WEBINAR

Study on Private Debt Markets in Africa

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Presentation Contents:

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Background of the study (i)

- FSD Africa, in line with its mandate and capacity to build and strengthen financial markets across sub-Saharan Africa, engaged Lion's Head Global Partners to conduct a study on Private Debt markets in Africa.

- While keeping a pan-African perspective, the study primarily focussed on **Nigeria, Kenya, Ghana, and Morocco** as markets of strategic importance and combined desk research with one on one stakeholder engagement.

- South Africa was used as a benchmark, given the development of the financial sector and the size and scale of the South African institutional investor base.

Background of the study (ii)

- Private capital markets are increasingly playing an important role in various sectors of the economy globally but represent only a fraction of the long-term finance in African economies
- Domestic institutional investors in Africa hold significant assets under management, with most invested in traditional assets
    - Private Debt can provide a means of channelling these assets, play a critical role in infrastructure funding and may provide greater flexibility in structuring solutions that meet the needs of both investors and borrowers
- In Africa, the Private Debt markets are also active but have been dominated by the DFI and MDB communities providing hard currency private loans to African companies
- Local currency Private Debt, especially in a format that is channelling the domestic savings is currently a very small segment of Africa's financing landscape, but it is critically needed if Africa is to increase its ability for "self-generated" economic growth

Contents:

Private Debt in Africa Overview

- Private debt is the investment of debt capital in a non-listed format including all forms of debt finance provided by non-bank lenders outside of public listed bonds.

- In Africa, the Private Debt market has historically been dominated by the DFIs and MDBs.
- Increasingly, specialist funds are developing that are able to build on the precedents set by the DFIs and MDBs to become an increasingly important supply of funds for Africa.

- Local currency offerings are still in the minority, but this is also changing with both the establishment of domestic funds that operate fully in local currency and certain international funds that have the capacity via hedging to offer both a local currency and foreign currency product.

Key Private Debt Strategies

Summary of Private Debt Strategies	
Direct lending/Senior Debt	*Bilateral arrangement between debt provider and borrower; most similar to traditional senior loans*
Distressed debt	*Specialised debt strategy for companies in default, near-default or under bankruptcy protection; purchase of distressed debt at a steep discount*
Mezzanine	*Sub-ordinated debt or preferred equity instrument with a fixed coupon and often the ability to convert into equity via warrants*
Private debt fund of funds	*Fund strategy in which capital is invested into several private debt funds to enhance diversification benefits*
Special situations	*Opportunistic debt strategy that looks to capitalise on the value of a company based on specific external events (M&A, spin-offs, tender offers, etc)*
Venture debt	*Lending to start-ups or early stage companies to complement growth (accounts receivable or equipment financing)*

Trends in African Private Debt Funds

Momentum is building, particularly in those sectors that are of interest to the international development finance community including access to energy, renewable energy, access to finance, infrastructure and transitioning to lower carbon economies

- The mezzanine asset class is reasonably well established and players have been active for several years

Recent fund closings include:

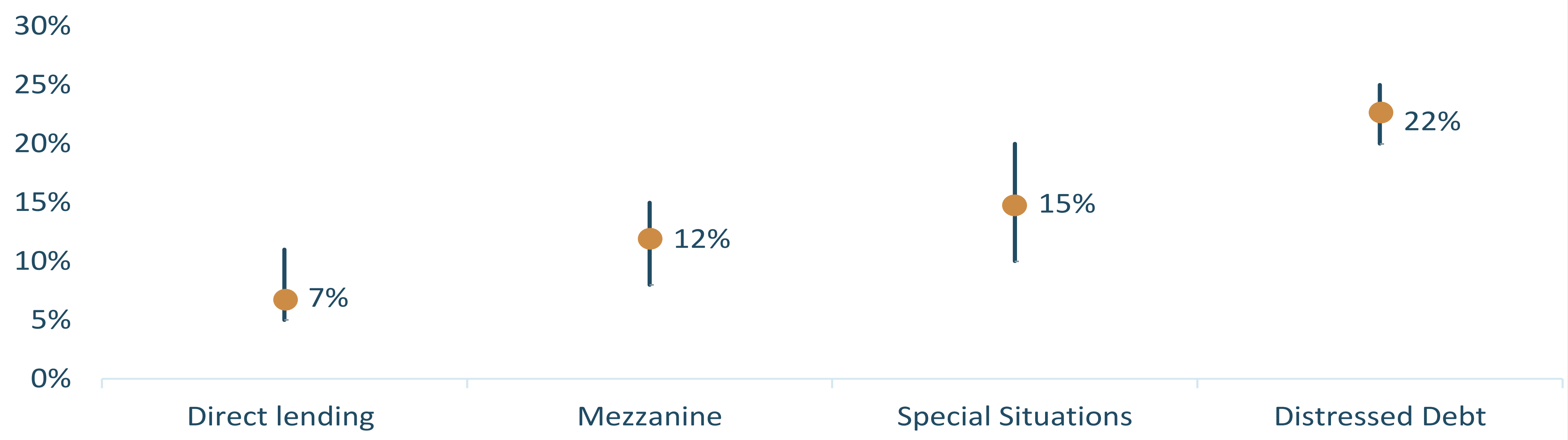
- Africa Go Green launched in 2021 reaching first close of USD 39.5m; anticipating a second close of 169m in 18 months;
- Vantage Mezzanine Fund IV announced a first close of USD207m in July 2021
- BluePeak announced a USD110m first close in 2021;
- The Facility for Energy Inclusion Offgrid and On-grid funds have raised a combined USD 307m since 2018;
- Ethos Mezzanine Partners III reached USD70m first close in 2018
- Specialist lender Sunfunder is working on a USD500m energy access fund
- SIMA is expected to start fund-raising for its successor fund imminently

Examples of Private Debt Funds

FEI OGEF | FEI Facility for Energy Inclusion | AGG AfricaGoGreen Fund | HELIOS Investment Partners | VANTAGE CAPITAL | BluePeak Private Capital | OIKO CREDIT | SunFunder | BlueOrchard Impact Investment Managers | CROSSBOUNDARY ENERGY | ETHOS MEZZANINE PARTNERS | SIMA SOCIAL INVESTMENT MANAGERS & ADVISORS | TripleJump | EMERGING AFRICA INFRASTRUCTURE FUND | symbiotics

Returns in Emerging Markets and Africa (USD)

Range and Average Interest Rate Charged to Investees in Emerging Markets and Africa, by Strategy (USD)

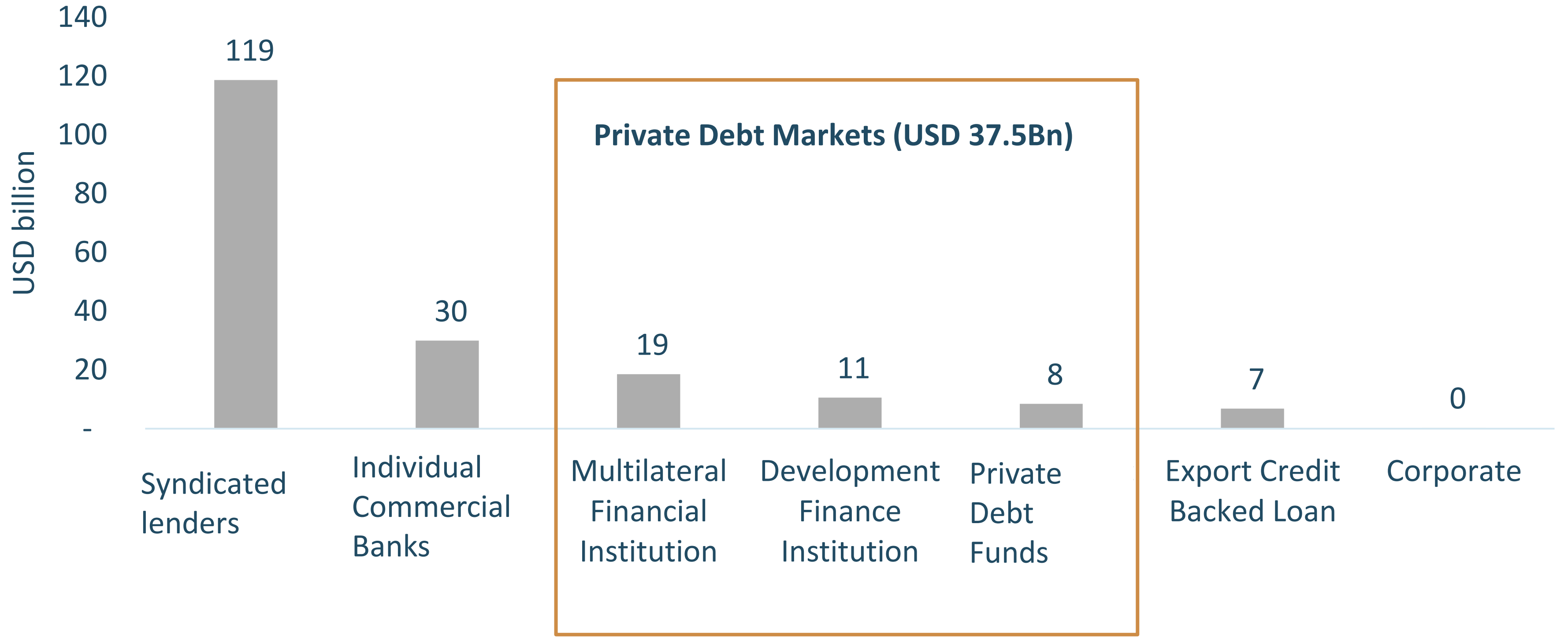


- Return targets vary by strategy and geography
- Performance-based returns (e.g., equity kickers) would increase target returns
- Factors that reduce returns include credit losses, trading costs and FX hedging costs

Source: EMPEA, LHGP analysis

Over the past 5 years, structured debt transactions worth more than USD193bn were carried out across Africa; private debt accounted for USD37.5bn

Structured Lending by Source (USD billions, 2015-H1 2021), total=193bn

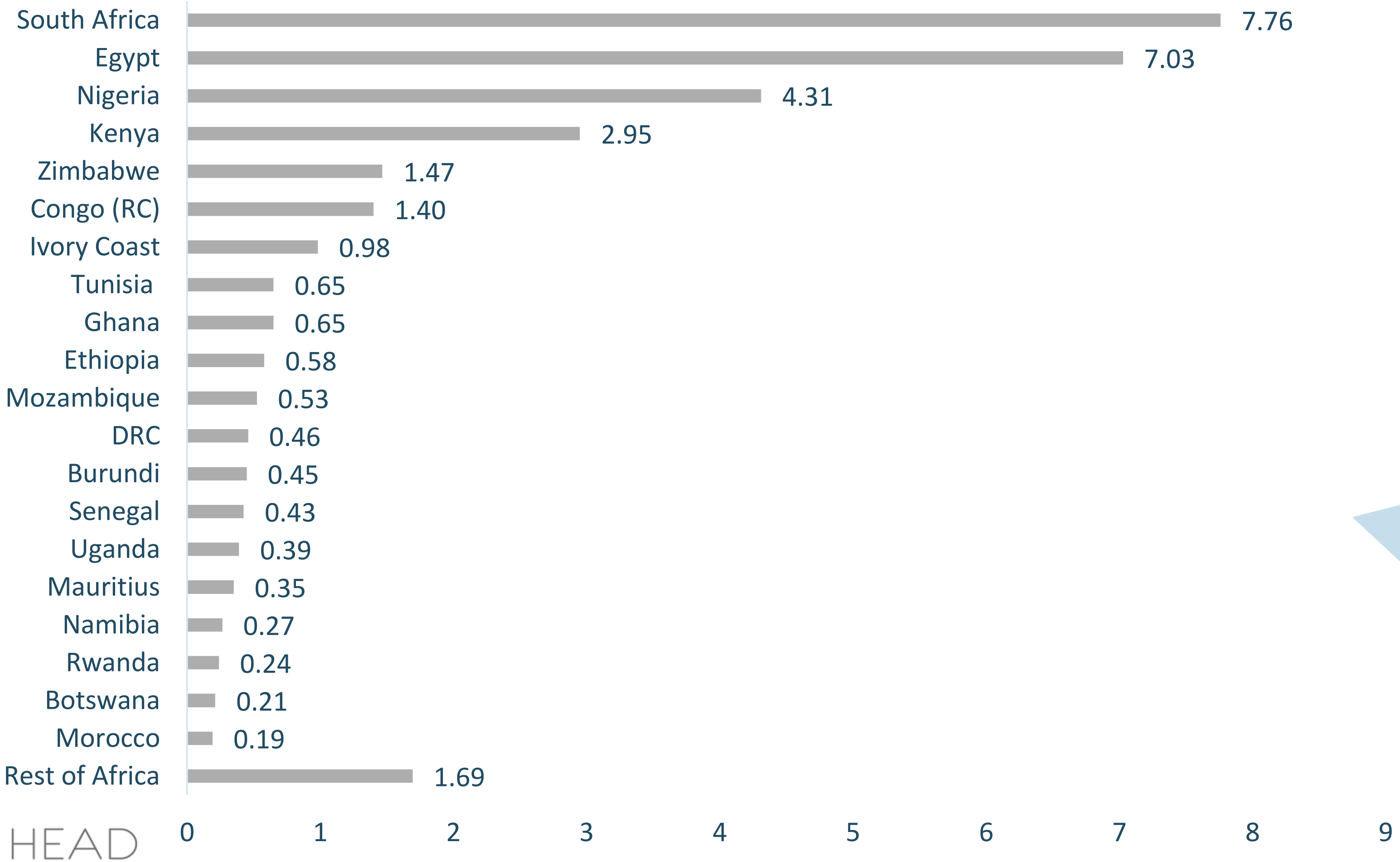


- USD 193bn of structured lending transactions identified btn 2015-H1 2020
- Of this, USD 37.5bn could be classified as Private Debt transactions with USD 8bn of non-DFI/MDB transactions
- The largest investors in the funds that make up the USD 8bn of transactions are also currently the MDB and DFI community

Source: Refinitiv, Preqin, LHGP analysis, individual Private Debt fund portfolios

South Africa, Egypt, Nigeria and Kenya lead in value of transactions

Private Debt Funding by country (USD billions, 2015-H1 2021, total=USD 37.5bn)

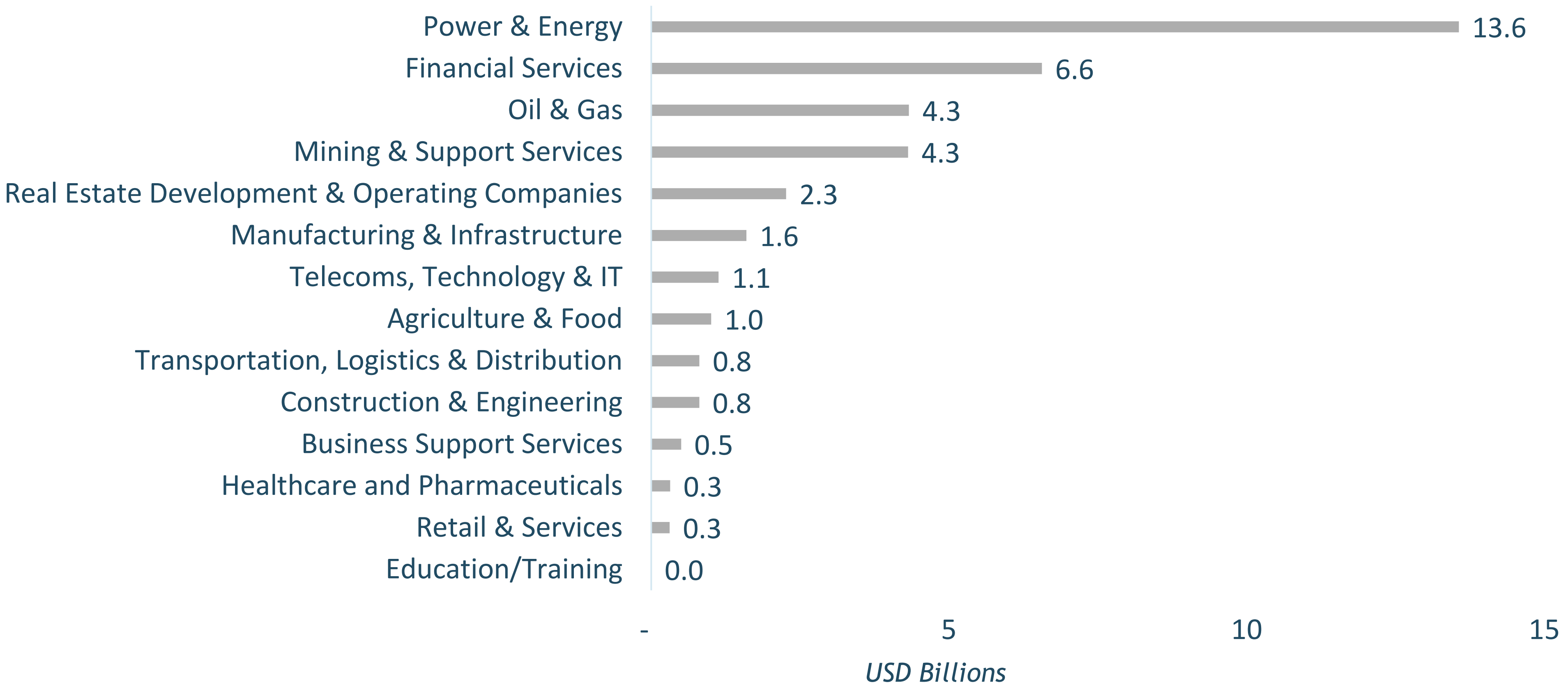


- Morocco is striking by the limited size of its market relative to the size of its economy

Source: Refinitiv, Preqin, individual debt funds, LHGP analysis

Funding distribution by sector

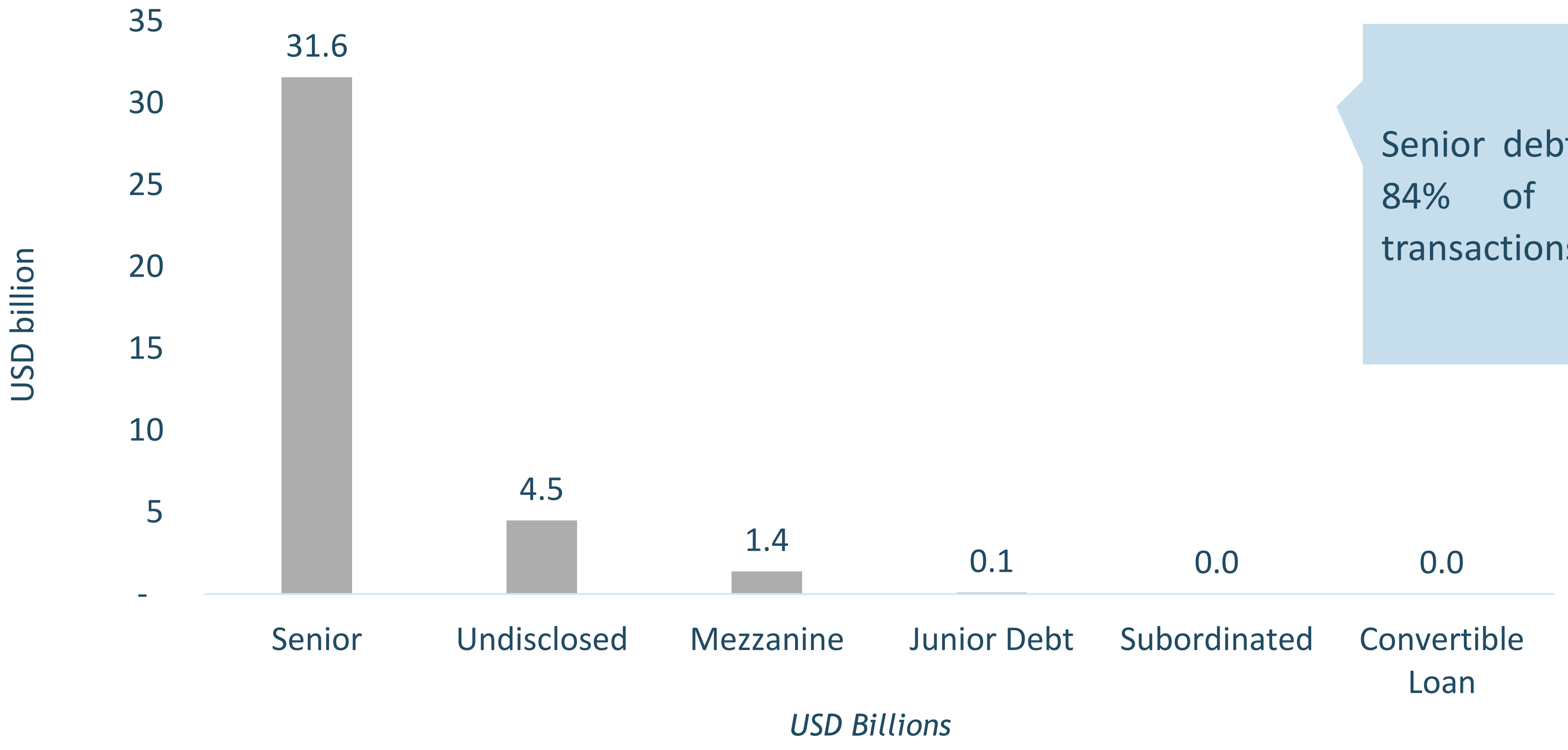
Private Debt Funding by Sector (USD billions, 2015-H1 2021), total transactions = USD 37.5bn



Source: Refinitiv, Preqin, individual debt funds, LHGP analysis

Senior debt was the predominant lending structure

Debt structure (USD billions, 2015-H1 2021) total transactions = USD 37.5bn

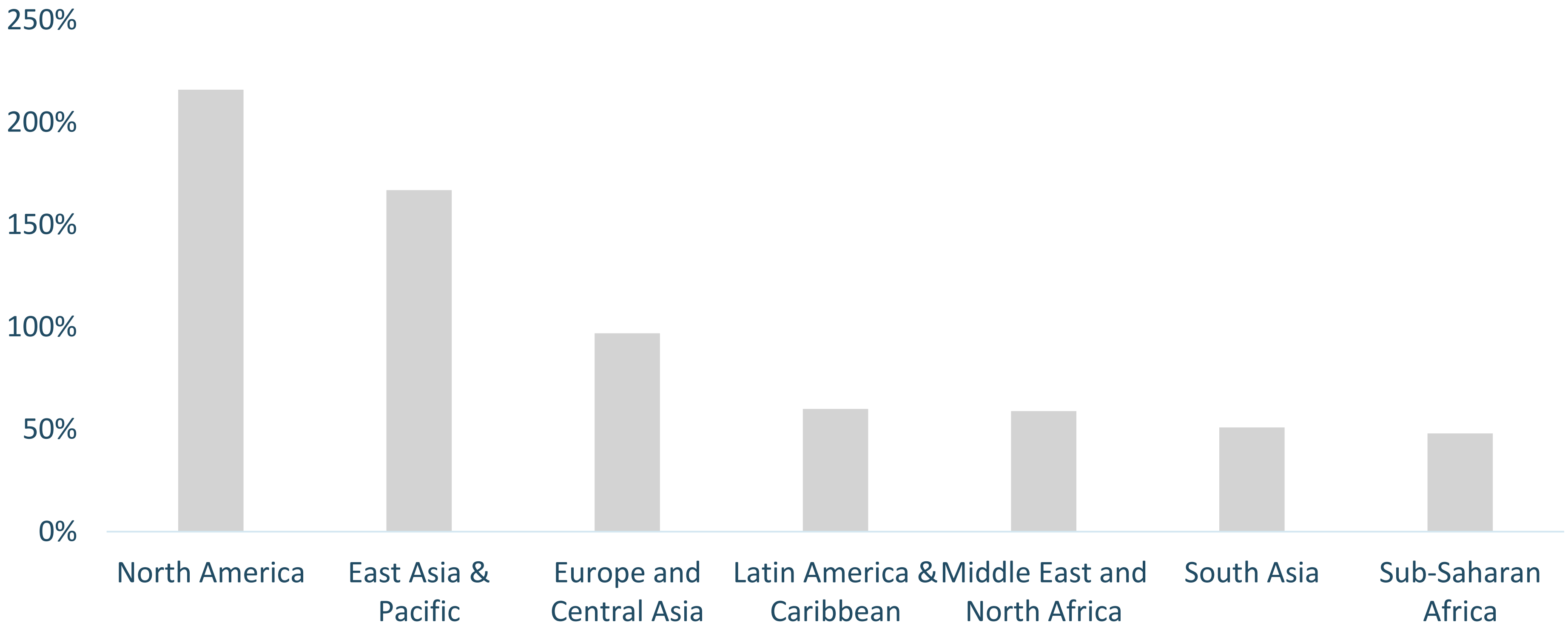


Senior debt accounted for 84% of Private Debt transactions

Source: Refinitiv, Preqin, individual debt funds, LHGP analysis

Sub-Saharan Africa lags other regions around the world in access to credit indicators as measured by credit provided to the private sector as a percentage of GDP

Credit provided to the private sector as a percentage of GDP

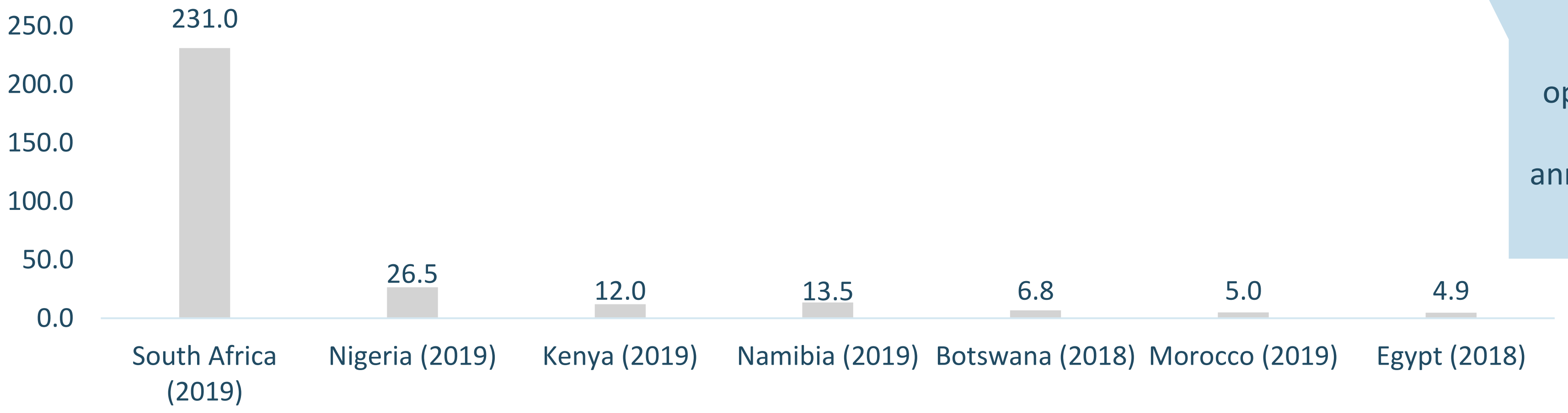


Source: World Bank Development Indicators

Private Debt can help address the financing gap in Africa

- Annual estimates of Africa's financing requirements range from USD 130 billion to USD 170 billion across sectors
  - This is driven by infrastructure investment required to achieve projected growth rates of 3-5% per year
  - Need to create employment to absorb growing youth population, estimated at 20m jobs required each year
- The financing gap is estimated at between USD 52 billion to USD 92 billion per year
- Non state financing sources e.g. ODI, local and international banks are unable to meet the financing gap
- Additional investment in private debt would be required to meet the gap, which can be sourced from local and international institutional investors

Pension fund assets in selected countries



Local institutional investors present an opportunity to reduce the annual financing deficit

Source: Infrastructure Consortium for Africa, AfDB, World Economic Forum, IMF, Riscura, AVCA, PwC, Oxford Business Group

Contents:

Highlights of stakeholder engagement

- The hard currency Private Debt is dominated by MDBS and DFIs that can fund at below commercial rates
  - Provide important precedents
  - Also provide competition for Private Debt funds
- There is potential for increased participation in Private Debt by domestic institutional investors given the desire for higher yields, however risk and regulations are key impediments
- In countries with attractive government security rates (e.g. Kenya), local institutional investors lack the motivation to pursue Private Debt opportunities given the attractive yields offered by government securities
  - In Morocco, where interest rates are low, there is a desire to branch out beyond traditional asset classes, but institutional investors are limited by regulations
- There is a dearth of data regarding Private Debt transactions in Africa making it hard for investors and funding seekers to connect, and for institutional investors to asses the space

Note: mode detailed recommendations are shared in the full report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