FOCUS ON WEALTH

Not much to show off

Very little money is flowing into Africa despite its major investment opportunities

Africa is seen as a major opportunity for investors and growth-orientated companies, but because of economic conditions, little new money is flowing into the continent.

Meanwhile, nervous investors sit on the sidelines.

Imara Asset Management chief executive John Legat says there is not much investment into Africa at the moment, whether by companies making direct investments or through investing in African equities.

"There has been very little activity on African stock markets for the past 18 months to two years, as indicated by the daily volumes on the various bourses.

"This is as a consequence of the weakness we have seen in emerging markets relative to developed markets. Africa as a frontier market has followed this trend.

"Arguably though, we are probably nearing the end of this period of underperformance from emerging markets," Legat says.

He points out that over the past 20-30 years there has been a high correlation between the strength of the US dollar and the weakness in emerging markets.

John Legat
Weak dollar good for commodities

WHAT IT MEANS

NOT MUCH INVESTMENT COMING INTO AFRICA

CORRELATION BETWEEN DOLLAR STRENGTH AND WEAK MARKETS

"The dollar is nearing or may have already reached its peak. The trade-weighted dollar has gone up about 40% over the past three years and the last time it moved that much was in 1997 during the Asian crisis. Therefore, it is probably coming to the end of its strength," Legat says.

He says a weaker dollar bodes well for commodity prices and this is reflected in a recent rally in commodity stocks in anticipation of stabilisation or even a bounce-back in commodity prices.

If there is a positive shift in emerging markets, Africa is likely to follow the trend — though with a time lag — and see greater strength in its share prices.

"Stock market valuations in Africa are about where they were in 2009 in dollar terms.

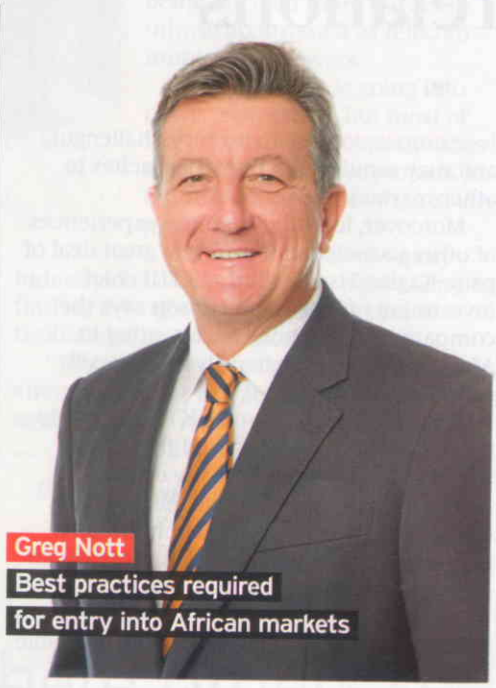
"Valuations, low p:es and high dividend yields suggest that we are close to a bottom. While prices may not go up any time soon, the worst seems to be over," Legat says.

In the short term, risks are high with countries poised to devalue their currencies, though much of this is already discounted in the share prices. In the longer term, risks are much lower.

Legat says foreign direct investment into Africa is continuing but probably not at the same pace that occurred four to five years ago.

Norton Rose Fulbright SA head of Africa practice Greg Nott says when SA companies consider moving into Africa their conduct across Africa must be beyond reproach.

"It has never been more important than now for SA companies to be on their best behaviour when operating in other African countries.



Greg Nott
Best practices required for entry into African markets

"Fences are still being mended after last year's xenophobic outbreaks and the moribund SA economy is forcing local businesses to look north for growth.

"When they do so, SA companies will increasingly find themselves jostling for space with a growing number of Asian and European investors," Nott says.

He says government's new guidelines on how SA companies should conduct themselves beyond this country's borders come at an opportune time.

The recently released "Guidelines for Good Business Practice for SA Companies Operating in the Rest of Africa" is a positive step that should help protect the reputation of SA and its companies.

"Though voluntary, the guidelines do have a legal context. They were developed to be consistent with the laws of SA and host countries, and draw on internationally recognised standards such as the UN Global Compact, the SADC Charter, King 3 and the OECD's Guidelines for Multinational Enterprises.

"However, the most compelling reason for companies to toe the line is the positive impact this will have on their business at home and across borders. Good business practices are good for business," Nott says. ■

RISK MITIGATION

Focus on healthy relations

Investing in Africa can be very challenging and may require different approaches to other markets to be successful.

Moreover, learning from the experiences of other participants can save a great deal of pain. Kagiso Tiso Holdings (KTH) chief investment officer Jacob Hinson says the company's motivations for investing in Africa are focused primarily on diversification and growth.

Over the past four years KTH has made three direct investments, and through its investee companies has made even more.

In terms of lessons learnt, Hinson says the company has learnt not only from its own experiences but also from those of other companies investing in Africa.

He says the hardest lesson of all is currency risk. In one transaction, KTH was able to structure the deal in such a way that a portion was local currency denominated while the balance was US dollar denominated, in terms of convertible instruments and straight equity.

"After we invested, the currency depreciated by about 20% and had we not been partially hedged we would have taken a significant early-stage knock on our investment," Hinson says.

Without a hedge, the potential risk is high and the financial pain can be severe.

For example, in a subsequent investment into Nigeria where KTH was not able to structure a hard currency hedge, the currency once again fell shortly after the investment was made.

"It is not always possible to hedge the full currency exposure but even having a portion of the investment hedged can prove very helpful, especially in the short term. In the long term, we expect these investments to outrun currency depreciation and provide attractive dollar returns," Hinson says.

He says KTH's experience also shows that the next most valuable lesson to learned when investing in Africa is the importance of prior knowledge of the counterparties. Relationships are a key to success on the continent.

KTH, for example, is not interested in the flood of investment opportunities that are sent its way, unless the company knows the people in those companies and has had time to develop relationships with them.

"We consider first if we know the people concerned and whether we have interacted with them for at least a year.

"Do we trust them? We also look at what the market says about the company. We only consider investing in companies with whom we have had a pre-existing relationship," Hinson says.

For example, when investment opportunities arose in Nigeria and Ghana, KTH had unique insights that helped it make its investment decision.

"There is no rush. Take your time getting to know the people and the markets. Walking a long road with our investment partners has proved very helpful in building trust, a useful element," Hinson says.

He says an important part of this process is identifying potential targets well ahead of time so that the company is able to cultivate relationships.

"We choose our sectors and make sure we know many of the companies and people in those sectors," he says. He says building knowledge before deals come to market is crucial as once a formal sales process has been initiated, the relationship development is more difficult and the deal becomes competitive.

Hinson says the third most important investment lesson KTH has learnt is the value of having a flexible approach.

"All too often as SA-based businesses we go into a transaction with almost a blueprint of how deals get done. For example, one of the issues most companies obsess about is control and having control from day one. We have taken a different approach and it has proven to be wise to not require control from the outset," he says. ■

Jacob Hinson Healthy partnerships facilitate deals

PRIVATE EQUITY FUNDS

Value and strategy are vital tools

While Africa is experiencing tough economic conditions and there are challenges when identifying suitable target companies, there are good opportunities for private equity investors on the continent — provided they are selective and patient.

RisCura associate Heleen Goussard says private equity interest in Africa, apart from SA, has been very high for the past five to 10 years due to macroeconomic factors that have resulted in greater stability and a more favourable investment environment.

"The political situation in Africa is still volatile but it is much better than it was 15 years ago. Though Africa has a long way to go, it is taking structural steps forward and this is reassuring for private equity investors.

"Most hard currency investors are concerned primarily with political risk and currency risk," Goussard says.

She says a lot of the interest was caused by the fact that people's wealth on the continent was slowly rising.

While this is probably continuing, the rate of progress has slowed.

A lot of wealth creation on the continent was linked to commodities, and lower commodity prices have hit hard.

"African growth was initially purely a commodity-driven story. However, the commodity boom created an opportunity to develop an economy around that.

"Most private equity players do not invest into commodity-driven businesses, and it is the economic activities that developed as a result of the commodity boom that interested them," Goussard says.

However, all that good news changed as the commodity super cycle turned the other way and commodity-dependent economies, with limited diversification in exports, have been caught on the back foot, hitting some currencies very hard.

With a lot of currencies under pressure, private capital is reluctant to make investments and existing investments are difficult to exit.

She says the situation brings a better understanding of the risks that have now come home to roost.

"When you invest in an African country,

your cost of equity should include potential liquidity issues, though people may not have been able to predict that it would be as steep or as volatile as has proved to be the case," Goussard says.

She says some countries are benefiting from the situation. For example, Kenya is a net importer of oil and this makes up a huge part of that country's forex. It uses a lot of diesel to generate electricity.

Therefore, the lower oil price is having a positive impact.

Looking to the future, Goussard points out that when the cycle turns, investors cannot realistically expect currencies to return to previous levels right away, if at all.

"The situation has shifted structurally, Goussard says. "At the same time there are good opportunities for wily private equity players, but they need to keep their vision very clear as to the risks involved when they are determining value and their strategy."

Kagiso Tiso Holdings chief investment officer Jacob Hinson says there are good opportunities for private equity funds and their investors across the African continent.

"Though we are an investment holding company and not a private equity fund, we compete with them on transactions.

Heleen Goussard
Africa has great opportunities for private equity investors

"There are associated risks and at times these are overstated. However, there are enormous opportunities," Hinson says.

He says a lack of familiarity can make people uncomfortable investing in Africa.

However, last year huge sums of money were raised by private equity funds around the world for investment into assets based in African countries.

Imara Asset Management chief executive John Legat notes that quite a lot of money — intended for investment in Africa — has been raised by the private equity industry over the past five years.

"However, little of this money has been invested. It is almost too big for Africa," he says.

"Private equity money is being directed more towards infrastructure such as telecommunications towers.

"Some money is going into power generation, but most of the private equity opportunities tend to be in smaller projects in the \$5m range rather than \$50m projects."

He says the private equity industry does face challenges, particularly in finding the right skills on the ground to facilitate relevant practices.

"The continent does not provide an easy environment for private equity," Legat says. ■

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