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GETTING THE DEAL THROUGH

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M&A

Global interview panel led by Alan Klein

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M&A IN AFRICA A REGIONAL OVERVIEW

Gavin Davies and Frédéric Bouvet are partners, and Richard Woods is a senior associate, at Herbert Smith Freehills, a firm that has advised on matters in each of Africa's jurisdictions.

Gavin Davies has over 20 years' experience of a wide range of cross-border deals and advisory work. He acts for corporates and financial buyers in Europe and Asia, as well as in Africa where, as part of the firm's Africa team, he has worked on agribusiness, consumer, energy, industrial and telecoms deals across the continent. Gavin also advises the government of Sierra Leone on a pro bono basis. He is recommended as a leading lawyer in *The Legal 500* 2016/2017.

Based in Herbert Smith Freehills' Paris office, Frédéric Bouvet has extensive experience of advising on mergers and acquisitions, capital markets transactions and private equity investments. Frédéric is particularly focused on African M&A opportunities, and has recently advised CFAO (the leading African retail distributor) on its partnership with Wendel and FFC, a joint venture between CDC International Capital and the Qatar Investment Authority. Frédéric is listed in *The Legal 500* Paris 2016/2017.

Richard Woods is based in the London office of Herbert Smith Freehills, and has previously worked in its corporate teams in Dubai and Moscow. He advises strategic and financial buyers on public and private M&A transactions and joint ventures, and is part of the firm's Africa group. In 2013, he was seconded to the government of Sierra Leone to advise on inbound investment opportunities.

What trends are you seeing in overall activity levels for mergers and acquisitions in Africa during the past year or so?

Gavin Davies, Frédéric Bouvet & Richard Woods: Following a particularly buoyant year for M&A activity across African markets, deal flow seems to have dropped off somewhat in 2016.

This slowdown can be understood, in part, by looking to the bigger picture: M&A activity has been sluggish globally and the aggregate value of deals completed in Q1 2016 totalled US$597 billion – lower than the same period in the previous year. A number of factors underlie this slowdown, not least the rebalancing of China's economy, uncertainty caused by Brexit and recent negative market reactions to the stock price of bidders offering, on average, higher prices to acquire companies this year compared with 2015. Low commodity prices and general anxiety about the health of the financial sector have also contributed to the decline in the level of activity.

Challenges closer to home have also contributed significantly to cooling investor appetite for doing deals in Africa. One such challenge is a degree of political instability in some of the largest economies on the continent. South Africa is a prime example with the recent threat of impeachment of Jacob Zuma. His replacement of finance ministers in quick succession late last year did little to allay such fears. The economies of Nigeria and Angola too have also suffered setbacks.

Another factor has been the reduced availability of affordable, quality, executable opportunities. The steady increase in M&A activity in the region seems to have raised seller expectations and has led to inflated valuations. Investors are therefore having to work harder to identify pockets of value in the region, with the result that other regions may be more attractive to investors looking to deploy capital quickly.

This drop-off has been counteracted by the availability of distressed assets in certain sectors, including the mining sector. Foreign investors in a position to pursue such acquisitions have recognised a 'once in a generation opportunity' to pick up high-quality assets that will offer returns in the longer term. Other sectors, including the internet and e-commerce fields and the pharmaceutical and infrastructure fields, are attracting interest both from African and overseas investors.

Notwithstanding the recent slowdown in M&A activity, medium-term factors such as increased political stability, economic and governance reforms, demographic growth, steady urbanisation and rapidly growing middle income populations – the 'Africa Rising' narrative – are continuing to provide a basis for inbound investment.

Which sectors have been particularly active or stagnant? What are the underlying reasons for these activity levels? What size are typical transactions?

GD, FB & RW: As middle-income African economies continue to develop, with a corresponding growth in the proportion of their population with capacity for discretionary spending, investors are continuing to look for opportunities to tap into the growing consumer goods sector. A number of significant deals have taken place within this sector over the past six months. Examples include Suntory Beverage and Food Limited's acquisition of the soft beverage business of GlaxoSmithKline Consumer Nigeria Plc, Japan Tobacco Inc's acquisition of a 40 per cent stake in National Tabaco Enterprise (Ethiopia) Share Company, and CFAO's partnership with Wendel and FFC in the retail distribution sector.

Exits by private equity sellers have provided another significant source of M&A activity. These transactions reached a nine-year high in 2015, with 44 exits achieved. Despite reports that the exit environment this year has worsened as a result of foreign exchange risk and sponsors predominantly being in the investment phase, there have been a raft of significant deals, including Bain's exit of its investment in South Africa based Edcon through US$1.5 billion debt-for-equity swap. Other notable exits include Rockwood's sale of its stake in Safripol, a deal valued at US$307 million, Actis' sale of Emerging Markets Payments to Network International in a deal valued at US$340 million and IHS Holding's acquisition of Helios' portfolio of mobile telephony tower sites in Nigeria, the first in-market consolidation in Africa.

In your experience, what consideration do shareholders in a target tend to prefer? Are mergers and acquisitions in your country primarily cash or share transactions? Are shareholders generally willing to accept shares issued by a foreign acquirer?

GD, FB & RW: Although it is difficult to generalise across a region of 54 jurisdictions, we have seen shareholders prefer cash consideration where available, particularly in a relatively stable overseas currency such as the US dollar. As in all jurisdictions, shareholders accepting equity consideration will need to be diligent about the acquiring vehicle, and investors will need to plan to take shareholders through legal structures that may be unfamiliar to them. Where the acquirer is itself a local entity, local counsel will need to advise on any formalities required for the issuance or transfer of the equity consideration.

In a number of African jurisdictions, exchange controls will apply to inbound and outbound currency flows, so it is important to check for any approval requirements at an early stage and plan

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for these as part of the deal timetable. Exchange controls may not be familiar to advisers familiar with US and European M&A (where controls may not have applied for a generation), so this is an area for early attention.

What are the recent keynote deals – what made them significant?

GD, FB & RW: A notable trend last year was the increased number of outbound M&A deals, demonstrating the increasing confidence of African buyers. Examples of this include the US$2.2 billion acquisition by Mediclinic International Limited, a South African healthcare company, of the Abu Dhabi-based Al Noor Hospitals and, in the UK, the public acquisition of the discount retail chain Poundland by South Africa's Steinhoff, which valued Poundland at £610 million.

Separately, investors have recognised the potential offered by the continent's online sector and supported the Africa Internet Group (AIG) in raising US$225 million in one of the largest rounds of fundraising seen for any Africa-focused technology company – making AIG Africa's first technology 'unicorn', valued at more than €1 billion. Africa Internet Group was initially funded by Rocket Internet, a German technology incubator, and supported by the Swedish telecoms group Millicom and the South African telecoms group MTN. Investors now include Axa, CDC, Goldman Sachs and Orange. This underscores the impact of Africa's growing middle class and corresponding opportunities for investment.

How has the legal and regulatory landscape changed during the past few years in Africa?

GD, FB & RW: An ongoing trend in the past few years has been the increasing harmonisation of commercial law across the region. The efforts of the Organisation for the Harmonisation of Business Law in Africa (OHADA) have been of key importance in driving such efforts forward. Since its establishment, the organisation has taken important steps to attract investment by helping to standardise business laws and implementing institutions across the continent. Perhaps the most notable of these efforts have been the moves to establish market norms for local security issues, dispute resolution procedures and, most recently, the reliability and flexibility of structuring investments within the region.

Another key development, in keeping with the trend for increasing convergence in commercial law across Africa, has been the establishment of the COMESA Competition Commission (CCC). The CCC is a supranational body covering 19 countries across eastern and southern Africa that works to enhance the integration of merger control regimes in the region. The CCC has recently introduced changes to reduce the breadth of its notification requirement and to introduce a cap on the filing fee. When combined with previous changes to clarify its jurisdictional test and to introduce the possibility of obtaining a comfort letter, we expect that the revised regime will provide even greater certainty for investors going forward. It is also reassuring that substantive interventions by the CCC have been limited to transactions that have the potential to meaningfully restrict competition in the COMESA area. Although the CCC has reviewed 104 transactions in the period between January 2013 and June 2016, 57 of these have been approved unconditionally and only three have been approved with conditions.

In contrast, navigating the regimes of increasingly interventionist domestic competition authorities may prove to be more difficult. This is particularly the case where the public interest impact of a merger forms part of the assessment. Botswana, Kenya, Namibia, South Africa, Zambia and Zimbabwe are among the countries where this is relevant.

Alongside the regional and national competition authorities, the central government may be another party taking a close interest in the deal, particularly where the state is involved as a commercial partner. Even where the state is not directly a partner in the deal, governments will be focussed on tax revenues available to the state, either as a result of the deal itself or from the target entity following the transaction – and this should be considered at an early stage in the transaction. Understanding the drivers for individual ministries or regulatory bodies and the individuals within them will be all the more important in this context.

In assessing the legal and regulatory landscape, it is critically important to recognise that Africa is a continent constituted of 54 linguistically and culturally distinct jurisdictions. Notwithstanding some regionalisation (eg, through initiatives such as OHADA and the CCC), integration of or alignment between legal systems remains limited. Investors should assess the political, economic, legislative and security landscape individually for the relevant country before proceeding with a deal.

Describe recent developments in the commercial landscape. Are buyers from outside Africa common?

GD, FB & RW: China continues to be a key trading partner for the continent, even as it broadens its investment appetite to other regions, such as Europe. This was emphasised by the inking of memoranda of understanding worth US$17 billion in July this year at the Seminar on China-Africa Business Cooperation in Beijing. The 400-plus delegates present at the seminar agreed to cooperate in sectors ranging from agriculture, infrastructure and energy to manufacturing, processing, pharmaceuticals and IT.

A number of other countries also seem to be gearing up to tap into African M&A opportunities. Foremost among these is Japan, which is becoming increasingly active in M&A activity across a range of sectors including financial services, mining, metals, consumer and TMT. As part of these efforts to build a presence in Africa, Prime Minister Shinizo Abe has recently pledged that Japan will mobilise US$30 billion in private and public funds to invest in Africa. The application of these funds is to be spread over three years, and will include US$10 billion for infrastructure projects, which are to be executed with cooperation through the African Development Bank. It is expected that another US$20 billion will be injected by private investors. In line with this, 73 MOUs, focusing on infrastructure, education, health, agriculture, ICT and mining, among other sectors, were signed at the Tokyo International Conference on African Development in Kenya, in August 2016.

India is another key player seeking to increase its presence in the region. As with China, India has historically focused on hydrocarbon and mineral resources. India has to date made acquisitions worth approximately US$6 billion in the oil and gas sectors in Africa, and India's oil minister Dharmendra Pradhan recently confirmed the country's continuing interest in such sectors, commenting, 'India needs a lot of oil equity... so Africa is a natural hot spot for us'. However, the Indian government and Indian businesses have long had a broader interest in Africa than just in resources – see, for example, the acquisition by Bharti Airtel of Zain Africa's mobile phone business, in 18 African countries in 2010. The scope for further investment in areas including financial services and agribusiness is also significant, and commentators are describing a new Indian Ocean trade zone across East Africa, the Gulf and India.

Are shareholder activists part of the corporate scene? How have they influenced M&A?

GD, FB & RW: Again, it is important not to generalise about Africa as a whole: the role of activists differs across its many jurisdictions.

In those countries with the most developed and liquid capital markets (eg, South Africa, Kenya and Nigeria), activism is a relatively new phenomenon compared to (for example) Western Europe or the US. However, investors are familiar with the standards of governance and transparency that are required of firms listed on the world's major exchanges, and with the constant attempts to improve and refine these regimes. Armed with this familiarity, there are signs of an increasing willingness to challenge boards and senior management, in AGMs and in other public forums, and to seek to hold to account governance and remuneration practices, as well as the performance of the company generally.

THE INSIDE TRACK

What factors make mergers and acquisitions practice in your jurisdiction unique?

Compared to other regions, African M&A deals tend to involve a number of different stakeholders, ranging from government ministries who need to approve the transaction (particularly in the extractives sectors and other sectors of national interest) to local partners who need to be brought onside to comply with indigenisation requirements. It can be a difficult balancing act to get stakeholder buy-in to a deal while also trying to maintain confidentiality, particularly in the early stages of a transaction. Due diligence in Africa may also be a more taxing process than in other regions, owing to the timescales involved in obtaining documents from public registries.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

In some African jurisdictions, local counsel may not have significant experience of advising on complex transactions where those transactions have not been a feature of that M&A landscape, so clients may consider appointing lead counsel with the experience to structure and manage the deal alongside local counsel. Doing business in Africa can involve practices that risk falling foul of Western anti-bribery legislation. To mitigate the legal and reputational risks associated with this, clients should look for counsel with an experienced anti-bribery and corruption advisory team. Clients will also need an adviser with a high level of familiarity with Africa's merger control sphere, which, with supranational regimes such as COMESA now being layered on top of domestic regimes, is becoming increasingly complex.

What is the most interesting or unusual matter you have recently worked on, and why?

Since 2010, we have been advising the government of Sierra Leone on inbound international investment issues, on a pro bono basis. Sitting on the government's side of the table has given us some strong insights into the concerns of African governments in this sphere: chiefly, attempting to balance the need to attract investment with securing a fair deal for the country (whether in tax revenues, local content, environmental standards or otherwise). In 2015, the government called on us for support and advice on the impact of the Ebola outbreak, on the country's contractual position with international counterparties and on producing *The Sierra Leone Investor's Guide*, along with Standard Chartered and Prudential plc, which was launched by President Koroma at the UN at the July 2015 International Ebola Recovery Conference (www.herbertsmithfreehills.com/latest-thinking/sierra-leone-an-investors-guide).

Gavin Davies, Frédéric Bouvet & Richard Woods
Herbert Smith Freehills
Africa
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Although there have not yet been many examples of activists succeeding in changing the board of a target company, we expect investors to become increasingly assertive and important players in M&A transactions in the region.

Take us through the typical stages of a transaction in your jurisdiction.

GD, FB & RW: Along with the target revenues, management and potential for growth, one of the factors that is usually key to a client's selection of a market and a sector is the target's ability to demonstrate compliance with local laws, and potentially preparedness for a 'compliance uplift' whereby overseas standards in relation to transparency and anti-corruption can be satisfied. This largely stems from reputational concerns and the desire to find a reliable local 'partner' with relevant expertise.

A common model for the provision of legal advice on an inbound deal into Africa, particularly on multi-jurisdictional deals, is for lead counsel to be based in the investors' home jurisdiction, to assist with deal structuring, to project manage the process and to negotiate the acquisition documents under an internationally recognised legal framework (eg, English law or New York law). The lead counsel would then work closely with local counsel to complete due diligence, design a transaction structure that is appropriate under applicable local laws and to identify any conditions that will need to be satisfied as a prerequisite to the deal (eg, merger control consents, foreign ownership approvals or exchange control consents).

In many African jurisdictions there are sector-specific foreign ownership restrictions, and we have seen this create obstacles during the deal-structuring phase. In particular, restrictions can arise where clients are seeking to obtain a level of control over the target, not only for consolidation purposes, but also to ensure that it has the ability to lead the company in key decision-making. Requirements for this kind of regulatory approval can be difficult to identify and to anticipate: in some jurisdictions, legislation is not available online and precedents for particular types of transactions may be limited. Once again, early engagement with experienced local lawyers and with government or regulators is key to identifying and addressing issues early in the process. Formal or 'soft' local content requirements, which take many forms across the continent, can give rise to similar issues.

All aspects of the deal process may at some point be impacted by practical considerations. A good example is document distribution. Lawyers will be familiar with uploading and managing large volumes of documenting diligence via online data rooms, but this will not always be possible on African transactions where documents may be held in paper form only. Indeed, we have seen creative uses of storage facilities like Dropbox being relied on in African transactions where a target's existing technological capabilities may not be able to deliver what is usually expected.

Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your country?

GD, FB & RW: As African businesses develop shareholder value and financial buyers approach their exit horizons, we expect increasing focus on routes to liquidity for local and overseas investors. In recent years, a large number of private equity exits have been achieved by means of a strategic sale or a sale to another private equity investor. There is a real opportunity for African governments to develop their stock exchanges as a source of liquidity. Regulatory regimes and technological infrastructure can be improved, along with residual exchange controls and company law frameworks, as a means of improving liquidity and investor protection. An increasing role for capital markets transactions and, consequently, on public M&A is a longer-term prediction for the African market.

Low commodity prices will continue to affect the public finances, not only of significant oil-producing countries, such as Nigeria and Angola, but also more diversified economies such as South Africa. It would be unsurprising, in these challenging circumstances, if political efforts to support the value of local currencies gave way to further devaluations. While this presents an opportunity for foreign investors to pick up quality assets at lower prices, it will also impact the ability of local investors to engage in pan-African and outbound acquisitions.

> *"Africa will have an ongoing need for infrastructure investment and we expect private sources of capital to grow in this area."*

What does the future hold? What activity levels do you expect for the next year? Which sectors will be the most active? Do you foresee any particular geopolitical or macroeconomic developments that will affect deal sizes and activity?

GD, FB & RW: Despite some of the challenges that have surfaced this year, the outlook continues to be positive for those adopting a medium to long-term view. The cooling of the market that we have seen in the past 12 months, combined with an increasing number of private equity exits, should lead to a repricing of assets in the region and the availability of some attractive assets. At the same time, Africa will have an ongoing need for infrastructure investment and we expect private sources of capital to grow in this area as compared to traditional foreign direct investment. We see real opportunities for selective and forensic investors in the coming years, particularly for private equity investors who are able to work with local management to develop value on the ground.

Although there are risks associated with investing in the region – as there are in any region – investors' ability to navigate the particular challenges associated with African jurisdictions is continuing to develop as familiarity with these types of transactions increases. The appetite of investors to accommodate these uncertainties is necessarily related to their experience of transactions in other regions: other emerging and even developed economies can present similar or even greater levels of uncertainty than some African jurisdictions, such that the perceived risk of investing in an African jurisdiction is seen very differently. Given this context, the potential offered by Africa will continue to attract investors encouraged by the efforts of African governments to improve the environment for foreign direct investment and the economic sense of investing into untapped markets.

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