PE Exits in Africa – A Way Out on the Horizon?

The African exit environment for PE funds is improving, but investment managers must remain nimble and take a long term approach to exit opportunities to achieve expected returns.

Exit opportunities for African investments have traditionally been limited, owing to illiquid domestic stock exchanges, a nascent secondary market and deal execution risks. However, a recent survey by Deloitte indicates that 67% of respondents expect the East African exit environment to improve over the next 12 months and 42% of respondents indicate the same for West Africa[1].

How are the traditional exit options developing?

There were 58 PE exits in 2015[2] (the highest on record since 2007)[3] with a mixture of exit strategies being deployed.

Trade sales to strategics still account for most PE African exits with Emerging Capital Partners exiting Continental Reinsurance to Saham Finances and Kibo Capital Partners exiting International Medical Group to Ciel Group and Fortis in the last 12 months. Research has shown that trade sales achieve the second highest exit price (after IPOs/public sales) and, given the current competition for quality African assets, we can expect auction trade sales to continue to deliver exit value.

PE exits via secondary sales account for the next largest proportion of exits, such as AfricInvest's exit from Kenya's Brookhouse Schools to UK PE firm Educas in 2015. Given the increasing number of African focused funds and their strong capital position, we expect that secondary transactions will account for an increasing proportion of exits going forward. What are rarer, however, are "portfolio" deals (i.e. packaging together a number of assets for sale to another fund as a portfolio). Whilst such structures are seen in Europe and the US[4], the scarcity of PE assets of a similar vintage (and accompanying valuation discounts) means such structures are unlikely to prove attractive in the near term. There have also been limited instances of PE firms "breaking up" investments into separate divisions/business, and selling them individually (African deals are already relatively small in size so do not lend themselves to break-ups).

Owing to complex and fragmented regulation, exits by way of IPO have traditionally been very limited (with the stock exchanges in Johannesburg, Cairo and Lagos having fairly modest success historically[5]). However, a number of initiatives are improving the efficiency of listing shares in African companies domestically and abroad[6]. For example, the UK and Nigeria established a new mechanism to trade and settle the ordinary shares of Nigerian companies listed in London and vice versa (their stock exchanges also signed a capital markets agreement to support African companies with dual listings on both exchanges[7]), and the East African Community has plans to integrate East African capital markets[8] to create a single liquid exchange. A strong pipeline of IPOs is anticipated for 2016 and so it will be interesting to see whether the reported initiatives improve the perceptions around the African public markets and encourage PE funds to devote more time to IPO exits.

What should investment managers be doing to improve their chances of a successful exit?

Whilst the statistics suggest that the PE exit environment is improving, compared to Europe[9] and the United States, the exit environment remains difficult. It remains to be seen whether Brexit, falling commodity prices and the Chinese economic slow down will continue to cool international markets, having a consequential effect on exit opportunities for PE in Africa.

So what should investment managers be thinking about to achieve a successful exit?

- Develop a long term (yet flexible) exit strategy contemplating different alternatives that can be deployed depending on future developments;

- Agree an exit timetable (which could, in some cases, take up to 10 years to realise) so that you and your management team understand each others' expectations and requirements;

- Ensure you have the legal right to take control of an exit process if one has not been delivered for you by a particular date. Commonly exit provisions will provide the PE fund with veto rights but are silent on whether the PE fund can take a more active role in the exit process. Clearly drafted exit provisions are invaluable and will avoid unnecessary arguments over "who does what" at different stages of the timetable;

- Understand the market and likely interested acquirers. Increasingly, PE funds are investing in Africa with a "ready made" exit partner in mind, which allows the fund to prepare the asset for such an acquirer and to identify and overcome obstacles in advance;

- If an IPO is envisaged, start preparations early. Such processes take a long time and can easily be elongated by issues that cannot be foreseen. Investment managers should therefore understand the public market they propose to use and seek advice on the expectations the market will impose on the fund (e.g. track record requirements and possible lock up expectations); and

- Consider alternative exit strategies. For example, should the PE fund have the right to demand that the investee company redeem its shares and, if so, what are the local legal restrictions on it doing so (e.g. Kibo Capital Partners partially exited Zambia's Madison Finance Company in 2015 by the redemption of its preference shares)[10]? Do the debt capital markets present a better exit option, if so, should the PE fund have the right to demand that its equity stake be redeemed in return for a debt instrument that can be sold on the debt markets? In either case, can the PE fund demand that the investee company sells or liquidates existing assets to fund such a buy back or redemption?

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[1] "Deloitte; Africa Private Equity Confidence Survey 2015" Deloitte, 2015.
[2] KMPG Deal Advisory: "Private Equity Trends Jan – Dec 2015".
[3] "Private equity roundup Africa", EY, 2015.
[4] E.g., Bridgepoint's recent announcement to sell a portfolio of its European assets for $2.2 billion to an affiliate of Harbourvest Partners ("Bridgepoint Said to Agree $2.2 Billion Portfolio Sale", Bloomberg, 25 January 2016).
[5] Most other domestic African stock exchanges have traditionally had less than 50 companies listed("Private Equity Investment in Africa: In Support of Inclusive and Green Growth", African Development Bank, 2012).
[6] African companies listed on the London markets had a combined value of US$75 billion in [2014] ("Out of Africa", London Stock Exchange Group)
[7] The agreement seeks to strengthen cooperation and promote mutual development between the two exchanges (Nigerian Stock Exchange, 18 November 2014).
[8] The East African Community plans to integrate securities laws/regulations and the capital markets of several Tanzania, Uganda, Rwanda and, potentially, Kenya, which would improve efficiency and reduce the costs of trading shares across East Africa.

[9] The European Private Equity and Venture Capital Association estimated that there were 2,416 of such exits in 2014 ("European private equity investment over €40bn in 2014, exits hit record levels, new EVCA data shows", Invest Europe, 12 May 2015).

[10] "Kibo Capital Partners Partially Exits Madison Finance Company (Sub-Saharan Africa)", Emerging Markets Private Equity Association, 14 December 2015.

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