THE EAST AFRICA PRIVATE EQUITY MARKET

OPPORTUNITIES & STRATEGIES FOR FIRST-TIME FUND MANAGERS

Master of International Business Capstone Project

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Report Outline & Assumptions

NB: Eastern Investment Advisors (EIA) and Western Capital Partners (WCP) are fictitious companies used in the following report for illustrative purposes only.

Purpose of report:
With plans to raise its first East African fund, Eastern Investment Advisors (EIA) has been contracted by Western Capital Partners (WCP) to conduct a regional private equity market assessment and provide a strategic framework for market access, with a particular focus on markets in Kenya and Tanzania.

Scope:
EIA has undertaken a comprehensive study of the Kenyan and Tanzanian markets within the context of the wider East African region. *Section I* of the report provides assessments of political stability, economic and financial foundations and dynamics, and relevant regulatory environments. *Section II* details the regional PE market, highlighting historic deal flow and trends, the landscape of active fund managers, and fundraising dynamics. *Section III* provides a strategic recommendation to guide the composition of Western Capital Partner's first East Africa fund, making proposals regarding fund size, geographical and sector focus, capital sourcing, fund composition, and avenues for exit.

The aforementioned assessments focus on Kenya and Tanzania, and where relevant, evaluate the East Africa region as a whole.

Objectives:

1. *Evaluate PE landscape* – key players, investment destinations (geography & sector), and deal size
2. *Analyze economic landscape* – important sectors and sources of financing
3. *Evaluation of financial sector* – institutional makeup, level of financial market development
4. *Regulatory assessment* – evaluation of regulatory barriers and policy trends that are relevant for investment decision making
5. *Exit opportunities*

Assumptions: Western Capital Partners Profile

- West African Private Equity GP
- Sub-Saharan Africa Focus
- 2 previous funds:
  - 1st fund
    - $50m
    - Nigeria
    - Sectors: multi-sector, including financial services & healthcare
  - 2nd fund
    - $100m
    - West Africa: Nigeria & neighboring countries
    - Sectors: multi-sector, including financial services & healthcare
- 3rd fund (planned)
  - Interested in East Africa – specifically: Tanzania and Kenya
  - Looking to raise ~$100m
  - Sectors of interest: non-agricultural consumer goods, agribusiness, insurance, healthcare

Executive Summary

East Africa is becoming a preferred region for private equity (PE) investment in Sub-Saharan Africa. Within the East Africa Community (EAC), between 2008 and the first quarter of 2016, $1.59 billion in disclosed capital was invested in 131 PE deals. In the last four years, EAC PE deal volume has doubled, while total disclosed transaction values have increased by over 4x. Deal opportunities have been driven by growth in consumer-facing industries catering to a growing and urbanized middle class. With the majority of transactions within the SME segment, ticket sizes, while growing, remain small. The EAC's high degree of economic integration increases the regional scalability of domestic SMEs, helping to cultivate an exit market rich for trade sales and secondary buyouts. First-time regional fund managers would be wise to take advantage of these market dynamics, focusing on scalable, consumer-facing SMEs, developing a strong pipeline of deals in sectors with continued growth prospects.

The East African Community (EAC), with a total population of 145 million and a combined GDP of $147.5 billion, is the second-fastest-growing economic trading bloc in the world. The strong integration of the EAC has made the region, with its growing, urbanized middle class, ripe for investment opportunities in scalable, consumer-facing businesses. With low levels of commodity dependence, East African nations have been shielded from the commodity bust that has shaken the reserve base of countries throughout Sub-Saharan Africa. This position has also forced these countries to develop a diverse group of productive, consumer-facing sectors that have emerged as attractive areas of investment. While corruption remains endemic throughout much of the region, more accountable governments are gradually addressing infrastructure constraints. Two particularly compelling cases within this narrative are Kenya and Tanzania.

Kenya is the largest economy in East Africa and the third biggest destination for PE investment in Sub-Saharan Africa behind South Africa and Nigeria. Kenya's 83 deals since 2008 reflect the nation's regional economic dominance. While the nation has, indeed, faced bouts of political unrest in the form of post-election violence in 2007-08, power struggles associated with the new constitution, and, like much of the world, a continued threat of terrorism, these issues are surmountable. On the back of its diverse economy and sophisticated financial services industry, the Kenyan economy is forecasted to grow at an average of 6.1% through 2020. While most regional PE houses call Nairobi home, the Kenyan PE market shows few signs of saturation. The nation is poised to remain the hub of international business and private equity investment in the years to come.

While the Tanzanian economic growth story may not be as familiar as its Kenyan neighbor's, it is certainly a compelling one. Tanzania has been, by all accounts, one of the most politically stable countries in Sub-Saharan Africa since the independence era. Challenges remain in the form of corruption and infrastructure development, but the recent election of a president known for incorruptibility, along with an increased focus on infrastructure spending, help to illustrate Tanzania's commitment to addressing these issues. With the second largest economy in East Africa and fifth largest economy in Sub-Saharan Africa, the Tanzanian economy is forecast to grow at an average of 7% through 2020. While only 17 private equity deals have been

registered in the country since 2008 – primarily in the promising agribusiness subsector – with market and demographic dynamics that closely resemble that of Kenya, Tanzanian deal flow is poised to grow and investors should take note.

Regional PE deal flow had grown steadily until a slowdown in 2015 caused by regional currency market volatility that left investors increasingly exposed to foreign exchange risk. With regional governments' subsequent introduction of prudent monetary measures, currency depreciation was slowed. Investor confidence should be restored and deal flow can be expected to rebound through the end of 2016 and into 2017.

Despite the entry of a number of international PE houses chasing a handful of big-ticket deals, regional PE transaction values remain small. The market's median deal size of $3.5 million reflects the deep pool of deals within the small and medium enterprise (SME) segment. Since 2008, the majority of regional deal flow – both in terms of volume and value – has occurred in agribusiness, financials, telecommunications, healthcare, utilities, industrial transport, and oil & gas. The industries, however, with the most consistent deal flow and continued investment prospects are consumer facing in nature. Regional populations are increasingly urbanized and the middle class is growing. In the future, regionally based fund managers will likely find many of the most attractive investment opportunities in agribusiness, financials, healthcare, and fast-moving consumer goods (FMCG).

The East African GP and fund landscape is diverse and segmented. At the one end, pan-continental, generalist PE houses like KKR and Actis manage funds of over $1 billion and have been attracted to the few deals in excess $100 million that pass through the regional pipeline. At the other end, there is a deep group of Sub-Saharan African GPs targeting SMEs with funds ranging from $25 million to $100 million, in many cases with a sector-specific or sub-regional focused investment thesis. Regional fund segmentation reflects the maturity of the PE market, which has been enabled by an increasing LP appetite for Sub-Saharan Africa investments. In fact, Sub-Saharan Africa-focused funds active in East Africa have raised a record amount of capital in the past few years. The $3.4 billion and $2.05 billion raised in 2014 and 2015, respectively, beat out the previous 10-year record of $1.7 billion raised in 2011.

Despite its underdeveloped capital markets, East Africa's integrated economic structure provides a relatively rich avenue for exit. With most deals in the form of SME growth investments, the region's liberal cross-border business environment creates a high threshold for scalability. Trade sales and secondary buyouts dominate. Willing buyers can be found in the form of MNCs interested in expanding their regional footprint, along with international PE houses attracted to opportunities to grow domestic companies into regional brands. With most investments requiring active management, holding periods are longer than in developed markets, averaging 4-6 years.

For first-time fund managers, a focus on SME growth investment deals within consumer-facing industries throughout the entire EAC is recommended. Market opportunities within this investment segment and geography encourage a fundraising target of around $100 million. In

terms of sectors, volume and growth prospects make deals within healthcare, agribusiness, FMCG, and insurance particularly attractive. With the majority of deals in the $1 million to $5 million range, local presence is vital for effective SME deal sourcing. Locality can also be an effective source of competitive advantage. With Kenya as the preeminent hub for regional private equity investment, Nairobi is the preferred base of fund operation, though a strong case can also be made for establishing satellite offices in regional economic capitals, particularly in Dar es Salaam, Tanzania. Fundraising for SME-focused funds should target development finance institutions (DFIs). While regulations and norms surrounding the allocation of domestic pension funds to private equity will be worth watching, DFIs continue to constitute the core of LP backing within East Africa. As anchor investors, DFIs are particularly important sources of capital in early-stage fundraising, helping to establish fund credibility.

Acknowledgements

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Part I. Country Context

KENYA

Despite post-election violence in 2007-2008 and an increasingly weak security situation, Kenya remains relatively stable and one of Africa's strongest economies. Due to its relatively strong economic landscape and skilled, English-speaking population, Kenya's capital, Nairobi, is a preferred base of operation for multinational business conducted throughout East Africa. In the World Bank's Doing Business 2016 report, Kenya improved by 21 spots from the previous year to 108th out of 189 economies for overall ease of doing business.[1] While challenges surrounding security, infrastructure, and corruption remain, with a diverse group of productive sectors and growing middle class, Kenya remains the region's most robust market.

Gross Domestic Product & Economic Growth

The Kenyan economy is the largest in the East African Community (EAC) with a 2016 GDP of $60.94 billion (fig. 1). Annual GDP growth rates have been steady and strong, reaching 5.4% in 2015, up from 5.3% in 2014 (fig. 2). By composition, in 2013, the services sector contributed 53% of GDP, followed by the agriculture sector with roughly 30%, finance, real estate and business services, together with 15.8% of GDP,[2] and manufacturing with 11.7% of GDP.[3] Overall, major economic drivers have been increased infrastructure investment, along with increased household consumption and demand for goods and services.[4] Expanding sectors – many of which have attracted private equity investment – include construction, manufacturing, finance and insurance, information, communication and technology (ICT), along with wholesale and retail trade.[5]

Going forward, the Economist Intelligence Unit (EIU) forecasts an average growth rate of 6.1% over 2017-2020, driven by an expansion in consumer services (including banking, retail and communications), urbanization, regional integration through the EAC, and structural reforms and infrastructure investment, including a new single-gauge railway.[6] Assumptions for continued growth hinge on lower oil prices and a stable Kenyan shilling,[7] while projections remain restrained by the prospect of an increased benchmark interest rate (from 11.5% in mid-2015), a downturn in tourism due to deteriorating security, and remaining infrastructure gaps.[8]

Figure (1): Kenyan GDP (2006 – 2014)

Figure (2): Kenyan GDP Annual Growth Rate (Jan 2013 – Jul 2015)

Inflation & Exchange Rates

Kenyan inflation increased to 6.6% in 2015 due to higher food prices and an overall increase in excise duties.[9] In the near and medium term, given assumptions of improved rainfall and continued low oil prices, the EIU foresees a favorable inflation outlook, predicting a reduction to 5.6% in 2016, along with a further medium-term inflation reduction to an average of 5.1% in 2017-20,[10] in line with the 5% government target.

As was the case throughout much of the region, the strengthening dollar in 2015 brought a devaluation of the Kenyan shilling, which lost roughly 12% of its value in the year (fig. 3), which brought uncertainty to the regional PE market, resulting in a nearly 50% reduction in PE deal volume and transaction value from the previous year. However, stability was realized after a tightening of monetary policy and a delayed increase of US interest rates. Forecasts call for a further weakening of the shilling in the medium term, but at a more manageable forecasted annual pace of 6.2%,[11] which should help alleviate fund managers' foreign exchange exposure concerns.

Figure (3): Kenyan Shilling to USD Exchange Rate (2012-2016)

Foreign Direct Investment

Over the past decade, Kenyan foreign direct investment (FDI) has surged, reaching $859.5 million in 2015, up from $371.8 million in 2013.[12] Prospects for the next five years remain good, with the EIU forecasting average annual FDI of $1.3 billion, up from an average of $485.8 million over 2011-15.[13] Much of this investment can be attributed to a stronger business environment driven by investment in the oil, gas, and manufacturing sectors, mainly from China, Japan, and the UK.

Beyond those sectors, FDI has been driven by growth in consumer spending (a catalyst for PE investment in the region), a good climate for cash crops, abundant labor and the implementation of pro-market reforms. Integration within the EAC and the Common Market for Eastern and Southern Africa (COMESA) is also spurring investment, as investors find greater opportunity for cross-border company expansion.

Challenges for foreign direct investment due remain, however, due subpar transport infrastructure, costly and unreliable power supply, high taxes (30%), and difficulties securing land.

External Sector

According to the World Trade Organization (WTO), the value of Kenyan exports increased to $6.1 million in 2014, up from $5.8 million in 2013. In 2014, agricultural products represented 50.8% of exports, led by tea and horticulture. With 11 agribusiness deals since 2009 at a total disclosed value of $34.39 million, PE has played a vital role in Kenyan agricultural export expansion. Meanwhile, with the African Growth and Opportunity Act (AGOA) increasing access to U.S. markets, textiles and apparel overtook coffee in 2013 to become Kenya's third largest export.[14]

Established under structural adjustment policies in the late 1980s and early 1990s to stimulate export activity, Export Processing Zones (EPZs) and Manufacturing Under Bond (MUB) programs offer a variety of incentives to firms engaged in exports. However, participation has been low. As of 2013, there were just 81 companies operating within EPZs, producing only 4.8% of exports, the majority of which were textiles exported to the United States under AGOA.[15] The poor response to these programs can primarily be attributed to the ineligibility of EPZ and MUB firms to receive preferential treatment in the regional market, which is the main market for Kenyan manufacturers and one of the biggest drivers of regional PE investment.[16] Further, under COMESA rules of origin, EPZ goods are treated as foreign goods. These regulatory constraints have thus restrained take-up of EPZs for Kenyan firms who see the East Africa region as their most lucrative export market.

Regional Integration

The East African Community (EAC) is the second fastest growing regional economic bloc after the Association of Southeast Asian Nations.[17] Comprised of Kenya, Tanzania, Uganda, Rwanda, and Burundi, as of 2010, EAC member states had a total population of over 145 million[18] and a combined GDP of $147.5 billion.[19] The EAC aims for regional economic and political integration, with hopes for a monetary union by 2024.[20] While integration plans have also called for a political federation, movement has been slow in that regard. Plans have also been outlined for the future integration of EAC member nations' stock exchanges into a single bourse.[21]

Since its formation in 2000, the EAC has made significant strides, albeit slowly, towards regional economic integration with three major agreements: the customs union (2005), the common market (2010), and the monetary union (2013). Under the customs union, the regional bloc established the EAC Single Customs Territory (SCT), requiring declaration only in the country where initial consignment occurs. The common market protocol, meanwhile, was enacted to allow the free movement of goods, people, and capital throughout the EAC.[22] While some obstacles remain, the EAC's efforts at regional economic integration have largely been praised. The economic integration of EAC member states has been particularly welcome by private equity investors, who see greater access to regional consumers and increased opportunities for

scaling domestic business, while creating more viable opportunities for exit, particularly via trade sales to strategic investors.

Kenya is cornerstone of the EAC economic bloc, accounting for about 45% of total intra-EAC trade. From 2008 to 2010, its trade value in the EAC region increased by 26.7%, from $1.2bn to $1.52bn.[23] Agricultural commodities and manufactured products form the majority of intra-EAC trade, including crops, livestock, beverages, and tobacco. Given the deep regional markets within these sectors, the region's active fund managers have naturally developed a keen interest in companies operating across these sectors.[24] Compared to its exports outside of the region, Kenya's exports within the EAC are far more diversified and include chemicals, fuels and lubricants, machinery and transportation equipment.[25]

Political Stability & Policy Trends

Kenya's next election will take place in 2017 and long-established political tensions are expected to escalate as campaigning begins. Yet, analysts foresee an overall stable political situation after a peaceful handover of power in 2013 to current president, Uhuru Kenyatta, and progressive adoption of the 2010 constitution.[26]

The EIU has outlined two major political threats: security risks associated with increased terrorist activity of Al-Shabaab and power struggles associated with the new constitution's mandate of decentralizing power to 47 new counties.[27] While the latter is seen as a short-term issue, analysts do not foresee any particular improvements in the security situation in the near term, as long as Kenyan troops remain attached to the African Union's (AU) Somali occupation.

Of primary policy concern in the near term will be the Kenyan government's ability to ease infrastructure deficiencies and skills shortages. After having successfully issued a $2bn Eurobond in 2014, the largest in sub-Saharan African history, and plans for a second,[28] the government is said to be prioritizing investment in transport and energy, while also undertaking deregulation and privatization reforms.[29] Regional economic liberalization and integration through the EAC continues to be a policy priority, while the country looks to develop its manufacturing sector through the establishment of special economic zones under last year's Industrial Transformation Program.[30]

In Transparency International's 2015 Corruption Perceptions Index (CPI), Kenya ranked 139th out of 175 countries.[31] Corruption is endemic, with 70% of respondents to Transparency International's Global Corruption Barometer 2013 indicating that they paid a bribe to at least one of eight public services in the twelve months preceding the survey.[32] Corruption increases business uncertainty and can restrain foreign companies who are subject to legal frameworks such as the foreign corrupt practices act, bringing potential competitive disadvantages in securing government contracts.

Finance & Investment Landscape

Banking Sector

The Kenyan financial landscape is dominated by a group of profitable commercial banks. As of 2015, there were 43 licensed commercial banks operating in Kenya, along with two newly established credit reference bureaus.[33] Major international banks include Bank of India, Barclays, Chase, Citibank, and Standard Chartered.[34] Domestic credit from the banking sector increased by roughly $4.5bn in 2014, a 21.1% increase from 2013, with private sector lending leading the way, accounting for 81.2% of total lending and growing by 24.5% in 2014.[35] Specific sectors seeing credit growth have been manufacturing, real estate, telecommunications, business services and individuals.[36] The World Bank's *Doing Business 2015* report cited a major improvement in the ease of getting credit by investors in Kenya.[37] While nonperforming loans have been an issue in recent years with the downturn in the tourism sector, analysts largely see the issue as manageable.

Even as private sector lending increases, debt financing is still prohibitively expensive. As of January 2015, the average commercial lending rate was 15.9%. The EIU, however, expects lending rates to decline slightly within the next few years to 14.5% by 2020, helped by the growing sophistication of monetary policy and increased bank competition.[38]

Credit growth has been increasingly funded externally, mainly due to increased use of medium-term, mostly concessional, foreign-currency lines from development finance institutions (DFIs) for small and medium-sized enterprise (SME) project financing and increased credit limits placed by international banks on their subsidiaries.[39] These developments further limit the amount domestic commercial bank credit available and keep rates high. At the bottom of the pyramid, financial inclusion has been growing with mobile banking loans and deposits driven by M-Shwari, a new mobile money lending service that had 7 million customers in 2012, its first year of operation.[40]

Despite the development of the financial services industry in Kenya, commercial banks continue to illustrate a general aversion towards private sector lending. While competitive lending rates can be negotiated by large, asset-heavy companies, most SMEs in need of growth financing will find debt financing prohibitively expensive, if available at all. Private equity has increasingly played a vital role in plugging the financing gap for promising companies that are excluded from affordable debt financing.

Capital Markets

While underdeveloped by western standards, The Nairobi Stock Exchange (NSE) is the largest securities exchange in both East and Central Africa, and as of 2014, listed 59 of all 93 listed companies in East Africa. Equity market capitalization grew to KES 1.921 trillion (USD 22.3 billion) in 2013 from KES 851 billion (USD 9.8 billion) in 2007.[41] It is the second-best performing stock market in Africa, with annualized returns of 36%.

The Capital Markets Authority (CMA) is the Kenyan securities regulatory body. The CMA has been working with regulators in EAC member states through the Capital Market Development

Committee (CMDC) and East African Securities Regulatory Authorities (EASRA) on a regional integration initiative, and has successfully introduced cross listing of equity shares on regional exchanges.[42]

The bond market is relatively weak and underdeveloped, dominated by trading in government debt securities. Long-dated corporate bond issuances are uncommon, leading to a lack of long-term investment capital.[43] Listed companies, including banks, are thus heavily reliant on short-term debt, which is relatively expensive and exposes borrowers to short-terms risks.

Regulatory Environment

Foreign Direct Investment

Generally speaking, the Kenyan legal environment makes few distinctions between foreign and domestic investors.[44] The Kenya Investment Authority (KIA) screens all foreign investments, but the process is not considered to be discriminatory.[45] Few restrictions exist besides foreign ownership in telecoms and insurance, sectors in which the KIA restricts foreign ownership of 66.7% and 70%, respectively.[46] These restrictions put some limitation on large, foreign PE fund's ability to take significant control in domestic telecoms and insurance companies, which have been two of the more popular Kenyan sectors for PE investment.

The repatriation of profits and capital, meanwhile, is unrestricted. In its 2014 World Investment Report, the United Nations Council on Trade and Development (UNCTAD) cited the restrictive and erratic application of work permit policies as the single greatest barrier to foreigners doing business in Kenya.[47] The Kenyan corporate tax rate is 30%, same as other EAC countries. Nonresident companies, including branch offices, pay a tax rate of 37.5%.

Capital Markets

Foreign ownership of firms listed on the Nairobi Stock Exchange (NSE) is restricted to 60%.

Private Markets & Pension Funds

Despite having the biggest private equity market in East Africa, and the third largest PE market in Sub-Saharan Africa behind South Africa and Nigeria, Kenyan pension fund investment in private equity vehicles is negligible. There is over $7 billion of AUM within the Kenyan pension fund system.[48] Current regulations permit 10% of pension funds to be allocated under "other assets," but there is no separate category for private equity as its own asset class.[49]

While the most popular source of third party funding in other regions of Sub-Saharan Africa, including Nigeria and South Africa, is pensions/endowments followed by development finance institutions (DFIs), in East Africa the reverse is true. Experts point out that the lack of pension fund investment in Kenya and other similar markets is due more to a lack of familiarity and experience with private equity than an aversion to the asset class, per se.

State-Owned Enterprises & Privatization

Despite 2013 plans by the Kenyan government for a further reduction of state-owned enterprises (SOEs) from 262 to 187, SOEs remain concentrated in particular sectors and often

receive favorable treatment, including easier access to government guarantees, subsidies, or credit at favorable interest rates.[50] The privatization of SOEs has at times come under public scrutiny due the lack of deal transparency, fueling accusations of corruption.[51]

According to the U.S. State Department, the energy industry remains the most publicly owned sector in Kenya, while most SOEs in the agricultural sector receive advantages that include preferential access to land and inputs due to established contract farming arrangements.[52] Despite restrictions in the agriculture sector, there have been 11 PE investments in Kenyan agribusiness since 2009, the most in the region. Private enterprise largely flourishes outside of the energy and agricultural sectors.

Expropriation

Expropriation risk in Kenya is low with few historical cases. The 2010 constitution guarantees safety from expropriation except in cases of eminent domain or security concerns, in which case fair compensation is to be provided.[53]

TANZANIA

Tanzania is one of the most politically stable countries in sub-Saharan Africa and is the fastest growing economy within the East African Community (EAC).[54] Since gaining independence in 1961, Tanzania, with a 2014 population of 47.4 million,[55] has responded well to multi-party, democratic politics. The country has managed five peaceful transitions of power and maintained overall political stability. Tanzania is a member of both the East African Community (EAC) and the Southern African Development Community (SADC), two regional trade hubs that have fostered expansive regional trade and helped facilitate South African firms' access to Tanzanian investment.

Gross Domestic Product & Economic Growth

The Tanzanian economy has been growing steadily, with 2014 GDP reaching $48.06bn[56] (fig. 4), while recording an average annual growth rate of nearly 7% year-on-year from 2002 to 2015 (fig. 5).[57] Growth has remained strong, reaching 7.3% in 2013 and 7.1% in 2015. While most sectors are expected to grow in relative terms with the economy,[58] the primary sectors driving recent economic expansion have been information and communications, construction, manufacturing, financial services, retail trade, mining, and tourism.[59] As of 2014, the top producing sectors in terms of contribution to GDP were agriculture (26.5%), industry (25.6%), and services (47.3%).[60]

In the medium-term, on the back of substantial public investment in infrastructure, particularly in the transport and energy sectors, the Economist Intelligence Unit (EIU) projects growth to remain near or above 7% through 2020.[61] GDP projections have been buoyed by prospects in the oil and natural gas sectors, with 55 trillion cubic feet of offshore gas recently discovered off the southern coast. Further, with the Government of Tanzania engaged in projects to refurbish its dated port and ancillary infrastructure, analysts project further economic expansion.

Figure (4): Tanzania Annual GDP (2006 – 2014)

Figure (5): Tanzania GDP Annual Growth Rate (Jan 2013 – Jan 2016)

Inflation & Exchange Rates

After reaching a high of 20% in December 2011,[62] inflation was brought under control and is projected to reduce in line with the government's 5% medium-term target,[63] to a projected 5.4% in 2016 from 5.6% in 2015.[64] While inflation is susceptible to domestic weather-related shocks due to the heavy weight of food in Tanzania's consumer price index (CPI), most analysts view Tanzania's sound monetary policy as an effective counter balance.[65]

Exchange rates throughout the region experienced volatility in the past two years, with the Tanzanian Shilling losing 9% of its value in 2014,[66] and falling a further 17% in 2015 (fig. 6). The Shilling's depreciation would have increased the currency exposure of most USD-denominated private equity funds active in the country. While Tanzania's annual PE deal volume is too small to establish a correlation between the Shilling's depreciation and deal flow, fund managers' increased exposure would have likely caused a wait-and-see attitude among investors, causing a slowdown in new deals, as well as longer holding periods and a delay in exits.

While the Shilling's depreciation was mainly due to the dollar gaining relative strength, the currency's decline can partially attributed to Tanzania's trade deficit, as well as a decrease in international aid flow following a major energy corruption scandal in 2014-15.[67] In the medium term, analysts see a further weakening of the Shilling, but at a more gradual pace as the government adopts a more sensible monetary policy, which should help alleviate foreign exchange risk concerns of fund managers operating in the region.[68]

Figure (6): Tanzania Shilling to USD Exchange Rate (2012 – 2016)

Foreign Direct Investment

Generally speaking, the Government of Tanzania has a favorable attitude toward foreign direct investment (FDI), successfully attracting $1.87 billion of FDI inflows since 2013, a 72% increase from 2012, and the highest in East Africa.[69] The government has sought to attract agriculture investment, in particular, through its Kilimo Kwanza ("Agriculture First") initiative and the development of the Southern Agriculture Growth Corridor of Tanzania (SAGCOT), while providing 100% capital expenditure deductions for agriculture investors. [70] These initiatives have helped attract the attention of PE fund managers, as nearly 40% of all Tanzanian PE deals and 83% of all disclosed PE investment has gone to the agribusiness sector since 2010. Similar incentive mechanism have been engineered by the government for the mining industry, though

in light of current commodity market volatility, private equity has shied away from mining investments and towards opportunities in consumer-facing sectors.

As part of the Tanzanian Investment Act of 1997, the government established the Tanzania Investment Center (TIC), a one-stop center to help investors obtain permits, licenses, visas, and land access, among other services. While registration is not mandatory, TIC offers investors incentives for engaging in joint ventures with Tanzanians and wholly owned foreign projects that invest a minimum of $300,000.[71] With TIC approval, incentives include VAT and import duty exemptions and 100% repatriation of profits, dividends, and capital after tax.[72]

Calls by the National Business Council to improve the investment climate identified the following as the most severe barriers to growth: (1) regulations; (2) access to land; (3) taxation and fees; (4) corruption; (5) labor law and skill-set; and (6) contract enforcement, law, and order.[73] In the process of legislation is a National Private Sector Development Policy that seeks to address several of these issues.

External Sector

Export growth is projected to continue, bringing further contraction to the current trade deficit - one of the largest in the region – which saw a reduction from 11.7% of GDP in 2014 to 9.6% in 2015.[74] Leading export growth will be manufactured goods, which overtook minerals in 2015 as Tanzania's primary export.[75] The agricultural sector is also projected to contribute, as cash crop industries including coffee, tea, and cotton have a received a boost through government support programs.[76] Meanwhile, as a net energy importer, large deposits of recently discovered natural gas could propel Tanzania to become a major energy exporter, which could help the country to reduce its current account deficit,[77] while hopefully bringing a cheaper and more reliable source of energy to the country.

In 2006, the Economic Processing Zones (EPZ) Act help establish Special Economic Zones (SEZs) in order to encourage green field investment in the agro-processing industry and agriculture sectors. EPZ investors can receive incentives that include location near ports and main roads, exemption on interest and dividend taxes for 10 years, duty free importation of capital goods, exemption on VAT for utilities, and exemption of local tax levies.[78] Additionally, registered companies receive faster and lower cost clearance on all imports.

Regional integration initiatives through the East African Community (EAC) and Southern African Development Community (SADC) have also illustrated positive contributions for export competitiveness of manufactured goods through improved regional transport networks.[79]

Regional Integration

The East African Community (EAC) is the second fastest growing regional economic bloc after the Association of Southeast Asian Nations.[80] Comprised of Tanzania, Kenya, Uganda, Rwanda, and Burundi, the EAC aims for regional economic and political integration, with the ultimate goal of a monetary union by 2024,[81] and an eventual political federation. Plans have

also been outlined for the future integration of EAC member nations' stock exchanges into a single bourse.[82]

Since its formation in 2000, the EAC has made significant strides, albeit slowly, towards regional economic integration with three major agreements: the customs union (2005), the common market (2010), and the monetary union (2013). Under the customs union, the regional bloc established the EAC Single Customs Territory (SCT), requiring declaration only in the country where initial consignment occurs. The common market protocol, meanwhile, was enacted to allow the free movement of goods, people, and capital throughout the EAC.

Since the SCT and common market protocols went into effect, trade volume between Tanzania and EAC members has increased substantially, from $1.37bn in 2010 to $1.99bn in 2013.[83] The success of EAC initiatives has helped make the region particularly attractive for private equity investors, which have been increasingly investing growth capital in domestic companies to fund expansion throughout the region.

While implementation of the monetary union protocol remains, a 2013 meeting of heads of state found agreement on benchmarks of inflation, foreign exchange reserves, and fiscal variables.[84] While investors have welcomed the increased integration of the region, the U.S. State Department notes that non-tariff barriers, including the administration of duties and other taxes and corruption preclude the region's full economic integration aspirations.[85]

Meanwhile, as the only East African member of the Southern African Development Community (SADC), Tanzania saw its trade with SADC member nations increase to $2.05 billion in 2013 from $1.45 billion in 2010.[86]

Political Stability & Policy Trends

Tanzania achieved independence in 1964, becoming a union formed between the mainland – a former German colony, and later a British protectorate, previously known as Tanganyika – and the semi-autonomous Zanzibar islands. Despite the country's substantial diversity, with about 125 ethnic groups, Tanzania has managed to maintain overall political stability since independence 40 years ago; a commendable achievement in a region wracked by civil conflict that is often sectarian in nature.

In the recent October 2015 election, the long-standing incumbent party, Chama Cha Mapinduzi (CCM), retained executive power with the election of President John Magufuli. The election, while peaceful, brought the most significant opposition challenge to CCM since Tanzania achieved independence in 1961. While Magufuli's election was due in large part due to his fiscal conservatism and hard stance against corruption, the recent election also revealed deep divisions within the ruling party. That said, the Magufuli regime brings with it pledges to improve the business environment and public sector efficiency. Fiscal prudence already demonstrated by the government, including limitations on foreign travel by MPs, has given hope to this commitment. However, uncertainties remain surrounding the removal of tax exemptions and

recently introduced regulations restricting expatriate workers, which could slow the pace of reform and create a deterrent against investment.[87]

Long-simmering political tensions between the mainland government and the semi-autonomous islands of Zanzibar will be worth watching, as violence has at times broken out in the midst of unresolved disputes between Zanzibari unionists and secessionists. The October 2015 election was hotly contested in Zanzibar and polls were annulled. Despite claims from international observers that last year's election was carried out without evidence of fraud, a rerun took place in March 2016, with the incumbent, President Ali Mohamed Shein, capturing over 90% of the vote and maintaining power for Chama Cha Mapinduzi (CCM), much to the chagrin of the Civic United Front (CUF), Zanzibar's secessionist political movement.[88]

While tensions within Zanzibar are notable and could present future challenges for the union, Tanzania has a long history of stability and a respect for democratic processes, leaving experts with little reason to suspect that current political divisions on the mainland or tensions on Zanzibar are a threat to the country's overall stability.

The government has outlined policy priorities for the country that include a focus on making Tanzania into an industrialized economy. So far, with Tanzania among the top five countries for manufacturing growth since 2010 with 8% growth per annum,[89] policies seem to be working. A recent report by Institute of Chartered Accountants in England and Wales (ICAEW) attributed the growth to a number of factors, including improved infrastructure, openness to foreign investment, business-friendly regulations, and skills investment.[90]

In order to attract additional investment, the government has been spending on port infrastructure expansion, while investing heavily in its power supply, along with establishing special economic zones (SEZs).[91] Plagued by infrastructure gaps and low productivity,[92] the agriculture sector, employing and supporting the livelihoods of nearly 75% of the population,[93] has been outlined as a major policy priority for the government to which private equity investors have responded with a series of deals.

Finance & Investment Landscape

Banking Sector

Since liberalization reforms in 1990s, the Tanzanian banking sector has grown considerably. As of March 2015 there were 56 licensed commercial banks operating in the country, up from 38 in 2009.[94] Despite the fact that just 12% of the Tanzanian population participates in the formal banking sector,[95] Tanzanian banks are well capitalized and maintain liquidity well above national requirements. According to the Bank of Tanzania (BOT), total bank assets were up to nearly $9bn in 2013, a 14.95% increase from 2012.[96] Overall, the sector is highly profitability.

Within the sector, a few large banks dominate, with the largest four holding 50% of total assets,[97] and 10 banks maintaining 80% of market share.[98] Commercial lending rates are quite high, averaging between 15-18% for ordinary borrowers, while large, asset-heavy commercial borrowers can often negotiate somewhat lower rates.[99] Small and medium enterprises, which

contribute around 27% of the country's GDP,[100] are often precluded from accessing commercial debt financing due to high lending rates. Private equity has thus emerged as important source of financing for promising SMEs in the region. The EIU forecasts that from 2016-2020, average commercial lending rates will remain between 15-16%.[101]

Major commercial banks operating in Tanzania include Citibank, CRDB, EXIM, National Bank of Commerce (NBC), Standard Chartered, Stanbic, and Barclays,[102] which recently announced plans for divestment of its Africa business. In terms of segmentation, multinational banks are primarily engaged with medium and large corporations and donor intermediation,[103] while international banks with African regional hubs predominately service business from their respective home countries. The local commercial banking market is composed of regional and domestic banks, with services tailored for SMEs and retail banking.[104]

Credit to the private sector has been growing. As percentage of GDP, lending to the private sector was 21.86% in 2014,[105] up from 10.9% in 2005,[106] still a relatively low allocation compared to Kenya, South Africa, and Nigeria. The banking sector's loan portfolio is relatively well diversified, with the 2013 loan distribution by sector as follows: trade (20.98%), personal loans (16.87%), manufacturing (11.24%), agriculture, fishing, hunting and forestry (9.85%), building, construction and real estate (9.65%), transport and communication (7.05%) and other sectors (24.36%).[107] There are few local banking institutions with the capacity to finance large-scale deals such as infrastructure and energy projects.[108] Most of the projects are financed through syndicated loans with development finance institutions (DFIs) as anchor investors.

Despite an increase in lending to the private sector, small and medium enterprises (SMEs) represent 95% of all Tanzanian businesses and contribute 35% of GDP, but often are unable to secure commercial bank loans. High lending rates – 15% to 18% – are cited as one of their biggest barriers to growth.[109] Some specific factors leading to SME financial exclusion in Tanzania are physical access to commercial banking services, lack of education, and subpar transport infrastructure.

Tanzania Agriculture Development Bank (TADB) and TIB Development Bank, support SMEs that focus on agriculture and key projects by offering financing at subsidized rates.[110] Likewise, the SME Impact Fund was launched in 2014 to provide loans to Tanzanian SMEs in agricultural business value chains.[111] DFI-backed agribusiness funds continue to gain traction in East Africa, due to the significant number of investment opportunities and chance to get a social, as well as financial, return. These types of funds have helped to drive the development of a number of sector-specific private equity funds throughout the region.

In consumer financing, Tanzania passed credit bureau regulation in December 2012 and two credit bureaus received licenses from the Bank of Tanzania (BOT) in 2013: Credit Info and Dun & Bradstreet.[112] In subsequent surveys, 50% of banks indicated they were using credit reports, while 44% had plans to do so. The survey indicated that 58% of banks expected credit bureaus to increase loan disbursement, while 98% foresaw a resulting reduction in non-performing loans.[113]

Capital markets

Tanzanian capital markets are underdeveloped. Established in 1996, The Dar es Salaam Stock Exchange (DSE) has a market capitalization of $11.8bn,[114] with just 16 domestically listed companies, along with seven cross-listed firms.[115] Regulating the DSE is the Dar es Salaam Stock Exchange (Foreign Investors) Regulations and the Capital Markets and Securities Act. The DSE is a secondary market for both equity and debt securities. Through EAC initiatives, cross listings among EAC member stock exchanges, including the DSE, are permitted.

Regulatory Environment

Foreign Direct Investment

There are no specific Tanzanian laws regulating general foreign direct investment (FDI) in Tanzania.[116] With the exception of land ownership restrictions,[117] foreign and local investors for the most part receive equal regulatory treatment. While screening of FDI projects does take place, projects with all required documentation are typically accepted.[118] That being said, given Tanzania's history of centralized governance, officials have at times been hostile toward foreign investment.[119] Further, despite a series of liberalization reforms in the 1980s and early 2000s, the government still retains dominant presence in the telecommunications, banking, energy, and mining sectors.[120] Tanzania's Capital Account regime restricts the free flow of investment in and out of the country, while foreigners are restricted from buying domestic bonds or other debt instruments.

Capital Markets

The Capital Markets and Security Authority (CMSA) regulate the DSE and restrict the listings of companies with more than 60% foreign ownership.[121] While foreigners are free to purchase shares on the DSE without limitation,[122] Tanzanians cannot sell or issue securities abroad without approval from the CMSA.

Private Markets & Pension Funds

The Tanzanian PE market is relatively small, but growing. Behind Kenya, it is the second largest PE market in East Africa. Despite private equity as a complementary investment vehicle for pension funds, according to an EMPEA report, there is no known history Tanzanian pension fund investment in private equity.[123] While Tanzanian pension fund managers continue to favor fixed income (67%) and equities (11%),[124] increasing familiarity with alternative asset classes, such as private equity, among fund managers gives hope that domestic pension funds will form an important source of limited partner (LP) capital in the future.

As of December 2012, there was a total of $3.1 billion in AUM within the Tanzanian pension fund system. Under the current regulatory framework, a 5% allocation of Tanzanian pension funds to the private equity asset class is permissible, though there is no known history of such investment. Section 18 of the pension fund guidelines specifically prohibits venture capital investment, prohibiting particular early-stage investment of pension fund capital.[125]

Tanzania pension funds guidelines regarding the explicit allocation percentage of AUM to private equity is a positive sign in a region where few pension fund regulations even acknowledge that private equity is its own asset class. This points to hope of an increasing role for Tanzanian pension funds as a source of investment in the medium term, particularly as the government realizes how private equity can play a significant role in driving domestic economic development.

If and when Tanzanian pension funds begin investing in private equity, the geographical reach of such investments will need to be made clear. Currently, Tanzanian pension fund investment is restricted to onshore investment, though it is unclear whether this restriction is at a country or regional level (East African Community).[126] This is a vital point, as most regional fund managers employ a regional if not pan-African investment strategy.

Until domestic pension funds emerge as viable fundraising alternative, development finance institutions (DFIs), foreign foundations, and foreign institutional investors will continue to form the core of LP backing for Sub-Saharan African funds.

State-Owned Enterprises & Privatization

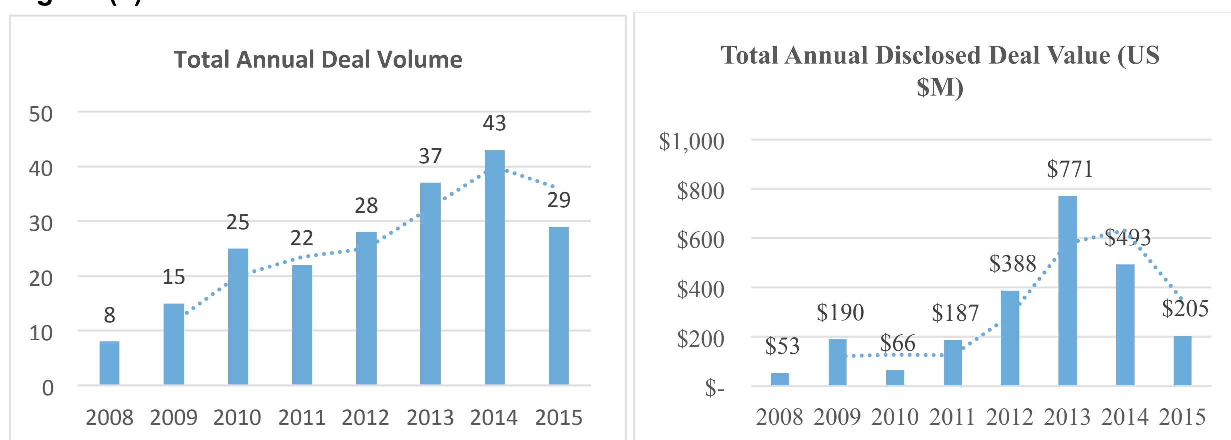
Tanzania underwent a significant process of liberalization in the 1990s that brought the privatization of most state-owned enterprises (SOEs), though several remain in major sectors, including power, communications, railway, telecommunications, aviation, and ports.[127] Given these entities access to government subsidies and other benefits, SOEs within these sectors do not compete on the same terms and conditions as private enterprises. As such, fund managers may find challenges in competing for investments within sectors that would perhaps otherwise be popular destinations for PE capital, including telecommunications.

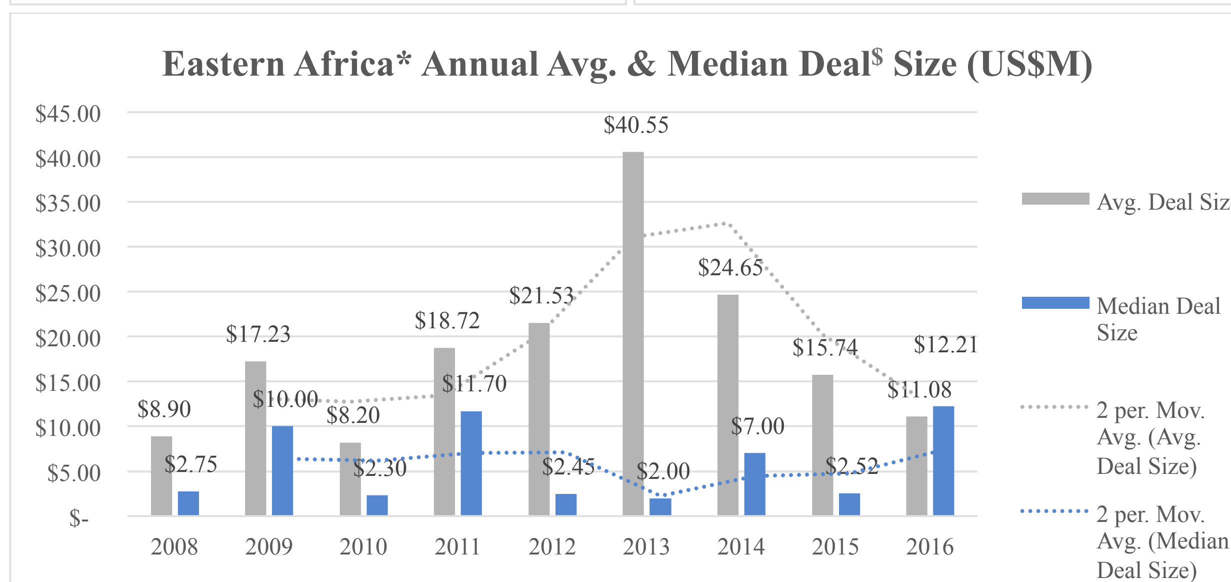
Part II. PE Environment in Eastern Africa

Regional Deal Flow Summary

According to data from EMPEA, from 2008 through the first quarter of 2016, roughly $2.4 billion was invested in 212 private equity deals throughout eastern Africa, a region including Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe. These investments were in 10 industries and 28 individual sectors. From 2008, the value of PE investment in the region has grown over eight-fold from $53 million in 2008 to its eight-year peak of $493 million in 2014 (fig. 7). For comparison, according to EMPEA, there was $8.1 billion of PE investment throughout all of Africa in 2014. Through 2015, the value of eastern Africa deals grew by an annual average of 69% YOY, while investment volume saw a concurrent increase, growing by an average of 26% YOY, from eight deals in 2008 to the region's peak of 43 deals in 2014. Reflecting market opportunities and the focus on small and medium enterprises (SMEs), from 2008 through the first quarter of 2016, the median transaction size in the region as a whole was $3.5 million. With consumer-facing SMEs as the predominant focus of regional PE investment, investments have consistently stayed in the range of $1 million to $5 million with the exception of a minority of big-ticket deals in the energy and infrastructure sectors. However, a 2016 survey by Deloitte indicates that regional fund managers expect deal sizes to increase in the short term, reaching an average of $6 million to $10 million.[128] Fund managers attributed the expected increase due to the combined effect of increased competition with the entry of large funds in the region coupled with the expected increase in access to debt financing for transactions.

Figure (7): Eastern Africa* PE Transactions 2008 – 2015





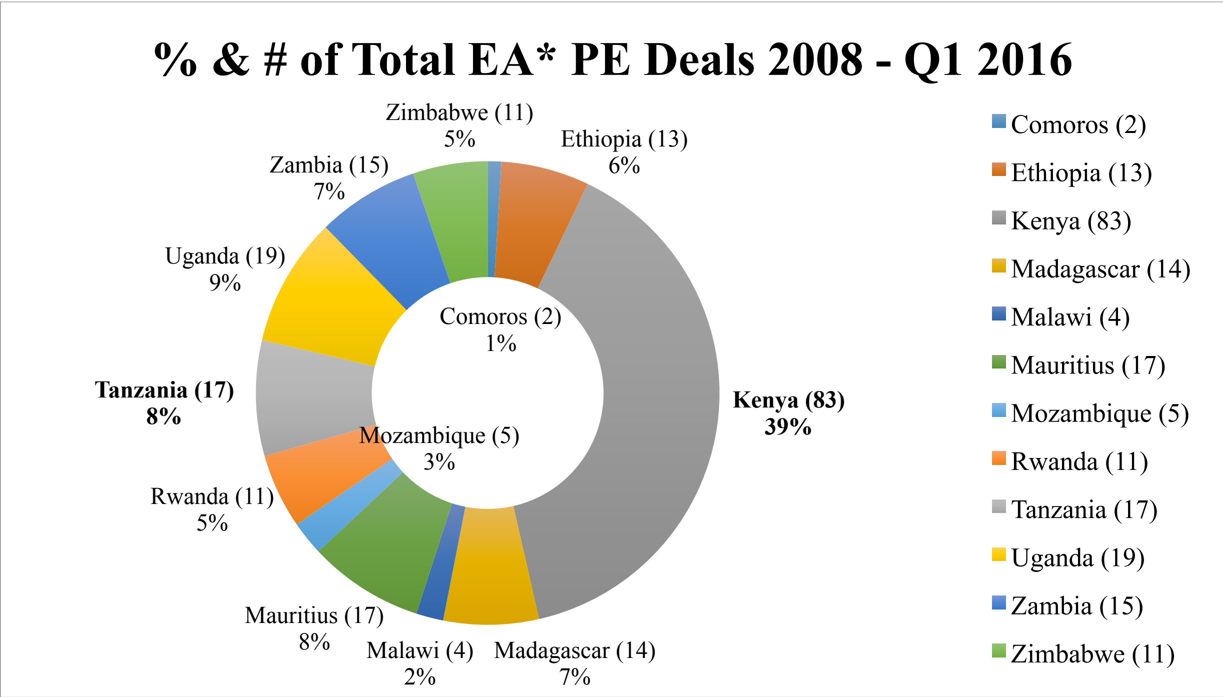
*Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe

$For deals with disclosed transaction value

Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

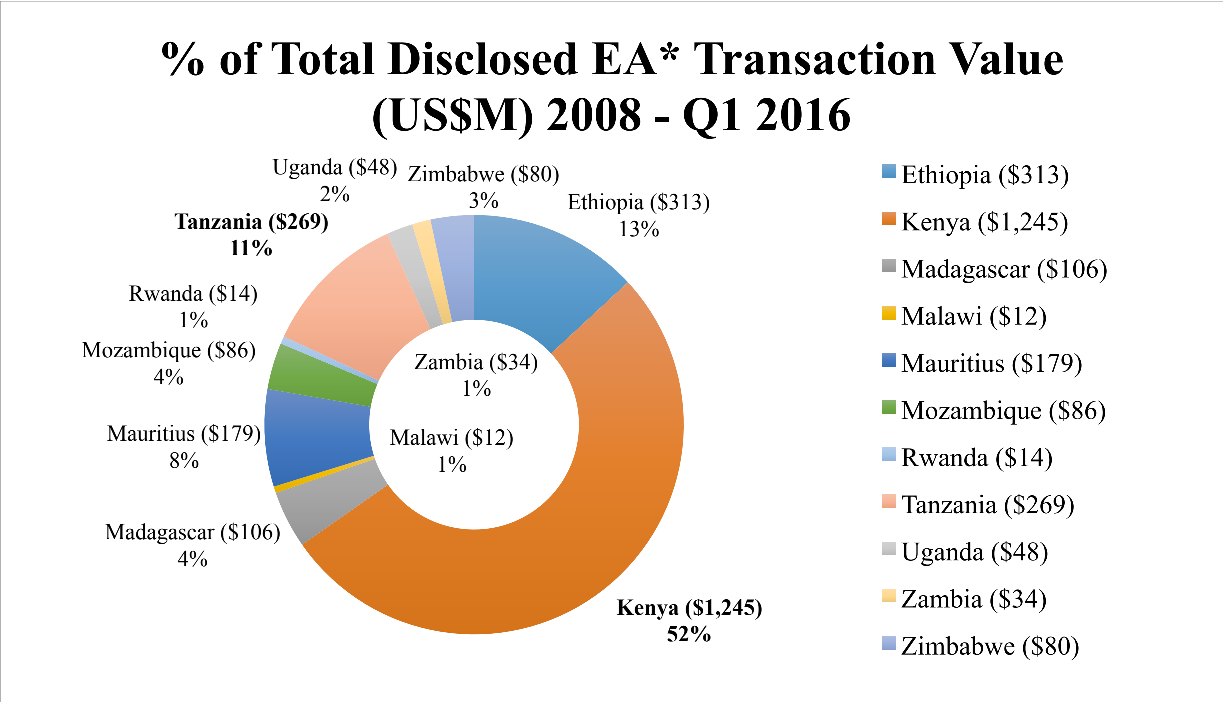
Within eastern Africa, Kenya has been the biggest destination for PE investment, having recorded 83 total deals for $1.25 billion in total disclosed transactions since 2008 (fig. 8 & 9). As the third biggest PE market in Sub-Saharan Africa, Kenya's deal flow substantially exceeds PE investment activity within the rest of the region. Tanzania, however, has one of the region's other most active PE markets, driven by deals in agribusiness and other consumer-facing sectors. Among the group of 12 eastern Africa countries, Uganda and Tanzania have recorded the second and third highest number of deals since 2008 with 18 and 17, respectively (fig. 8). In terms of total disclosed invested capital, Tanzania ranks third behind Ethiopia with $269 million (fig. 9).

Figure (8): Total Deal Volume by Country/Region 2008 - Q1 2016 (# and % of total)



*Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe
Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

Figure (9): Total Disclosed Deal Value (US$M & % of total) by Country/Region 2008 - Q1 2016



*Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe
Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

The increase of eastern Africa PE investment beginning in 2008 can at least be partially attributed to the global financial crisis, when investors shifted capital away from underperforming

developed equity markets and toward higher performing emerging markets that were largely isolated from recessionary shocks. However, after steady deal flow growth through 2014, the following year brought a slowdown, as investment dropped for the first time since 2008 – both in terms of volume and value – to $205 million of disclosed investment in 29 deals throughout eastern Africa, from the region's 2014 peak of $493 million invested in 43 deals (fig. 7).

Driving the 2015 regional PE slowdown was macroeconomic uncertainty surrounding local currency depreciation, commodity market volatility,[129] and Chinese economic contraction.[130] The contraction of the PE market in 2015 was reflective of deal flow patterns continent-wide, as deal volume decreased from the record 200+ transactions recorded in both 2013 and 2014 to roughly 150 total transactions in 2015, a reduced level of activity not seen since 2010-11 (fig. 10).[131]

In Kenya, Tanzania, and the majority of East Africa, currency volatility was likely the primary cause of slowdown within those markets. With regional currencies losing much of their value from 2014 through 2015, smaller funds and those with a sub-regional focus in East Africa would have become substantially more exposed to currency fluctuations than the larger pan-African and global funds that employ a natural hedging mechanism through their expansive geographical reach. Most funds – but not all – are USD denominated.

While some may point to the possibility that the downturn in 2015 was a result of market saturation with an increasingly deep pool of capital chasing fewer opportunities, experts counter this claim; A survey of Africa-based investors and PE advisors by Mergermarket, in conjunction with Control Risks, illustrates investor's expectations for a rebound and continued growth in the market, citing that the lack of large-cap investments in South Africa and Nigeria, the two biggest PE markets in Africa, will continue to drive East African growth investments in the future, seeing particular opportunity for future investment in insurance, consumer-facing sectors, manufacturing, technology and telecoms, and healthcare.[132] Despite the 2015 slowdown in deal activity, investor appetite for African PE investment remains strong, with a record $4.5 billion raised by Africa-focused funds in the same year (fig. 11).[133]

Figure (10): African PE Transaction Activity 2009 – 2015

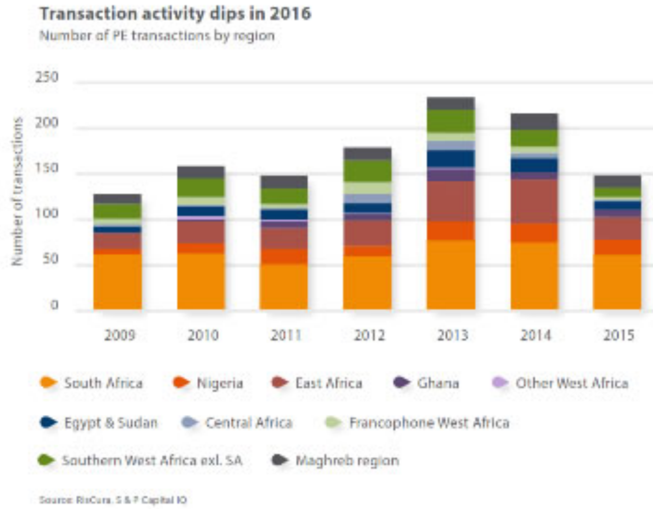
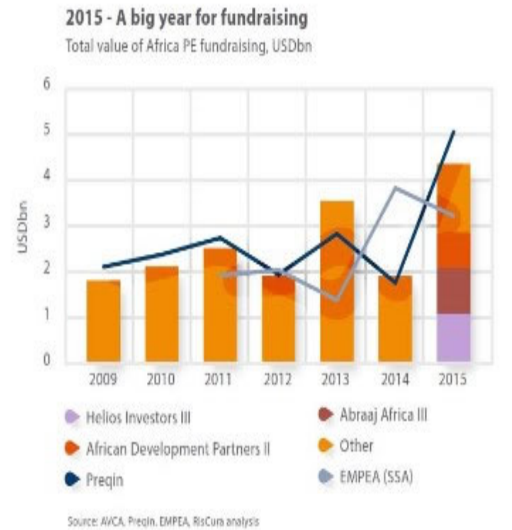


Figure (11): Total Africa PE Fundraising '09 – '15



Source: FinancialNigeria.com, Bright Africa: Private Equity Report 2016, RisCura, EMPEA, and AVCA Preqin

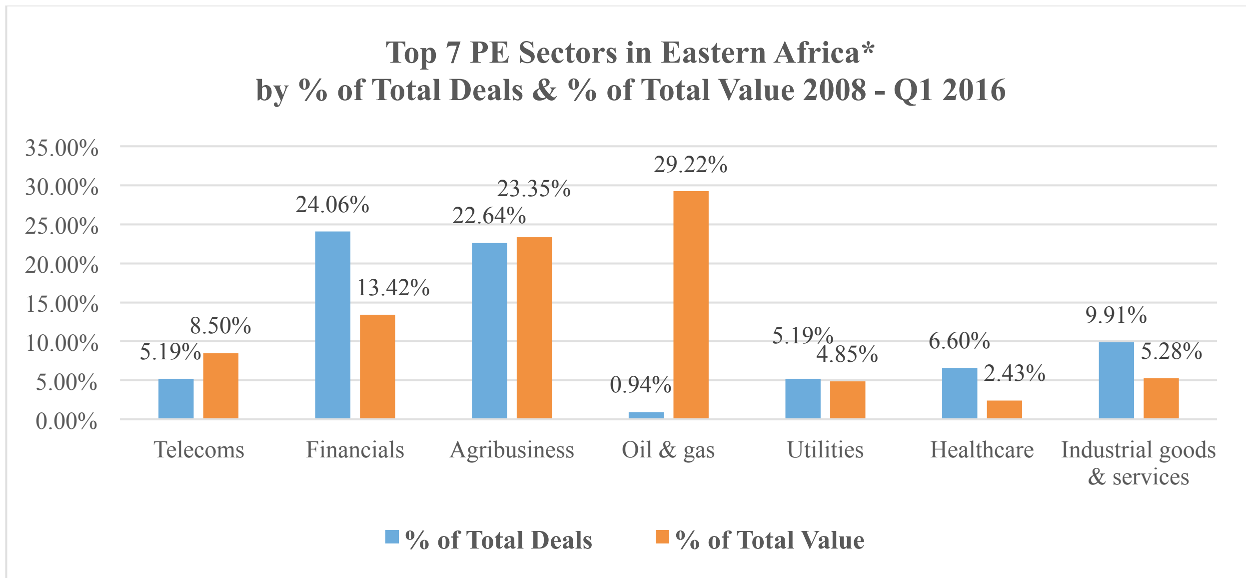
Deal Flow: Industry & Sector Analysis

Eastern Africa

Since 2008, the sectors in eastern Africa[1] attracting the majority of PE investment – both in terms of volume and value – have been agribusiness, financials, telecommunications, healthcare, utilities, industrial transport, and oil & gas (fig. 12). These seven sectors captured 65% of total PE deal volume and 84% of total disclosed PE deal value in eastern Africa over the covered period. While the oil and gas sector recorded the highest total disclosed transaction value at $700 million, it was for just two deals with Kenyan oil and gas exploration companies. The first was in 2013 when Warburg Pincus invested $600 million in Delonex Energy, and Helios Investment Partners' $100 million investment in Africa Oil Corp in 2015. While big-ticket extractives and infrastructure deals occasionally come through the deal pipeline, regional PE investors have kept their focus on a deeper pool of opportunities within consumer-focused sectors.

[1] *Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe

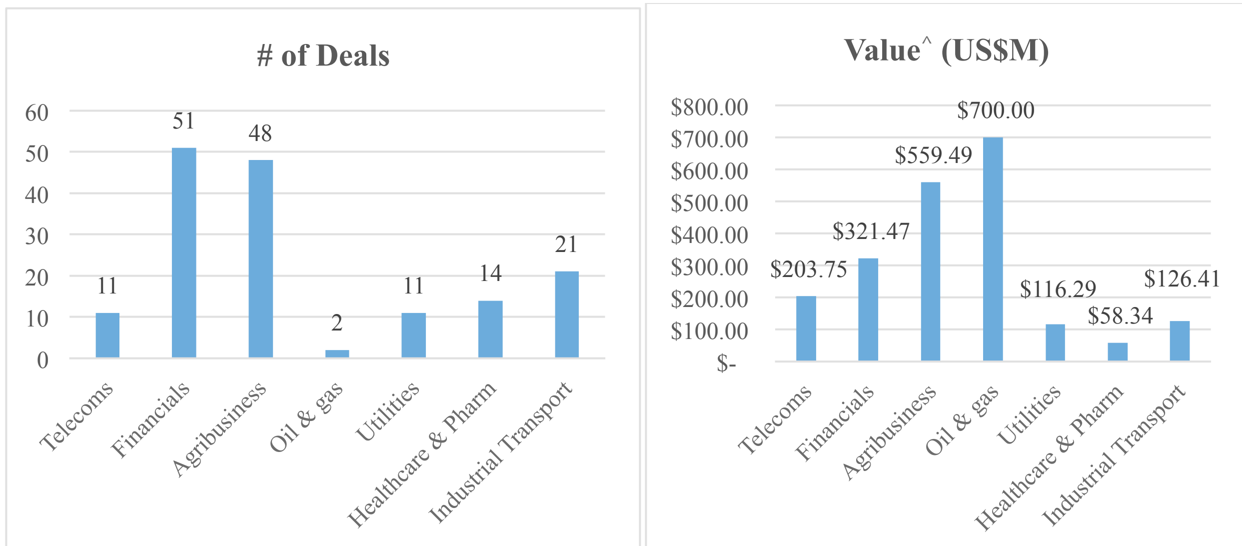
Figure (12): Top Sectors PE Investment in Eastern Africa*



*Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe
Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

While oil and gas deals have offered the highest transaction values, the sectors within the region attracting the most consistently high deal value and volume have been agribusiness and financials, followed by industrial transport (fig. 13 & 14). This is indicative of trends occurring throughout many of the Sub-Saharan Africa's more productive economies, as previously extraction-based economies see a shift toward developing stronger consumer-facing industries.

Figure (13) & (14): Top Sectors - PE Investment in Eastern Africa* 2008 - Q1 2016



*Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe
^Data for deals with disclosed transaction value only
Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

Agribusiness PE investment trends help to illustrate this economic shift. Since 2008, there have been 48 agribusiness deals worth $559 million throughout eastern Africa, making it the sector with the greatest balance between high deal volume and value in the region. This has been achieved with a large pipeline of lower value deals and a handful deals valued over $20 million. With 10 transactions since 2009, Kenya has attracted the most agribusiness deals in the region, followed by Uganda and Ethiopia, each with seven, and Tanzania with six. Tanzania and Ethiopia stand out by having attracted the only two agribusiness deals of $200 million or greater. In 2012, Carlyle Group led a group of investors with an injection of $210 million into Export Trading Company, a Tanzania-based agricultural company that sources commodities from Africa's smallholder farms and exports them primarily to China and India.[134] In 2014, at the height of regional PE activity, KKR invested $200 million in Ethiopia-based flower exporter, Afriflora.

These deals were the first sub-Saharan Africa investments by The Carlyle Group and KKR, and while indicative of large, international PE funds growing interest in the continent, agribusiness deal sizes largely remain significantly lower in value than these high-profile deals otherwise indicate. Since 2008, eastern Africa agribusiness deals have averaged $16.46 million, with a median deal size of $4.75. With the sector primarily composed of smallholder farms, deal opportunities are mostly early stage growth investments ranging from $500k to $5 million. In the medium term, as infrastructure continues to improve, it can be expected that both deal volume and value will increase further.

Overall, investment in the agribusiness sector has grown steadily over the years, though investment slowed down after the sector peaked with 14 deals in 2012. In the three subsequent years, the sector saw an average of eight deals per annum. Much of the slowdown can be attributed to currency exposure that caused investors to adopt a wait-and-see attitude across all sectors.

The most active GP within agribusiness has been Pearl Capital Partners (PCP), an East African GP that exclusively targets SME agriculture investments of between $250k and $2 million. PCP administers portfolio management on behalf of two impact-oriented, international funds: African Agricultural Capital Fund (AACF), a $25 million fund launched in September 2011 and African Seed Investment Fund (ASIF), a $12 million fund launched in August 2010. Since 2008, PCP has secured 45% of the 29 agricultural production-focused agribusiness deals in eastern Africa. At its inception, PCP focused on social impact rather financial returns, but now, after seeing greater than expected financial returns, it considers impact and financial returns equally in evaluating investment opportunities.[135]

Driven by the financial and banking demands of a steadily growing middle class, financial services have become one of the most heavily invested PE sectors throughout eastern Africa with 51 deals and a total of $321 million in disclosed investment since 2008. The subsectors of financial services that have received PE capital since 2008 reflect growth in a market seeking to meet the increased financial services needs of an expanding middle class. These included commercial banks, insurance, investment services, specialty and consumer finance, as well as

real estate holding and development. Commercial banks have secured the majority of regional financial services investment with 23 recorded deals funding the domestic and regional expansion of consumer and retail banks, such as Jamii Bora, a Kenyan commercial bank that focuses on relationship banking and SME financing. With 14 total deals within financial services, Kenya has been among the most attractive destinations for financials investment. The nation's innovative use of mobile payment systems built off the M-Pesa mobile money platform have helped expand financial services access to previously unbanked populations, particularly in the microfinance subsector, while also introducing effective payment collection platforms for insurance companies that have been instrumental in driving the industry's growth.

Fundraising & Fund Managers Active in East Africa

Fundraising Overview

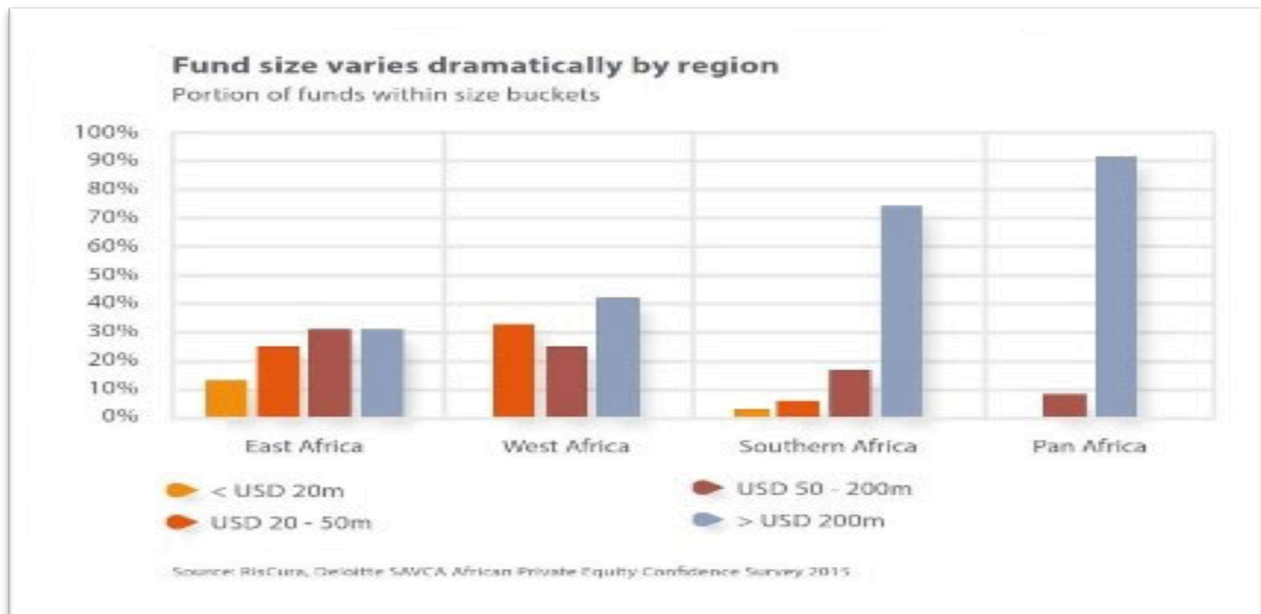
According to EMPEA data as of March 2016, since 2006, under the management of 79 active fund managers, there were 137 individual funds that have either closed (110) or are currently seeking capital (27) in eastern Africa.[2] Of these 110 closed funds, there has been roughly $30.2 billion of total assets under management (AUM), of which roughly $13.8 billion – just under half – was, or currently is, managed by funds focused exclusively on Sub-Saharan Africa investments (as opposed to multi-region funds that invest in multiple continents).

Aggregate East Africa fundraising trends of both multi-region and Sub-Saharan Africa funds have largely tracked cycles in global private equity fundraising, with regional fundraising illustrating a five-year cycle (fig. 16). Since 2006, multi-region funds have had three significant fundraising years in 2008, 2009, and 2013 when roughly $3 billion to $4 billion was raised annually (fig. 16). The lack of significant Sub-Saharan African-focused fundraising in these years illustrates the dominance that large funds like Actis Emerging Markets 3 – a $2.87 billion fund that closed in 2008 – have over regionally focused fundraising efforts. While large funds like Actis do invest in eastern Africa, a relatively small portion of that capital goes toward regional transactions.

In terms of fund size, the East African PE fund ecosystem is relatively more diverse than other regions of the sub-continent (fig. 15). This segmentation illustrates a healthy mix of opportunities for deals across a wide variety of sectors and growth stages throughout East Africa.

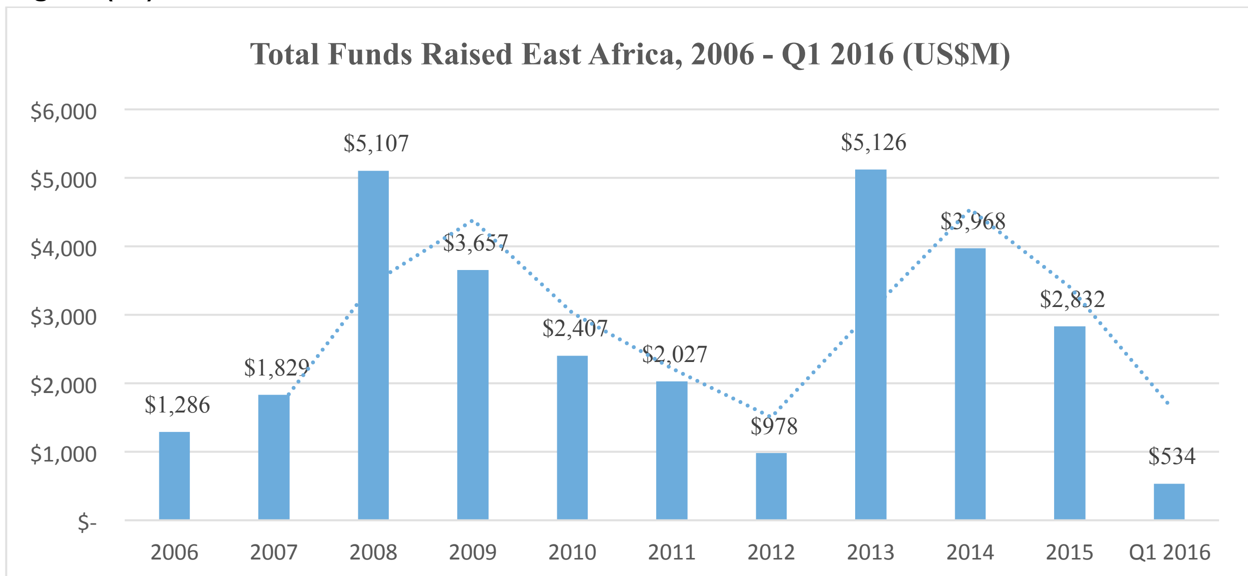
[2] Includes Comoros, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Tanzania, Uganda, Zambia, and Zimbabwe

Fig. (15): African PE Fund Size by Region



Source: RisCura

Figure (16): Total East African Funds Raised

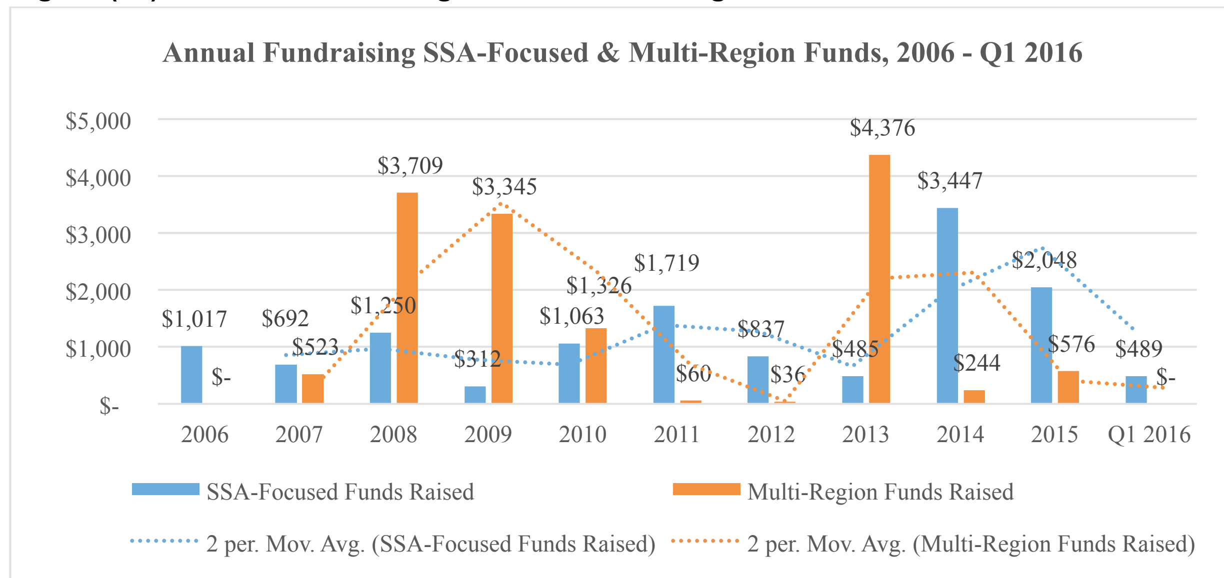


Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

For this analysis, it is helpful to take a closer look at Sub-Saharan Africa (SSA)-focused funds, specifically, which have significantly increased their share of capital raised in the past few years. SSA-focused fundraising for the region peaked in 2014 when $3.4 billion was raised (fig. 16). This compares to the $4 billion that was raised by pan-African funds that year, which means that of all Africa PE funds raised in 2014, 75% included eastern Africa within that fund's geographic investment profile. Regional fundraising stayed strong through 2015 with over $2 billion raised,

while $576 million was raised through the first quarter of 2016, indicating another potential banner year for fundraising in Sub-Saharan Africa (fig. 17).

Figure (17): Annual Fundraising – SSA- & Multi-Region Focused Funds

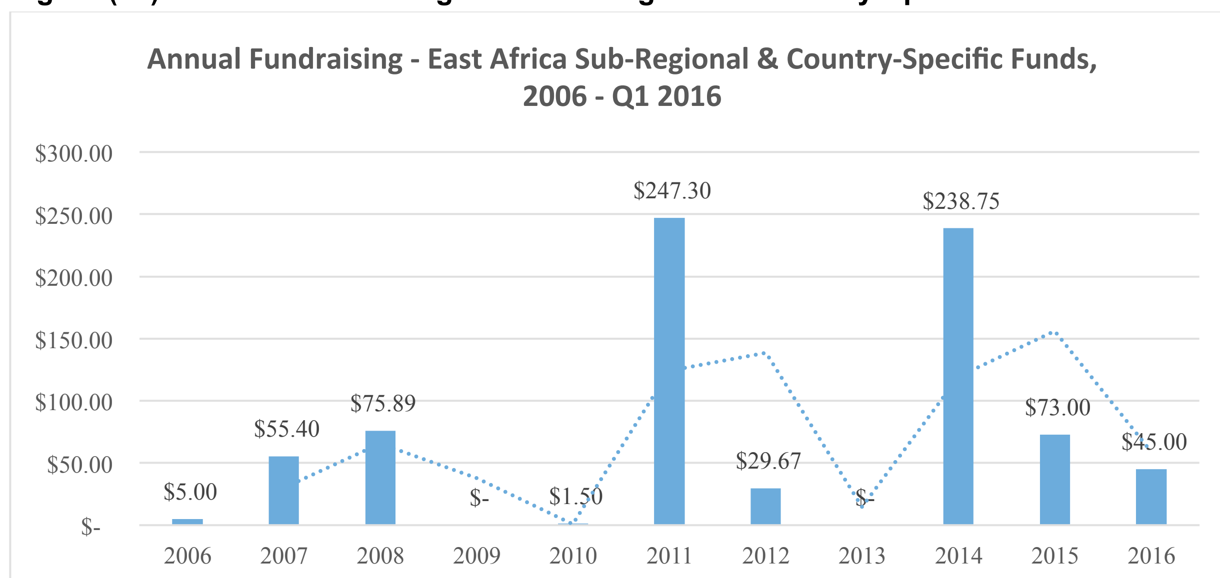


Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

Geographic Differentiation

Sub-Saharan Africa fundraising can be broken down further into a subgroup relevant to our analysis: East Africa-focused sub-regional & country-specific funds (fig. 18). These types funds have increasingly emerged within the segmented PE landscape, offering locally based GPs and opportunity to either tap into the rich pipeline of SME investment opportunities as generalists or establish a sector focus. Since 2006, a total of 13 East Africa sub-regional & country-specific funds have raised $665 million in capital, at an average close of $51.15 million. Four of the 17 closings were sector-specific funds, of which two were agribusiness-focused; the $25 million African Agriculture Capital Fund, closed in 2011 and managed by Pearl Capital Partners, and Voxtra's $19 million East Africa Agribusiness Fund. The other two were East Africa Capital Partner's (EACP) $98 million Africa Telecommunications, Media and Technology Fund I, which was closed in 2011 and was dedicated to fixed line communications investments in East Africa, and Progression Capital Africa, which closed its Eastern Africa Microfinance Equity Fund (PEAMEF) in 2011 at $32 million. Country-specific funds have traditionally been restricted to the well-developed South African PE market, though Business Partners International's Kenya SME Fund, closed in 2007 at $14.1 million, and Assante Global SME Fund I, which is currently seeking capital, illustrate the increasing opportunities that differentiation presents within the fast-growing Kenyan market.

Figure (18): Annual Fundraising – EA Sub-Regional & Country-Specific Funds



Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

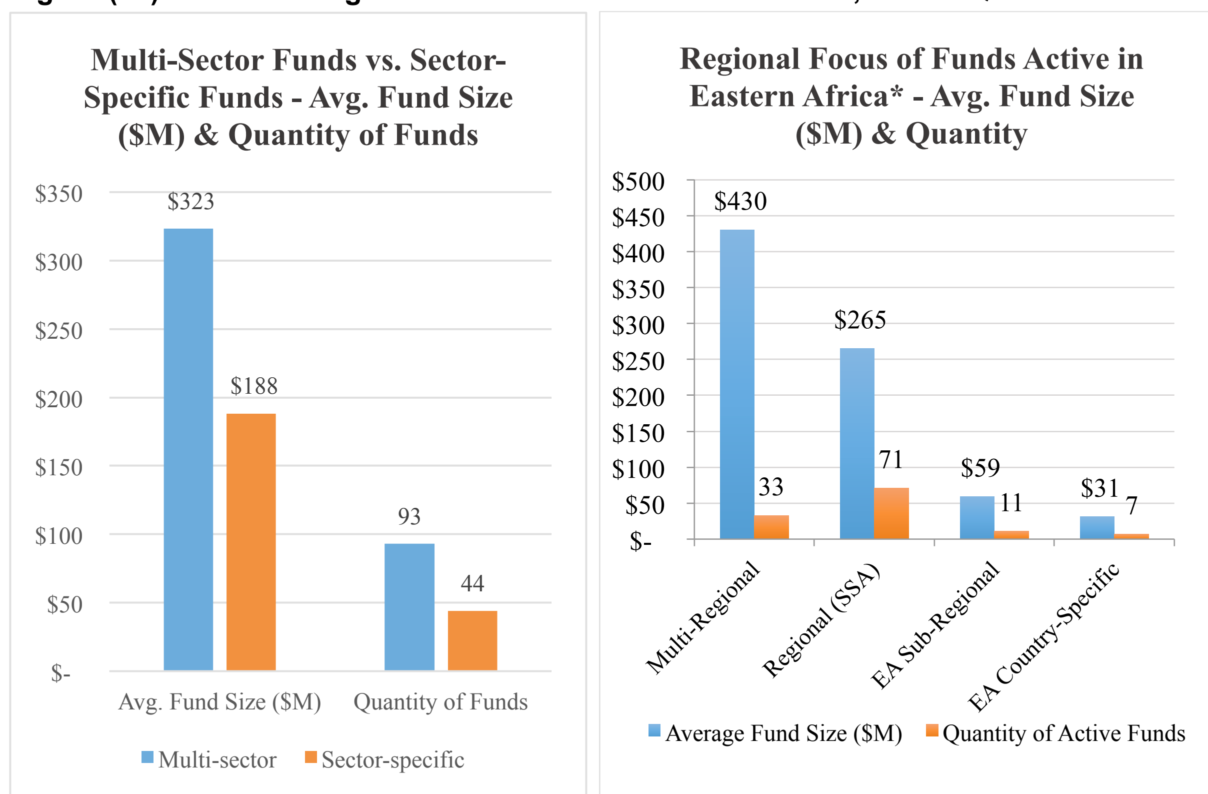
Kenya is the focal point of eastern Africa PE activity, not just in terms of deal flow, but also as a base of operations for regional GPs. In Nairobi, Kenya's capital, 31 fund managers (40%) either maintain their headquarters (8) or have a regional office (23). Deal flow statistics since 2008 indicate that in terms of capturing overall eastern Africa deal volume, a Nairobi office does not bring any particular advantage; The 212 transactions recorded over the period have been roughly split evenly between GPs with a regional hub or head office in Nairobi and those without a domestic presence. However, when targeting Kenyan investments specifically, GPs with a local office demonstrate a clear advantage in acquiring domestic deal volume, having secured 75% of Kenya's 83 deals since 2008. As one might suspect, due to the relative size of funds vis-à-vis their geographical footprint, while foreign-based fund managers only secured about a quarter of Kenyan deal volume since 2008, these deals, with $796 million in disclosed investment, represented 65% of the total disclosed PE capital invested in the country, and an median deal size of $16 million versus $3 million for locally based GPs. For pan-regional funds targeting high profile, high value deals throughout the sub-continent, a local office in Nairobi may not be necessary. However, when targeting the high volume pipeline of early stage SME investments within the growing Kenyan market, a local presence is key.

Sector Differentiation

East Africa's 137 active funds include both Sub-Saharan Africa (SSA)-focused and multi-regional funds, all with varying degrees of investment focus in terms of sector and geography. While the average total AUM of fund managers operating in the region is roughly $280 million, funds vary in size according to the depth of a GP's geographic and sector specificity. That is, generally speaking, the more differentiated a GP's investment thesis, the smaller the fund. This applies both in terms of sector specificity and geographic focus.

Including multi-regional funds (investing on multiple continents), there are 44 active sector-specific funds in eastern Africa, representing 32% of the total number of funds and the 22% of all AUM in the region. With an average fund size of $188 million, sector-specific funds are significantly smaller than multi-sector funds, which average $323 million (fig. 19). The four primary sectors within the sector-specific fund group are financials, agribusiness, energy, and healthcare, sectors where the highest volume of deals is found. Funds specializing in financial investments are the most prevalent with 17 funds and a total value of $3.13 billion under management since 2006, and an average fund size of $196 million.

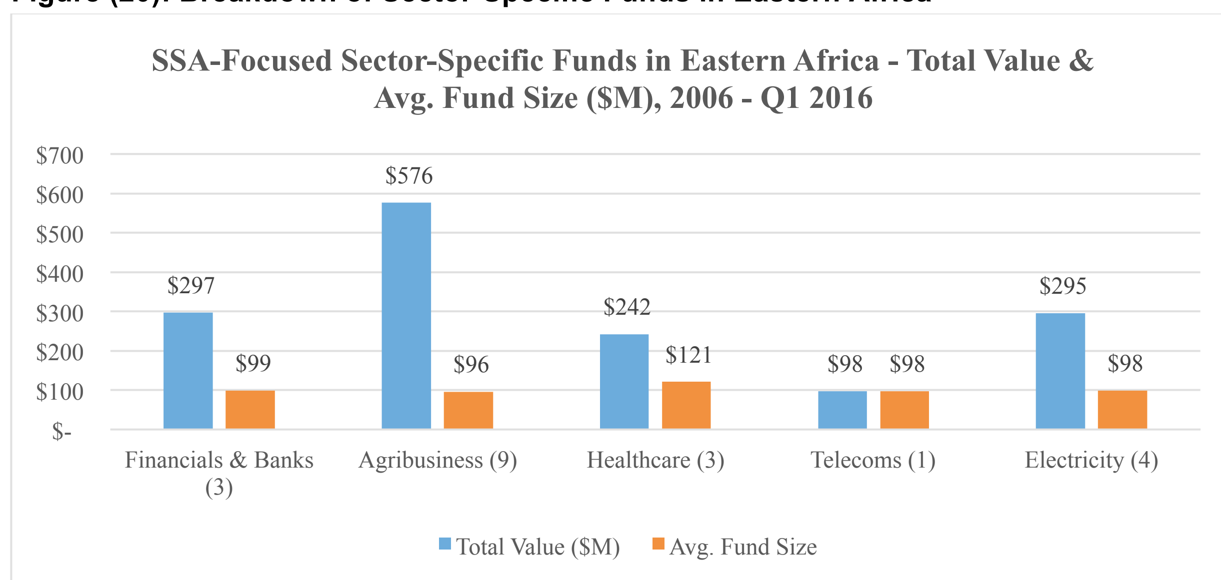
Figure (19): Sector & Regional Focus – Eastern Africa Funds, 2006 – Q1 2016



Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

For our analysis, it is beneficial to evaluate those sector-specific funds that are investing exclusively in Sub-Saharan Africa and are active in eastern Africa, in particular (fig. 20). There are 20 of these funds, averaging $75.36 million in AUM. Agribusiness-focused funds are the most common within this group with nine total funds, and averaging $96 million each. Interestingly, while all nine agribusiness-specific funds are active in eastern Africa, the only agribusiness funds with an exclusive sub-region of focus are the two targeting East Africa. These funds are Pearl Capital Partners' (PCP) $25 million African Agriculture Capital Fund, which closed in 2011, and Voxtra's $19 million East Africa Agribusiness Fund, which closed in 2014. The two fund managers are among the most active regional agribusiness investors, investing in a combined 16 deals since 2010, and co-investing in two deals in Kenya and Uganda.

Figure (20): Breakdown of Sector-Specific Funds in Eastern Africa*



*Kenya, Tanzania, Comoros, Ethiopia, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Uganda, Zambia, and Zimbabwe

Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

Due to solid, sustained growth and a growing middle class with increased demand for quality healthcare and financial services, three sector-specific funds in both healthcare and financials, have been raised since 2006, averaging $121 million and $99 million per fund, respectively. The majority of sector-specific fundraising in the region has taken place in the last five years, demonstrating investor confidence for continued growth within these sectors. The Abraaj Group with its $105 million Africa Health Fund that closed in 2011 has been the most active in the region with five healthcare investments, four of which were in Kenya. Abraaj is currently raising a second healthcare fund with a focus on healthcare investments in Sub-Saharan Africa and South Asia. The fund has a target of $1 billion.

The continued integration of the East African Community (EAC) should help to make East African-focused and sector-specific funds – currently four – an increasingly attractive investment vehicle, particularly in the region's growing sectors, such as agribusiness, healthcare, and financials.

When evaluating the regional, sub-regional, and country focus of a particular fund (if any at all), similar to sector differentiation, a tighter geographic focus generally implies a smaller fund. This, of course, is unsurprising given that investment opportunities become scarcer as the geographic footprint for deal sourcing decreases. Multi-regional funds, like those raised by Helios Investment Partners, The Carlyle Group, and DFIs such as the International Finance Corporation (IFC), average $430 million, while East Africa sub-regional and East Africa country-specific funds average $59 million and $31 million, respectively.

The market has become segmented, which indicates a maturing of the regional PE market. While large, international firms chase the few big-ticket deals of $100 million to $200 million that come through the regional pipeline, significantly higher deal volume has occurred among those

funds employing a tighter regional focus, and in some cases, sector focus, with a median deal size of all transactions since 2008 of $3.5 million. While the figure undoubtedly skews lower by the fact that the deal values within many of the high value sectors, including financials and telecommunications are often undisclosed, 80% of disclosed deals are less than $15 million, indicating a general scarcity of high value deals.

An increasing number of GPs have taken notice, and rather than compete with the likes of Helios and Carlyle for one of the few big deals that comes through the pipeline, a more effective strategy for smaller, regionally focused funds has been to focus on volume. Novastar Ventures exemplifies this approach. The Nairobi-based and East Africa-focused Novastar has been among the most active fund managers in the region with eight deals since 2014, seven of which were in Kenya. With its $80 million DFI-backed Ventures East Africa Fund I, which closed in 2015, Novastar invests across a variety of sectors in East Africa, including education, technology, and agribusiness.

It is, however, not only locally based, sub-regional funds that are choosing volume over value. The Tunis-based and multi-region AfricInvest has had 13 deals worth a total of $54 million throughout eastern Africa since 2009. While AfricInvest looks for deals across a wider geographic range of eastern Africa than Novastar, it has utilized its Kenya office as a hub to invest in 8 countries throughout the region. With deals averaging $4.5 million, AfricInvest differentiates itself further by focusing specifically on the booming financial services sector.

Pearl Capital Partners (PCP) is perhaps the most differentiated of GPs in the region. PCP is an East Africa-based and focused GP that manages the $25 million African Agricultural Capital Fund (AACF) on behalf of LPs that include USAID, Bill & Melinda Gates Foundation, and The Rockefeller Foundation. AACF funds are earmarked exclusively for East African agribusiness investments. Since 2010, PCP has secured 12 deals, averaging $1.22 million per transaction. Half of these deals were in Kenyan and Tanzanian companies.

Bigger PE houses are beginning to see the value of African fund differentiation, as well. The Abraaj Group's Africa Health Fund, which closed at $105 million in 2011 and is dedicated solely to healthcare investments in Sub-Saharan Africa, has had success in deploying a focused investment strategy, having invested over $14 million in four separate Kenyan healthcare deals. After having secured 18 healthcare investments in African healthcare with two exits,[136] Abraaj is currently raising a second dedicated healthcare fund, The Abraaj Growth Markets Health Fund with a target of $1 billion, which will invest in Sub-Saharan African and South Asia markets.

The segmentation of funds indicates an increasingly developed regional PE market. While international PE houses like Helios Investment Partners and The Carlyle Group have been attracted to eastern Africa's bigger ticket investment opportunities, the market is populated by a large number of smaller, regional-focused and/or sector-focused firms that seek earlier stage, venture and growth investments. Given the size of eastern African economies and the focus on SME investments, 80% of fund managers sensibly employ a strategy that either includes or is restricted to growth capital investments.

For fund managers considering a dedicated East Africa fund, there is a likely advantage in focusing on SME investments. Targeting SMEs provides investors with the opportunity to cultivate a deep knowledge of developing sectors that will likely continue to mature and present higher value investment opportunities in the future. Focusing on this segment not only plays into the region's dominant market dynamics and deal flow, but it also helps GPs who are new to the region to establish the credibility they may need to raise subsequent pan-regional funds. Nairobi-based Fanisi Capital provides a good illustration. Fanisi's first fund was a $40 million multi-sector Venture Capital Fund I, which closed in 2009 and targeted agribusiness, healthcare, energy, retail and consumer services companies in Kenya, Tanzania, and Uganda. Having had success with its East African fund, Fanisi is currently raising Venture Capital Fund II with a target of $100 million, which will be invested throughout Sub-Saharan Africa.

Exit Environment

Even with volatility in the commodity and currency markets driving uncertainty and creating longer holding periods, African PE exits marked a nine-year high in 2015 with 44 exits, an increase from 39 in both 2014 and 2013.[137] Over the two-year period from 2014-15, financial services remained the most common sector for exits (24%), while consumer goods and services (16%), industrials (14%) and healthcare (14%) have also seen high levels of exit activity.[138]

With six exits in 2014-15, East African PE exits were the best performing in Africa, returning two times an equivalent hypothetical investment in the MSCI Emerging Markets Index, assuming the same period as when the PE firms' investments occurred.[139] For comparison, South Africa and West Africa, the biggest PE markets in Sub-Saharan Africa, each posted returns of 1.5x the MSCI Emerging Markets Index.

The uncertainty of a viable avenue for exit has been and continues to be one of the biggest drivers of PE investor hesitation in less-developed markets throughout Sub-Saharan Africa. Much of this uncertainty stems from the underdeveloped and often nonexistent capital markets of these economies, which generally, but not necessarily, have precluded investors from cashing out via IPO.

However, while average holding periods in Sub-Saharan Africa are in fact longer than more developed markets – 4-6 years[140] vs. 3-5 years – the perception that the Sub-Saharan Africa PE exit environment is weak is largely overblown. In eastern Africa, most deals are for growth-stage SMEs and average $3.5 million per deal, meaning that IPOs would only be a viable exit for a minority of high value deals under the best of circumstances. With 80% of eastern Africa fund managers employing a strategy focused at least partially on growth, PE capital is predominately going to SMEs to fund expansionary investments that involve a significant level of active management.

Playing an active role in the development of SME portfolio companies, fund managers are often in a good place to make domestic portfolio companies attractive for acquisition by MNCs via trade sales, which have long been the most popular exit route throughout the sub-continent with

53% of all exits in 2014-15 (and 44% in 2007-13).[141] Trade sales are particular appealing among fund managers in East Africa, as the EAC's integrated economies offer the opportunity for GPs to develop domestic companies' capacity and then, after regional potential has been realized, sell them to MNCs – often from South Africa – who are interested in strategic expansion into new regions or countries.

Secondary buyouts, as the second most common exit route, continue to gain traction as an exit avenue, illustrating the increasingly segmented and diversified food chain of fund managers that are active on the continent. Secondary buyouts represented 18% of exits in 2014-2015 compared to 13% in 2007-2013.[142] As opportunities for follow-on investment and the number high value deals increases, secondary buyouts will likely become an ever more viable exit opportunity.

While holding periods may be longer in Sub-Saharan Africa than in more developed markets, experts indicate that the exit market is poised to improve. In Deloitte's 2015 Africa Private Equity Confidence Survey 67% of surveyed East Africa fund managers expected the exit environment to improve over the next 12 months due to greater interest from local, regional and transnational secondary buyers and trade buyers.[143] The same survey also indicated that fund managers expected future holding periods to decrease, with 54% of fund mangers expecting the average lifecycle from initial investment to exit to be more than five years. This is a decrease from 67% in the 2014 survey.

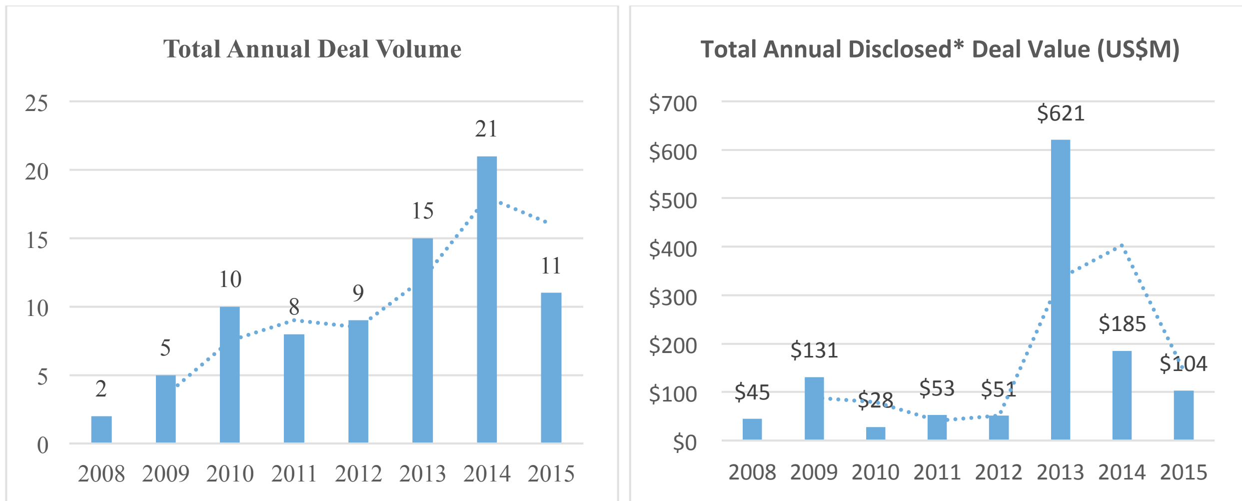
Kenyan PE Landscape Overview

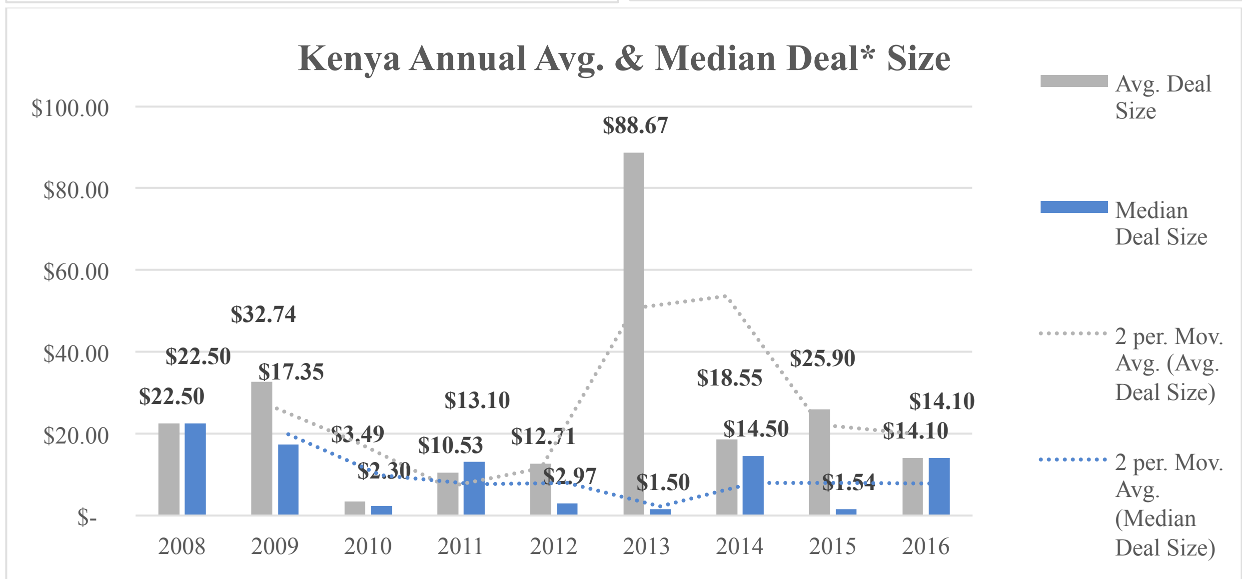
With roughly 50% of the region's total disclosed PE deal value and 40% of the region's total deal volume since 2008, Kenya stands out as the hub for PE investment in eastern Africa. Since 2008, the country has had 83 total PE deals and $1.25 billion in disclosed transactions, and as the most developed market in the region, relatively high average and median transaction values of $27 million and $5 million, respectively (fig. 21).

As the focal point of regional PE investment, Kenyan transaction volume and value have largely tracked PE trends within eastern Africa and the continent as a whole. The Kenyan PE market peaked in 2013-14, with deal value reaching an apex of $771 million in 2013, while a record high of 21 deals were recorded the following year.

In 2015, Kenyan PE deal flow tracked continent-wide PE trends as investment value and volume dropped by over 50%. With a relatively low dependence on energy and mineral exports, and few PE investments in those sectors, Kenya's 2015 drop in PE investment had less to do with commodity market volatility that has driven uncertainty and contraction in several other productive African markets. Instead, Kenya's deal flow contraction can primarily be attributed to the increased currency exposure that investors faced when the Shilling lost 12% of its value over the year. Fueling investor uncertainty was an increased number of headline grabbing attacks by Al-Shabaab. As a result, fund managers demonstrated a wait-and-see attitude in 2015 and the country's PE market temporarily cooled off.

Figure (21): Kenyan PE Transactions 2008 – 2015





*Data for deals with disclosed transaction value only

Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

Going forward, while security concerns do not show signs of abating, prudent monetary policy demonstrated by the Kenyan Ministry of Finance has brought stability to the Kenyan shilling, which should ease GP's concerns regarding foreign exchange exposure. While only two deals were recorded in the first quarter of 2016 – both in the booming financials industry – it is unlikely that deal flow will rebound to its 2013-14 peak this year. However, if EIU forecasts of average annual GDP growth of 6.1% through 2020[144] remain valid, and the Shilling remains stable, investment activity should pick up in the medium term.

Active sectors of Kenyan PE investment since 2008 have increasingly been in consumer-facing industries that include financial services and banks, food & beverage, insurance, retail, and healthcare. Telecommunications, with 10 deals and an average deal size of $58 million has been a significant area of investment since 2008, helping push the Kenyan mobile phone penetration rate up to 88.1%,[145] on par with the U.S. rate of 89% and a remarkable increase

from just 9% in 2002.[146] While additional PE deal opportunities may open up in the future as newer communication platforms and technologies take hold, the recent slowdown in telecommunications deal flow from peak investment of four deals over 2009-10 indicates saturation.

With a large and increasing portion of the population utilizing formal financial systems for the first time, a plethora of PE investment opportunities have emerged in the Kenyan financial services and banking sectors. With 10 deals averaging $10 million each since 2010, investors have been particularly attracted to deals with commercial banks, as an increasing number of domestic and regional banks expand their footprint to meet the growing middle class' demand for retail and commercial banking services within Kenya and the EAC. Other popular subsectors of financials investment have been insurance, microfinance institutions, and commodity exchanges. With a population that continues to urbanize and develops a need for a variety of financial services, investment opportunities should persist.

While lower in average investment value, Kenyan food & beverage companies primarily engaged in agribusiness have been another active area of PE investment with 10 deals since 2009 averaging $3.5 million per deal. Investment picked up in 2013-14, in particular, with 6 deals over the period, driven by an increased consumer demand, both domestic and regionally, for quality food products. Food & beverage investment opportunities should continue to emerge and grow in value, as consolidation occurs to meet the food and beverage demands of an increasingly urbanized Kenyan population.

SECTOR FOCUS: Kenya

Healthcare

Public health services offered in Kenya are generally quite poor. As the middle class grows, Kenyans have increasingly looked to the private sector for their healthcare needs. Since 2000, expenditure on private healthcare has grown faster than the overall Kenyan economy,[147] with the value of Kenyan health services increasing by two thirds between 2005 and 2009 to $753.8 million. While growing overall, expenditure on health care services is increasingly shifting from the public to private sector. From 2000 and 2012, the public allocation of total healthcare expenditure decreased from 45% to 33%.[148] Experts foresee the government's role in Kenyan healthcare to continue to wane. While donors have initially made up for much of the government's funding gap, Open Capital Advisors, a leading financial services and investment strategy firm in East Africa, estimates that private investment will account for 75% of health expenditure by 2025.[149] Supplying this increased demand for private healthcare options will require significant capital outlays. Open Capital Advisors estimates that private expenditure on healthcare will be between $1.8 billion to $3.1 billion by 2025.[150]

Kenyan health infrastructure is subpar, particularly in the public sector, with low coverage, limited diagnostic and treatment equipment, insufficient supply of clinic-level medication, and lack of centralized health records.[151] Beyond service delivery, there is great demand for a more developed insurance market and pharmaceuticals industry. Many experts believe that the private healthcare sector in Kenya is best suited for private equity investors, as effective

investments will require patient, long-term capital.[152] Some fund managers have already been attracted by the Kenyan healthcare industry's growth prospects, with nine PE deals recorded since 2009 for a total of $46 million in disclosed capital in subsectors that include drug retail, healthcare providers, medical supplies, and pharmaceuticals.

After closing its $105 million Africa Health Fund in 2011, The Abraaj Group has established itself as the most active PE investor in East African healthcare, with four of eastern Africa's 14 total healthcare deals since 2009, and three of Kenya's nine healthcare PE deals over the same period. Since 2003, The Abraaj Group has invested over $350 million in 17 healthcare businesses throughout the sub-continent. In 2013, Abraaj co-invested $6.5 million, along with Swedfund, Sweden's state venture capital company, into The Nairobi Women's Hospital to help fund a modernization and expansion plan.[153] Previously in 2011, Abraaj invested $2.5 million in the Avenue Group, a Kenyan hospital and health insurance company, which offers affordable healthcare cover integrated with quality healthcare provision.[154] The investment was directed towards the Avenue Group's domestic expansion plan in Kenya. Abraaj's Africa Health Fund has been financed with substantial support of the Bill & Melinda Gates Foundation, along with other development finance institutions (DFIs) for deals targeted in socially responsible and financially sustainable private health companies in sub-Saharan Africa with a target value of $250,000 to $5 million per deal.[155] The fund has a target IRR of 8-10% per annum.[156]

Despite healthcare investments from firms like Abraaj, studies indicate that the Kenyan healthcare sector still has substantial room for growth and the investment market is far from saturated.[157] With the healthcare sector attractive not just for its financial returns, but also social impact, it is conceivable that the market could present price premiums in a competitive landscape that includes social impact investors and NGO subsidies.[158] DFIs and foundations like the Bill & Melinda Gates Foundation will remain important LPs within private healthcare fundraising.

Pharmaceuticals & Pharmacy Retail

A survey by the National Quality Control Laboratories (NQCL) and the Pharmacy and Poisons Board in Kenya found that almost 30% of antimalarial drugs in Kenya were counterfeit.[159] The trade of counterfeit pharmaceutical products in Kenya has been found to account for approximately $130 million in annual revenue.[160] Experts believe that if quality and affordable drugs were to be made more widely available at reliable retail outlets, the counterfeit market would quickly deteriorate.[161]

Nigeria, Ghana, and Kenya together represent approximately 20% of Sub-Saharan Africa's pharmaceutical production.[162] Of these three countries, only Kenya produces significant volumes for regional export, with between 35% and 45% of Kenyan manufacturers' export revenues from EAC and COMESA countries.[163]

Retail within the healthcare industry is the most profitable healthcare segment within most of sub-Saharan Africa, with net margins often reaching 50%.[164] Most pharmacies are private, single-outlet retailers, leaving significant room for consolidation in the market. Fund managers

are beginning to take note of the opportunity. In 2013, Fanisi Capital invested $1.5 million to fund an expansion of Halton's Pharmacy, while Catalyst Principal Partners' made an undisclosed investment in 2014 to fund a similar expansion of Goodlife Pharmacy, which subsequently secured a second round of financing in 2015 with a $4.5 million injection from the International Finance Corporation (IFC). Kenya's expanding middle class are increasingly interested in these high-quality, one-stop shop pharmacies, as urban population becomes more time-constrained and cognizant of the risks of counterfeit drugs at independent drug retailers.

Financing Healthcare

The IFC indicates that beyond generally high borrowing costs in Kenya, the fragmented nature of the Kenyan private healthcare industry largely precludes healthcare companies from accessing commercial lending, with banks lacking the capacity or desire to lend to SMEs, in general, while attaching greater risk to healthcare firms, in particular, stemming from the banking industry's lack of healthcare sector knowledge.[165]

In general, due to some of the financing constraints illustrated in Kenya, the IFC sees the African healthcare market particularly suited for private equity investment. Looking at the overall sub-Saharan Africa healthcare market, there is significant range in potential deal size, from under $250,000 to over $3 million.[166] Retail, distribution, and outpatient services tend to represent lower value deals, while inpatient services and pharmaceutical production present higher value deal opportunities.[167] With significant financial, as well as social returns, those healthcare sector opportunities that may not normally be financially viable for PE investment become so with international donor co-investment, as we have seen with the 2013 co-investment by Swedfund on Abraaj's deal with Nairobi Women's Hospital, and LP capital commitments from the Bill & Melinda Gates Foundation and other DFIs for Abraaj's $105 million Africa Health Fund.

Kenyan Healthcare Deal Flow

From 2008 through Q1 2016, $58.3 million was invested in 14 healthcare industry deals throughout eastern Africa, including drug retail. Kenya has become the focal point of regional healthcare investment with $46 million invested in nine Kenyan healthcare deals, representing 11% of the total number of Kenyan PE deals and 3% of total disclosed capital invested over that period. With the exception of the four healthcare deals recorded in 2011, the Kenyan healthcare sector has seen deal volume and value spread evenly over the past seven years without any notable trends, though growth remains steady.

Overall, healthcare industry PE deals have averaged $6.6 million. Health Care Providers have had six deals averaging $6.9 million – mainly in Nairobi-based hospitals and treatment centers – has attracted the majority of subsector investment, fueled by increasingly wealthy Kenyans' demand for high quality health services.

The Kenyan drug retail sector has attracted increased attention from PE investors in recent years with two deals that have helped meet consumer demand for greater consolidation in the highly fragmented Kenyan pharmacy sector. In 2013, Fanisi Capital, a $50 million Nairobi-based

fund, invested $2 million in Halton's Pharmacy, providing capital for expansion from 3 to 50 outlets. Subsequently, in 2014, Catalyst Principal Partner's invested an undisclosed sum in Goodlife Pharmacy, capital that was to support a planned expansion from 12 to 50 stores.

These investments reflect the Kenyan middle class' increased demand for higher quality drug retail outlets. The sector is highly fragmented, composed mainly of single-outlet retailers that often have shelves stocked with counterfeit drugs. According to the Kenyan Pharmacy and Poisons Board there are 5,000 registered pharmacies in the country, along with an estimated 15,000 unregistered outlets. With net margins reaching up to 50%, pharmacy retail is the most profitable healthcare segment throughout most of sub-Saharan Africa.[168] With one of the most developed pharmaceutical industries in Africa,[169] fund managers should see further opportunities for pharmaceutical value chain integration and regional retail expansion beyond Kenya's borders into other EAC markets.

The highest PE deal flow volume within the healthcare sector since 2008 was recorded in 2011, when four of the nine total deals were recorded. The Abraaj Group, with three of the nine total Kenyan healthcare PE investments since 2009 (and all in 2011), has established itself as the most prominent GP in the Kenyan healthcare sector, driven by its Africa Health Fund (AHF), a $105 million fund dedicated to private healthcare investments in Africa. Abraaj's AHF is backed by investors that include the IFC, Gates Foundation, African Development Bank, and Norfund.[170] The AHF helps to illustrate the nascent, but growing healthcare sector in Kenya. With its African healthcare-focused fund, Abraaj targets small deals ranging from $250,000 to $5 million with an investment period of no more than five years.[171] In 2011, boosted by Abraaj's three investments, Kenyan health sector investment reached a high of four deals. Since then, the market cooled with just three healthcare investments in the subsequent four years. The majority of private healthcare companies in Kenya are currently early stage, giving way to small deal sizes that will likely increase in value as healthcare expenditure continues to shift from the public to private sector. From 2000 to 2012, public expenditure on Kenyan healthcare decreased from 45% to 33%,[172] while experts forecast that by 2025, the private sector will be investing between $1.8 billion to $3.1 billion, representing 75% of total healthcare investment in the country.[173] With prohibitively high lending rates and the Kenyan commercial banking industry attaching a high level of risk to the fragmented healthcare industry, [174] private equity investors will likely play a vital role in financing the industry in the coming years.

However, as the market for healthcare investments grows, smaller GPs may face competition from multinational firms like Abraaj, which is currently raising its second Africa-focused healthcare fund, Abraaj Global Healthcare Fund (AGHF), at a target of $1 billion. Nevertheless, as the private healthcare market grows, opportunities for segmentation will develop, giving locally based GPs an advantage in identifying earlier stage investment opportunities, while multinational PE houses seek out higher value healthcare deals.

Insurance

Kenya has a modest, but relatively well-developed insurance market that has significant room for growth. According Swiss Re's World Insurance 2014 report, Kenyan insurance premiums

were equivalent to 2.9% of GDP in 2014. The market is much smaller than that of developed markets or South Africa, which has a penetration rate of 14%, but Kenya's penetration rate of rate of 3.17%[175] still compares favorably with other major African economies, such as Egypt (0.7%) and Nigeria (0.3%).[176] Ernst & Young (EY) is projecting the market expand two-fold from 2016 to 2018.[177]

Despite the market's quick growth, vast room for insurance industry expansion remains. As of 2010, only 10% of Kenyan risks were insured, which pales in comparison to most developed countries where risk coverage is typically greater than 90%.[178] In 2009, of the insured market, commercial and industrial property made up 76.9% of all premiums.[179] Foreigners and major corporations make up most of this coverage, while the domestic business market and private lines of insurance have remained underdeveloped, but poised to grow.

Due largely to regulatory reforms, the market is beginning to open up. In 2007, supervision of the insurance sector was transferred from the Ministry of Finance to the Insurance Regulatory Authority, which is entrusted with the provision and withdrawal of licenses, the assurance of solvency and capital requirements, as well as the restriction of black market activity.[180] The move was praised by the industry. Liberalization of the sector primarily through bancassurance arrangements has made it easier for insurance companies to access banks' deep pool of customers at a low cost. Mobile phone technology, meanwhile, has enabled insurance companies to more easily collect payments via mobile money payment platforms.[181]

As of 2014, there were 49 licensed insurance companies in Kenya with premiums reaching just over $1.5 billion in 2013, and 3.2% of GDP in 2012.[182] In 2011, the Association of Kenyan Insurers (AKI) forecasted that premiums would see an average annual increase of 22%, up from the previous five-year growth rate of 16%.[183] Fairly competitive, the insurance sector is without any particularly large firms dominating, facilitating opportunity for consolidation and PE investment in scalable insurance companies. In 2014, Kenya's largest insurance company, Jubilee, accounted for 12.1% of gross premiums, while the five biggest companies together accounted for 38.7% of the market. This left 43 firms sharing the remaining 61.3%, giving an average market share of just 1.3% each.[184]

Several foreign companies – mainly from South Africa – have entered the Kenyan market in recent years, though full foreign ownership in the industry is not permitted. Foreign companies include Pan African Life, Sanlam, Metropolitan, and Old Mutual. Many point to the entry of foreign players as an encouraging sign for the future of the Kenyan insurance sector.[185]

Non-Life Insurance

The Kenyan insurance market is dominated by non-life insurance.[186] According to Sigma RE, non-life insurance premiums represent 65.8% of the total insurance market value in 2014, a slight decrease from 69% in 2005, reflecting the 16.9% annual growth rate of the life insurance segment.[187] However, with the majority of Kenya's population still living below the poverty line, Kenya's life insurance penetration ratio of 1% is low, but still higher than most other African

countries.[188] Of the 2012 non-life insurance market, the most significant segments were car insurance with 41%, medical insurance with 22%, and fire insurance with 10% of the market.

Health Insurance

As of 2012, out of a population of roughly 45 million, 33 million Kenyans – nearly 75 percent – lacked any type of health insurance coverage.[189] Of the insured group, private health insurance policies cover just 750,000 to 1 million Kenyans. Among the primary barriers to accessing private health insurance, cost is the most significant. Average premiums for coverage start at 33% of Kenyans' annual per capita income, compared to 6% of individual income in the US. There is an uninsured or underinsured middle-class market of roughly 10 million Kenyans who desire private insurance, but cannot afford it.[190] Presently, Kenyan health insurance is largely a push market with longer-term potential. Though, in a country with high mobile phone penetration and great familiarity with mobile-based products, partnerships with telecom companies are providing a cheaper platform for distribution of insurance products and collection of payments.

The Role of Technology

Kenya's relatively deep penetration of insurance can primarily be attributed to its relatively well-developed financial sector and innovative platforms for insurance delivery, particularly through mobile phones. Kenya ranked 31st out of 148 countries for financial market development in the World Economic Forum's 2013/14 Global Competitiveness Index (CGI), with only South African and Mauritius ranking higher among African countries.[191] Meanwhile, with a mobile phone penetration rate of nearly 90%,[192] mobile platforms including M-PESA and Airtel Money, offer Kenyans easy access to insurance products, while lowering the cost per customer for insurance companies that telecoms partner with. In 2015, Airtel, a pan-African telecoms company, unveiled its Airtel Insurance package in partnership with Pan Africa Life Insurance. Covering life, accident, and hospitalization insurance, Airtel customers in Kenya are eligible for cash payouts based on how much they spend on Airtel's network.[193]

Kenyan Insurance Deal Flow

Since 2011, there have been three private equity deals in the Kenyan insurance market, with the sector offering relatively high regional PE deal values. Leapfrog Investments, an international fund manager specializing in insurance sector investments in Asia and Africa with over $800 million raised since 2006, has secured two of these three deals. In 2011, Leapfrog invested $13.1 million in Apollo Investments, a Kenyan full-line insurance provider, and $18.65 in 2014 with its investment in Resolution Insurance, one of Kenya's leading health insurance providers. The Abraaj Group, one of East Africa's biggest PE investors, had a 2012 deal worth $44.8 million for a 13.6% stake in UAP Holdings, a full-line insurance provider. Illustrating the interest of international insurance companies in the Kenyan market, the Abraaj secured a full exit of its investment in 2015 after a holding period of just three years when it sold its stake to Old Mutual, a London-listed international investment, savings, insurance and banking group, for roughly $55.6 million at return of nearly 20%.

Many experts point to insurance as the most promising areas for Kenyan PE investment in the coming years. Deloitte's 2015 Africa Private Equity Confidence Survey indicated the insurance

market offers perhaps the highest growth potential among East African investment sectors,[194] while Maria Knapp, Director, Europe and Africa at Control Risks indicates that beyond its high growth potential, "going forward the insurance sector will remain the likeliest focus area for deals due to higher capital demands."[195] With the country's relatively well-developed financial services industry, positive regulatory reforms that encourage bancassurance, and high degree of competition in a market that has not nearly reached its full potential, the Kenyan insurance market offers a pipeline of PE deal opportunities in the coming years, particularly as middle class consumer demand for non-life insurance increases.

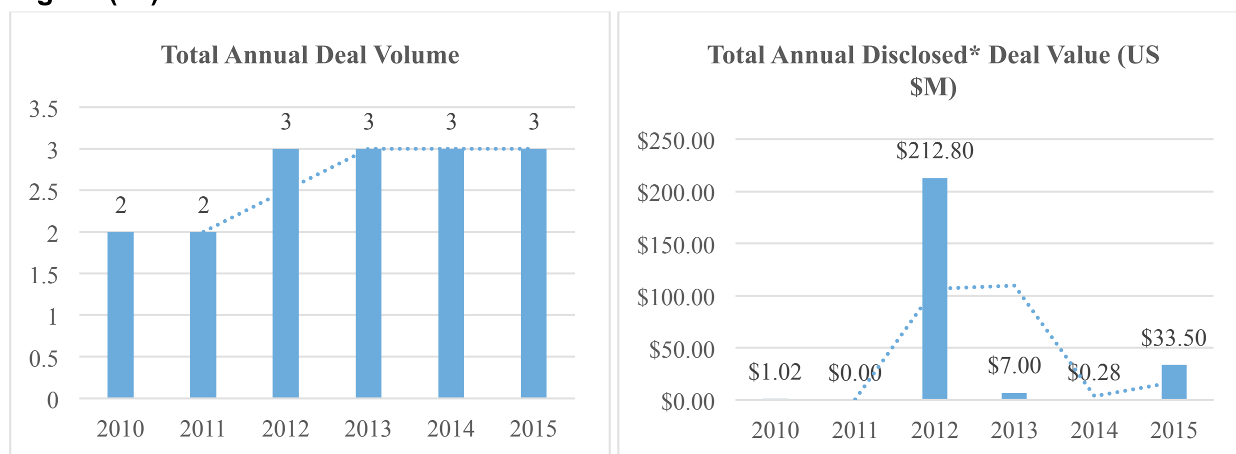
Business Monitor International (BMI), meanwhile, indicates "a bright future for Kenya's insurance industry, with domestic economic growth driving expansion of both the life and non-life sectors."[196] The local insurance market is deep with companies using innovative distribution channels and locally tailored products. In a highly fragmented, competitive domestic market, BMI foresees opportunities for regional and global insurance players to expand into Kenya through local acquisitions.[197] With three private equity deals in the Kenyan insurance since 2011, fund managers are seeing opportunities for growth and consolidation in the market. With transactions ranging from $15 million to $50 million, insurance offers some of the highest value deals in the region.

Tanzanian PE Landscape Overview

While its investment activity has not come close to matching that of Kenya, Tanzania has emerged as one of the top destinations for PE in all of eastern Africa. Since 2008, Tanzania has ranked 3rd among the 12 evaluated eastern Africa countries with our data set, both in terms of total annual deal value and volume, trailing only behind Ethiopia and Uganda in each category, respectively, with 11% of total disclosed regional deal value and 8% of total regional deal volume (fig. 22).

With a PE market that only records two to three deals annually, finding meaningful growth trends within the Tanzanian PE market relative to the continent and region as a whole is problematic. Nevertheless, while annual PE volume in Tanzania has been relatively consistent (fig. 22), the country has recently faced similar macroeconomic conditions as its Kenyan neighbor. The Tanzanian Shilling lost 9% of its value in 2014,[198] and a further 17% in 2015,[199] which would have brought uncertainty to investors facing increased currency risk exposure with their predominately USD and EUR denominated funds. However, with the Tanzanian Ministry of Finance establishing prudent monetary policy and the country's balance of payments improving, the Tanzanian Shilling should remain stable through 2016, easing foreign exchange exposure concerns of GPs.

Figure (22): Tanzania PE Transactions 2008 – 2015



*Data for deals with disclosed transaction value only

Source: EMPEA. Data as of 31 March 2016. Published 2 May 2016.

The sector makeup of Tanzanian PE investment has been similar to its Kenyan neighbor, with capital predominately heading towards earlier stage consumer-facing businesses, including financial services and renewable energy. Agribusiness, however, has emerged as Tanzania's biggest PE investment subsector with 35% of the country's total deal volume since 2008. Continued government-sponsored initiatives to boost domestic agriculture productivity should help drive agribusiness deal flow even further. With a population of nearly 50 million, a stable Shilling, and strong economic projections of average annual GDP growth of 6.4% through 2020,[200] it is likely that additional investment opportunities in other consumer-facing sectors will open up in the near to medium term. Local GP presence in Tanzania is low, with only three fund managers maintaining a local presence in the country. For GPs willing and able to establish deep local networks, establishing a local office or headquarters in Dar es Salaam could provide a first-mover advantage and rich pipeline of early-stage SME deals.

SECTOR FOCUS: Tanzania

Agribusiness

The Tanzanian agriculture sector employs roughly 80% of the nation's workforce and contributes about 30% of overall GDP.[201] Most farming is smallholder-based and productivity is low due to lack of modern technology, subpar infrastructure, and lack of access to financing.[202] The sector has a great degree of potential for increased productivity, with just 24% of arable land currently under production.[203]

Within the agriculture sector, Tanzanian agribusiness is a relatively underdeveloped, yet promising segment for investment. The country has a varied climate and a substantial endowment of arable land. Traditional export crops have included cashews, coffee, tea, and tobacco, while major subsistence crops include bananas and cassava.[204] With a price premium on imports, domestic and regional market demand for domestically produced food products is strong.

The Government of Tanzania has made agriculture development a major policy priority and has been actively engaging the private sector through a variety of policy initiatives. In 2006, the government, through the support of international donors, launched the Agriculture Sector Development Program for 2006-13, which aimed to support:[205]

1. Rural infrastructure, including irrigation
2. Agriculture research and extension services
3. Capacity building among producer associations, public sector service providers, and rural financial institutions
4. Private investment in input provisioning and marketing
5. Regulatory framework reform in the agriculture sector
6. Vertical integration through the establishment of agro-processing clusters

In 2009, the Tanzania National Business Council launched Kilimo Kwanza ("Agriculture First"), an initiative aimed at shifting agriculture from the subsistence to commercial level by facilitating private sector engagement throughout the value chain, including input provisioning, marketing and agro-processing.[206] Subsequently, in 2010, the government launched the Southern Agriculture Growth Corridor of Tanzania (SAGCOT) Initiative, which focuses on promoting agriculture along the most fertile agriculture land corridor within Tanzania, located conveniently along the country's infrastructure backbone, running southwest from Dar es Salaam to the Democratic Republic of Congo, Malawi, and Zambia (fig. 4), a region where maize, rice, beans, livestock, tea, coffee, sugar, citrus, sunflowers, and a variety of other crops thrive.[207] The SAGCOT Initiative aims to:[208]

1. Strengthen infrastructure, including transport, power, irrigation, and storage facilities
2. Develop clusters to connect smallholders to agricultural businesses through contract farming
3. Improve support services among farmers
4. Develop new financing mechanisms for farmers and agribusinesses

The launch of Kilimo Kwanza and SAGCOT in 2009 and 2010 has helped generate a growing PE interest in Tanzanian agribusiness, with 6 deals and a total disclosed investment of $225 million between 2011 and 2015, representing by far the most significant subsector for PE investment in the country.

Figure (23): Southern Agriculture Growth Corridor of Tanzania

Source: http://www.sagcot.com/who-we-are/what-is-sagcot/

Besides the country's productive land and positive public policy environment, Tanzanian agribusiness offers an attractive investment opportunity due to the country's low labor costs, trainable workforce, access to competitive sources of inputs, a quickly growing domestic and regional market, as well as port access to export markets.[209]

Within agribusiness, agro-processing offers a particularly attractive market for private equity investment. Agro-processing is Tanzania's biggest manufacturing subsector, representing a 55% share of all manufacturing in 2008.[210] With most agricultural products currently exported without processing, additional sector expansion is possible.

The Tanzanian agro-processing sector includes 287 companies that account for 65% of total manufacturing employment in the country.[211] More than 80% of these companies are small, bringing significant opportunity for scaling and consolidation. Within the agro-processing subsector, food processing contributes more than half of value added, while beverages, fish products, grain mill products, and animal and vegetable fats and oils represent the most

significant components within the food-processing segment.[212] The government has outlined edible oil, cashew nuts, fruit processing, and milk and dairy products as the agro-processing segments it targets for expansion.[213]

Among the biggest cited constraints within Tanzanian agro-processing are limited commercial farming, lack of access to financing, broken supply chains, low access to agriculture inputs and services, and lack of quality and affordable packaging. With the support of government initiatives like Kilimo Kwanza, private equity offers an opportunity to fill remaining value chain gaps within the agro-processing industry (fig. 24). Storage, logistics, and processing are underdeveloped,[214] while affordable, long term financing is either unavailable or prohibitively expensive. By offering stable and patient growth capital, and leveraging industry experience to help agro-processors improve input sourcing, and improve distribution networks, GPs can facilitate scale in an underdeveloped and promising market.

Figure (24): Agribusiness Value Chain

Source: Dalberg and EMPEA

Despite employing nearly 80% of the population, contributing a third of GDP, and a third of exports, agriculture lending is low. According to the Bank of Tanzania, agriculture finance accounted for only 15.4% of all commercial bank lending in 2015,[215] while surveys indicate that only 11% of agribusinesses have access to credit.[216] According to the Bank of Tanzania, agriculture commercial lending rates range from 14-24%, with the lower band indicating subsidized loans.[217] The Tanzanian commercial lending spread is around 8%, compared to South Africa at 3.4%.[218] The ratio of gross nonperforming loans to agriculture sector is high, ranging from 18% in December 2010 to 58% in December 2011.[219]

The agriculture sector's weather dependence, along with many enterprises' inability to post collateral due to land tenure policy, gives commercial banks a high-risk attitude towards lending.[220] Private equity-based investment vehicles can thus play a vital, disruptive role for financing the industry, while perhaps negotiating fairly favorable deal terms due to businesses lack of alternative financing mechanisms.

On top of its agriculture initiatives, the Government of Tanzania has begun granting permission for private sector entities to compete in the processing and marketing of cash crops, while revising land laws to allow for long-term leases of up to 99 years for foreign companies.[221] The Integrated Road Projects (IRP), meanwhile, aims to open up transport networks including rural roads in key agricultural areas. Additionally, the Business Environment Strengthening for

Tanzania (BEST) incorporates a land registration component under which the Government proposes to provide land titles[222]. Agriculture development stands to be a major driver of growth in Tanzania, with agro-processing providing significant opportunity for value addition.

Tanzanian Agribusiness Deal Flow

With six of Tanzania's 17 total deals since 2011, agribusiness has been the biggest sector of PE investment in Tanzania, and one of the most attractive investment areas in eastern Africa, generally. The Tanzanian government has played a vital role in driving PE capital toward agriculture, primarily through the country's Kilimo Kwanza ("Agriculture First") and Southern Agriculture Growth Corridor of Tanzania (SAGCOT) initiatives of 2009 and 2010, respectively. These initiatives have directed infrastructure investment towards the agriculture sector, while creating incentives for private sector investment. Besides The Carlyle Group's 2012 investment of $210 million in Export Trading Group, Tanzanian agribusiness deal flow has predominately gone toward SME agribusiness companies operating within the SAGCOT zone, with deals averaging $3.7 million, and reflecting the Tanzanian government's desire to increase production primarily among smallholder commercial farms.

For investors interested in agriculture investments, sound environment, social and governance (ESG) standards are critical. International NGOs, such as Grain, have taken to putting pressure on PE funds operating in an industry that groups often view as exploitative.[223] The agribusiness investment landscape has thus become increasingly composed of funds specializing almost exclusively in African agribusiness investments. This degree of sector focus is somewhat unusual in a Sub-Saharan Africa PE market where funds tend to employ a multi-sector investment approach, segmenting themselves more on investment stage and geography, rather than sector of investment.

With agriculture investment among the primary sectors of interest for social impact investors and DFIs, some GPs may find themselves incentivized to specialize in agriculture due to the numerous DFI- and foundation-backed funds that not only provide a deep pool of capital for agriculture investment, but also lend credibility and reduce liability of GPs who might otherwise be accused of exploitative agriculture investments by international NGOs.

Since 2008, there have been nine agribusiness-specific funds active in eastern Africa with total AUM of $596 million. Two of these funds are geographically specific to East Africa, while the rest operate across multiple regions of Sub-Saharan Africa and other emerging markets. Among the agribusiness-focused funds in eastern Africa are Pearl Capital Partners (PCP), Voxtra, Agri-Vie, and Databank Agrifund Manager (DAFML), which together had 20 of eastern Africa's 46 agribusiness deals since 2008. In particular, PCP stands out from the crowd with 12 of these deals in seven East African countries.

Regional agribusiness funds tend to range in size according to the intended geographical footprint of investment. At the smaller end, there is Voxtra's $19 million East Africa Agribusiness Fund, which closed in 2014 and was backed by Norfund and other Scandinavian institutional

investors. At the other end, there is the European Union-backed and Phatisa managed $243 million African Agriculture Fund, which targets agriculture investments throughout the continent.

With Tanzanian commercial banks attaching a high risk profile to agriculture lending, private equity will continue to play a vital role in providing patient, long-term capital for promising domestic commercial food producers in the country. With fund managers' ability to enable scale, these domestic producers are finding an increased ability to compete on price and quality with imported products, despite Tanzania's infrastructural constraints.

The opportunity is illustrated in Mtanga Foods' two rounds of PE financing. In 2012, Voxtra, a Uganda-based GP managing the Norfund-backed East Africa Agribusiness Fund made a $1.5 million investment in Mtanga Farms (MFL), a commercial farm engaged in fully integrated meat production, processing, and distribution in the SAGCOT region of Tanzania. Voxtra's investment enabled MFL to take its seed potato business to a commercial scale, triple its farmed acreage, and significantly ramp up its promising livestock operation. South African-based fund manager, Africa Agribusiness Investments (Agri-Vie) followed with a second round of financing in 2013 with its $6 million capital injection. With 700 metric tons of processed meat imported into the Tanzania annually,[224] these types of investments are helping agribusinesses achieve the scale necessary to meet the increasing domestic and regional food demands of an urbanized, middle class.

Another agribusiness deal highlight came in July 2015 with Fanisi Capital's $6 million dollar investment in Kijenge Animal Products Limited (KAPL), a Tanzanian maize milling and poultry farming and processing company. With the deal, Fanisi secured a significant minority stake with about 40% ownership in the company. Fanisi's investment was to help KAPL expand its product lines and upgrade its plant and equipment, as the company seeks to establish a foundation for its next growth phase.

With an unmet and growing domestic food market, along with a range wide of regional and international export opportunities, vast investment opportunity remains within agribusiness in Tanzania and in the wider region as a whole. However, investors should be aware that agriculture investment has often become politically sensitive due to issues surrounding land allocation, perhaps making it a risky sector for fund managers who have not already been involved in the sector or lack local networks. Likewise, while a high volume of $1 million to $5 million agribusiness deals exists for GPs willing to focus on a few countries within a region, fund managers should be aware that much of the committed capital for agribusiness investment is in form of pre-packaged, DFI- and foundation-backed agriculture-exclusive funds. There are, however, several GPs that have found success in securing agribusiness deals in eastern Africa while remaining sector generalists.

Fanisi Capital, for example, is a Nairobi-based $50 million generalist fund that seeks investment opportunities in sectors that include agri-business, healthcare, energy & natural resources services, retail & consumer goods, and education in Tanzania, Kenya, and Rwanda. Within agri-business, Fanisi looks for opportunities to optimize linkages between production, value addition

and markets within the agriculture sector.[225] LPs backing Fanisi's fund include DFIs and social impact investors such as the International Finance Corporation (IFC), Norfund, Proparco, Finfund, Soros Economic Development Fund, and Lundin Foundation. Fanisi Capital is one of the strongest locally based GPs in eastern Africa with 12 deals since 2009.

Fast Moving Consumer Goods

With a population of nearly 50 million that is increasingly urbanized, Euromonitor International has identified Tanzania as one the 20 Markets of the Future in terms of offering the most opportunities for consumer goods companies globally.[226] In recent years, as supermarkets and other formal retail outlets have increased, the demand has grown considerably for packaged foods, beverages, and personal and household goods in Tanzania, and throughout East Africa as a whole. Demand drivers are largely the same as other booming consumer-facing sectors: urbanization and a growing middle class exposed to new products it can increasingly afford.

On the back of a rising middle class, all Tanzanian consumer categories recorded significant growth from 2009 to 2013. Packaged food, valued at $720 million in 2013, grew by a 14% value CAGR from 2009, with particularly strong growth within oils and fats (14% CAGR), bakery (14% CAGR) and confectionery (12% CAGR).[227] The beverage segment performed strongly, as well. In 2013, the value CAGR for soft drinks stood at 12%, with carbonates maintaining the most significant sales volume and a value of $403 million.[228] While carbonates are the biggest segment within the beverages market, the primary driver of growth has been concentrates with a 25% current value CAGR from 2009 to 2013. Bottled water and fruit/vegetable juice, meanwhile, have recorded CAGRs of 20% and 18%, respectively.[229] Euromonitor International's 2014 to 2018 growth projections for packaged food and soft drinks were 9% and 12% value CAGRs,[230] respectively, driven by assumptions of rising disposable incomes, urbanization and the expansion of official retail channels, such as malls.[231]

Tanzanians primarily purchase household goods from independent, family-owned neighborhood shops known as "dukas". Recently, however, the formal retail market has become increasingly organized, providing middle-class Tanzanians with increased access to diverse products in supermarkets and malls.[232] For the growing middle class, as well as a large population of expatriates, supermarkets are becoming more popular and accessible, as consumers seek greater variety and higher quality products.

African international retailers, including Shoprite, Game (owned by Massmart), and Woolworths from South Africa, as well as Kenya's Nakumatt, are now operating in Tanzania. Currently, up to 80% of goods sold within these retail outlets are imported, particularly from Dubai, Kenya, and South Africa.[233] Overall, private-label products have not yet gained significant retail traction, yet some local consumer brands, including Chemi-Cotex's Whitedent toothpaste are very well established and receive significant shelf space. Likewise, Azam, which is perhaps the most recognizable Tanzanian brand, with its very wide range of consumer goods, including juices, water, biscuits, flour, dairy, among many others, has illustrated the signficant traction that local brands can gain among Tanzanian consumers. In addition to supplying the Tanzanian market,

Azam and Chemi-Cotex are now exporting regionally throughout the EAC and other parts of Africa.

With disposable incomes rising, Tanzania's burgeoning middle class has been shifting its buying habits from beyond essentials to more specialized product offerings. Tanzanians currently spend one-fifth of their income on consumer-packaged goods (CPG) products, driven largely by food, while beverages have become a particularly significant growth category, as well.[234] Euromonitor International is projecting the fastest growth from 2015 to 2020 to be in alcoholic drinks (20% CAGR), hot beverages (17% CAGR) and tobacco (16% CAGR).

Beverages are among the most popular categories within the CPG segment, driven primarily by carbonated soft drinks and tea. Energy drinks are have also gained significant traction among wealthier consumers and are one of the top products desired by the rest of the population, reflecting the growth and influence of the middle and upper classes.[235] Personal care items, including toothpaste, are also among the most popular CPG products in Tanzania.

Prime drivers for purchase decisions include recommendation, affordability, availability and familiarity. Brand loyalty is strong among Tanzanian consumers, who show an affinity for local brands. In a recent Nielsen survey, almost half of the respondents expressed reluctance to change their brands, reflecting the opportunity for first-movers to build strong lifetime customer value and brand loyalty. Private equity deals in domestic, scalable consumer goods companies can thus offer attractive investment opportunities, building domestically branded companies and their expansion strategies.

Tanzania Consumer Goods Deal Flow

Tanzania has had two FMCG PE deals since 2008, both investments made by the Nairobi-based and East Africa-focused Catalyst Principal Partners, which closed its first fund at $125 million, the multi-sector Catalyst Fund I. Catalyst focuses on investments in consumer goods, financial services, technology and industrials, and appears one of the few regional funds directing investment efforts to the promising Tanzania market. In 2011, Catalyst made an undisclosed investment in Chemi & Cotex Industries, a Tanzanian manufacturer of FMCG products include the ever-popular Whitedent toothpaste, as well as a number of other very successful cosmetic and personal care brands. The success of Chemi & Cotex brands, which are now available throughout East Africa thanks to Catalyst's growth investment, is largely due to effective pricing and domestic advertising, which have given Tanzanians access to brand categories that were previously only available as expensive imports.

In 2013, Catalyst made its second Tanzanian investment, acquiring TransCentury's entire shareholding of Chai Bora Limited, Tanzania's leading packaged tea manufacturer. With its investment, Catalyst planned to support the continued growth and expansion of the Chai Bora's business within Tanzania and throughout East Africa.

While FMCG deal flow in Tanzania since 2008 has been limited to Catalyst's two successful investments, there have been 13 total FMCG deals throughout eastern Africa over the same period. Disclosed transactions have averaged $18.5 million. As the retail landscape continues to expand, local brands will continue to offer an important segment of affordable products that appeal to local sensibilities. While multinationals such as Procter & Gamble, Unilever, and Nestle are increasingly active in the market, their brands are generally priced too high for the majority of East African consumers. With local brands such as Chemi & Cotex and Chai Bora catering to a more price conscious consumer demographic, the entrance of international brands into the East African FMCG market, should be encouraging for private equity investors, as their presence not only indicates healthy demand, but also creates viable exit opportunities via trade sale to multinational, strategic investors seeking to capitalize on the local brand strength.

Part III. Strategic Framework for Market Access

Fund Recommendation Overview

East Africa is increasingly becoming the preferred region of private equity investment in Sub-Saharan Africa due a strong and stable regional economic bloc, favorable demographics, a strong mix of productive, consumer-based sectors, and a lack of sufficient debt financing alternatives. Since 2008, the value of eastern African private equity deals has grown by an annual average of 69%, while volume has increased by an average of 26% per annum. It is poised to grow further.

With an increasingly wealthy middle class helping to drive the growth of a range of consumer-facing sectors, the integration of the East African Community (EAC) is helping to make cross-border business expansion between regional economies increasingly viable. While East Africa has some of the fastest growing economies in the world, several individual markets, such as Rwanda and Burundi, are quite small. As a whole, however, the EAC, with a total population of 145 million[236] and a combined GDP of $147.5 billion,[237] offers a much deeper consumer base than any one individual market. As a result of the EAC's liberal cross-border trade environment, GPs will find target companies with relatively high thresholds for scalability given regional market access. The EAC's strong integration makes target companies with regional expansion capacity inherently more valuable, while also providing a richer exit environment; particularly via trade sales to MNCs interested in establishing a regional footprint. It is thus no surprise then that of all Sub-Saharan African funds with a specific sub-region of focus, East Africa-specific funds are among the most popular.

With the exception of recent political instability in Burundi, the EAC's smallest economy, the region has consistently maintained one of Sub-Saharan Africa's most stable political environments. While terrorist attacks in Kenya have made global headlines, the region has lacked the type of sustained insurgency or conflict that would materially affect the cost of doing business or domestic consumer demand. Last year's election of Pres. John Magufuli in Tanzania on a pro-business, anti-corruption platform has been received well, while public infrastructure investment throughout the region is helping to drive down the cost of business. In order to take advantage of the strong economic and political fundamentals of the region, Eastern Investment Advisors (EIA) is recommending that Western Capital Partners (WCP) look to source deals not only within Kenya and Tanzania, but throughout the entire East African Community; the nations of Kenya, Tanzania, Uganda, Rwanda, Burundi, and South Sudan. While country-specific funds are active in Sub-Saharan Africa, besides not being able to take advantage of cross-border business opportunities and a limited number of overall investment opportunities, a country-specific fund would leave a fund increasingly exposed to the regional currency fluctuations witnessed in 2014-15. While subject to many of the same macroeconomic trends, investing throughout the East Africa region would help to mitigate that exposure.

Within East Africa, the most promising sectors for private equity investment are financial services, healthcare, agribusiness and FMCG. These sectors play well into the region's current underlying market fundamentals, which are driven by compelling demographic trends and urbanization. These sectors indicate substantial room for growth, both in terms of deal volume

and value. Considering WCP's previous experience managing multi-sector West African funds and the firm's relative inexperience with East African markets, EIA is recommending a multi-sector, growth-stage East Africa small & medium enterprise (SME) fund in the range of $75 to $125 million. The fund has been tentatively titled "East Africa Fund I." While EIA recommends targeting deal opportunities throughout the EAC, a particular focus should be put on the stronger economies of Kenya, Tanzania, Uganda, and Rwanda.

Strategic Positioning

As the regional hub for international business and private equity, Nairobi is a sensible location for the fund's primary office. Of the over 100 Sub-Saharan Africa funds active in East Africa, 40% either maintain their headquarters or a satellite office in Nairobi. When targeting SME investment in particular, a local presence seems to pay off. Deal flow statistics indicate that since 2008, GPs with an office in Nairobi secured 75% of Kenya's 83 deals. With a median value of $3 million, the statistics indicate that local offices are the ones securing the majority of SME deals.

In order seize unrealized and growing SME market opportunities in Tanzania, EIA recommends that WCP establish a secondary office in Dar es Salaam. GP presence in Tanzania is negligible with only three fund managers maintaining a local office. As a foreign team of investors, developing strong local partnerships will be key. With most deal opportunities at around $5 million or less, developing a strong pipeline of SME growth investments will be dependent on developing a strong source of local knowledge. While Kenya's well-educated English speaking population may help to make the country a natural fit for foreigners conducting regional business, GPs may find promising markets like Tanzania a bit more challenging to navigate without a local presence. Furthermore, in the near term, a local Tanzanian office would provide substantial logistical advantages in deal sourcing and due diligence as most agribusiness target companies are rurally based, making site visits to/from Nairobi problematic. In the medium term, a local presence would help WCP to establish a first-mover advantage in cultivating a pipeline of Tanzanian investments in the same sectors that have established Kenya as the region's preeminent private equity destination.

Fund Size & Investment Allocation

It is recommended that WCP establish a fundraising target for East Africa Fund I of $75 to $125 million, depending on the specific allocation of companies and sectors that the fund seeks to target. EIA recommends focusing investment efforts in the sectors of healthcare, agribusiness, FMCG, and insurance.

Transaction sizes in East Africa, including Kenya, are generally small compared to other more developed markets. Median deal sizes in the region are in the range of $3 million to $5 million, while averages are skewed upward to roughly $10 to $15 million due to a handful of big-ticket deals. East Africa Fund I's SME growth-capital investments will vary according the sector of the target company. Expected investment ranges outlined below are values that will secure significant minority, if not majority, stakes within portfolio companies. As SMEs these growth-focused investments will require active management.

While the specific quantity of portfolio companies allocated to each sector will be subject to market conditions and opportunity, average deal sizes within a sector are negatively correlated to the quantity of available deals within that sector. For example, low-value agribusiness deals will be relatively plentiful, while high-value insurance deals will be relatively scarce. These assumption have been carried into the recommended target fund size of $75 to $125 million. The quantity of companies EIA is advising WCP to carry within its East Africa Fund I portfolio takes account of market conditions, projected deal flow, and opportunities for exit, with an eye toward diversification.

Sector Recommendations

Healthcare has become one of the most promising sectors of investment in recent years, particularly in Kenya. However, with similar demographic and urbanization trends occurring throughout the EAC, healthcare investment in regional subsectors that include healthcare providers, pharmaceuticals, medical supplies, and drug retail, will continue to gain traction as populations seek out private healthcare services in place of subpar public facilities and services. Recent PE investments in healthcare reflect the nascence of the industry, with deals averaging $4-6 million in expansion capital. These investments fit well into the portfolio of the proposed $75-$125 million East Africa Fund I.

However, there will be competition. PE investment in East African healthcare has grown considerably with the entry of a number of healthcare-specific funds, including a $105 million managed by The Abraaj Group, which is in the process of fundraising a second healthcare fund. Given the growth of the market and relatively early stage of investments occurring, the entry of healthcare-focused funds should not discourage WCP from targeting the sector. Nearly all of these deals have thus far been in Kenya where large PE houses like Abraaj tend to focus their investment efforts. With a stronger eye towards the other high-performing markets of the EAC, including Tanzania and Uganda, a pipeline of investment opportunities should emerge. Healthcare deals can be expected to range from $3 million to $15 million, with higher value deals secured primarily in the subsectors of healthcare providers and pharmaceuticals. A relatively high volume of regional healthcare deals can be expected in the near term, providing evidence to estimate that healthcare sector deals could form roughly 25% of East Africa Fund I's total estimated portfolio of 17 companies.

Agribusiness has become among the most active areas of regional PE investment. Land within the EAC is highly arable, but underutilized. As populations have become more urbanized, there has become a greater demand for large-scale, domestic food production. Recent infrastructure improvements are improving market access, while government initiatives like Kilimo Kwanza in Tanzania are incentivizing and creating environments conducive to commercial agribusiness activity. Private equity can take advantage of these improvements, scaling commercial agriculture and improving supply side productivity. The EAC's strong regional and international export markets create an environment conducive to scale and, as a result, exit. Recent agribusiness investments have resulted in a high volume of small investments ranging from $500,000 to $5 million in expansion capital for businesses almost exclusively focused on the

domestic market. East Africa Fund I's agribusiness investments can be expected to fall within this price range and will likely form roughly half of the estimated 17 companies that WCP aims to hold within the East African Fund I portfolio.

Financial services continue to be one of the most substantial sectors of PE investment throughout Sub-Saharan Africa. Thanks to urbanization, an expanding middle class, and innovative technologies that have made customer servicing cheaper and easier, since 2008, eastern Africa registered 51 financial services deals across a wide range of subsectors. Within East Africa, the insurance market is poised to become the most promising subsector of financial services investment. Deals within insurance have principally taken place in Kenya, though evidence points to a growing demand for and environment conducive to insurance market development throughout the rest of the region, as well. Regional insurance deals within the past few years have been few (just seven since 2008) but also high in value, with disclosed deals averaging $25 million. While deals of this size do not necessarily seamlessly into the fund's SME profile, WCP's previous experience executing insurance deals in the more developed Nigerian financial services market lend the firm credibility needed to secure deals in the more nascent East African market. Particular opportunities should be sought within the non-life insurance category and focus on both commercial and consumer-based lines of insurance. Financial services and insurance deals will require the most significant capital outlays, with expected transaction sizes ranging from $10 million to $30 million for a significant minority stake. Financial services and insurance deals should be expected to make up 10-15% of the East African Fund I portfolio.

Fast moving consumer goods (FMCG) are another one of the most attractive investment sectors. Deals within this sector are built on the expanding and increasingly urbanized middle class. In recent years, throughout East Africa, a number of successful domestic producers of packaged foods and beverages, personal care, and household goods have cultivated a significant base of domestic consumers who maintain increasing disposable incomes for non-essential goods, but cannot necessarily afford expensive imports. Domestic FMCG companies are offering more affordable prices and locally tailored branding and advertising that appeal to this group. PE deals with FMCG companies have thus been on the rise, with 13 deals throughout eastern Africa since 2008. Given demographic trends and predictions for continued economic growth throughout the region, it is likely that the demand for FMCG will only grow further. Giving the scaling requirements necessary to make these companies attractive for trade buyers or secondary buyout, a significant minority or majority stake in these companies will required in order to bring operations up to international standards and exert necessary influence on family-dominated boards. FMCG deals in the region, while varying significantly depending on the stage of investment, can be expected to range from $1 million to $5 million at the SME growth stage. Deals within FMCG can be expected to make up 10-15% of East African Fund I's portfolio.

Fundraising & Target LPs

The most popular source of fundraising in East Africa will continue to be development finance institutions (DFIs). DFIs tend to like East African investments due to the "impact" orientation of

the regional private equity market. With most regional PE capital going towards SMEs, DFIs can link their investments to job creation and economic development. Deloitte's 2016 survey of East African fund managers indicates an expectation that DFIs will further increase their share as a source of total East Africa fundraising in 2016 up to 74% of all funds raised.[238] Deloitte primarily attributes the increase in DFI sourced funds to the contraction the European market, which has caused European DFIs to shift more capital to Africa. Throughout the continent, DFIs have long been valuable as anchor investors in Sub-Saharan Africa fundraising. WCP would be wise to focus initial fundraising efforts on DFIs, securing the initial capital necessary to lend credibility to the fund. With a DFI anchor investment, WCP may find it easier to attract institutional LPs who have long demonstrated some level of risk aversion toward investments in Sub-Saharan Africa, though that is beginning to change.

While regional fundraising will continue to focus on DFIs in the near term, there is growing hope that a significant pool of capital will emerge with the continued reform of East African pension fund capital allocation requirements. Throughout most of East Africa, recent reforms have made pension fund allocation to private equity permissible – typically at a cap of 5% to 10% and through an "other" designation. However, regulations generally include a number of caveats and take-up has been quite low. Risk-averse pension fund trustees continue to show preference for short-term, low-growth government bonds. Private equity associations, such as the East Africa Private Equity and Venture Capital Association (EAVCA), which was formed in 2013 by regional PE houses, could help. While EAVCA can use its network to lobby governments to create better incentive mechanisms to drive trustees to invest in private equity, one of the most significant roles that regional PE associations can play is to create a greater understanding of private equity as an asset class. It is the ignorance of PE as an asset class among bureaucrats that many believe is primarily reason for African pension fund reluctance toward PE investment.

While necessary reforms may not be in place in time for Western Capital Partners to raise its first fund, domestic pension funds will most likely be playing a significant role in Sub-Saharan Africa fundraising in the near term. In the meantime, given the strong orientation of WCP's East Africa Fund I toward SME investments, DFIs should be the primary target of fundraising. European DFIs, in particular, have demonstrated a strong interest in East Africa. Scandinavian DFIs, including Norfund, have taken a keen interest in agribusiness financing, while international foundations including the Bill & Melinda Gates Foundation have demonstrated particular interest as LPs for healthcare specific investments. In addition to playing into regional fundraising dynamics by targeting DFIs, WCP will want to leverage its extensive LP networks in West Africa. With the commodity market downturn putting contractionary pressure on the Nigerian economy, in particular, WCP's LPs from previous West African funds may find particular attraction in the current portfolio diversification opportunity in the form of East Africa Fund I.

Exit Avenues & Holding Periods

The most dominant exit routes across Africa remain trade sales to strategic investors followed by secondary buyouts by PE funds. As an SME fund focused on growth financing, East Africa Fund I will find these two exits avenues to be the most promising. The idea is to build a profile of scalability into portfolio companies, making them attractive acquisition targets for multinationals

seeking to enter the region, or as targets for secondary buyout by international PE houses that aim to scale these companies through additional rounds of financing. IPOs would be the least attractive exit route due to the immaturity of regional capital markets and the early stage of East Africa Fund I's investments.

The holding period of East Africa Fund I investments can be expected to be 4-6 years, if not slightly longer. As SME growth stage investments, these will be significant minority, if not majority, deals. Investments will require the substantial strategic and operational support from Western Capital Partners in order to create value, and as a result, longer investment time horizons.

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