Realizing Africa's Economic Promise through Private Equity

Keynote Address:	Arunma Oteh, OON, Director General, Securities and Exchange, Commission, Nigeria
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1. It gives me great pleasure to be here and I am very delighted to give the keynote address at this year's Private Equity in Africa Summit. I feel particularly honoured considering the high caliber of keynote speakers at past editions of this event and because of the high-profile delegates in the audience today. I commend This is Africa and the Emerging Markets Private Equity Association (EMPEA) for the great initiative to organize this summit

which is in its fifth edition. This is indeed a unique platform for exchanging ideas and sharing experiences about opportunities and challenges of Private Equity (PE) and Venture Capital (VC) in emerging markets.

2. I have three important messages to convey through this address. My first message is that private equity is more than just an asset class; it adds value to companies, generates growth in the economy and transforms the society. Secondly, I will be making a strong case for investing in Africa not just because of its famous natural endowments but more importantly because of many other opportunities it offers beyond commodities and PE has a critical role to play in harnessing these opportunities. Lastly, I will highlight some of the key reforms governments across Africa have been making especially because of the unique perspectives I bring as someone who has been championing such reforms for the last three and half years.
3. The PE/VC industry has really come a long way and has recently been attracting a lot of attention both from regulators and from the public at large. I see this new scrutiny as a unique opportunity that the industry must leverage to enlighten the general public about the immense value private equity adds to an economy and its transformative effects on the society as a whole.
4. As an asset class private equity stands out among the pack in terms of returns to the investor. Research by Ernst & Young revealed that PE investments outperformed investments in comparable public companies by a factor of 3.6 times in Europe. A similar study of North American PE deals showed that PE-backed firms produced returns of more than 5-fold that of investor returns on publicly held companies. Research on major pension funds in Canada recently found out that private equity brings the largest returns for pension fund administrators as shown in the figure below.

   Returns to Canadian Pension Funds (2002 to 2012)

Source: Bain & Co.

5. However, it is very important to note that private equity is not just an asset class and private equity investors are not like regular institutional investors. In addition to providing capital, PE investors, like you, get involved in the operations of a business, influencing the business strategy, providing guidance on ways to cut cost, boost innovation, improve operational efficiencies, enhance corporate governance and accountability within the business and ultimately nurturing the business to maturity. Many of the world's most famous and largest corporations today attest to the transformative effects of PE. Who would have thought that when Andy Bechtolsheim gave Larry Page and Sergey Brin US$100,000 to start up a company called Google that it would grow to have one of the largest market capitalizations in the world? The question could be asked of other companies backed by PE investors in their early days; Microsoft, Apple, Facebook, Federal Express in the US, MTN in South Africa and Nigeria, Brookside Dairy in Kenya, Voltic Limited in Ghana and so on.
6. Private equity is not just transformative at the level of a company but when the right ecosystem is created, PE and VC can transform an entire nation and indeed the world at large. One of my favorite examples of how venture capital has been able to accomplish this feat is the State of Israel. The Israeli government made the right choices in 1993 aiming to create an ecosystem that brings together entrepreneurs, venture capital funds and government

agencies to catalyze the innovation. That quickly attracted venture capital from all over the world into Israel making it have the deepest VC industry in the World with $170 venture capital committed per capita compared to second placed United States with $75 per person. Thanks to the vibrant VC industry in Israel, the small country has more companies listed on NASDAQ than the whole of Europe and invented some of the most widely used technologies in the world including instant messaging and flash drives, as well as a plethora other medical, computing and security devices.

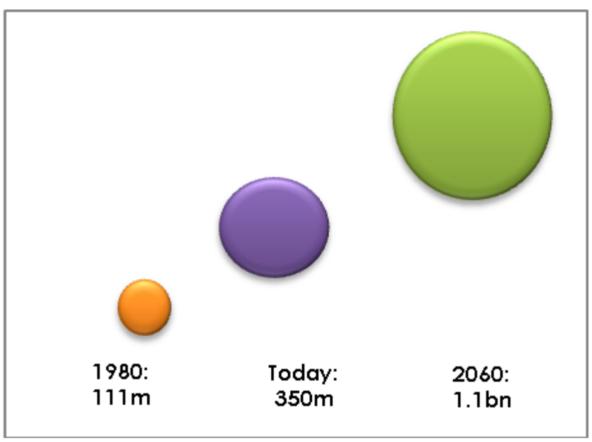
7. Last year, for the first time, up to 20% of the $200 billion raised by private equity firms went to emerging markets including countries like South Africa, Nigeria, Kenya, Columbia, Chile, Peru, Mexico and the BRICs. These huge inflows reflect the desire of PE investors to cash into the amazing growth in these countries. Africa embodies the ideal concept of an emerging market not only because of the high growth it is currently enjoying but also because of the structural transformation on-going across the continent. The IESE publishes annually the Private Equity Country Attractiveness Index which captures the amazing progress Africa has made in major areas that concern investors including Economic Activity; Depth of Capital Markets; Taxation, Investor Protection & Corporate Governance; Human & Social Environment; and Entrepreneurial Culture & Deal Opportunities.
8. What Africa has achieved over the last two decades is indeed praiseworthy. More than 80% of Africans today are enjoying democracy and responsible monetary and fiscal policies have sustained macroeconomic stability in most parts of the continent. Gross Domestic Product (GDP) has grown on average above 5% over the last twelve years while inflation has been brought under control from upward of 20% in the 1990s to single digits presently. Most African economies have enjoyed stable exchange rates over the last five years, trade and public deficits have eased and are maintained within acceptable

limits. Other governments have even gone further to build buffers to help insulate their respective economies from external shocks.

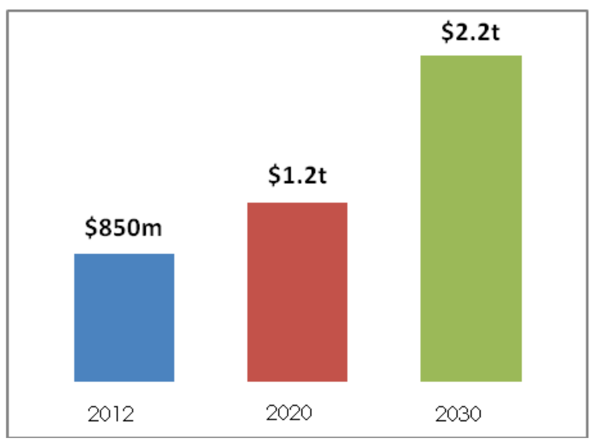
9. As a result of this favorable macroeconomic environment, Africa continues to be among the leading growth regions of the world as six of the ten fastest growing economies over the last decade are African. Africa is the only continent whose growth for this year has been reviewed upward by the World Bank within the context of a weakening global growth and concerns over a slowdown in the BRIC and East Asian economies[1].

10. Africa is poised for even better growth rates considering its huge human and natural resources. In terms of human resources, the continent is the youngest[2] and fastest growing population[3] and also has the fastest growing middle class in the world. The growing middle class in Africa is spearheading a consumer spending boom expected to top US$1.4 trillion by 2020 according to the McKinsey Global Institute.

Growing Middle Class in Africa



Growing Consumer Spending in Africa



Source: African Development Bank

[1] On 8th October IMF cut global growth forecast to 2.9% this year, a cut of 0.3% from July's estimate; forecasts for East Asia, Europe, the US and latin America were also reviewed downward.

[2] Median age is currently about 20 in Africa compared to a world average of 30.

[3] Africa's population increased from 703 million in 1994 to a projected 1.2 billion in 2014. The UNDP expects Africa's population to double by 2050 to 2.4 billion.

11. Africa is richly endowed with natural resources. It is home to some of the world's most coveted resources including 30% of the world's total hydrocarbons and mineral reserves, 12% of the world's crude oil reserves, 42% of the world's bauxite, 38% of uranium, 42% of gold, 88% of diamonds, 44% of chromite, 82% of manganese, 95% of vanadium, 55% of cobalt and 73% platinum. The continent also boasts a quarter of global arable land and 60% of the world's uncultivated arable land.
12. Africa's impressive growth has led to equally impressive performance of private equity funds focused on Africa. The International Finance Corporation (IFC) recently reported that its Africa portfolio has historically outperformed its entire emerging market portfolio between 2000 and 2010 with an average 21.7% annualized return. In the same vein, Cambridge Associates and the African Venture Capital Association (AVCA) analysis revealed that African private equity funds outperformed U.S. venture capital over the last ten years posting an 11.2% annualized return. For 10-year periods ending between 2008 and 2010, African PE firms beat the 10-year emerging markets benchmark[4]. Returns for the 10 years ending in 2010 were 13.9% for Africa-focused PE firms, compared with 10.7% for emerging markets. In 2008, the difference was even more remarkable, 10.2% for Africa compared with 3.1% for emerging markets. It is therefore not surprising the interest level PE investors continue to show in Africa in recent times. I am delighted that private equity investors have been at the forefront investing in Africa and the entry of some of the biggest General Partners (GPs) in the world including Carlyle, Blackstone, KKR, Warburg Pincus. Carlyle launched a sub-Saharan Africa fund of about $750 million with offices in Lagos and Johannesburg; Blackstone has been investing in Africa for nine years now; Helios has gathered up to $900 million

[4] Over 40% of the funds in the African Private Equity and Venture Capital Index beat the broad emerging markets median fund for their vintage year, according to the Cambridge Associates.

for investment in sub-Saharan Africa; BTG Pactual has raised $1 billion dollars targeting Africa. In addition, a survey conducted by EMPEA found that a majority of Limited Partners (LPs) said they were planning to begin or expand commitments in sub-Saharan Africa. There are currently over 200 PE funds in Africa with well over $33 billion in capital closed since 2002 as Africa's share of total emerging market fundraising has doubled[5] over the last 5 years. Interest and activity of PE firms in Africa are becoming more geographically diversified. Last year US$1.16 billion was invested across 58 deals in Africa, 45% of which occurred in Kenya, Nigeria and South Africa. By contrast, these three countries accounted for 60% of deals in 2011.

13. Now let me focus on the role that capital markets play in enhancing the ability of private equity to transform Africa. Private equity investors consider the level of sophistication of a domestic capital market as an important consideration in their investment decisions. However, many people take the simplistic view of capital markets as mere exit channels for private equity investors but the capital market is much more than just exit window for PE. Capital markets are known to play a critical role in the economic development of a country because they serve as an important source of affordable medium to long term capital for businesses and also provide resources for building infrastructure. In this way, the capital market helps to create an enabling environment for businesses to thrive thereby paving the way for private equity investments in those businesses. But capital markets are not just important for raising money, they also engender good governance and accountability while promoting transparency. Capital markets enable wealth creation and distribution which foster political stability and social cohesion. They democratize access to prosperity and champion meritocracy.

[5] EMPEA data shows that in 2007 sub-Saharan Africa's share of total emerging market fund raising was 3% by 2012 the region's relative share improved to 6%

14. African capital markets have undergone a lot of reforms aimed at preparing them to perform these roles efficiently. Securities regulators in Africa who are members of the International Organisation of Securities Commissions (IOSCO) employ regulatory best practice in line with IOSCO's 38 principles of securities regulation. These principles clearly mandate regulators to ensure the integrity, fairness, orderliness and transparency of the capital market in a manner that engenders investor confidence.
15. Permit me to use Nigeria as a case study to illustrate the tremendous reforms that are taking place within African capital markets. The NSE's market capitalization has grown by more than 3,000% between 1999 and now and has grown in both breadth of product offering as well as in liquidity. In 2010 we intervened to change the management of the Nigerian Stock Exchange (NSE) in response to a forensic audit which revealed various forms of wrongdoing. Our goal was to maintain the integrity of the exchange and of our market as well as strengthen it. We therefore paved the way for a new team in a bid to professionalize the management of the exchange. We are delighted by the commitment of the NSE management team has shown in upgrading the exchange's ICT capabilities including the introduction of a new trading platform, the X-GEN as part of efforts to prepare our market for the future. We approved new listing rules for the exchange to encourage companies to list, especially upstream oil & gas and telecommunications companies while advocating the eventual listing of just-privatized power companies in the country. To further boost liquidity in our market we introduced market making and securities lending. Since we started our reforms the market capitalization has almost tripled.
16. African capital markets are a lot more sophisticated than most people realize and some of them have been among the top performing exchanges in the world for the past few years. Year-to-date (YTD)Ghana Stock Exchange is at

number one globally at 72.56% YTD appreciation. While their nascent status is most times taken to mean that they cannot serve as proper exit channels African stock markets still show that an initial public offering (IPO) can still occur and the example that took place last year is instructive to show that there is actually a hunger for listing in African markets. In 2012, Actis promoted Umeme, the Ugandan national utility distributor, initially on the Ugandan Securities Exchange (USE) and then cross-listed on the Nairobi Stock Exchange where the offer was oversubscribed by 37%. In the deal, Actis sold shares worth $66.73 million and retained a 62% equity stake in the business.

17. Astute investors have been innovative when it comes to exits in Africa. Data released by AVCA and Ernst & Young showed that more exit activities occurred than most observers expected as PE managers found innovative ways to achieve exits. According to the study, there were 118 known realizations[6] in sub-Saharan Africa between 2007 and 2012, 42% of which were in South Africa. West Africa had the second highest portion of exits, 25%, while the 3 other regions each accounted for 11% of exits. 2012 saw 22 known exits; being the best year (by number) since the global financial crisis in 2007. This shows that Africa is weathering the storm quite impressively. Looking at the exit by sector, financial services was the most active accounting for 23% of exit numbers indicating that investors are looking to cash in on the expected growth of the sector due to rising household incomes and improving financial inclusion figures.

18. Performance of other sectors in the realizations show that investors are paying attention to the growing middle class in Africa and the attendant consumer boom. Food and beverage (9%), Telecommunication (8%), Health Care (5%), Travel and leisure (3%) and Consumer goods (2%) combine to form 27% of total number of exits. Still on exits, the Ernst &Young/AVCA study showed a maturing PE industry in Africa as firms become established and

[6] Many of the sales are concluded privately making it difficult to obtain an accurate figure of the number of exits.

raise more funds. This is evidenced by an increasing share of secondary buyouts (sale from PE to PE) in total exits, while secondary buyouts accounted for only 12% of exits in 2007, last year they accounted for 23% of sales by PE firms. Even with the lack of depth and insufficient liquidity of some African stock exchanges stock sale on public market and initial public offerings (IPO) occur.

19. Apart from making it easier to do business, African governments are taking the venture capital approach as well, taking a lead from Israel's sterling example to set up technology incubators. In Nigeria for instance the Federal Government set up a $15 million ICT Innovation Fund with a seed capital of $3.5 million to enable the emergence of an ecosystem for ICT entrepreneurs. The Kenyan Government has equally championed such initiative launching a $1.6 million technology incubation centre in January this year. There are similar initiatives across the continent recognizing that technology not only permeates all aspects of our lives from leisure to medicine, from productivity tools to entertainment, but is also most relevant to a teeming youthful population in Africa. It is important for Africa to develop homegrown ICT ecosystems because the world is moving from a resource-based economy to a knowledge-based economy. India which started such investments before Africa is reaping the benefits supplying Silicon Valley with armies of engineers and entrepreneurs and also developing a homegrown software industry with annual software exports in excess of $50 billion.
20. I know you may be wondering which sectors in Africa I consider most promising and the truth is that the choice is a tough one. Picking companies to invest in is more of an art than science so in my opinion PE can target sectors that can have the greatest impact on other aspects of the economy such as Healthcare, Infrastructure, Real Estate, Agriculture, Manufacturing and ICT. Infrastructure is a challenge in Africa but also remains one of its most

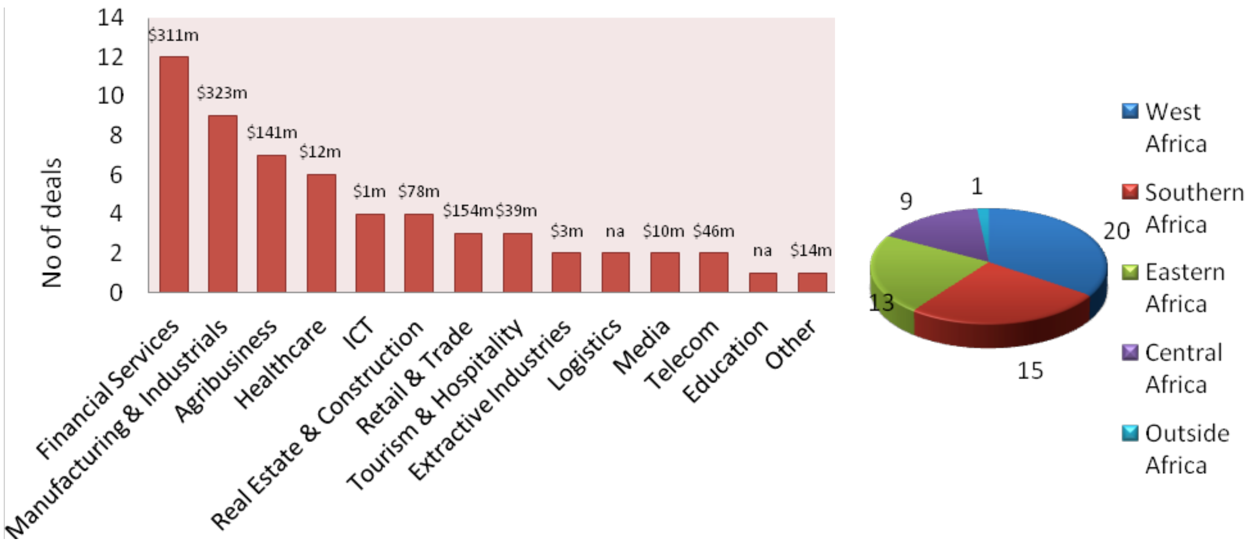
attractive opportunities. Africa needs massive investments[7] in power, transportation and sanitation infrastructure over the coming decades, these investments will further propel the continents growth and generate attractive returns. Housing is another area with massive needs and potential for outsized returns. Agriculture and ICT have predominantly SME participation in Africa and I believe they are sectors that provide the PE manager with unique sets of opportunities to make the kind of impact desired. Agriculture for example is already a major employer of labour on the continent but these are disaggregated small-holder farmers who lack back inputs, storage capacities and access to market. By supporting an SME into agriculture, the fund manager can help aggregate a number of these farmers, improve the entire value chain and enhance the capacity of the business. This can have immediate impact on the lives of thousands of farmers and by implication their families and society. Nigeria recognizes that private equity can help achieve this in agriculture and has partnered the German KfW to establish a fund called Fund for Agricultural Finance in Nigeria with seed capital of $27 million, the fund is expected to grow to $100 million by 2015. The Fund will have an average investment size of $2-3 million with a minimum investment size of $500,000 in debt, equity and hybrid instruments.

21. When you look at the sectors that have attracted the most attention from PE fund managers, you will agree with me that private equity can indeed lead to the diversification of African economies.

Number and Value of Deals by Sector in sub-Saharan Africa in 2012

Number of Deals by Region

[7] Nigeria alone needs to invest US$350 billion over the next 10 years (ADB) and $3.9 trillion within the next 30 years (Nigeria's Integrated Infrastructure Master Plan)



Source: Deloitte Research

The Manufacturing sector which has struggled in Africa over the years got the largest share, US$323 million of deals closed last year followed closely by financial services.

22. I will round up my remarks by focusing on an area related to what I have been involved in for the last three and half years which is securities regulation and capital market development. I believe what we have been doing in the capital markets is critical for the future of venture capital and private equity in Africa and also for the entire economy. The relationship between capital markets and PE is an intriguing symbiotic relationship that sometimes appears contradictory. Private equity takes companies off the stock exchanges and brings new ones in a fascinating fashion. When a publicly listed enterprise is struggling, PE investors make it a private company to improve the company's business. At the same time, PE also takes up small unknown companies and converts them into Twitters, Facebooks, Apples, Microsofts, MTNs, helping to deepen capital markets and the entire financial system by listing these companies. But what exactly does the capital market hold for private equity? Capital markets provide the liquidity that give PE investors the

comfort to support entrepreneurship, without the possibility of exits (which capital markets provide) PE cannot develop. That is why securities regulators in Africa mostly have a dual function to regulate and develop their respective markets and they have indeed been doing so much of that. Over the last three and half years I have been chairing the Africa Middle-East Regional Committee (AMERC) of the International Organization of Securities Commissions (IOSCO) and I have first-hand knowledge of the efforts my colleagues at AMERC and I are making to deepen African capital markets. In my time as Director General of SEC Nigeria, we took giant steps to strengthen and deepen our capital market, particularly the Nigerian Stock Exchange (NSE). In 2010 we intervened to change the management of the NSE with a goal of professionalizing the running of the exchange. We introduced new listing rules to encourage SMEs and other companies with great business plans to list on the exchange without the usual requirement of long track records. These new listing rules which take into account the peculiarities of different industries will attract listings from upstream oil & gas and telecommunications sectors. We introduced market making and securities lending to boost liquidity and we are pushing for the eventual listing of newly privatized power companies to further deepen our market. Since we started our reforms the market capitalization has almost tripled and Nigeria, along with other exchanges in Ghana and Kenya are among the top performing stock markets in the world year-to-date.

23. It is truly an honour being a part of the transformation going on in Africa and I am delighted by the level of interest the PE world has shown in that process. A hundred years from now when historians are penning down the history of how the 'hopeless' continent transformed into the 'hope' of mankind, I hope that they will reserve a special chapter for private equity detailing the amazing accomplishments that may otherwise not have been possible without private equity and venture capital.

Thank you for your kind attention.