HOW WE MADE IT IN AFRICA

AFRICA BUSINESS INSIGHT

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Phatisa sees increasing investor interest in Africa's food supply chain

PRESS OFFICE: Phatisa

__How we made it in Africa__ asks private equity fund manager Phatisa about its investments in Africa's agricultural sector.

Phatisa is fund manager of the African Agriculture Fund (AAF). Give us an overview of the Fund's major investments to date.

Phatisa's AAF is an African private equity food and agri focused fund. To date, it has committed investments in excess of US$123m in 16 investments across the continent, ranging from Sierra Leone in West Africa, to Mauritius and Madagascar off the east coast of Southern Africa. They touch on primary farming, protein production, processing, inputs, fertiliser, mechanisation and FMCG beverages. These portfolio companies, which include investments made through AAF's SME Fund, account for 50% of the $246m of AAF investor commitments available to date.

AAF's first deal was Goldtree, an early-stage investment in post-conflict Sierra Leone, building a new palm oil mill which would buy its inputs from thousands of outgrowers in the eastern part of the country. Construction and commissioning of the mill took 18 months under challenging circumstances. While the business experienced the usual teething issues associated with early stage private equity, both the fund manager and investors have shown commitment.

With a capital injection from multinational investors, the long-abandoned palm oil plantation and mill in Daru, Sierra Leone, have been successfully rehabilitated. A nursery and irrigation system are up and running, resulting in the improved condition of seedlings. The plan is to replant 300 ha by the end of 2014 and 550 ha in 2015.

Prior to the AAF investment, Goldtree employed very few full-time staff. Today the company boasts around 500 employees.

Complementing its own plantation output, Goldtree supports an extensive agricultural community, buying in fruit from over 9,000 local outgrowers. It is working on significantly improving the fruit yields and technical skills of these smallholder farmers while mitigating against environmental risk and dangerous agricultural practices. Goldtree is an ideal example of the sustainable and far-reaching impact of development equity.

AAF’s second deal was driven by anomalies in the poultry industry on the continent. Eggs are the cheapest source of high quality protein per gram, but most African countries are net importers of both eggs and chickens. Phatisa concluded a $24m investment in Goldenlay in early 2012, and the Phatisa deal team structured and negotiated a leveraged management buyout transaction that resulted in the exit of private equity shareholder Aureos (now known as Abraaj).

The Fund invested alongside management in a combination of mezzanine and equity funding. Phatisa committed to providing strategic focus as well as assisting with operational issues such as the expansion of egg production and feed milling facilities; vertical integration, both up and down stream, in order to secure raw feed material; and continuous improvement in biosecurity on the farm.

Goldenlay production facilities are now high-tech and comprise rearing houses with the capacity to hold 80,000 growing chickens; environmental controlled layer houses which can each house more than 67,000 layer hens; as well as open shed production units. The company currently produces 330,000 eggs per day, which is 4m trays per year – a staggering 120m eggs annually. The aim is to increase production to 416,000 eggs per day or 5m trays annually, by 2016.

“Since launch, AAF portfolio companies employ approximately 7,500 people and we have built relationships with around 110,000 outgrowers and vendors across Africa” says Duncan Owen, Senior Managing Partner at Phatisa. “Supporting the need for food security in Africa, the AAF portfolio currently produces in excess of 450,000 tonnes of inputs, food and beverages and hopes to treble this output within five years.”

African agriculture is dominated by small-scale farmers. How does the AAF, through its investments, empower rural farming communities in Africa?

To enhance its impact on development, the Fund has established two influential support initiatives. Its €10m Technical Assistance Facility supports capacity-building for small- and medium-sized enterprises, such as outgrowers, smallholders and bottom-of-the-pyramid distributors. This grant facility has the discretion to spend up to $500,000 in each AAF investment, and is managed by TechnoServe, a non-profit organisation resident throughout Africa.

A further development initiative is the $36m standalone AAF SME Fund which invests in agri and food businesses, with an individual investment limit of $4m. This subsidiary fund is focused on boosting the development returns in small to medium sized enterprises, and has concluded six investments to date.

Phatisa describes its approach as ‘development equity’. How does development equity differ from normal private equity?

Development equity has always been at the heart of Phatisa’s investment philosophy. Food security and affordable housing are crucial issues across Africa and both of our funds (AAF and the Pan-African Housing Fund) are aimed at combating the chronic undercapitalisation evident in these sectors. The Phatisa funds behave similarly to traditional private equity funds, by optimising operational efficiencies and maximising value on exit. However, we focus on specialist sectors we know and understand so we are able to stimulate development in food and housing in Africa.

We have encapsulated our development equity ambitions into this unique formula:

DevEq = PAT * x + i 2 ™; being a balanced blend of private equity and development finance which strives to build sustainable assets on the ground; while ensuring best possible returns for investors as well as the communities in which Phatisa's portfolio companies operate.

Development Equity (DevEq) equals PAT (profit after tax) times a given exit multiple (x) plus impact (i) squared.

"Development equity is exceptionally hard work" says Owen. "Businesses are based in remote geographies and very young markets where skills and infrastructure are lacking. The challenges can be huge. Nevertheless, Phatisa is single minded in its efforts to find investment opportunities throughout sub-Saharan Africa, aligning ourselves and our investors with the best of African businesses. The common goal is to build long-term sustainable value that will continue far beyond the life of the fund – leaving a tangible legacy for a more prosperous Africa."

What are the greatest challenges facing agriculture and food companies in Africa, and how can private equity help companies overcome these hurdles?

Probably the two major obstacles facing African agri businesses are difficulties in accessing finance, and a lack of local skills.

Although agriculture represents around 25% of GDP in sub-Saharan Africa, the share of commercial bank lending to the agriculture sector remains very low: 3% in Sierra Leone, 4% in Ghana and Kenya, 6% in Uganda, 8% in Mozambique and 12% in Tanzania. Also, agriculture and food related companies can safely take on only a limited amount of debt, and this constrains their ability to grow. The AAF therefore provides an invaluable funding gap to these businesses – it can accommodate and facilitate their expansion which would not otherwise be possible through the traditional lending channels.

The inadequate teaching facilities and research capacities of African higher education and research facilities are negative factors affecting agriculture, industry and manufacturing in many countries.

Education and skills development is therefore an important feature of the AAF investment philosophy. As a focused fund, we are able to support our investment companies with specialised in-house skills, such as: tropical agriculture experts; routes to market professionals; hands-on financial management; marketing and branding; corporate governance and ESG; and soil management, to mention but a few. The effective transfer of knowledge, besides offering a key solution to many common business challenges, also enables the development of local know-how, which in turn supports sustainable long term growth.

Finding and retaining experienced and sophisticated management at various skill levels is always a challenge. As a fund manager, we are able to draw on our years of experience and our Africa network to assist in the selection and recruitment of the best candidate for the position.

As a crucial support component of the AAF, the Technical Assistance Facility (TAF) provides technical assistance and improved access to rural financial services for outgrowers supplying AAF portfolio companies. TAF also builds the capacity of the small and medium-sized enterprises (SMEs) invested in by the AAF SME Fund, identifying and addressing their skills shortages.

How would you describe interest from international institutional investors and development finance organisations to investing in African agriculture?

Foreign and DFI interest is significant. Food security is a key concern for the continent and therefore building food production capacity in Africa, for Africa, is a key development impact.

Developing countries are expected to be the leading source of demand growth for agricultural products in the next few decades. In the developing world in general, and particularly in sub-Saharan Africa, three notable trends are increasing demand for basic food products, in turn creating attractive investment opportunities:

Firstly, the African population is increasing faster than in any other region. Currently estimated at 925m, the sub-Saharan African population is forecast to reach 1.2bn in 2025 and 2bn in 2050. (Sources: UN Population Division, Deutsche Bank Research)

Secondly, incomes are rising steadily. Based on GDP forecasts by the African Development Bank and population projections by the UN, sub-Saharan Africa's average GDP per capita will increase by around 30% between 2010 and 2030, and by around 80% between 2030 and 2050.

Thirdly, urbanisation – currently around a third of sub-Saharan Africa's population lives in urban areas; by 2035 it is estimated to be half.

Concerns over food security are not limited to Africa, and this is now a global worry. The World Bank anticipates that urban food markets will increase fourfold by 2030, to exceed $500bn, (on the premise that the value of food consumption per capita is 25% higher in urban areas than in rural areas). Food production needs to more than double to meet this growing demand and Africa can be an important part of the global solution.

There is increasing investor interest in sub-Saharan Africa along the whole food supply chain. Challenges remain in terms of infrastructure and trade, but there is increased commitment from governments and other partners to a sector offering strong growth opportunities. In spite of well-known risks, the continent offers both huge agricultural potential and fast-growing markets.

As the investment strategies of European DFIs have evolved, along with their heightened interest in Africa and growing concerns over food security, this has created a gap in the market for development equity specialists. The larger private equity managers have traditionally focused on generalist funds and are less interested in specialist food and agriculture. So development equity managers, such as Phatisa, are finding a niche for themselves by supplementing the DFIs (which traditionally provide softer loans) and the African development banks (which are focused on industry growth, job creation, entrepreneurship and improving environmental and social governance).

Private equity investment in agriculture and food related businesses can ensure and drive efficient and sustainable agricultural production, helping to boost food security, economic growth and poverty reduction in sub-Saharan Africa. And development equity in particular can play a meaningful role in this regard.

This is where Phatisa finds its niche. Through its two focused funds – the African Agriculture Fund and the Pan African Housing Fund – Phatisa's remit is to feed and house Africa.

About Phatisa

Phatisa is an African private equity fund manager, operating across sub-Saharan Africa, with offices in Mauritius, South Africa, Zambia, Kenya, and Ghana, as well as London. The firm has two sector-specific funds under management, totalling more than US$285 million, focused on food and *affordable housing. Phatisa comprises a team with a significant track record of managing private equity funds and businesses throughout the continent.*

Phatisa's African Agriculture Fund has committed investments in excess of US$135 million, from Sierra Leone in West Africa to Mauritius, East Africa and 13 other countries in between. This reflects a total of eight portfolio companies across diverse sectors: primary farming, palm oil, processing, inputs, mechanisation, fertiliser, protein production and FMCG beverages. Phatisa also introduced an eastern and southern African investment initiative in response to the ever-increasing housing shortage – the Pan African Housing Fund (PAHF). The US$41.95 million Fund commenced operations during Q1 2013 and has concluded three investments to date.

*At the heart of Phatisa is development equity, as embodied in the unique formula of DevEq = PAT * x + i 2 ™; a balanced blend of private equity and development finance – striving to build sustainable assets on the ground; ensuring best possible returns for investors, including the community in which these operate.*

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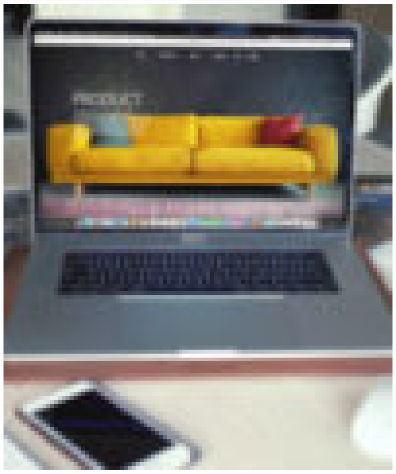

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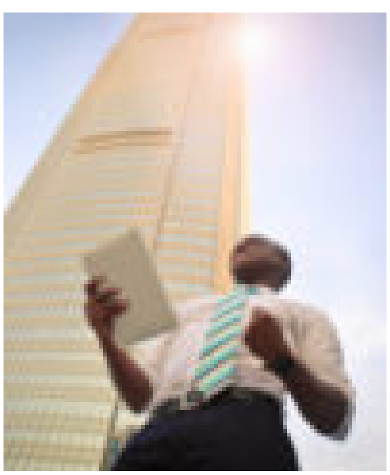

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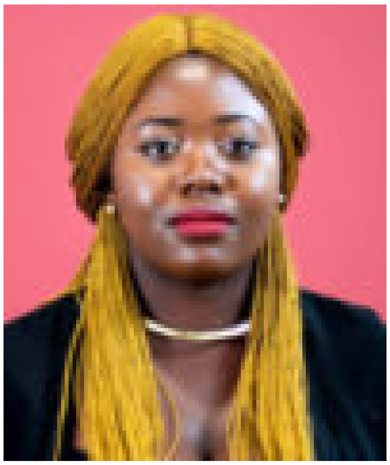

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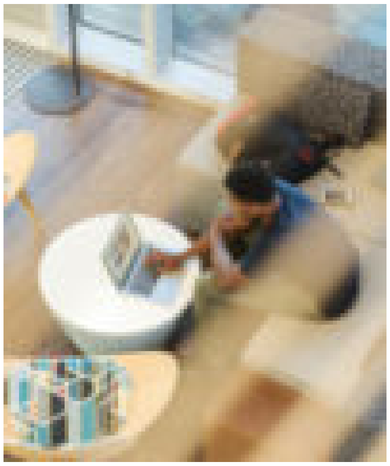

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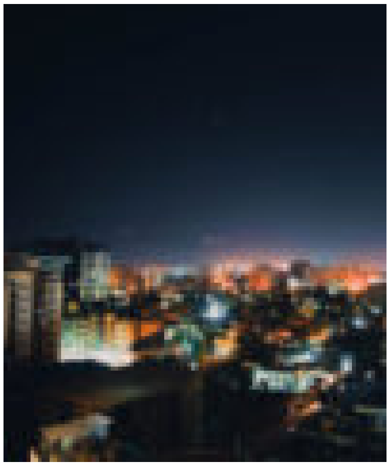

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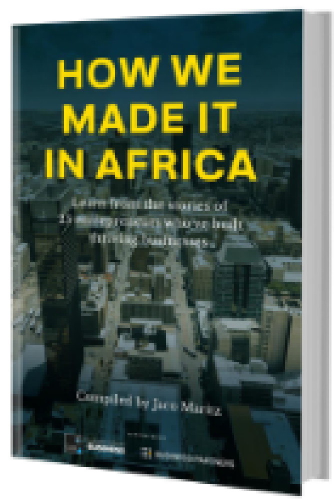

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