EAVCA

East Africa Venture Capital Association

EXITS COMPENDIUM

APRIL 2023

Introduction

As part of the EAVCA compendiums for 2023, EAVCA is delighted to present the first issue examining the private equity (PE) exit landscape in East Africa. Through analysis of investment data and interviews with executives, this compendium provides insights into the factors that impact successful exits and the outlook for the East African private equity market.

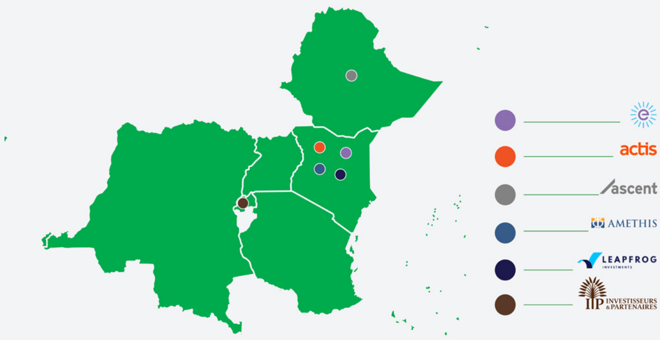
Market Highlights 2022

Drivers of Exit

1. Fair value of portfolio companies:

To achieve profitable exits, private equity (PE) investors need to establish a balance between value creation and the market's willingness to pay. A business needs to be sold while its growth is accelerating to increase buyer appeal. Finding the balance between the size and the market's willingness to pay is essential for generating sufficient value for the investee firm, enabling a profitable exit. When investing, PE investors need to consider the inflection points in valuation and ensure that the market's valuation of the investee firm aligns with their own value creation efforts. Finding this balance can be challenging, but it is crucial for driving successful exits in the private equity market.

EXITS 2022

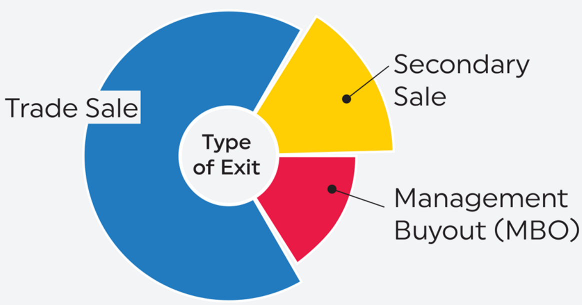


Disclosed deals 2022.
Exit activity remained highest in Kenya with 4 deals. Ethiopia and Rwanda each registered 1 exit.

2. Demand by strategics: Trade buyers drive the willingness of PE investors to exit by providing an attractive exit avenue as compared to other exit options. They bring a different perspective to the table and are interested in acquiring companies that can complement their existing businesses or help them enter new markets. Additionally, their expertise and resources can help the investee company continue to grow and expand, which may be attractive to the PE investor who wants to see the company thrive post-exit.

3. Competition: Depending on the competitive landscape in which the underlying portfolio entity operates, the availability and number of similar companies looking for investors through a capital raise or buy-outs can impact pricing at exit. This would also be true if there are multiple PE investors exiting similar investments at the same time, although this scenario is yet to be experienced in East Africa. On the other hand, if there are PE investors looking to acquire attractive companies their preference would be to acquire companies in which there is a PE investor.

PREFERRED EXIT MODES



Preferred exit modes 2022.
Exits were mainly through trade sales (strategics). Trade sales and secondary buyouts remain active and are likely to increase as the industry matures.

4. Timing: Timing is an interesting aspect of PE investing. Every PE investor develops clear value creation initiatives prior to investing and the expected investment return metrics over time. The right time to exit an investment will be dictated by the holding period or the receipt of an attractive offer - from a potential buyer - that matches the expected return of the PE investor.

Spotlight

1. Amethis Finance Exiting Naivas Ltd.

AMETHIS Entry 2020 Exit 2022	Portfolio Company Naivas Sector FMCG Country Kenya	Exit to IBL and other investors Type of Exit Strategic

Amethis invested in Naivas during a risky period that was characterized by major retailers in the Kenyan retail sector running out of business. They identified Naivas as having great market potential and worked closely with Naivas' management team to improve operational efficiency, expand Naivas' product offerings, increase its digital capabilities, expand its network across the country and strengthen the brand. Digitizing operating models and investing in centralized data rooms increased the appeal of Naivas to potential acquirers. The data allowed Naivas assess granular components of their business and achieve growth by opening other lines of business.

Within the first 2 years post-investment, Amethis received an attractive offer to sell their investment through a trade sale and successfully exited their investment to a consortium of investors led by IBL Group, Mauritius. Amethis nearly doubled its initial investment and generating significant returns for its investors. Naivas also found a fitting long-term strategic partner to bring in more expertise for its future path. Leveraging on East Africa's open economy and large population, Amethis achieved their expansion prospects over a shorter holding period.

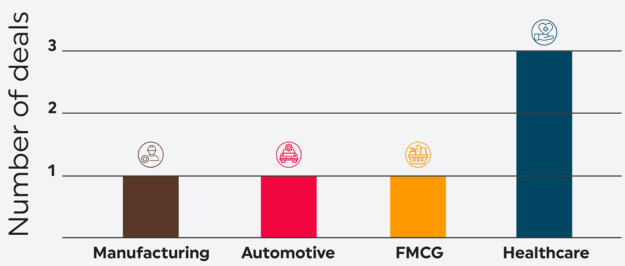
2. Ascent Capital Exiting MedPharm Holdings

ascent Entry 2015 Exit 2022	Portfolio Company Medpharm Sector Healthcare Country Ethiopia	Exit to Cerba Lancet Africa Type of Exit Strategic

Medpharm holdings is the sole owner of International Clinical Laboratories (ICL), a leading medical diagnostics provider in Ethiopia. Medpharm was the first investment of Ascent's vintage fund through a growth capital fundraise. Medpharm was able to expand its services across Ethiopia and other Sub-Saharan countries.After a holding period of 7 years, including a 3-year interruption by the COVID-19 pandemic and the social-political situation in Ethiopia, Ascent was still able to successfully exit its investment through a trade-sale to Cerba Lancet Africa, a leading provider of laboratory services across Sub-Saharan Africa, more than doubling its initial investment.

This successful exit is the first for an SME in Ethiopia, demonstrating the country's potential for investment and highlighting opportunities for growth, profit, and impact in the healthcare sector.

DEALS BY SECTOR



Deals by sector 2022.
The healthcare sector registered the highest number of exits in 2022, demonstrating the potential for deals in this sector. Areas of focus include improving access to diagnostics and treatments, as well as building local healthcare capacity. Private equity investors can make healthcare available and affordable to the middle and low-income population through public-private partnerships, which not only generate profits but also create impact on a well-served population.

Positioning For a Successful Exit

Pre-Investment

Thorough due diligence (DD) is crucial for successful investments in emerging markets. This includes understanding the company's operations, market position, and growth potential to assess the risks and challenges. A well-planned strategy can then be built to help PE investors navigate unforeseen circumstances, as seen with Amethis' strategy that lasted them through the pandemic, and into achieving a successful exit.

Having a well-defined exit strategy from the beginning is crucial. The DD should include aligning exit mechanisms and expectations between the PE investor and the potential investee, and other shareholders/sponsors and the Management team. Aligning management incentives with the PE investor return expectations always yields positive results. Potential exit routes should be analyzed, and the most viable option selected while considering timing and process.

Different jurisdictions have different regulatory frameworks and having this in mind at the outset helps visualize the end game. In East Africa, there are several regulators to consider depending on country/jurisdiction and industry. For instance, in addition to COMESA regulations, there are more than four (4) competition authorities to consider: The Competition Authority of Kenya (CAK) – Kenya; The Fair Competition Commission (FCC) – Tanzania; The Ethiopia Investment Commission (EIC) – Ethiopia; and The Rwanda Inspectorate, Competition and Consumer Protection Authority – Rwanda. Currently, Uganda has no competition authority. There is, however, a Competition Bill before Parliament which, if passed, could result in the operationalization of one. The framework set up by these authorities will have to be considered alongside other industry regulators e.g., Central Banks, Insurance Regulatory Authorities and Capital Market Authorities of the different countries.

A good exit strategy should consider the restrictions, approvals, and jurisdiction of the investment, and the deal structure should be designed accordingly. For Ascent, the structure of MedPharm made it possible to execute its transaction viably and secure the proceeds of sale in foreign currency. This was only possible through investing in the right structure prior to investing. Having the right advisors can help navigate the regulatory landscape and ensure a smooth exit

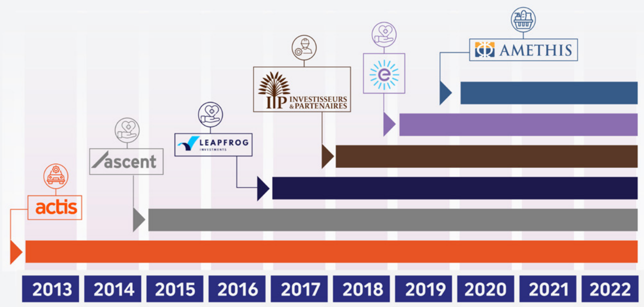
Holding Period

To boost a firm's exit readiness during the holding period, PE investors should provide active engagement, training, and support to enhance value generation. This creates a sustainable, value-driven organizations with a strong market position, generating cash flow and growth by expanding into new territories and introducing new products or services through strategic partnerships.

With global supply chains having become increasingly important, PE investors should ensure that best practices and good governance measures are upheld to make businesses sustainable to better grasp opportunities with secondary investors. Like Ascent, PE investors should be prepared to take an active role in managing portfolio companies to overcome limited operational expertise and institutional infrastructure. They should gain a deep understanding of the market and create deep networks to better position themselves to benefit from the opportunities presented by the economy. Amethis supported Naivas through operational improvements, expanding the store network, and strengthening the brand, proving that active management can create value.

To prepare for an exit, regular and transparent conversations about exit options should take place throughout the holding period. PE investors should also consider having conversations with potential buyers of their investee companies. The exit team should build the appropriate infrastructure for the chosen exit route as the process approaches.

AVERAGE HOLDING PERIOD



Investment period.
The average investment period was 5 years. With holding periods of between 2 and 9 years. Longer investment periods were due to due diligence curtailment during the pandemic following restrictions on travel and lockdowns leading to deals being concluded outside the average 5-7 years.

Exiting

A rigorous exit process should start with selecting an advisor whose strengths align with the chosen exit strategy. A concrete follow-up system should be established to ensure nothing is overlooked, and tax planning is important to minimize tax leakage and optimize tax implications, including transfer pricing.

Selecting the right partner is crucial, as demonstrated by the MedPharm-Ascent-Cerba Lancet Africa deal. Ascent provided strategic guidance for MedPharm's expansion, ensuring alignment with the acquirer to preserve and scale sustainable business practices. Cerba Lancet Africa was a strategic buyer with a long-term pan-African expansion plan and sought to enter Ethiopia through a local experienced firm.

A good understanding of the regulatory framework in the country of exit is important to avoid jeopardizing the exit. With the help of the right advisors, Ascent was able to obtain regulatory approval and sell the business at an attractive profit.

With proper planning and execution, PE investors can sell their business at an attractive profit. The success of both highlighted deals was the result of a carefully planned and executed process, which generated value for all parties involved.

Opportunities and Outlook

PE activity: PE activity is expected to increase due to venture capital investments and increased DFI participation. As vintage funds reach maturity, more exits are anticipated, which will lead to higher private equity activity towards the end of the year. PE activity is also expected to remain active due to global growth dynamics, which will see a resurgence in trade player interest in sub-Saharan Africa, with East Africa having an advantage due to its diversified consumer market and significant investments in infrastructure across the region.

Currency risk: Foreign currency shortages and exchange rate fluctuations are expected to pose challenges to equity investing. PE investors have been keenly looking to invest in export-oriented businesses to help manage foreign currency risk.

Country risk: PE investors have been investing across sectors and geographies to diversify their portfolios and hedge against country risk. In addition to diversifying across countries, strong relationships between governments and PE investors can lead to policies that are both investor and business-friendly and can change the region's perceived business environment. East Africa offers well-diversified markets with Kenya having less market interventionist policies, Tanzania enacting favorable policies for foreign investment, DRC joining the East African Community (EAC) presenting a new market for regional business, Uganda having a strong currency and developing an oil pipeline, and Ethiopia being expected to be more stable after the implementation of the peace deal in Tigray.

The growing middle class: Rising incomes, urbanization and changing consumer preferences have driven the demand for consumer goods and quality healthcare in East Africa. PE investors should look to invest in companies that are well-positioned to benefit from these market dynamics. Investing in resilient businesses in the healthcare, consumer goods and infrastructure sectors has demonstrated good growth opportunities and yielded positive returns for PE investors.

Building strong local partnerships: This is increasingly important when investing in East Africa. As the market matures, having the right relationships and strategic guidance from qualified and experienced advisors will accelerate local operational expertise, which will make the market more attractive to foreign buyers and accelerate the level of exits.

Conclusion

To improve the investment climate in East Africa's economies, there is a need to strengthen corporate governance in both public and private sectors. While exits through IPOs are limited, maintaining dialogue between private and public sectors can grow the capital markets and provide greater liquidity. PE investors must also adapt to the ever-evolving market and engage with industry leaders to be successful in their investments.

PE investors often face a dearth of quality companies in Africa due to limited information, and operational and management challenges, as entrepreneurs generally prefer borrowing to giving up equity stakes. To shift this trend, PE firms need to demonstrate the ability to create value for their investee entities by providing expertise, brand recognition, financial resources, and human capital that incumbents lack. This will unlock the potential for future growth and can make founders more open to investment.

Private equity investments yield benefits for various stakeholders/sponsors, including general and limited partners, portfolio companies, and consumers, while also creating other socio-economic benefits such as sustainable employment. The hands-on approach of PE investors results in faster business growth for these companies compared to other differently funded companies. PE investors should work to improve governance standards, that will optimize management and returns on investments, and increase investment inflows.

Having a long-term view when investing, investing patient capital and committing to support portfolio companies' growth over several years is key to strong returns and successful PE exits in East Africa