This article sponsored by Mediterrania Capital Partners originally appeared in The Africa special 2018 published by PEI in September 2018

NORTH AFRICA

Positioned to obtain high returns

Local knowledge and a clear diversification strategy are key to mitigating macro concerns in North Africa, says founder and CEO of Mediterrania Capital Partners Albert Alsina

North Africa has weathered seismic political and economic shocks over the last few years. The Arab Spring raised fears of social unrest and the devaluation of the Egyptian pound two years ago jolted the region's largest economy, yet North Africa specialist Mediterrania Capital Partners has continued to rack up double-digit returns by investing in the mid-market. The secret, says its founder and CEO Albert Alsina, is to diversify across countries, sectors and deal segments and ensure that you have people on the ground to provide true local expertise.

Q How would you characterise the last 12 months?

The last 12 months have been incredibly busy. Our third fund targeting €250 million hit a first close of €103 million in November after just six months on the road and we are looking at a second close towards the end of 2018 or early 2019. We've already deployed more than 60 percent of the first close with three deals: leading a consortium investing €55 million in Morocco's largest construction company TGCC; investing in Cairo Scan, the leading private provider of diagnostic and interventional imaging services in Egypt; and developing an equity line of which €20 million has already been invested in Côte d'Ivoire-based Cofina, Africa's leading provider of remittance services and mezzo-finance loans for SMEs.

Q Has the focus of your business shifted away from North Africa?

One of the trends in recent years has consisted of North African companies entering sub-Saharan Africa. We originally started our operations with North Africa in mind, but soon we were getting a lot of dealflow from francophone Africa, and so we opened an office last year in Abidjan, Côte d'Ivoire. That's how the Cofina deal came about. With more than 1,000 employees managing 90,000 clients across its six subsidiaries, Cofina services the missing middle of entrepreneurs and SMEs who lack access to financing. The plan is to raise more capital for future development up to an additional €40 million-€50 million. Cofina has an extraordinary team that is delivering double-digit growth on sales and EBITDA while substantially growing the net profit with a very low volume of non-performing loans.

Q How do you factor in the macro uncertainties and political upheavals?

Every emerging market involves political risk, but LPs often overstate this risk – after all, private equity investors don't invest in the country itself but in its companies and in the microeconomy. We insured the political risk in our first fund through MIGA, a World Bank subsidiary, but found we never needed it. Also, the way we manage risks – not just political risks but also macroeconomic ones such as currencies – is through diversification. A clear diversification strategy is very important in emerging markets.

Q How do you ensure diversification?

Firstly, we look at geographical diversification so this is why we invest in many different countries – seven so far. Secondly, we ensure high diversification across sectors, and thirdly we do so by deal type. In terms of sector diversification, we try to balance our investment between sectors with long-term potential such as healthcare and education and sectors that offer larger short-term gains such as fast-moving consumer goods. We also diversify the size and type of deals. We have some large deals, »

Alsina: *mid-market has the biggest opportunities*

» some midsize ones and smaller deals with different financial instruments such as convertible bonds, shareholder loans with a coupon at the end of the year and holding period, or buybacks with call options (rather than pure equity deals).

We have found that having a diverse portfolio of geographies, sectors and deal types helps mitigate the different risks that may arise.

Q What about the fears of currency devaluation?

Currency is a big risk theme in Africa but less than you might imagine in the countries that we invest in. As far as North Africa is concerned, the devaluation of the Egyptian pound in 2016 and its subsequent flotation enabled the currency to reach its true value, so today it's less of a risk. The Moroccan dirham is a basket linked 60 percent to the euro and 40 percent to the dollar, so there's a low risk of devaluation. In the francophone region of sub-Saharan Africa, the common currency is the CFA franc which is linked to the euro due to its strong connections to France and the French Central Bank. The North African country that is perceived to have a higher currency risk is Algeria, which is precisely where we have obtained the highest returns so far. Overall, we can say that in North Africa the currency risk is effectively controlled.

Q How important is local knowledge?

Having a team that understands the local context is very important in order to assess the reality of each country's changes and to find the best opportunities to invest in. Undoubtedly, having a strong foot in the country is crucial for the success of any PE firm in Africa. And you only achieve this by hiring professionals from that country, who over the years can build a strong network and in-depth knowledge of the economies, financial systems and the political environment, as well as having a full understanding of the social trends and needs.

> ***“We have seen a great increase in the number of large international funds buying assets from smaller PE firms”***

Q What are the main investment opportunities in North Africa?

The reality is that there are opportunities in all segments. For us, however, the biggest opportunity lies in the mid-market segment – with deals of between €10 million and €30 million – because of the lack of capital entering that market. In North Africa, as well as a small number of PE firms focusing on the mid-market like us, you have a few large companies such as Carlyle, DPI, Helios, Actis and TPG among others which are doing €70 million to €100 million-plus transactions. As a result, there's very little competition and lower pricing pressure in the mid-market.

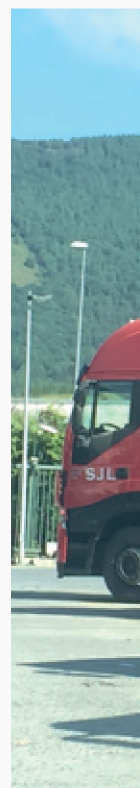
SLEEPING BEAUTY

Under Mediterrania Capital's ownership, Grupo San Jose & Lopez became one of the leading road freight carriers between Europe and North Africa

“SJL Morocco has invested heavily in a new automotive manufacturing plant in Tangier and had huge logistics needs, but when we acquired a stake in international road freight transport company SJL in June 2013, it was totally in dormant mode. It was owned by three Spanish families and had 26 shareholders, with headquarters in Tangier in Morocco and Oiartzun in Spain. The company had a clear governance and direction issue, with excellent services in great demand but flat sales and profits. We initially acquired a 49 percent stake and later on, with a co-investor, we bought the rest of the company.

In the four years of ownership, we more than doubled the EBITDA. We opened offices and warehousing facilities in Tunisia, expanded internationally and changed the governance and the structure. In that time, we managed to transform SJL into a full pan-African/European company with new distribution hubs in France, Germany and Spain, providing just-in-time services to Renault, Nissan, Tyco and many other customers from the automotive, textile and agribusiness industries,

We sold the company to Investec Asset Management in 2017, providing a very good return for our investors, and the company is in very good hands to deliver further growth and expansion.”



Q Are these larger private equity firms stimulating the market for secondary buyouts?

In the last five years, we have seen a great increase in the number of large international funds buying assets from smaller PE firms through secondary transactions as generally these assets are of high quality and can be easily taken to the next level. This is very common in developed economies but relatively new to the African continent. Nearly 40 percent of exits in Africa last year were to another private equity house, compared with 10 percent in 2011 and only 8 percent in 2008.

Q How high are the returns?

Over the last few years, GDP rates in North Africa and francophone Africa have been quite steady with 2.5 to 5 percent growth. That obviously helps ensure good investments with very good prospects.

In this context and also as a result of the right implementation of our value creation model, we are seeing our partner companies achieve double-digit growth, not only in sales but more importantly in EBITDA. Our second fund, MC II holds a portfolio of eight companies that have delivered 25 percent average EBITDA growth for the last four years.

In Africa whenever you have a winning company that delivers double-digit growth for a significant time, anyone trying to enter that market and gain market share will find it very hard. For example, we are part of a consortium that acquired a 49 percent stake in Algeria's leading manufacturer and distributor of generic pharmaceuticals Biopharm in March 2013. We listed the company on the Algerian stock market two years ago and it is doing phenomenally well. When you have a champion asset like that it is very difficult for a competitor to come in and take that position, as Africa is a fragmented continent with little competition for its market leaders.

The favourable environment is enabling leading companies to grow and consolidate their position in the market: in North Africa PE firms that do things properly are able to deliver between 22 percent and 25 percent IRR to investors. That's equivalent to a money multiple of between 2.5 and 3 times depending on the holding period.

Q How would you describe the fundraising environment in Africa today?

Well, there is a lot of competition among mid-cap PE firms investing in Africa. When you look at our rivals, we do not compete in terms of deals, because we often co-invest, but in terms of fundraising instead. Some LPs view Africa in the same way as Latin America and Asia 10-15 years ago. On top of that, the $150 million or $200 million investment ticket of big managers, endowments or pension funds is too large for a mid-cap firm like us. So we seek out the smaller investors instead, requiring much more work and a stronger distribution network. But Africa has great momentum and investors can see the benefits of investing here. The challenge lies in educating them about the growth potential and the many opportunities in the continent.

Q Are there any typical concerns for LPs considering investing in Africa?

The main issue is the high perceived risk of investing in Africa. Many investors don't know the actual performance of the individual economies, so they think the risk is higher than it actually is.

A major concern is that many investors see Africa as one region, whereas in fact it is composed of 54 countries with very different economies and political situations. Morocco, for example, offers great prospects for PE investments thanks to a stable political situation, good banking system, favourable demographic trends and a rising middle class with increasing demand for education and healthcare. Algeria too delivers high returns despite it being perceived as a high-risk market. As a result, understanding the real risk versus the perceived risk in each individual country is very important.

The other factor that LPs must bear in mind before investing in Africa is that executing deals takes longer than in other regions. Generally, a typical investment requires a good six months to be fully executed. We are talking in many cases about family-run businesses, meaning that negotiations are highly complex and involve emotional aspects. Exits can take even longer. However, investors who understand the African reality have a lot to gain. ■