

Changing faces

Europe has been the main hunting ground for managers looking to raise private equity funds for Africa. However, recent private equity regulatory changes in Europe may now see managers look more to the US, where institutions are warming to Africa as the last frontier for growth.

Tom Minney and Gail Mwamba report



FOR A GOOD NUMBER OF fund managers, looking for commitments for Africa-focused vehicles has been a less painful exercise in Europe than in the US. Europe-based institutions have been able to leverage legacy ties from their days of empire, which has also given them a better understanding of Africa's business cultures across different regulatory jurisdictions.

A quick scan of private equity fundraising activity for the African market over the last decade reveals the heavy involvement of groups such as UK-based Commonwealth Development Corporation (CDC), which is understood to have committed more capital to the region than any development financial institution (DFI).

CDC currently has an African portfolio worth \$1.4bn (£877m) and is planning to commit about 50% of its new commitments to investments in sub-Saharan Africa (SSA). Other top Europe-based institutional players in the market have been Germany-based DeutscheInvestitions- und Entwicklungsgesellschaft mbH (DEG) and Proparco, a French DFI, and Netherlands Development Finance Company (FMO).

Tapping Europe-based investors for commitments is however going to become a very complicated process, as new European Union rules come into play. Non-EU fund managers, as of 2015, will be required to apply for a 'passport' that will enable them to market their funds across Europe. The new set of rules, called the Alternative Investment Fund Manager (AIFM) directive, has

been structured to add new compliance requirements, primarily targeted at private equity and hedge fund managers.

Despite rigorous debate concerning the overreaching supervision of managers, the European Union (EU) Parliament Economic Committee have provided backing to the directive. The directive stipulates increases to initial capital requirements, greater transparency and operational changes that affect all fund managers. The rules broadly impose stricter rules on non-EU investors, who among other things will be additionally required to appoint an EU-based legal representative as a point of contact.

Tarred with the same brush

Private equity managers have tried to argue that they should not be placed in the same basket as hedge funds who traditionally tend to take more risks. However, their complaints have so far mainly fallen on deaf ears. Criticisms of the directive have included its ambiguity in many areas, which has left a number of managers scratching their heads to figure out implementation.

For instance, EU member states are expected to have fully implemented the new regulations by 2013. Non-EU managers, however, will only be able to apply for the 'passports' in 2015. It therefore remains unclear how the regulation will pan out in the short term. The implication is that the managers will be able to market their funds as they do at present.

The bigger issue for non-EU managers, however, is the amount of capital they will have to hold to be able to be given a passport to market their vehicles in Europe. This rule applies to all managers, including EU-based groups. Fund managers will be required to have at least €125,000 of their own funds and an additional 0.02% of the amount by which the value of their portfolios exceed €250m.

The European parliament and council put a cap of €10m on the total capital required for an initial investment (the minimum is at least €125,000 + 0.02%). Managers must also ensure that at least 25% of the fund's target is made up of their own money before they can try to market the fund in Europe. Smaller funds have an opt-in provision, if they want to obtain the passport.

As such, managers seeking funds from groups such as the CDC will also have to ensure they abide by these rules. Although the rules stifle the growth of the global private equity industry, emerging markets will be the worst hit, according to Sarah Alexander, chief executive at the Emerging Markets Private Equity Association.

“The directive could effectively kill private equity as a source of development finance in the world’s poorest countries,” she says in a letter to the Financial Times. “In the developing markets private equity is often the only finance option available, and it is the most efficient, driven by professional investors who manage the funds.”

Recent developments in the UK also mean funds should expect to get less commitments from the CDC. The UK secretary of state for international development, Andrew Mitchell, is leading a public consultation into the reform of CDC, which would include the resumption of direct investments – a move away from its current fund-of-funds investment model.

US investors know what they are missing

While a cloud of uncertainty hangs over future commitments from Europe, US-based institutional investors are opening their doors wider to Africa-focused fund managers. US investors are quickly realising that they have spent too much time on the back bench, when it comes to Africa, and have lost out on opportunities to snap up reasonably priced assets and generate mouth-watering returns.

“US investors will be coming into Africa in a big way,” says Rafael Stone, a Seattle-based attorney at Foster Pepper, a provider of investment advisory services to institutional investors looking to invest in Africa. “There are tremendous opportunities, and I think you are going to see a lot more than \$750m funds coming into Africa from the US.”

Private equity funds flowing into the African market will also be bolstered by giant US-based fund managers structuring Africa-focused funds. Carlyle earlier this year announced that it was setting up local presence in Johannesburg and Lagos, which to some signalled that equity investment in Africa is indeed going mainstream. The significance of the move lies in the fact that, as investors hunt in packs, the global giant putting its stamp of approval on the continent means that others will soon follow suit.

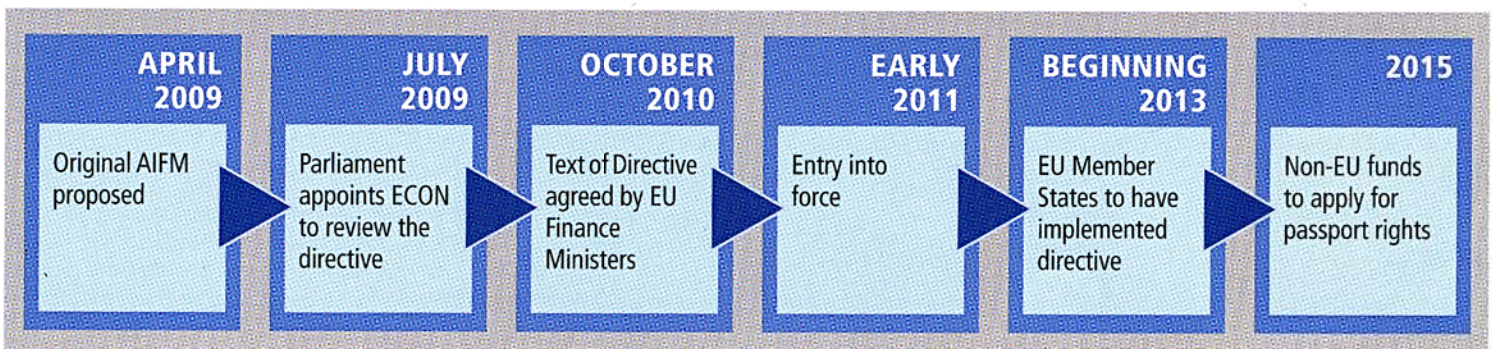
Carlyle was ranked as the second largest global private equity group by Private Equity International in 2010 – having raised nearly \$48bn in the preceding five-year period. The group was only surpassed by Goldman Sachs which had raised \$55bn for direct private equity investing – over the same period. Carlyle’s backers include the California Public Employees’ Retirement System (CalPERS), one of the biggest private equity institutional investors in the US.

“Our experiences speaking to American institutions about investing in Africa have been quite positive,” says Walé Adeosun, chief investment officer at Kuramo Capital Management, a New York-headquartered company that invests on behalf of US-based endowments and foundations. “Capital flows from US investors will come, for as long as Africa continues to offer good returns.”

Education, education, education

Even so, managers may have to wait a little while longer before the capital floodgates fully open for Africa. A good number of US-based investors are yet to gain an adequate understanding of the African terrain, in terms of differences in business cultures, opportunities and risks across different regions and countries. As such, managers are still faced with the task of having to spend a significant part of their pitching time educating the investors.

Alternative Investment Fund Manager Directive – Implementation timeline



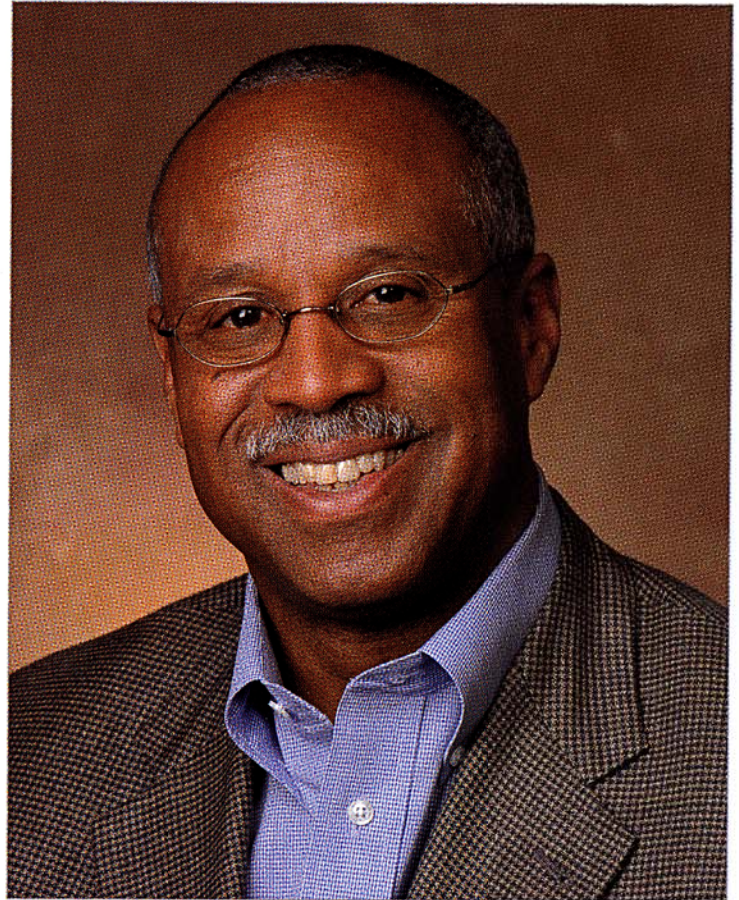
“One problem with Americans is that we seem to think that Africa is one country,” says Stone. “There is a lot of education that has to take place with respect to Africa.”

Even those that have adequate knowledge of the market have, however, been deterred by the low number of specialist funds operating in Africa. Specialist managers remain a strong preference for a significant part of the US investment community, according to Stone. This is because they can rest in the knowledge that the manager has an in-depth understanding, expertise and skills to be able to generate healthy and sustainable returns in a specific sector. In the past, some US investors have opted to co-invest in specific deals that they feel the manager has expertise in, and not in the whole fund.

“The problem that we have had is that Africa has funds that invest across multiple sectors, and we really do not invest that way,” explains Stone. “We are more comfortable in investing in a manager that is a specialist in a particular sector, than someone that has an array of options with our dollars.”

Some managers are waking up to the merits of differentiating themselves as specialist players in the market. Adlevo Capital last year announced the first closing of its maiden \$100m technology fund, which has received backing from a number of US investors. Phatisa Group also entered the market with a \$135m vehicle, targeting the agriculture sector. Aureos Capital is also on track to close its \$100m healthcare fund, which counts the Bill & Melinda Gates Foundation among its backers.

A number of market participants, however, say that the US interest in Africa is a lot of talk, and not much action. Whether this is true or not remains to be seen. However, what the industry is certain to see over the medium- and long-term is a change in the faces of institutional investors backing Africa-focused managers.



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Sample of specialist funds investing in Africa

Fund manager	Fund name	Fund size	Key investors
Adlevo Capital Managers	Adlevo Capital Fund	\$100m	EIB, CDC Group, IFC
Phatisa Group	African Agriculture Fund	\$135m	AFD, AECID, Proparco, IFAD, AfDB, DBSA, BOAD, EBID, AGRA
Seven Seas Capital	Africa Healthcare Fund	\$135m	IFC, AfDB, Gates Foundation, DEG
East Africa Capital Partners	Africa Telecommunications Media & Technology Fund	\$100m	OPIC, private US investors, Emerging Capital Partners
African Capital Alliance	Capital Alliance Property Investment Company	\$200m	IFC, AFC, OPIC
African Health Systems Management	Investment Fund for Health in Africa	€50m	Goldman Sachs, African Health System Management Company, AfDB, Pfizer, FMO, APG, IFC, Social Investor Foundation for Africa. Contributors to SIFA include: ACHMEA, AEGON, Heineken, Shell, SNS-REAAL and Unilever

Source: Preqin