Africa's private debt goes digital

How private debt is unlocking investment opportunities in Africa

Digitising Africa's investment ecosystem

Introduction

Africa is home to an increasing number of growth companies in need of capital. Before these businesses start tapping into sources of funding to expand operations, they must evaluate the type of finance that suits their particular needs.

There are a number of capital options for fundraisers, which include conventional debt from local banks, investment from Private Equity (PE) firms and soft loans from Development Finance Institutions (DFIs).

But the structural mismatch between the supply and demand for capital has been a recurring theme in the African investment ecosystem, despite the different channels for raising funds. In our view, this has led to the emergence of private debt as a preferred investment type.

As the total value of available capital increases and the investment ecosystem deepens, access to credit will be critical to boost the performance of African companies and the overall macroeconomic environment.

Funding options in Africa: the status quo

1. Domestic Banks

Banks in Africa have tended to provide finance to the public sector, which means they have limited amounts of risk capital for the private sector. According to the AfDB, 88% of African SMEs have a bank account while only a quarter of these have a loan or a line of credit. Despite the challenges in sourcing funds from banks there is an enormous opportunity for the development of the domestic debt landscape, which will provide credit-constrained businesses with loans and stimulate growth.

2. Development Finance Institutions (DFIs)

DFIs are the backbone of the African financing ecosystem. They have been providing funding across the continent for many decades and can raise significant capital volumes to allocate on competitive terms. Bilateral and multilateral institutions deploy patient capital across the range of investment types, including debt, PE and mezzanine financing. Credit arms of DFIs have also become more prevalent in the last few years as they see a gap in the market.

However, there are a number of constraints that deter growing companies from accessing DFI funding. Some of these include:

- **Time**: the often drawn out periods taken to get financed
- **Scale**: companies are required to be of a certain size before they are economically attractive to DFIs
- **Bureaucracy**: perceived DFI bureaucracy explains why funding can often be better suited for longer gestation projects as opposed to growth businesses in need of 'quick funding'

3. Private Equity

The number and volume of African PE transactions is growing, with 953 reported deals from 2012-17 at a total value of $24.4bn according to the African Private Equity and Venture Capital Association (AVCA). Africa-focused funds have continued to scale and deploy capital across the continent. However, this doesn't come without its challenges, such as issues of alignment between business owner and PE investor interests. This is driven mostly by the fund mandate and investment horizon, which can be out of sync with that of the company. This misalignment often leads to deals being dropped or not considered in the first place.

4. Debt

In comparison to global levels, the ratio of private debt to equity funding is much lower across Africa. Research from the Emerging Market Private Equity Association (EMPEA) shows that 7% of funds raised in Africa in the last 10 years have been debt. But debt is growing in popularity, especially among low-cap to mid-cap companies, due in part to lower returns across other asset classes.

Debt comes in different tiers, with some of the primary types in Africa being:

- **Trade finance**: short-term credit to facilitate international trade or commerce
- **Mezzanine finance**: hybrid finance where debt can be converted into equity
- **Bridge finance**: short-term working capital or temporary finance prior to an equity fundraise
- **Corporate debt**: short or long terms loans taken on a company's balance sheet

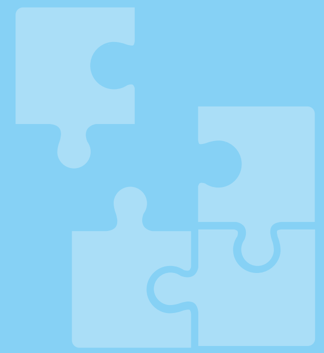
Banks

Debt

PE

DFIs

The overhang: mismatched capital allocation



Despite the increasing capital available to Africa focused investors and growing number of investable companies, there can be a mismatch between fund managers and business owners.

In some cases fundraisers are unable to offer equity; in others equity is not what the business needs. On the other hand, local bank loans priced between 15% and 25%, coupled with often inflexible repayment structures, are often too costly for growing businesses.

This mismatch is a contributing factor to the capital overhang in Africa's investment ecosystem, prompting certain funds to pull out of the market and leaving many companies unfunded.

The opportunity for debt in Africa

Based on our conversations, many of the businesses raising funds on the Orbitt platform aren't even aware of the private debt option. Nor are they structured to take on this tier of capital.

Our data show that the number of debt funds focused on Africa has increased over the last couple of years.

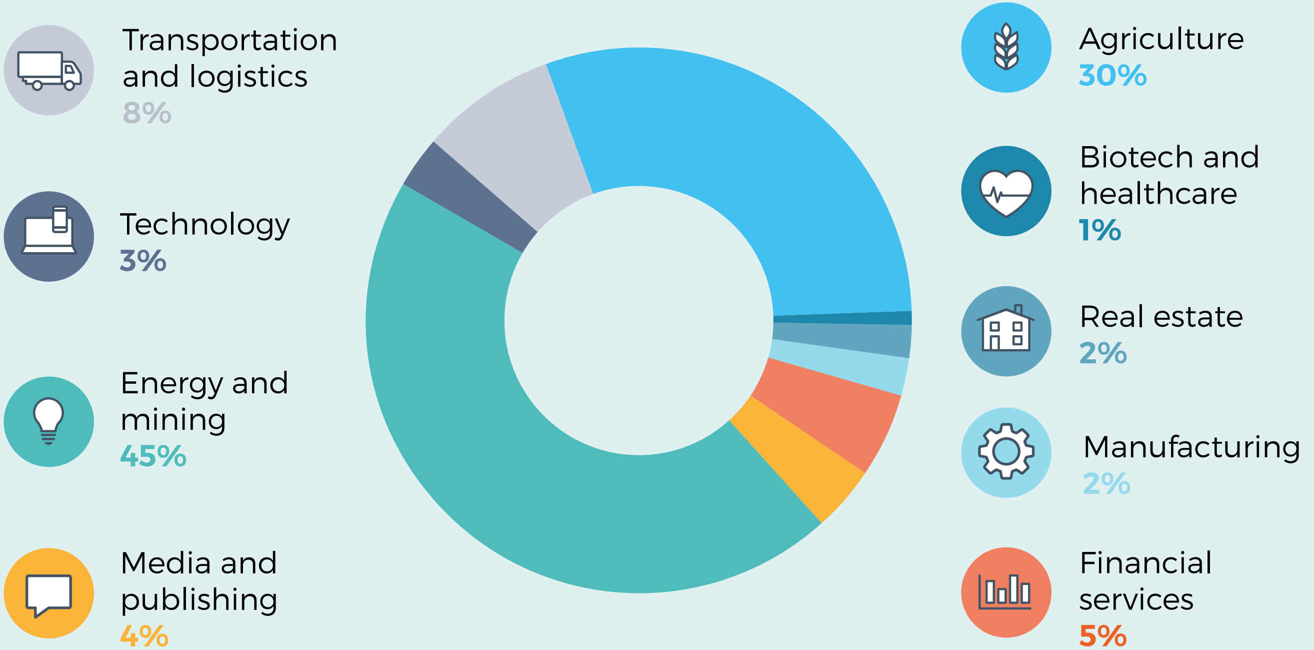
Orbitt has grown to house investors with $4bn of private debt assets under management, including debt funds, mezzanine and trade funds. These funds are seeking opportunities across various industries, with Agriculture, Energy & Mining, FMCG and Financial Services being the most sought after sectors.

Private Debt AUM on Orbitt Platform

$4 bn

At the same time we are seeing an increase in the number of opportunities for debt financing in all sectors and regions on the platform. Of the current $850m of opportunities there are $300m of debt and $100m of hybrid deals which sit within a wide range of industries and sub-sectors.

Debt deals by sector



Not only does debt offer an alternative to companies that may be unable to raise equity financing, it also offers certain advantages compared to other funding options on the table.

From an investor point of view, assessing risk is an important element in the investment process and debt provides a number of ways to minimise risk through varying structures.

Although just one-third of private investment capital structures in Africa are debt, the financial position of African companies that have drawn debt investment over the past five years is positive. Debt/EBITDA ratios grew to 2.14x in 2016 according to RisCura[1], showing robust progress over the years and demonstrating that there is room for growth for companies that are able to handle increased debt investments.

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[1] Source: BrightAfrica Private Equity Report, October 2017

Assessing debt funding in Africa

Advantages

- Quick turnaround
- No equity giveaway
- Flexible structuring
- First in line for repayment

Challenges

- Pricing
- Due diligence costs

Orbitt's new functionality to address the growing demand for debt deals across Africa

As part of the recent upgrade to our product, based on feedback from debt funds and debt sell-side intermediaries on the platform, we have added debt-financing functionality to Orbitt.

Investors and companies can now specify debt transactions by their preference of credit rate, debt term and type of debt.

We expect the growth of private debt as an African asset class to continue into the foreseeable future.

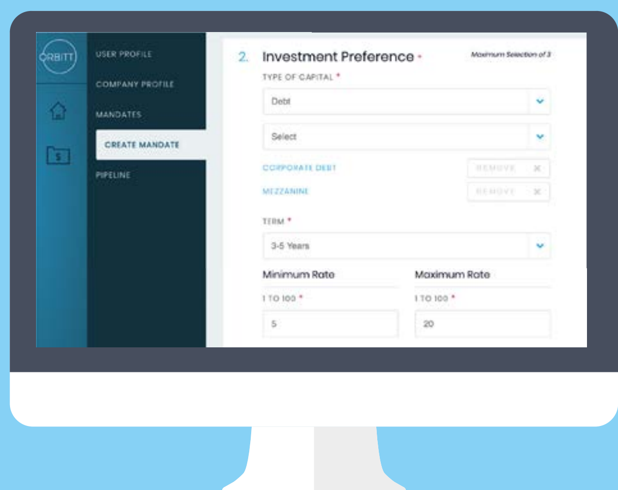
We, at Orbitt, have optimised our platform for both investors and target companies to get matched and succeed in their debt financing objectives.

Orbitt debt-financing functionality

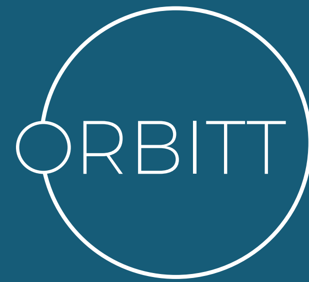
Type of debt (trade finance, corporate debt, bridge finance, mezzanine)

Credit rate

Debt term



About Orbitt



Orbitt is a digital deal origination and processing platform for investors, intermediaries and companies across Africa's investment community.

With our smart matching technology, Orbitt enables users to find the right investments, investors and seamlessly manage the investment process.

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