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**From:** Judith McHale <[redacted]>  
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**To:** H  
**Subject:** Africa

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I know you are in the middle of a marathon trip but given your interest in Africa I thought you might find this piece from the FT of interest. Figured you could file it away to read at some point in the future. Interesting in terms of both the financial challenges and opportunities facing SMEs across Africa. I'm heading to DC on Monday for some meetings aimed at restarting the Fund I was involved in before I went to State. I do believe there are pockets of capital here and elsewhere, particularly in the Middle East, that we might be able to tap for an initiative to help support and grow the critical consumer goods and services sectors across Africa.

Take care and safe travels.

Judith

### **African private equity: start small-ish**

June 27, 2012 10:51 am by Rob Minto



With Africa playing catch-up on developed countries and other emerging markets, it's easy to focus on the infrastructure projects or the big consumer market plays. And at the other end of the spectrum, for (really) small investments, there's microfinance.

That leaves something of a "forgotten middle": African SMEs with the potential for high growth but are not big enough to get on the radar of most western investors, and have trouble getting lending from local banks.

Large private equity funds in Africa will, by virtue of their size, grab the attention. For example, in May, Brazilian billionaire André Esteves launched the biggest private equity fund for Africa, promising to raise at least \$1bn for investments in energy and infrastructure.

A fund of this size can hardly invest in SMEs, where deals are usually under \$10m. But the value of big projects to an economy can be hard to measure, whereas the smaller players keep the engine running. In developed economies SMEs are crucial for employment: as much as two-thirds of jobs in Europe are from SMEs, and African figures suggest a similar ratio could be attained.

So stepping into this middle ground are some niche PE funds, keen to capitalise on the rise of the African consumer, and the continent's growth in general. For example, Jacana Partners, an SME specialist, look at deals around \$1m-\$5m. Jacana has around \$35m in assets under management in two funds, and is looking to raise a third fund of \$70m, and also expand the countries of operation.

TLG Capital, another small business specialist in Africa, recently converted to being an investment holding company from a PE fund. According to founder Zain Latif, they don't do deals over \$15m. TLG's total investment value is around \$22m, but it is hoping to increase to \$30m by the end of the year. "Our biggest deal is \$10m-\$12m, but in some countries that goes a long way."

According to numbers from the Emerging Markets Private Equity Association, PE fund-raising for sub-Saharan Africa hit a high of \$2.2bn in 2008 – last year saw \$1.3bn. Compared to the US market high point of \$325bn in 2007, it is small beer. But compared to say, central and eastern Europe and the CIS states, with \$1.7bn last year, it looks respectable.

Yet for many dealmakers, it's hardly worth getting out of bed for. As Anthony McWhirter of Debevoise and Plimpton, a law firm that advises PE clients, pointed out to beyondbrics: "The Alternative Investment Fund Managers Directive regards a 'small' fund [in developed markets] as under \$500m. For Africa, \$50m is a comparable figure."

Which prompts the question – why bother? PE funds in this area tend to emphasise the "doing good" aspect. TLG Capital refers to "commercial and social returns". Jacana's founders have a strong track record in philanthropic ventures. But there is also good money to be made.

So what's the approach?

According to Simon Merchant of Jacana Partners, which invests in SMEs in six sub-Saharan countries, there's no substitute for expertise – and that is what is usually lacking in smaller funds: "You often get first-time fund managers using African funds as a springboard to something bigger – and that means the expertise and know-how doesn't get built up. Any SME experience moves on."

Jacana can take 12 to 18 months from first meeting an African entrepreneur to investing in the business. And then, the deals are often a not your typical straight equity approach. Often a blend of financing options are used, including royalty structures or loans: so-called 'mezzanine financing'. This is partly due to suspicion or unfamiliarity with PE among some African businesspeople. When getting money has always previously meant going to the bank for a loan, having an equity partner involved is a very different experience.

Jacana also dedicates people on the ground, rather than managing the investments from afar. Again, for mainstream PE funds to dedicate management expertise, deals have to be "big enough to move the needle", as Merchant puts it. That normally isn't the case for deals focusing on small businesses in Africa.

However, this isn't charitable work. "We think about the exit right from the first meeting," says Merchant.

Jacana said its first fund, set up in 2002, was run for a development agency. For its second and third funds, investing money put up by the Jacana partners and by private investors, it is aiming for 15 per

cent returns per year in hard currency. "For some of these businesses, they just need that extra jump, and then you can hardly not make money."

TLG expects 20 to 30 per cent increase in value in assets, with at least 10 per cent annual return as a cash yield. TLG moved from being a private equity fund to an investment holding company for a few reasons, according to Latif: "The fund structure isn't always optimal [in Africa]. A typical seven-year exit isn't always easy to do. There's also a wider spectrum of investors, as you can sell shares in the deals we've done already." The investment company structure is also cheaper, he adds.

Of course, for investment companies and PE funds there are challenges. As Philipp von Holst of Debevoise and Plimpton pointed out, for many African countries private equity is a new form of investment that requires new forms of regulation. "Add in political risk, exchange risk and possible corruption, and for some investors it simply isn't worth it."

But yet they will come. "There is investor appetite. There's a perceived lack of deals in Europe, on top of the euro crisis. Africa is viewed as a good opportunity, with low valuations and good growth forecasts," says von Holst. "Plus first time movers are having success."