Analysis of Kenya's Doing Business Environment, & Cytonn Weekly #43 2018

Private Equity

Catalyst principal partners, a Kenyan Private Equity firm specializing in growth, emerging growth, expansion, buyout, recapitalization, acquisition, replacement capital, and pre-IPO investments in medium-sized companies, has raised USD 155.0 mn in its second round of funding. The capital was mainly from local pension funds and international investors. The capital raised will target USD 7.5 mn - USD 22.5 mn range of investments, targeting companies in Kenya, Uganda, Tanzania, Ethiopia, Zambia, Rwanda and the Democratic Republic of Congo. They mainly focus on Consumer goods and Retail, Financial and Business services, Industrials, Manufacturing and Value-add processing, Technology and Communication sectors. Founded in 2009, Catalyst partners secured their first funding in November 2012 of USD 125.0 mn under Catalyst Fund I. They have made investments in a range of companies with the most recent in May & April 2017, when they invested in Britania Foods Limited and Kensta Group respectively.

Their investment criteria for Catalyst Fund I is:

- USD 5.0 million to USD 20.0 million for strategic minority or control transactions,
- Expansion and replacement capital, recapitalizations and pre-IPO investments,
- 4 to 6 year investment horizon, with exits via trade and financial buyers, capital markets and self-redeeming instruments, and
- Target 20.0% to 25.0% USD cumulative net returns.

Their Investment focus is on sectors with attractive underlying fundamentals, driven by compelling demographic trends and urbanization, rising consumer demand, a deepening middle class, under-penetrated rural mass market as well as convergence and integration of the regional economies

MFS Africa, a Pan-African FinTech company founded in 2009, headquartered in Johannesburg, South Africa, announced the close of its second round of Series B funding, raising equity totalling to USD 14.0 mn. The funding was from a consortium of investors, who participated in undisclosed portions led by LUN Partners Group, a Shanghai-based global investment management group, Goodwell Investments, an Amsterdam based investment firm, ShoreCap III, a private equity fund managed by US-based Equator Capital Partners, and UK-based FSD Africa, bringing the total round of funding to USD 14.0 mn. The total equity raised of USD 14.0 mn will be used for the expansion of its mobile financial services (MFS) into additional areas in Africa, starting with Mauritius, Rwanda, Tanzania, Uganda and Kenya. The FinTech Company operates the largest digital payments hub in Africa. This payments hub is connected to over 170 mn users across sub-Saharan Africa via partnerships with money transfer organizations, banks and other institutions, enabling money remittances to and from mobile money accounts. MFS Africa connects mobile money systems to each other and to money transfer organizations, banks and other financial institutions, enabling money remittances TO and

FROM mobile money accounts.

South African private equity firm, Ethos, announced a USD 49.0 mn investment into Channel VAS, a FinTech provider that specializes in data analytics, airtime credit services and mobile financial services. The stake acquired in this transaction has however not been disclosed. This investment was the first to be made by the firm's new buyout fund, Ethos Fund VII, which has set the trend for the firm's increasing investments towards technology, with the fund set to invest alongside the firm's specialized Artificial Intelligence Fund. The fund is targeting USD 563.0 mn in capital from local and international investors, having already raised USD 141.0 mn, with the remaining USD 322.0 mn by Q1'2019. This reinforces the huge opportunity for value creation in the Fintech sector in Sub-Saharan Africa. This partnership will be instrumental in helping Channel VAS expand geographically into other regions, to increase their coverage from the current 650 million users in the 30 countries that they cover, both in Sub-Saharan Africa and in the Middle East. Ethos will also leverage the brand value and market share of Channel VAS in its plan to effectively conquer the Fintech sector.

FinTech remains the most attractive sector and the highest funded sector for investors in 2018 with 4 of the 10 largest deals made in 2018 being from this sector. The growth in the funding of FinTech companies is expected to improve due to;

?. **High Returns** - According to data collected by Crunchbase, since 2007, Fintech start-ups have raised an average of USD 41.0 mn in Venture Capital and exited for an average value of USD 242.9 mn. This gives investors a better opportunity to invest in a sector that attracts a growing pool of new investors and in the end exit at a high price,
i. **Attractive Realization Periods** - Private equity firms typically focus on investing for a short lead-time, often between three to five years. Many Fintech companies start showing profits by year three hence giving a chance for investors to realize their gains in time, and,
ii. **Cheaper Running Costs** - They are cheaper to run since the FinTech company is not weighed down by the same burden of costly regulation that governs traditional businesses. This makes PE firms to manage their FinTech portfolio with easy flexibility.

FinTech lending and microfinance institutions in general have been a major attraction for investors in Kenya and Sub-Saharan Africa. Lack of access to finance is a major issue for entrepreneurs and Micro, Small and Medium Enterprises (MSMEs) across Africa. According to the IMF, there are 44.2 mn MSMEs in Sub-Saharan Africa with a potential demand for USD 404.0 bn in financing. The current volume of financing in Sub-Saharan Africa is estimated at USD 70.0 bn signifying a huge financing gap of USD 331.0 bn. Microfinance institutions aim to bridge this gap by offering convenient access to credit.

Private equity investments in Africa remains robust as evidenced by the increasing investor interest, which is attributed to; (i) rapid urbanization, a resilient and adapting middle class and increased consumerism, (ii) the attractive valuations in Sub Saharan Africa's private markets compared to its public markets, (iii) the attractive valuations in Sub Saharan Africa's markets compared to global markets, and (iv) better economic projections in Sub Sahara Africa compared to global markets. We remain bullish on PE as an asset class in Sub-Sahara Africa. Going forward, the increasing investor interest and stable macro-economic environment will continue to boost deal flow into African markets.