains as a hero for many Africans his role in ending white minority rule. At this point in time it seems optimistic, but then optimism is a key part of the African psyche. Ababio echoes the sentiment of many when he says: "Zimbabwe won't have much difficulty coming back to what it was with the exception of agriculture." Displaying true African optimism he goes on to say: "But there are quite a few agricultural funds in existence now."

Jamille Jinnah, director at CforC, which is a risk management consultancy focused on emerging markets, notes: "Currently, there is no unified plan for reconstruction through aid agencies or NGOs in Zimbabwe. The major donor countries have recently announced that they will move from giving humanitarian aid to providing Humanitarian Plus aid. This gives donors the freedom to start funding areas such as infrastructure, which are more like rehabilitation and recovery than strictly humanitarian. People are watching this transition government with cautious optimism because of recent progress, which has meant employees can get paid in foreign currency, which they are able to use legally to pay for goods and services in Zimbabwe. We believe that there will be opportunities for the private sector to partner with the transition government and donor agencies to develop major areas of infrastructure, such as power, water and sanitation. The funding agencies should see this as a priority, and it must be, if you are trying to get the economy going."

In all Zimbabwe is regarded as something of a wait-and-see case but with many investors keen to take the leap early if signs remain positive. They are buoyed by the thought of the economy's pre 1997 potential. But much of Africa may suffer from the wait-and-see approach for the time being, as Warren Hibbert points out: "On the fundraising side, it's a very difficult time to be out in the market and it's probably not going to get much better for the next 12 – 24 months. International LPs had the spotlight on Africa in 2007 and part of 2008, but their priorities are now elsewhere as they focus on limiting the loss on their core portfolio; predominantly western markets. Any which way you look at it, [fundraising has been] put on hold for quite some time now, particularly given the quantum of support received historically from the US pension and endowment community, who are some of the most severely affected. It's not Africa-related, but unfortunately it's put the growth of the private equity market back a few years."

That said, the FDIs who have been the best and in some cases only supporters of private equity funds investing in Africa's SME space, remain committed. And if local sources of funding come on stream, when international investors come back the private equity landscape in Southern African could be all the more interesting if more local and regional funds emerge.

COMESA member States

Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

Go to www.comesa.int for more information.

SADC member States

Angola, Botswana, the Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe.

Go to www.sadc.int for more information.