Inside Perspectives: An Interview with Okechukwu Enelamah of African Capital Alliance

Okechukwu ("Okey") Enelamah, a Founder and Chief Executive Officer of African Capital Alliance (ACA), spoke with Nadiya Satyamurthy of EMPEA's Research Department during the 14th Annual Global Private Equity Conference in Washington, D.C. to share his insights on the opportunity set in Africa and offered his advice on how to convert growing LP interest in the region into capital commitments. ACA is a private equity firm investing in West Africa, principally in Nigeria and countries in the Gulf of Guinea. With over US$700 million in fund capital raised to date, ACA is focused on mobilizing capital, technology and management resources from local and international sources to unlock Africa's private sector potential.

You have personally been involved in Africa's private equity industry for nearly two decades, starting in South Africa and then focusing on Nigeria and the broader West Africa region. How has the environment for sourcing deals evolved and where do you currently see the greatest investment opportunities?

Deals often come out of important trends in the macro environment. In the mid-1990s, when I was in South Africa, the key development there was economic democratization, following Mandela's successful democratic presidential election. As a result, blacks became more meaningful participants in the economy and conglomerates began to focus on their core businesses, therefore enabling opportunities for new groups to invest. Taking the same approach to Nigeria, I saw that the private sector had to, and would, play a meaningful role in the economy as a result of the political democratic process there. When Obasanjo became president in 1999, one of the key thrusts of his government—and one that remains in place today—was the deregulation of key sectors of the economy to allow meaningful private sector participation and leadership.

We have seen a great amount of deal flow coming out of deregulation—one sector in particular from which we have benefitted disproportionally is telecoms. However, the factors driving growth in this sector are not unique to telecoms; we see the same patterns in power, financial services, oil and gas, etc. The main driver is significant pent-up demand for basic services that people require to live a good life in a modern economy. When the public sector dominates, the lack of competition leads to little innovation; but when you let the right players come in, services tend to improve. As the key sectors in Nigeria deregulate, we have brought in private equity capital and expertise, including management, to be part of that process, and the returns have been there to show that the effort has been worthwhile.

In looking at Africa's broader commercial environment, large corporations certainly offer local private equity players opportunities as potential exit strategies. But what impact, if any, do these corporates have on initial deal flow?

With regard to corporates, one of the biggest trends we are paying attention to is an increase in outsourcing. Historically, you will find that when an economy is somewhat closed, as was the case in Nigeria, there aren't many suppliers of services available. For services that were mission critical to companies, whether it was in data or telecoms, firms often did everything themselves. Companies would literally hire people and buy equipment in order to have everything in-house. However, as more established players come into a market, companies are increasingly prepared to outsource these services. It is a great private equity investment to partner with providers of non-core services to big corporations—such services are usually not very capital intensive, so the return on capital tends to be quite good.

One of the best performing investments in our portfolio was a company called Outsourcing Services Limited (OSL). OSL was a joint venture with a South African company formerly called Gray Securities Services that provided security and asset protection services for large corporates in South Africa and Southern Africa. We invited them to partner with us in Nigeria to perform the same services. We put up less than US$1 million in capital and the company literally grew by leaps and bounds before we sold it after some years for a healthy investment return. But it wasn't just the capital that was required to generate a strong return; it was putting the company in touch with the market opportunity in Nigeria, including helping them to recruit locally, obtain a license, and deal with all the other local factors. It is not just about the capital, but what comes with the capital.

The enormous amount of recent global investor interest in Sub-Saharan Africa has not yet translated into a significant flow of LP capital into these markets. In EMPEA's most recent LP Survey, political risk ranked as a leading concern for LPs considering investing in the region. What additional factors are deterring investors and how do you address their concerns?

In our experience, the best way to respond to risk is through an understanding of the problem and being able to respond in an informed and disciplined manner. This approach resonates well with private equity, because private equity works best when people play in the markets and sectors they understand and with teams that are hands-on. When you do that, you will find that even in the midst of risk, you can make things work. This explains how, even though there are problems in Africa, people are making money in these markets. That doesn't

African Capital Alliance: Sampling of Investments to Date

Fund	Company	Country	Sector	Transaction Value (US$m)	Transaction Date	Equity (%)
CAPE I	GS Telecom	Sub Saharan Africa	Telecommunications	3.8	Dec-98	40
CAPE I	MTN Nigeria	Nigeria	Telecommunications	10.7	Sep-01	2
CAPE I	ABC Transport	Nigeria/West Africa	Transportation	2.3	Feb-03	30
CAPE I	Dorman Long	Nigeria	Oil and Gas	2.7	Dec-04	45
CAPE II	Swift Networks	Nigeria	Telecommunications	7.8	Jul-06	30
CAPE II	Cornerstone Insurance PLC	Nigeria	Insurance	26	Feb-07	51
CAPE II	MTN Nigeria	Nigeria	Telecommunications	15	Mar-07	1
CAPE II	eTranzact	Pan-African	Financial Services	7.5	Dec-07	32
CAPE III	First HydroCarbon	Nigeria	Oil and Gas	30	Oct-10	13
CAPE III	Union Bank Nigeria	Nigeria	Financial Services	75	Mar-11	10

mean everyone can make money, but those who understand these markets and can address the risks can still get results. It is for this reason that informed LPs will always tell you that they are very big on manager selection.

One of the main limiting factors in Africa is capacity. The capital right now is looking for enough fund managers that understand these markets and have the track record, deal flow and capacity to deploy. Rather than be passive about this problem or moan, my attitude is to throw this challenge back to the industry and say we need to raise our game in terms of the quality of our fund managers. We need to help mentor and encourage other players to come into our markets. It is not a bad thing to have the bulge bracket firms, first-time funds and the new sector specialized funds come in. It would be narrow-minded to want to limit competition—you need everyone to sell the attraction of private equity as a channel to access the market. We all have a vested interest in bringing in more LPs—and most LPs choose to back more than one manager anyway.

The huge influx of people interested in Africa, but not converting, should be viewed positively as the first step in the commitment cycle. When I was in business school, I remember learning about how a purchase happens—the key was to get people into the store and then move them to a purchase. Here it is the same thing, but the cycle is longer. Of the people who actually visit us, the conversion rate is very high: we probably convert 2 out of 3, if not 3 out of 4 LPs. When people talk to me, I focus on what will it take to draw them closer to the market because the reality of Nigeria is much better than the perception. Nigeria is certainly not heaven on earth, but the perception is so bad that it is almost an advantage. When people come and see the energy, the vibrancy and quality of the people, the fact that businesses are doing well, they generally tend to want to progress to the next step.

In December 2010, we saw Nigeria's National Pension Commission (PenCom) grant local pension funds permission to invest up to 5% of their assets in private equity. However, despite these efforts to unlock local pension capital for the asset class, few of the pension funds have invested into a Nigeria-focused private equity fund. What still needs to be done to engage these local LPs?

Our number one challenge is developing a greater understanding of the asset class. Private equity is specialized, and while local investors may like the sound bites associated with it, they still need to know it better before they can commit capital. Most local LPs see private equity as a black box. In response, there has been a huge amount of education taking place to help them understand the asset class, the players, the track record, the deal flow, etc. Many of these LPs have also engaged the international development finance institutions (DFIs) and other players from outside of their markets to partner with them. The initial results have been positive: we have received about US$45 million from local pension funds into our third fund.

Many of the original requirements set by PenCom were designed to be fairly stringent and conservative in order to be prudent with pensioners' funds. For instance, regulations state that fund managers should employ investment professionals with ten years of experience, which is not very common in Africa. They additionally require fund managers themselves to invest up to 5% of the fund size, which is high for the industry. However, when we as an industry went back to PenCom with our feedback, we were received very well. We expect to see a new set of guidelines coming out that reduce the required fund manager commitment to a more realistic percentage. In addition, regulators are now prepared to accept professional experience that may not be specifically related to private equity, but is nonetheless relevant.

The Nigerian example is not dissimilar from the rest of the continent in the fact that regulations were set up in a very conservative manner. People do not want to lose money; they have more of a risk aversion than an appetite for return. We have to demonstrate to these local investors that, at least on a portfolio basis, funds under experienced fund managers are unlikely to lose money. I have had deals that lost money but have never been in any fund that lost money on a portfolio basis. LPs need to understand that private equity is an

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investment vehicle where there is a reasonable probability that they could make their money several times over.

Given the lack of a formal private equity index focused on Africa, how do you measure your performance as an investor in the region, particularly in markets that do not have robust stock exchanges?

The major DFIs that have invested across Africa (IFC, CDC, FMO, EIB, etc.) have the most data. In terms of benchmarking and actual investment results, my understanding is that Africa stacks up very well. I'm not someone given to competition as a matter of personal philosophy, but I know that we live in a world where relative performance matters. The good news, which is contrarian, is that people who focus on "running their own race" tend to perform well. By just trying to do what I am doing well and encouraging others to do the same, I find I tend to come out ahead.

It is my understanding that the first fund we invested in is one of the best performing funds on the African continent with a return of approximately 15x. There was a huge amount of luck and good timing there, so we don't take excessive credit for it, but it is still a good result. However, we know there is much room for improvement, so we are trying to strengthen our team quality as well as our profile. Exposure to the LP community is important to becoming more sophisticated. Fund managers need to speak in a language that the LPs understand and know their customer requirements and needs, rather than just presuming LPs will accept them the way they are.

We want to do our utmost to encourage investors to see that our returns have been there, as have the investment results of the other established players in Africa. In this regard, we are very happy to work with the African Venture Capital Association and Cambridge Associates on the development of an Africa-focused private equity performance benchmark. This information needs to get out in a more robust manner. Investors may say, 'I wish I was in your first fund or second fund,' but they really want to see that this is in your DNA. They want to see that these are the results the market will offer going forward and that it is not just a fluke.

What opportunities and/or challenges is the growing interconnectivity between emerging markets creating for the private equity industry? China in particular is playing a more prominent role in Africa, including in West Africa, through agreements in oil and infrastructure projects, among other ways. What impact, if any, will a slowdown in China have on the region?

Capital flows is one area where we are seeing increasing interconnectivity between emerging markets. The United States and Europe are no longer the only sources of capital; there is a surplus of money in other parts of the world, such as Asia, the Middle East, Russia and Africa, that has become very important to private equity. A second area highlighting greater interconnectivity is sector-specific expertise. For instance, India has been a great provider of healthcare services and they are now taking their expertise abroad and coming to our markets. In the oil and gas sector, services are ramping up with support from China. In terms of intra-Africa connections, we have seen a number of South African companies expand into Nigeria. Finally, we see growing interconnectivity in terms of people: resources, expertise and management. People are now hiring from all over the world.

China has become a factor, but China is not the only game in town. A slowdown in China may lead to a decline in oil prices, which will in turn have an impact on Nigeria. But it is the same way a U.S., European or Japanese slowdown will have implications in the broader context of globalization. Having said this, Africa, remarkably, has not been directly correlated to all of the problems in the West. A slowdown in China may not significantly impact Africa because the growth in Africa is fundamental.

To give an anecdote, we invested in MTN Nigeria in 2001, which was the same year the telecom bubble burst. Some of the LPs in our fund, who were based abroad, expressed concerns about us investing in this sector. We told them that mobile phone services in Nigeria would sell very well, independent of the global slowdown. While they thought we were being insular and not paying attention, the history is there now to prove our case as MTN is one of our most successful stories (although not the only one). The lesson here is that we have a fundamental opportunity in terms of pent-up demand. Growth-led as opposed to momentum investing is what makes Africa so attractive.