AFRICAN CONSUMERS:

DRIVING THE AFRICAN PRIVATE EQUITY OPPORTUNITY

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Contents

AFRICAN CONSUMERS: DRIVING THE AFRICAN PRIVATE EQUITY OPPORTUNITY 1

Introduction 2

The African Growth Story 2

The African Consumer 3

Main Drivers of the Consumer Market 4

Young Population 4

Urbanization 5

The Growing Middle Class 5

Technology 6

Business Climate 6

Investment Opportunities 8

Fast-Moving Consumer Goods 8

Financial Services 9

Agribusiness 11

Telecommunications 12

Infrastructure 14

Domestic Manufacturing 15

Private Equity in Africa 16

Market Access 16

Value 16

Low Private Equity Penetration 16

Uncorrelated Returns 17

Maturing Private Equity Universe 17

Approaches to Investing in Private Equity in Africa 17

About FMO-Fairview 19

Introduction

Within the emerging markets realm, African countries have long been considered to be on the frontier – poised for growth and ripe with business opportunity, yet not mature enough for most institutional investors to consider seriously. This rationale has faded rapidly since the turn of the century as growth and progress across the African continent have become too substantial to ignore. Sub-Saharan Africa is home to 10 of the 20 fastest growing countries in the world.[1] It is home to a rapidly burgeoning middle class, with increased spending power, on pace to rival those of other emerging regions such as China, India and Brazil. Meanwhile, vastly improved governance coupled with a more transparent and investment-friendly business climate have been driving investor confidence. While Africa has certainly benefited from the surge in commodity prices over the past decade, only 24% of real GDP growth is attributable to natural resources. The vast majority of growth is driven by consumer spending, manufacturing and service industries, including construction, retail, banking and telecommunications.[2] Since the vast majority of African enterprises are private and closely held, public markets offer limited access to the companies benefiting from and supporting the resilient consumer growth across the continent. Private equity, therefore, provides the best mechanism through which to access the most compelling investment opportunities. Navigating the rapidly developing private equity market in Africa may seem a daunting task for institutional investors. However, through investment platforms providing the right mix of relationships, experience and market insights, opportunities can be accessed prudently and efficiently.

The African Growth Story

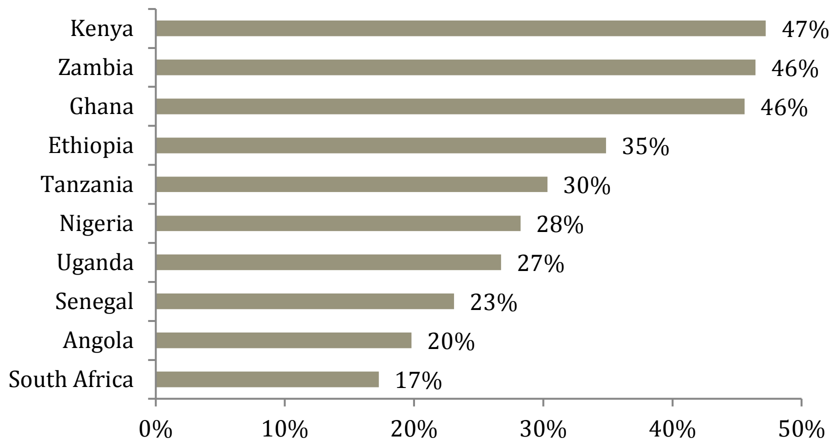
Africa is the second largest continent in the world in terms of both land area and population. It is a large and diverse continent comprised of 55 countries with a land mass larger than the collective land mass of the United States, China, and India. By 2020, the continent's GDP is projected to climb to $2.6 trillion which is equivalent to the current size of the Indian and Russian economies combined.[3] Consumer spending is also expected to reach $1.4 trillion by that time and the number of African households with discretionary income is projected to reach 128 million – more than the total number of households currently in the United States.[4] Growth in Africa has also been resilient: since 2002, Africa's average rate of growth has been 5.2%[5]; and the continent's lowest aggregate GDP growth rate over the past decade has been 3.1%, in the depths of the global economic downturn in 2009. There are numerous pockets of growth that are poised to outpace the continent's overall growth. For example, between 2013 and 2018, rapidly developing countries such as Kenya, Zambia and Ghana are projected to increase GDP per capita by over 40%. (See **Figure 1)**

Africa's consumer facing sectors represent the largest opportunity and are a key driver of the continent's appeal relative to other regions of the world. In fact, these sectors are growing two to three times faster than those in the OECD (Organization for Economic Co-operation and Development) countries. The growth spans a range of consumer facing sectors. Between 2002 and 2007, Wholesale/Retail spending and Agriculture accounted for 13% and 12% of growth, respectively. Transport and Telecommunications

[1] Lucas Kawa, *The 20 Fastest Growing Economies in the World*, Business Insider (Oct. 24, 2012)
[2] McKinsey Global Institute, *Lions on the Move: Progress and Potential of African Economies, 4-8* (Jun, 2010)
[3] McKinsey Global Institute, *Lions on the Move: Progress and Potential of African Economies, 4-8* (Jun, 2010)
[4] The U.S. Department of Commerce, Census Bureau (Mar 12, 2013)
[5] African Development Bank

accounted for 10% of growth during the same period, Manufacturing accounted for 9%, and Financial Services accounted for 6% while Construction accounted for 5%.[6]

Figure 1: Projected GDP per Capita Growth by Country, 2013-2018



Source: International Monetary Fund, World Economic Outlook Database

The African Consumer

By 2008, roughly 85 million African households had passed the $5,000 annual earnings threshold – the level at which households have discretionary income and typically spend half of their income on items other than food. Further, it is projected that by 2020, the number of households with this level of discretionary income will reach 128 million, and the percentage of the population that cannot go beyond meeting basic consumer needs will be just 18%.[7]

Private consumption in Africa is already higher than in India or Russia; it rose by $568 billion from 2000 to 2010. By 2020, consumer-facing industries are expected to grow a further $410 billion, representing the continent's largest business opportunity. Apparel, consumer goods, and food are expected to account for $185 billion, or 45%, of that amount.[8] The growth in the African consumer market is the result of the confluence of a number of factors, demographic and developmental.

[6] *See* McKinsey Global Institute *supra* note 2. Global Insight, Aram Monetary Fund, African Development Bank
[7] Mckinsey Global Institute, Canback Global Income Distribution Database
[8] McKinsey & Company Africa Consumer Insight Center, *Rise of the Africa Consumer*, 1 (October 2012)

Main Drivers of the Consumer Market

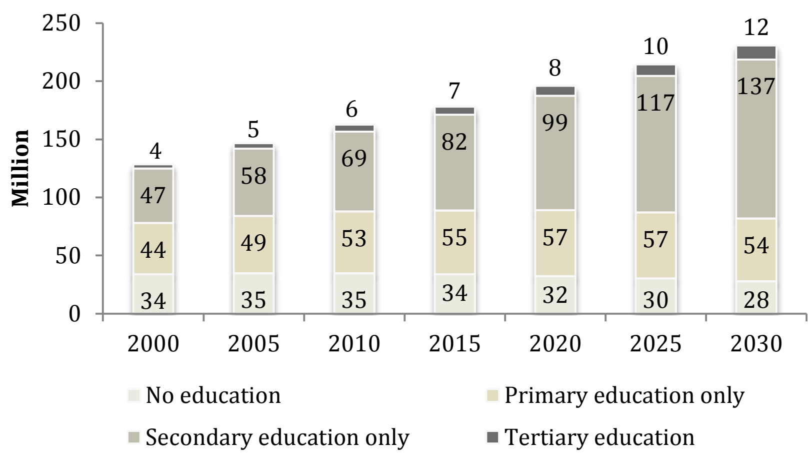
Young Population

Africa has the youngest population in the world, with over 200 million people between ages 15 and 24. This corresponds to a higher ratio of working age to non-working age citizens, and rapid and more sustainable economic growth. Africa has over 500 million working age people (age 15 to 64) and this number is expected to double by 2040 resulting in a work force of over 1 billion people, which would make it the largest in the world, surpassing both India and China.[9]

Africa's young population is not only growing rapidly but it is also becoming educated, making it an increasingly affluent and attractive consumer base. Based on current trends, 59% of 20-24 year olds will have had secondary education in 2030, compared to 42% today. This will translate into 137 million 20-24 year olds with secondary education and 12 million with tertiary education in 2030 (See **Figure 1**). These young people are becoming educated at a growing rate because the growing African job market demands 21st century skills in healthcare, science, technology, manufacturing and business.

The International Labour Organization (ILO) estimates that between 2000 and 2008, Africa created 73 million jobs.[9] By comparison, the U.S. (though roughly one-third the population of Africa) created less than 3 million net jobs during this period.[10] Africa's young people are becoming better educated, filling the growing workforce and consuming more goods and services at an increasing rate. As the workforce grows, it is creating a larger class of skilled, educated consumers that will drive economic growth further still. This growing workforce will increase demand for consumer goods and services such as groceries, high quality clothing and apparel, bank accounts, financial intermediation, mobile phones and internet access. Africa's favorable demographics and growing workforce are fostering dynamic consumer-driven economic growth across the continent.

Figure 2: Rapid Growth of Educated Young People in Africa (Millions)



Source: World Bank EdStats

[9] African Economic Outlook, *Promoting Youth Employment in Africa*
[10] The Wall Street Journal, *Bush On Jobs: The Worst Track Record On Record* (January 9, 2009)

Urbanization

The African population is growing at 2% a year and is projected to reach over 2 billion by 2060. More importantly, the percentage of Africans living in cities is expected to increase to 50% in 2030 (versus 37% in 2009).[11]

With 40% of its population living in cities, Africa is more urbanized than India (30%) and nearly as urbanized as China (45%). By 2016, over 500 million Africans will live in urban centers, and the number of cities with more than 1 million people is expected to reach 65, compared with 52 in 2011. This is already on par with Europe and higher than India and North America. Between 1990 and 2009, the urban population in Sub-Saharan Africa rose by 102%, to 408 million people, compared to the rest of the world where urban population grew by only 54% reaching 3.5 billion people.[12]

This increasing urbanization will help ensure consumer-driven growth opportunities as urban spending is increasing twice as fast as rural spending. Urban per capita incomes are, on average, 80% higher than those of African countries as a whole. In Ghana, for instance, only 29% of households have disposable income of more than $5,000; this increases to 55% in the capital city of Accra. Higher productivity of urban workers accounts for much of the difference.[13] Further, because cities are more densely populated, consumers are easier to reach. This means companies catering to African consumers can more efficiently reach their target markets.

As more Africans move to cities to take advantage of opportunities, a virtuous cycle is likely to drive an increasing proportion of the population to urban areas where they can earn higher wages and have more disposable income. By 2030, the continent's top 18 cities are expected to have a combined annual spending power of $1.3 trillion.[14]

The Growing Middle Class

The African Development Bank (AfDB) defines the African middle class as those spending between US$2 and US$20 a day.[15] This figure may appear low when compared to developed markets but the Bank deems this range appropriate given the low cost of living on what still remains the world's poorest continent. Middle class is defined in relation to the average income and that average is much lower in Africa than in the West. At 313 million, the African middle class is roughly the same size as its Indian and Chinese counterparts.

From 1990 to 2000 Africa's middle class grew from 151 million, or 27% of the continent's population, to 196 million. Then, from 2000 to 2010, the middle class grew impressively to 313 million, or 34.3% of the continent's population. As the middle class has continued to span a cross-section of the African populace, new increasingly affluent customers are entering the consumer markets. It is projected that by 2060, the African middle class will grow to 1.1 billion, representing 42% of the continent's population.[16]

[11] McKinsey Global Institute, African Development Bank.
[12] Avanz Capital, *The Private Equity Climate in Africa: Embracing the Lion, 3* (Aug. 2012)
[13] *See* McKinsey & Company *supra* note 9 at 4
[14] *See* McKinsey *supra* note 4 at 38
[15] Deloitte, *The Rise and Rise of the African Middle Class*– Deloitte (2013)
[16] Deloitte, *The Rise and Rise of the African Middle Class*– Deloitte (2013)

Despite the enormous attention the African middle class has garnered in recent years, several misconceptions exist concerning these families and their economic situation. They typically do not derive their income from farming and rural economic activities – they typically live in urban centers. They generally have higher levels of tertiary education, hold salaried jobs, are small business owners, have fewer children than previous generations, and tend to prefer private education and health services.[17]

The greatest upshot of this emerging African middle class is the explosion in demand for consumer goods and services, such as consumer business/retail (both food and clothing), technology, mobile and telecommunications, entertainment, financial services and healthcare, with a spill-over effect into other areas like construction, infrastructure development and agriculture.[18] While the majority of Sub-Saharan African consumers are currently in lower-income, more price-sensitive groups, many will move up into more affluent segments as they urbanize and their incomes increase. Such movement will create a large, growing, attractive opportunity for consumer facing companies.

Technology

Usage of technology has increased demand for consumer goods, particularly in rural areas. Africa is the fastest growing mobile phone market in the world and it is estimated that more than 50% of Africans owned a mobile phone at the end of 2012.[19] The market is increasingly competitive and world-class local enterprises are emerging in voice and data services. Telecom revenues increased at a compound annual growth rate (CAGR) of 40% between 2003 and 2008 and the number of subscribers now exceeds 400 million.[20]

Internet penetration in urban Africa compares favorably with that in other emerging markets. In Africa's major cities, 52% of those surveyed have connected to the internet in the last month, compared with 54% in China. Some countries have relatively high exposure; for example, 78% of Kenyans and 54% of South Africans said they use the internet at least monthly. Some surveys suggest that potentially as many as 26% of urban Africans are connecting daily to the internet, led by Kenyans at 47%.[21]

When Africans log on, social networking is the leading use of the internet, with about 57% of urban African users saying they visited such sites often. E-mail and music/video usage followed in popularity.[22] It is also important to note that online commercial activities such as banking, shopping, and travel still have relatively low penetration. This presents compelling opportunities for virtualization of consumer services and the sale of consumer goods online as the level of connectedness and the level of trust Africans place in internet transactions increases.

Business Climate

Africa's consumer facing industries are operating in rapidly progressing business environments. Improvements in business environments and political stability have attracted increased foreign investment. Greater trade liberalization between Africa and its international partners continues to stimulate growth. Regional Economic Communities and Free Trade Areas have formed the building

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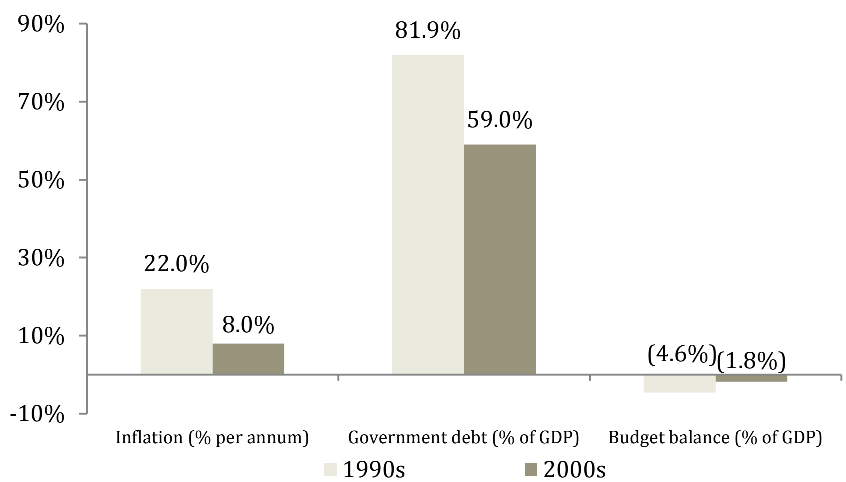
[17] Deloitte, *The Rise and Rise of the African Middle Class*– Deloitte (2013)
[18] Deloitte, *The Rise and Rise of the African Middle Class*– Deloitte (2013)
[19] McKinsey Global Institute, African Development Bank
[20] McKinsey Quarterly, *Africa's Path to Growth: Sector by Sector*, 16 (2010)
[21] *See* McKinsey & Company *supra* note 9 at 15
[22] *See* McKinsey & Company *supra* note 9 at 15

blocks for accelerated regional integration. Perceptions of the Sub-Saharan region have improved significantly given the sharp reduction in armed conflicts, coupled with the rise in stable democracies featuring peaceful transitions of power between democratically elected leaders.

Further, the continent's governments have improved macroeconomic stability by reducing the collective inflation rate from 22% in the 1990s to 8% since 2000. During this period, African governments collectively cut their combined foreign debt from 82% of GDP to 59% and shrunk their budget deficits from 4.6% of GDP to 1.8%. Many of these reforms have been highly correlated with improved economic conditions (See **Figure 3**). African nations have also allowed an increasingly larger share of economic activity to be driven by the private markets, with Nigeria, for example, privatizing more than 116 enterprises between 1999 and 2006. Furthermore, Morocco and Egypt have formed free-trade agreements with the European Union and Rwanda has formed commercial courts to adjudicate business disputes.[23]

Figure 3: Improving Governments



Source: McKinsey Global Institute

African nations are also promoting more regional integration and working more cohesively to foster a healthy investment climate across national borders. Nontrade barriers between Sub-Saharan nations are coming down, double –taxation agreements and investment promotion pacts have been made with more such pacts looming in the near future. There has been a rise in inter-governmental organizations such as: the Southern African Development Community (SADC), comprised of South Africa, Mozambique and Zambia among others; Economic Community of West African States (ECOWAS), comprised of Nigeria, Ghana, and Cape Verde among others; and the East African Community (EAC), consisting of Kenya, Tanzania and Uganda. These organizations have fostered trade, standardized passports to promote travel and generally spurred economic activity between their member states.

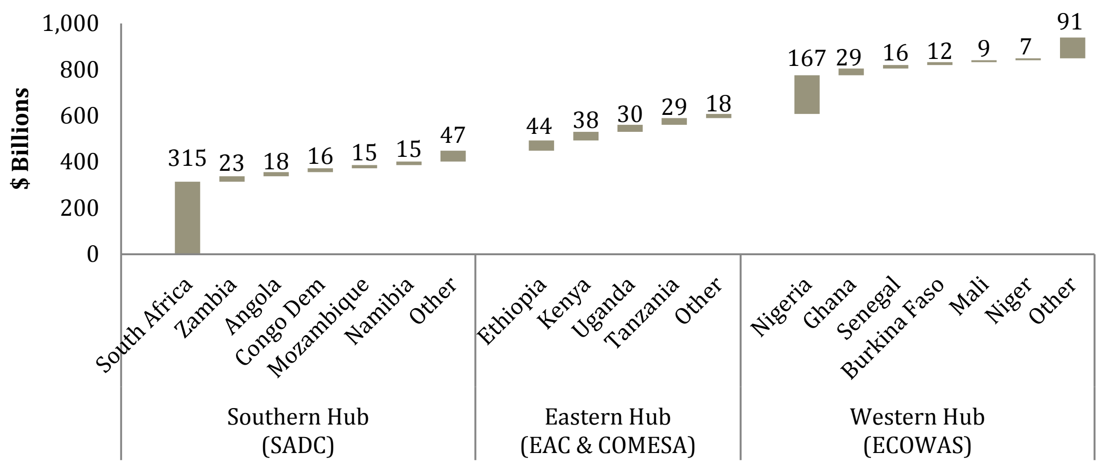
[23] *See* McKinsey Global Institute *supra* note 2 at 12

Investment Opportunities

Fast-Moving Consumer Goods

Africa's rising consumption is creating more demand for local products and sparking a virtuous cycle of increasing domestic growth. The products driving this growth include affordable food products, beverages, personal grooming products and household cleaners (fast-moving consumer goods or "FMCG"). The opportunity is quite widespread as consumer spending growth across the continent is expected to be driven by a diverse range of countries.

Figure 4: African Estimated Consumer Spend by 2020 ($ Billion)



Source: Euromonitor

A clear link exists between the growth of African economies and the FMCG market. GDP per capita is the single most important driver of global growth in the consumption of fast-moving consumer goods, accounting for an average of around 73% of total growth across 60 product categories. While the influence of other factors, such as education and local customs, varies between categories, GDP per capita dominates how much money consumers spend on FMCG in Africa because many markets are in the early stages of development.[24]

Many of the world's largest and most successful retailers and consumer goods companies have recognized the immense FMCG opportunity in Africa. Many modern retailers are establishing a presence in Africa as a result of increased demand for FMCG products, the development of urban centers and improved supply and store networks. FMCG manufacturing in Africa is also gathering momentum. A series of capacity additions across the continent, largely by multinationals such as Unilever and Nestle, has been a notable development. Large firms such as these have paved the way for other FMCG manufacturers and their activity in many ways serves as a proxy for the growth of the FMCG opportunity in Africa. For the five year period between 2012 and 2017, Unilever expects to double its revenue in Africa. The company is focused on major markets South Africa and Nigeria, as well as smaller markets such as Kenya, Ethiopia and the Democratic Republic of Congo – reflective of the geographic expanse of

[24] The Economic Times, *Africa's Rapid Growth Creates Vast Opportunities for FMCG Companies*, (August 20, 2010)

the opportunity.[25] Designing products that appeal to differing localities is still a challenge though, leaving room for smaller FMCG manufacturers to carve out attractive niches.

A major factor that will contribute to the success of FMCG in Africa is distribution networks. Supermarkets not only exemplify the consumer opportunity in Africa, but they are also an efficient means through which consumer products can be distributed. Their rapid growth is a boon for fast-moving consumer goods. In Nigeria alone, store openings are growing by 36% a year.[26] Supermarkets have spread fast in Southern and Eastern Africa, already expanding beyond middle class big-city markets into smaller towns. The share of supermarkets in national food retail in South Africa is already 55%, similar to the share in Argentina, Chile, Philippines, and Mexico (and not far behind that of the U.S., currently 70%).[27] Supermarkets are taking over the most dynamic segments of the food retail markets – the rapidly growing urban areas where incomes and profit margins are higher.

Case Study: NCA Rouiba	
NCA Rouiba **Country:** Algeria **Sector**: Agribusiness & Food processing **Investment Type:** Expansion **Internet:** www.rouiba.com.dr	**About NCA Rouiba:** Founded in 1966, NCA Rouiba is Algeria's market leader in the production and distribution of juice, nectars and still drinks. **Strategy:** The company seeks to offer quality products in a large variety of categories and puts innovation high on its strategic agenda to ensure adherence to advanced international standards. NCA Rouiba's mid-term strategic priority is to target neighboring markets initially through export sales and later by establishing affiliates in Tunisia and Morocco. **Role of Private Equity:** Private Equity investors have been instrumental in the design and implementation of an industrial master plan, which included a reorientation on the core business (e.g. closing of canned food/ milk product lines), industrial upgrading (e.g. new packaging machinery, upgraded filing lines, premises refurbishment), rejuvenation of the marketing/branding strategy (e.g. refreshed logo and packaging) and building a logistical platform. Also, the private equity investors formalized an internal corporate governance code and led the structuring of a participating loan provided by European Investment Bank (EIB). The PE investor exited partially in 2013 through an IPO on the Algerian stock exchange – the first IPO for a private company in Algeria.

Financial Services

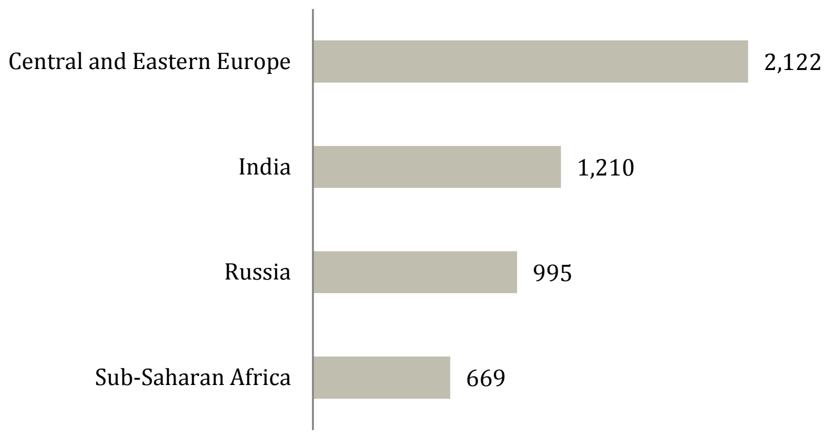
Whether foreign or indigenous, most banks in Africa's financial services industry have traditionally focused their retail banking services on middle- and upper-income customers. In aggregate, however, the entire financial infrastructure in most nations is typically underdeveloped. Opportunities range from specialized leasing companies to commercial banks financing businesses.

In recent years, rising incomes in many African countries have prompted banks to seek to expand their customer base and penetrate large unbanked populations. Despite the acclaim that the growth in the

[25] Reuters, *Unilever Aims to Nearly Double Africa Revenue in 5 Years*, (May 10, 2012)
[26] *See* McKinsey & Company *supra* note 9 at 4
[27] McKinsey Quarterly, *A Seismic Shift in South Africa's Consumer Landscape*, 1 (June 2010)

financial sector in Africa has received, most of the continent is still largely unbanked and primed for growth in the financial sector.

Figure 5: 2008 Total Banking Assets ($ Billion)



Source: McKinsey Global Institute

The race to reach this unbanked population is understandable as retail banking is expected to account for 40% of the African banking sector by 2020. Financial services as a whole are expected to grow at a CAGR of 15% through 2020. In 2009, financial services totaled just 11% of Africa's GDP but are projected to reach 19% of GDP by 2020.[28]

In urban areas, large numbers of new customers are relying on branch networks, but in rural areas, the cost of a traditional brick-and-mortar presence is prohibitive. Mobile financial services have become more popular, although many of these offerings remain limited to payments and money storage, with no mobile mechanisms yet available for savings and credit or insurance.[29] To extend coverage in new ways, retail banks are looking to lower the costs of distribution, banking products and operations.

Many banks now have a tiered branch system to meet different customer needs ranging from a branch that serves more affluent customers, a branch for the majority of individuals and small businesses, and mobile branches through vans driven to rural communities, typically for one day a week, where a permanent branch is not yet viable. Bank representatives also set up booths in markets and similar locations, where they provide basic financial education. Significant opportunity remains in addressing the needs of Africa's under-banked populations.

[28] Reuters, *African Banking Set for Impressive Growth,* (Mar. 4, 2011)
[29] Accenture, *At the Tipping Point: African Financial Services Coming of Age,* (2011)

Case Study: Union Bank

Union Bank

Country: Nigeria

Sector: Banking

Investment Type: Recapitalization/turnaround

Internet: www.unionbankng.com

About Union Bank: Union Bank of Nigeria ("UBN") is one of the oldest (est. 1917) and most recognized universal banks in Nigeria and, in the decades prior to the 2009 Nigerian financial sector crisis, was one of the top 3 banks in Nigeria. . The bank, however, failed to modernize its culture and risk management practices, thereby losing market share and leading to an NPL build up. This, coupled with poor corporate governance, led to the bank's failure and Central Bank intervention in 2009.

Strategy: An experienced, professional and aligned investor base was required with a commitment to international best practices. This then would position Union Bank to implement strategies to successfully turn the business around through strong management, governance and controls. Once stabilized, Union Bank would be able to serve a rapidly growing customer base.

Role of Private Equity: African private equity investors participated in an international consortium to re-capitalize the failed bank and return it to its former glory. The deal was an economically attractive transaction with the ability to acquire a controlling stake at an attractive entry valuation, in a leading bank with a clean balance sheet, and strong exit prospects via acquisition by a reputable international financial institution.

Agribusiness

Today, agriculture accounts for 25% of the continent's economy and employs over 70% of the workforce. Agriculture still employs such a large portion of the continent's workers because in many countries, most crops are produced by small-sized farms with limited mechanization and capacity, leading to poor yields. Fragmented markets, price controls, and poor infrastructure also hamper production. The predominant agricultural products include maize, rice, and palm oil.[30] Although many of continent's products aren't currently priced competitively, there is an enormous opportunity for investors. Africa is home to 60% of the world's uncultivated arable land, and crop yields are less than half that of other regions.[31] New farming technologies and other inputs across the value chain offer significant potential opportunities. The World Bank Group is investing more than $6.1 billion in African agriculture every year. The IFC is looking to increase its agriculture investments across the continent from $550 million to over $2 billion over the next four years alone. FMO has identified agribusiness as a key focus sector and has significantly ramped up activity in recent years. New products, such as local currency financing, risk sharing facilities, and comprehensive support to farmers through intermediaries is bridging the gap, and infrastructure projects such as water reservoirs and storage facilities are primed for investment.[32]

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[30] International Finance Corporation (IFC), *Agribusiness in Africa*

[31] McKinsey Global Institute, *Sizing Africa's Business Opportunities*

[32] *See* IFC *supra* note 39

Case Study: Socolait	
Socolait **Country:** Madagascar **Sector:** Food Processing (dairy products) **Investment Type:** Buyout (Carve-out) **Internet:** www.socolait.mg	**About Socolait:** Socolait is a food processing company selling a variety of dairy products such as yogurts, cheese, condensed milk and baby flour. **Strategy:** Priorities for Socolait are the development of a family of fresh products in synergy with its long-duration line, expanding their distribution network and improving standards and infrastructure in their production processes & supply chain. **Role of Private Equity:** Socolait was acquired as a carve-out from a larger enterprise. The company lacked essential management systems, requiring extensive involvement by its private equity investors. Together with the recruitment of a new Manager Director, a management accounting process was implemented, cash management was improved, new distribution agreements were signed, a dedicated sales team was deployed in two cities and new brand identity and promotional materials were developed and tested.

Telecommunications

Today more than 50% of Africans own a mobile phone and this figure is growing at more than 15% per annum – making the continent the fastest growing mobile phone market in the world. [33] In fact, several of the continent's most advanced nations have already passed the 100% mobile phone penetration mark.[34] This remarkable growth is largely driven by the fact that mobile phones represent more than 90% of all telephonic communications in Africa. Mobile data and broadband technologies are increasingly being used as a substitute for poor or non-existent fixed-line infrastructure in Africa. In vast parts of the continent, the mobile network operators are the only providers of any kind of telecommunication service apart from satellite services, which is among the many reasons why investors still perceive cell phone towers and infrastructure as a compelling opportunity. As subscriber growth peaks, many mobile service providers have established themselves as Internet Service Providers (ISPs) and are playing an increasing role in the broadband sector, competing directly with fixed broadband services such as DSL. As a result, internet use has grown across the continent, led by Nigeria (See **Figure 6**). Many of the aforementioned industries, such as consumer goods and financial services, are poised to benefit from increased internet and mobile penetration.

[33] *See* McKinsey Global Institute *supra* note 2
[34] KPMG, *Telecommunications in Africa* (2012)

Case Study: IHS

Towers of strength

IHS

Countries: Nigeria, Cameroon, Ivory Coast

Sector: Telecommunications Infrastructure

Investment Type: Growth

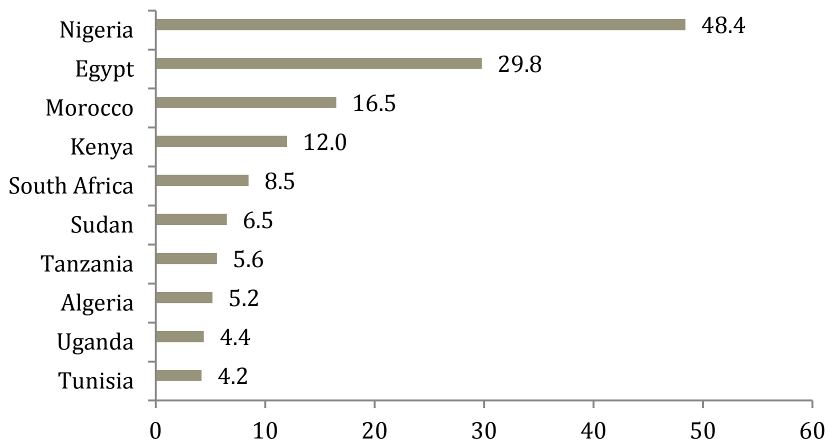
Internet: www.ihstowers.com

About IHS: IHS is a pan-African telecommunications infrastructure provider that independently owns, manages and operates wireless communications towers for telecom operators.

Strategy: IHS seeks to benefit from rapidly increasing mobile penetration rates and ongoing upgrading of telecom networks (e.g. 2G to 3G) in key African markets. Main elements of its aggressive growth strategy include: 1) continued expansion in Nigeria, 2) pan-African expansion through a combination of acquisitions of tower portfolios and building new towers and 3) focus on tower sharing to improve co-location/tenancy ratios.

Role of Private Equity: IHS has used private equity investment to expand domestically within Nigeria from less than 200 towers in early 2011 to over 1000 towers by 2013. As a result of expansion, IHS has become the largest tower company in Nigeria. In addition, follow on investments have been used to fund acquisitions in Cameroon and Ivory Coast where IHS is becoming a dominant player.

Figure 6: African Countries with Highest Number of Internet Users, 2012 (Millions)

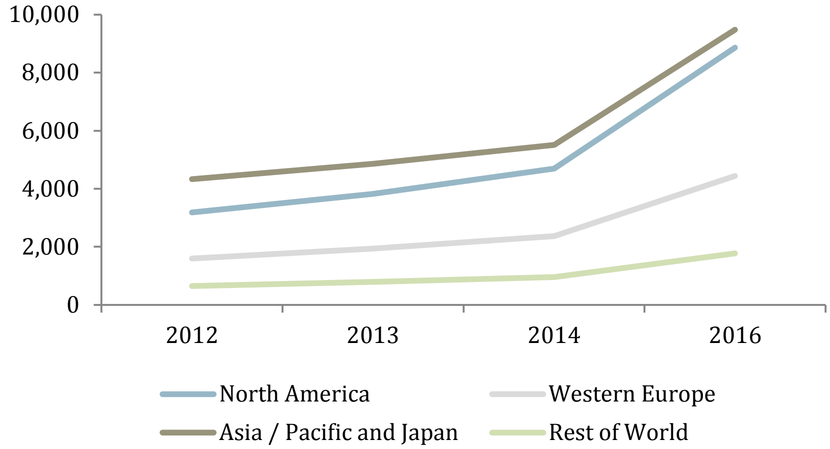


Source: Internet World Stats

Mobile phone penetration rates are high in several African nations; however the potential revenue streams to be harnessed from mobile devices is still nascent (See **Figure 7**). Some estimates put mobile ad revenue for African telecoms on pace for $1.3 billion by 2016, up sharply from the current $136 million level.[35] The major drivers of this growth in advertising opportunities is expected to come from internet search, internet display, SMS, MMS, mobile apps, downloads and streaming advertisements.

[35] Brandon Gregory, Human IPO, *African Mobile Advertising May Reach $1.3 Billion*, (January 8, 2013)

Figure 7: Projected Mobile Advertising Revenue by Region, Worldwide ($ Million)



Source: Gartner

Infrastructure

The infrastructure needs and thus opportunities for investment across Africa are enormous. From rural roads, railways and harbors, to irrigation systems, telecommunications, clean water, sanitation and energy as well as such basic social infrastructure as health, education, banking and commercial services. While the continent is certainly experiencing increasing urbanization, the majority of the population still lives in rural areas where most of the opportunity for infrastructure investment lies. Rural women walk an average of 6 kilometers daily to rivers and springs for piped water and wells, and only 56% of the population drinks clean water. Further, just 4% of the farmland is irrigated, only a third of the continent lives near a road, and Africa has less than a quarter of the paved roads per kilometer that other developing nations have. An example of the consequence of these challenges is that the cost of transporting goods and products to markets are two to four times higher per kilometer than they are in the United States, and travel times along key export corridors are two to three times as high as those in Asia.[36]

Africa's largest infrastructure deficit is to be found in the power sector as less than a third of the continent has electricity. Whether measured in terms of generation capacity, electricity consumption, or security of supply, Africa's power infrastructure delivers only a fraction of the service found elsewhere in the developing world. The 48 countries of Sub-Saharan Africa (with a combined population of 800 million) generate roughly the same amount of power as Spain (with a population of 45 million). Power consumption, at 124 kilowatt hours per capita per year and falling, is only a tenth of that found elsewhere in the developing world, barely enough to power one 100-watt light bulb per person for three hours a day.[37]

With these current deficiencies come enormous investment opportunities in projects such as power generation, renewable energy, utilities and transportation providers. Renewable energy is considered one of the fastest growing subsectors on the continent. Foreign direct investment in African infrastructure jumped from $8.8 billion to nearly $17 billion from 2005 to 2007 alone. Some estimates gauge there to be

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[36] The World Bank, Fact Sheet: *Infrastructure in Sub-Saharan Africa*
[37] The World Bank, Fact Sheet: *Infrastructure in Sub-Saharan Africa*

more than $38 billion in immediate infrastructure investment opportunities on the continent with energy representing the most pressing projects.

Domestic Manufacturing

Africa has all the necessary inputs for a competitive manufacturing sector: a comparative advantage in low-wage labor, abundant natural resources, privileged access to high-income markets for exports, and in most cases a sufficiently large local or regional market to allow emerging producers to develop high-volume production, and quality control in preparation for breaking into more competitive export markets. Several nations also have tangible geographic advantages: for instance, Tanzania has quick access to the coast, while landlocked Zambia has natural protection from competition with Chinese firms for industries whose products are high in volume and heavy in weight.[38]

Today China is the world's largest low-cost manufacturer but as its economy shifts from an export-driven focus to one more dependent on domestic consumption, Africa stands to benefit tremendously. Rising wages in China, the expansion of a costly social safety net, and the prospect of further increases in the value of China's currency signal an erosion of the nation's comparative advantage in labor-intensive manufactured goods. This shift has created an enormous opportunity for African nations to assume an increasingly larger share of global manufacturing output.

African economies are increasingly producing manufactured goods domestically, particularly for export to other African nations. Successful products include processed fuels and food, chemicals, apparel, and cosmetics. Manufactured goods exports grew from just $1.5 billion in 2000 to nearly $10 billion in 2008 (See **Figure 5**). Kenya increased the share of manufactured goods in its exports from 21% to 37% since 2000; Uganda from 6% to 30%; and Senegal from 27% to 39%.[39] Egypt, Morocco, South Africa and Tunisia also have very healthy industrial sectors as manufacturing and services account for 83% of their combined GDP. [40] As these increasingly diversified economies expand manufacturing, particularly in food processing and construction materials for local and regional markets, an additional benefit is that it reduces the need for imports, easing current-account deficits and reducing GDP growth volatility. Labor-intensive manufacturing has led the economic transformation of many of the most successful developing countries and it is poised to do the same in Africa.

[38] Africa Development Forum- World Bank Group, *Light Manufacturing in Africa: Targeting Policies to Enhance Private Investment and Create Jobs*, 41
[39] *See* McKinsey Global Institute *supra* note 2 at 32
[40] McKinsey Quarterly, *What's Driving Africa's Growth,* (2010)

Private Equity in Africa

There exists a robust supply of privately held companies in Africa that can capitalize on favorable local demographics, attractive economic trends and growing consumer incomes on the continent. However, in many African countries, underdeveloped capital markets and unfavorable lending terms can result in a financing gap for these companies. Private equity fills this need for investment capital and can permit investors to access targeted high growth opportunities. There are numerous examples of African companies that, with the injection of private equity capital, were able to expand into new markets, launch new products, and achieve revenue and profitability growth. The African private equity market features many attractive characteristics and can be accessed in a number of ways.

Market Access

Many of the most innovative companies in Africa are still privately held and the stock exchanges are relatively small. For instance the Johannesburg Stock Exchange (JSE), the largest exchange in Africa, is capped at approximately $947 billion and the others are much smaller. In South Africa alone there are an estimated 400,000 private companies compared to fewer than 400 publicly listed firms. In fact, across the entire continent there are only approximately 2,000 listed companies.[41]

Value

Most companies have difficulty accessing growth capital due to nascent capital markets, which is reflected in low average entry valuations. Almost half of global deals take place in the 5-7.5x EV/EBITDA range, and a quarter in the greater than 7.5x range, leaving only around 20% at below 5x. In contrast, 40% of African PE deals take place at less than 5x EBITDA.[42]

There are much lower levels of debt in African PE transactions than is the case globally. African deals on average use only half the levels of debt compared to global private equity, and only a third of the debt used in an average US private equity deal.

Attractive entry multiples, lower absolute entry prices and low levels of debt allow growth equity investors to acquire larger ownership levels and have more influence to position companies for higher growth and exit opportunities resulting in significant value creation.

Low Private Equity Penetration

The scale of private equity across Africa remains modest compared to other markets as Sub-Saharan Africa accounted for less than 4% of total capital raised for emerging markets private equity in 2012. Private equity investment as a percent of GDP in Sub-Saharan Africa was just 0.09% in 2012, compared to 0.86% in the U.S.[43] With private equity activity well behind the levels seen in developed markets, the industry has significant room for growth in Africa. The relative nascence of the market provides tangible benefits, such as greater value and less competition, representing an attractive opportunity for investors.

[41] Africanir, *1,652 Listed Companies in Africa*, (July 12, 2010)
[42] Riscura, Bright Africa Report (April 2013)
[43] EMPEA Industry Statistics 2012

Uncorrelated Returns

Several Africa-focused fund managers have achieved impressive returns for their respective limited partners and have well-established track records. Historically, African markets have had a low correlation with developed and other emerging markets, providing opportunities for diversification. During the global financial crisis, Africa's real GDP growth never dropped below 3.1% and was north of 5% in both 2008 and 2010. Capital inflows to Africa are smaller in magnitude than other developed and developing regions but have been more stable. Inflows to the continent have been positive every year dating back to 1991,[44] which, combined with increasing foreign-exchange reserve levels, have provided a base for stability. Against this backdrop, Africa's demographic shifts are unrelenting, the characteristics of which support the continent's growing consumer class.

Maturing Private Equity Universe

Funds currently in the market exhibit a diverse range of investment strategies and geographic foci. Strategies include generalist funds as well as industry specific agriculture, infrastructure and debt funds. Geographic foci range from pan-African funds to funds focused on particular regions or countries. The pool of investable funds will continue to grow as the market develops further and as experienced investors spin-out or team up with other groups to pursue new opportunities. A large portion of funds in the market can be considered first time funds and the number of first time funds continues to grow. Despite being newer fund managers, African private equity professionals are increasingly more skilled, having built experience with top firms around the globe or at firms within Africa. At the end of 2012, there were over 200 African private equity funds in the market with a median target size of approximately US$100 million.[45]

In 2012, $1.4 billion of capital was raised for Sub-Saharan Africa private equity, roughly in line with the fundraising totals for the previous three years. On the deal side, however, more deals were executed in 2012 than any of the preceding three years. In terms of size, the vast majority of deals, nearly 65%, are under $25 million.[46]

Approaches to Investing in Private Equity in Africa

Institutional investors looking to build African private equity exposure have many options. While the options and their appropriateness typically vary depending on the size, sophistication and risk tolerance of investors, there are a handful of common approaches. African private equity can be accessed by building an in-house platform dedicated to developing a robust program of several local funds, or through commissioning broader investment managers (either global or pan-African private equity funds) or specialized managers like funds of funds. One approach not recommended is an ad-hoc program investing in one or a limited number of local or focused funds, without the necessary diversification to mitigate idiosyncratic country or sector risk. This strategy would not be prudent in developed markets and is certainly not prudent in Africa.

Institutional investors looking to develop exposure to smaller and mid-sized companies in industries benefiting from the growth in domestic demand in Africa may consider developing an in-house platform for African private equity. While this may not be a viable option for all institutional investors, some may

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[44] McKinsey Global Institute, *Mapping Global Capital Markets 2011,* (2011)
[45] Fairview and FMO research
[46] EMPEA Q4 2012 Sub-Saharan Africa Data Insight, 1

find it practical to dedicate the time and resources to developing the knowledge, networks and platform for a full-fledged African private equity program. The commitment to building such a program is significant and undoubtedly entails a learning curve. Staff would likely have to be dedicated to research and due diligence as well as investment and monitoring. In addition, structural aspects such as navigating the diversity of legal and tax systems, languages, customs and cultures would have to be addressed. Once well established, an in-house African private equity investment platform can be a powerful tool for institutions as they look to build a robust and effective program.

If institutional investors are open to investing through outside managers, global and pan-African private equity funds can be a another way to develop a private equity program's initial exposure to Africa. Global private equity funds can provide broad international and/or emerging markets exposure which may include an allocation to Africa. However, depending on their strategy, exposure is likely to be limited and in some cases, global funds may not even guarantee exposure. Pan-African private equity funds can guarantee the full application of a commitment to African private equity deals across the continent, although, fund managers may lack networks in all areas of the continent and may not be able to execute with the expertise of localized managers. Both global and pan-African funds tend to be larger in size, meaning the size of deals they conduct will likely also be larger. A consequence is that they may not develop exposure to smaller and mid-sized companies.

Finally, institutional investors may consider investing though specialized managers employing vehicles such as funds of funds dedicated to African private equity. These types of investment vehicles may be appropriate for a range of institutional investors. Organizations looking to deploy large sums of capital but have restricted personnel capacity may utilize a fund of funds to develop a diversified portfolio of characteristically smaller African private equity funds. Organizations looking to deploy smaller sums of capital may find significant value in diversification. Even organizations in the early stages of developing their own in-house platform may utilize an investment manager to mitigate the learning curve and more quickly develop relationships – in this case transparency and access to managers is vital. One notable advantage of a fund of funds is the breath of diversification they can provide along several dimensions, including geography, sector and vintage year.

In all cases, investment managers developing funds dedicated to Africa should have the expertise, personnel, networks, systems and experience, ideally though a demonstrable track record, to execute well. Just as important is an investment manager's ability to provide an investment vehicle that will prudently and efficiently address all legal, tax and accounting matters so that the experience for the investor is seamless. Lastly, institutional investors should consider the strategy offered by investment managers. Strategies will likely vary, but those targeting consumer-oriented opportunities are likely to benefit from the demographics and trends supporting the relentless growth of the African market.

About FMO-Fairview

The Netherlands Development Finance Company ("FMO") and Fairview Capital Partners ("Fairview") in partnership have formed FMO-Fairview Africa Fund, LLC ("FFAF" or the "Fund"). The Fund will provide institutional investors with access to attractive and diversified private equity investments in the high growth markets of Africa. The partnership draws upon the track record, investment expertise, processes and infrastructure of FMO and Fairview.

Established in 1970, FMO is a leading bilateral development finance institution based in The Hague, the Netherlands, and has committed over US$1.7 billion into private equity investments throughout the world's emerging markets. FMO has been investing in Africa for over 42 years and in African private equity for 18 years. FMO has built extensive geographical coverage of the African continent through well-established relationships with fund managers and other local partners. Currently, there is a 12-person dedicated Africa Private Equity team with a constant presence on the continent.

Fairview is a US-based private equity investment management firm established in 1994 and manages 18 funds of funds and customized separate account portfolios with an aggregate capitalization of US$3.4 billion. Fairview's clients include public and corporate pension plans, endowments and other institutional investors. Fairview has a highly skilled investment and finance team that has experience investing in established and new private equity partnerships.

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