



Doing deals in Nigeria 2019

Key insights from dealmakers

February 2019

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Table of contents

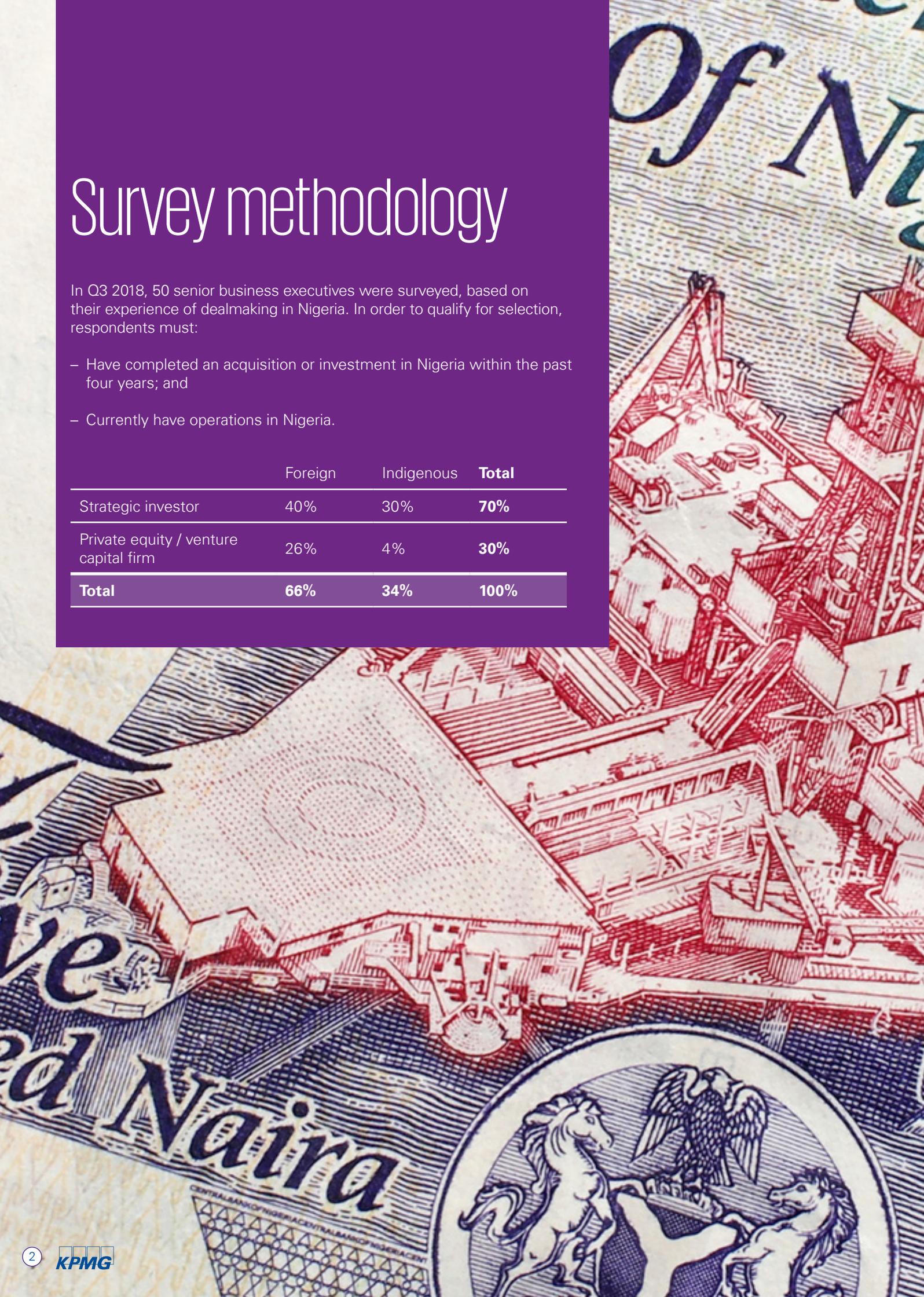
Survey methodology	2
Foreword	3
Executive summary	4
Investor optimism returns to Nigeria	6
Dissecting deal activity	14
Overcoming obstacles	20

Survey methodology

In Q3 2018, 50 senior business executives were surveyed, based on their experience of dealmaking in Nigeria. In order to qualify for selection, respondents must:

- Have completed an acquisition or investment in Nigeria within the past four years; and
- Currently have operations in Nigeria.

	Foreign	Indigenous	Total
Strategic investor	40%	30%	70%
Private equity / venture capital firm	26%	4%	30%
Total	66%	34%	100%



Foreword

Nigeria is one of the most compelling M&A markets in Africa today. As Africa's largest economy and most populous nation, the country is naturally an attractive location for dealmakers – both inter-regionally and cross-border. Add to this an increasingly sophisticated consumer market in view of the strength of the country's population and an expanding middle class, it is no surprise that M&A is expected to rise sharply in the coming years.

Our research, conducted in association with Mergermarket, attempts to take the pulse of buyers in their approach to this sometimes complex but rewarding market. A crucial factor that is expected to enhance deal flow is the improving macroeconomic situation. Around three-quarters of Nigeria's exports comprise crude oil, making the country one of the biggest losers following the price crash of 2014. Market softness in the final quarter of 2018 notwithstanding, the oil price has staged a marked recovery over the last two years, meaning greater revenues for oil producers like Nigeria and, with it, a return of confidence.

Indeed, an impressive 80% of our survey sample expects deal activity to increase over the next year and more than three-quarters of respondents said they were more likely to invest in Nigeria as a result of their previous M&A experience in the country; almost half (48%) suggest that they are now significantly more likely to invest in Nigeria.

As incomes rise and Nigerians increasingly access banking services, there are likely to be two notable sectors that benefit: consumer and financial services. Supporting this, we see that one out of every three deals (33%) in 2017 and 2018 were in the consumer sector versus 21% in 2015 and 2016 combined. Domestic demand is on the rise and acquirers increasingly recognise the potential of entering and consolidating the Nigerian market via M&A.

Notwithstanding, the country is not without its challenges. Lower reporting standards can prove to be an obstacle for some acquirers, as many private businesses in Nigeria are not subject to full-scale financial audits.

The survey responses and insights herein demonstrate that experienced local advisors, with an understanding of Nigeria's regulatory and legal complexities and cultural sensitivities, are necessary in what continues to be one of the most promising M&A markets in Africa.



Dapo Okubadejo
Partner & Head
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KPMG in Nigeria

Executive summary

1 Consumer sector on the rise

Nigeria's consumer industry is showing signs of a robust recovery. On a short-term basis, this is being driven by the country's continued emergence from a recession that began in 2016, the direct result of the oil price slump. The International Monetary Fund (IMF) predicts that the country will post growth of 1.9% in 2018, compared with just 0.8% in 2017 and -1.5% in 2016.

The Naira has also stabilised following the introduction of various policies by the Central Bank of Nigeria (CBN), notably 'the Investors and Exporters' (I&E) window, which has led to more balanced retail prices. According to Nielsen Africa, 83% of Nigerians in the second quarter described the state of their personal finances over the next year as excellent or good.

On a long-term basis, meanwhile, Nigeria has favourable demographics: the UN estimates that by 2050, the country will become the third most populous nation in the world, surpassing the US. Lagos alone is home to 21 million inhabitants, with 2,000 new arrivals each day. As Nigerians' purchasing power increases, so too will the consumer opportunity.

In 2018, the sector saw a boost in M&A activity over the previous two years, with consumer deals accounting for 33% of Nigeria's total M&A value in 2017 and 2018 combined, compared with 21% in 2015 and 2016 combined. And this situation looks set to continue as three-quarters of respondents agree that the consumer sector will be the country's most attractive sector for M&A over the next two years. Legislative changes should have a positive impact, with the Federal Competition and Consumer Protection Bill awaiting enactment. This modernisation of the country's anti-monopoly laws and market regulation is expected to drive interest in consumer-facing businesses and attract more foreign investment to the market.

2 Potential for an increase in financial services M&A

Financial services was named as the second most attractive sector for Nigerian M&A over the next five years, with 40% of respondents citing this as producing attractive investment opportunities. It is estimated that only 40% of Nigerian adults have an account with a financial institution or a mobile money provider, leaving significant headroom for growth.

Deal opportunities within the financial services sector are not limited to banks, of course. As more Nigerians open bank accounts and the country moves from a cash to a digital economy, companies and investors will seek to acquire payment processing businesses, fintechs and ancillary service providers.

The insurance space is also ripe for investment, with big names turning to Nigeria for deals. For instance, Germany's Allianz and the UK's Prudential have both recently made acquisitions of Ensure Insurance and Zenith Life Assurance Company respectively, with Allianz viewing Nigeria as a "high-potential market" with "promising demographics".

3 Optimism around deals on the up

Our survey reveals that respondents are optimistic that M&A will increase over the next two years. A sizeable 80% expect it to increase overall, and a majority (56%) say it will increase significantly. This reflects an appreciation of the long-term opportunities that the country offers.

Another supportive factor is the improvements in the business climate and macroeconomic fundamentals, influenced also by oil price recovery.

Nonetheless, there is reason to exercise caution. Nigeria's stock market has been in bear territory since the beginning of 2018, and in the last quarter of the year oil markets fell by upwards of 20%. The stock market decline has been associated with the prevalent political tensions and uncertainties, ahead of the country's presidential, gubernatorial and senatorial polls scheduled for February 2019. But while caution still prevails for some dealmakers, the general view is one of stronger deal flow in the pipeline amidst sustainable long-term growth expectations.

4 Doing deals in Nigeria is getting easier but it's not easy

The country now ranks 146th out of 190 countries in terms of the ease of doing business, having climbed 24 places in 2017, and was recognised by the World Bank as one of the top 10 most improved countries with regards to factors such as regulatory and legal frameworks globally, despite slipping a position in 2018. However, there should be no room for complacency as it is still not easy to do business in Nigeria.

Nearly 9 in 10 (86%) respondents found that the biggest challenges to completing their most recent Nigerian deal were in tackling existing legal and regulatory policies, with 66%

regarding compliance requirements as one of the biggest challenges to investing in the country. The principal legislation regulating M&A in Nigeria is the Investment and Securities Act 2007, the Securities and Exchange Rules and Regulations and the Companies and Allied Matters Act. However, an abundance of often overlapping by-laws creates ambiguity for companies and can lead to arbitrary interpretation.

Further complicating matters, in several industries, there are multiple regulatory bodies operating independently of each other, and after years of relatively lax enforcement more than 10 companies in various sectors have been hit with fines ranging from N1 billion to N1 trillion in the last two years. There also continues to be variation in business regulations and their implementation across Nigeria's 36 states.



Chapter 1: Investor optimism returns to Nigeria

Nigeria is not a market without its challenges, but investors continue to see it as an attractive location for dealmaking





Nigeria has the kind of characteristics that acquisition-minded corporates like. It possesses the continent's largest consumer market, with a youth-oriented demography – almost two-thirds of the population is under the age of 25. Its labour pool is low cost and competitive, while its natural resources are substantial, the country being the eighth-largest oil exporter in the world.

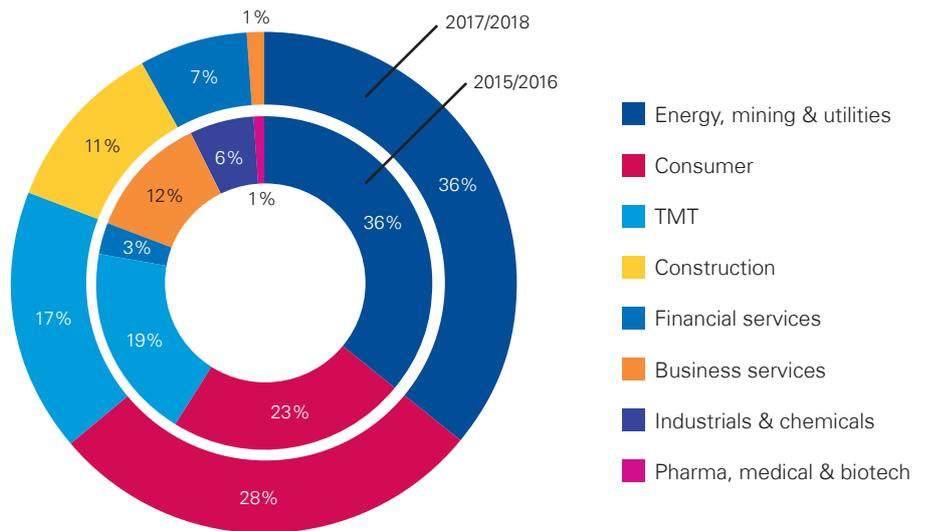
It remains a platform to conduct business across the wider region, with low trade barriers for other member states of the Economic Community of West African States (ECOWAS). Company valuations are also competitive: the price-to-earnings (P/E) ratio of the Nigerian Stock Exchange Main-Board Index (NGSE Index) was around nine at the end of 2018, versus the FTSE/JSE Africa All Share Index's P/E ratio of approximately 15.

Nigeria M&A, 2012-2018

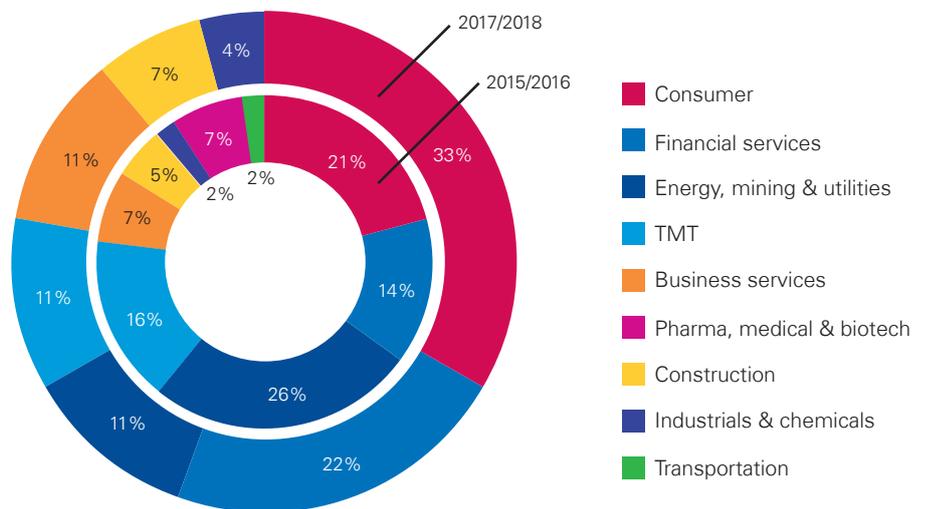




Nigerian M&A deal value by sector, 2015-2018



Nigerian M&A deal volume by sector, 2015-2018



In addition, the commercial, political and social climate in Nigeria is becoming more conducive to dealmaking. The government has made reform of the investment climate a priority, streamlining and expediting the processes required for company registration and permits, publishing all relevant regulations, fee schedules and pre-application requirements online. These measures have helped move the country up the World Bank's annual Doing Business rankings from 169 as recently as 2016 to its current position at 146 out of 190 economies in the 2018 report.

A stable outlook

Nigeria is due to hold general elections in the first quarter of 2019. The elections are expected to be the most fiercely contested, since the country's transition to democracy in 1999. The choice remains between the incumbent President Muhammadu Buhari and Atiku Abubakar, a former vice president of the country under Olusegun

Obasanjo's two-term presidency from 1999 to 2007. The country has emerged from its recent recession with its current account returning to a surplus of US\$5.7 billion in the second quarter of 2018

The stability of the forex market with the introduction of the I&E window by the CBN as at April 2017, improved foreign investors' confidence and supported US\$25 billion inflows in its first year. Improved global oil prices should deliver an economic boost, but much will hinge on the ability of the government to implement the budget and much needed economic reforms, including investment in critical infrastructure.

Many have attributed the current equities bear market to uncertainty surrounding the forthcoming elections, expected to take place in 2019. Foreign investors may temporarily refrain from deploying capital until the electoral process is concluded.

A Corporate Director of acquisitions at a media company in Nigeria says that there remains concerns of upheaval in the wake of the looming elections.

The improved macroeconomic and political backdrop is supportive of stable deal flow. Nigerian M&A activity in 2018 was on par with 2017 value-wise, with nine deals at a total value of US\$2.7 billion.

"Nigeria is turning out to be an investment haven," says an EMEA-based director for a TMT corporation. "Investors see long-term opportunities in the country and these investors can start from the grassroots level moving vertically and growing fast."

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EMEA-based director for a TMT corporation

Nigeria's consumer industry enjoyed a boost in M&A activity over the previous two years, with the sector accounting for 33% of Nigeria's total deal value in 2017 and 2018 combined, compared to 21% in 2015 and 2016 combined.

Outlook positive for Nigerian M&A

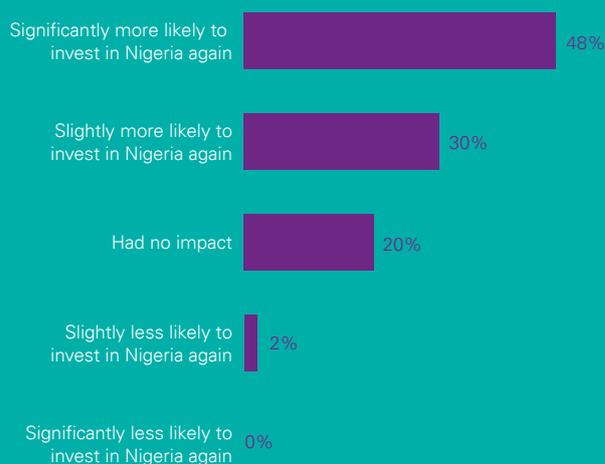
A clear majority of respondents (80%) expect M&A activity in Nigeria to increase over the next two years, with 56% envisioning activity to increase significantly. Of all the respondents surveyed, 62% are considering an acquisition in Nigeria over the next two years.

Yet some voices urge caution as to whether Nigerian M&A will increase in volume and value. One CEO of a private equity firm describes it as a "no-change" situation. "Deal activity has been solid in the past two years. This means that the number of attractive targets has reduced and investors will have to wait until certain investments mature and new investors come to market. Until then I feel that transaction activity will be the same."

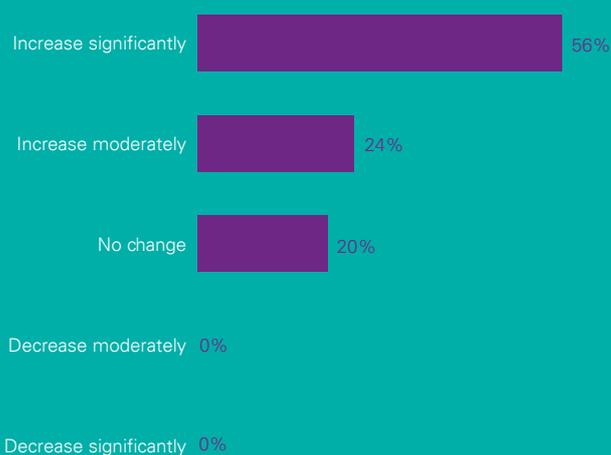
Experience tends to breed a level of confidence in Nigeria's M&A market. A large majority – 78% of respondents – say that they are more likely to invest in Nigeria as a result of their previous M&A experience in the country. Almost half (48%) go further, saying that they are now significantly more likely to invest in Nigeria as a result.

"We have seen the success of the previous deal and understand that there are certain niche business opportunities in the country," says an EMEA-based managing director of a private equity firm.

How has your previous M&A experience in Nigeria impacted upon your strategy?



How do you expect M&A activity in Nigeria to develop over the next two years? (Please select one)



Are you considering an acquisition in Nigeria over the next two years?



Protect and serve

How the Federal Competition and Consumer Protection Bill 2017 is helping to improve the outlook

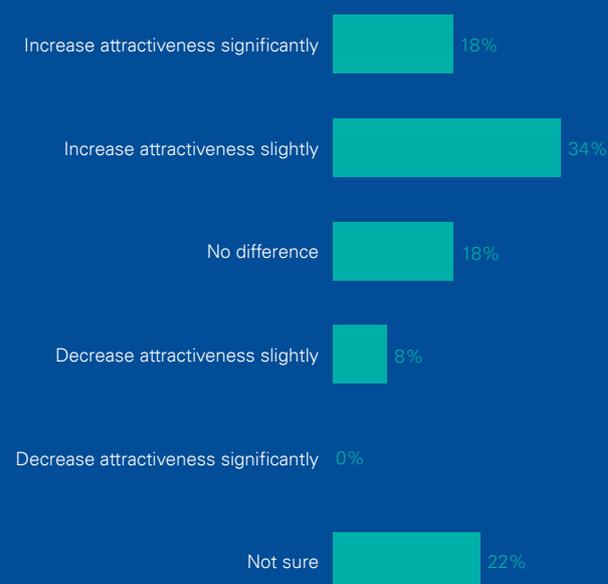
Over half (52%) of respondents believe that dealmaking in Nigeria will become more attractive once the Federal Competition and Consumer Protection Bill 2017 is passed into law.

The Bill applies to all businesses and commercial activities in Nigeria, with a series of fines to be levied for non-compliance, including a general penalty for offences of up to 10% of the company's annual turnover in the preceding business year.

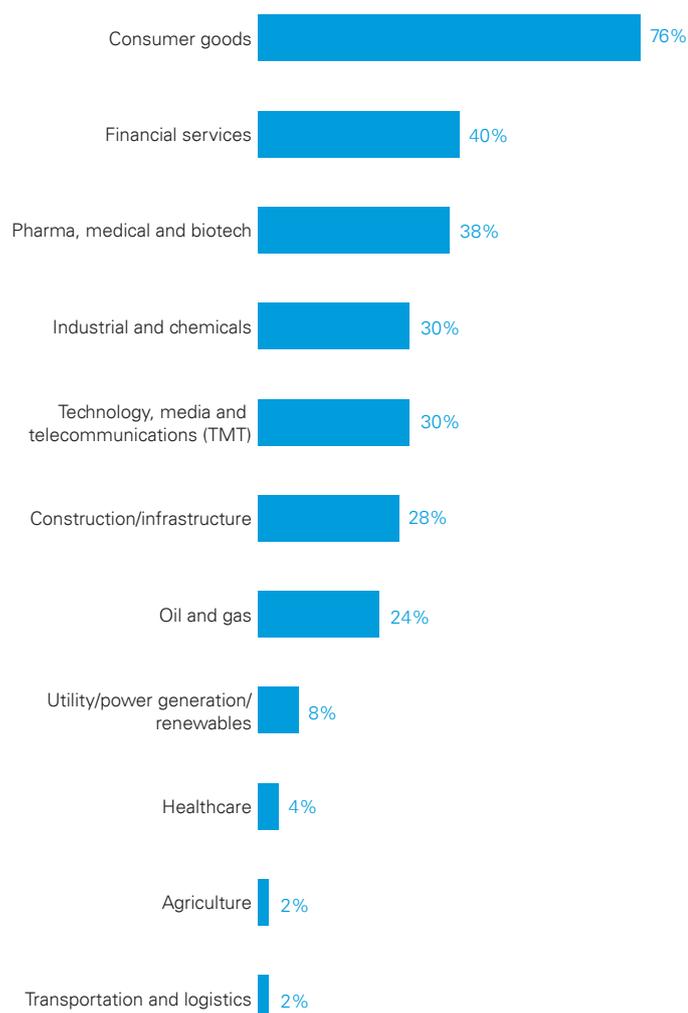
Above all, the Bill aims to overhaul Nigeria's complex competition laws, with the Federal Competition Commission to be handed supremacy over other government agencies. Increased competition and the prevention of monopolistic behaviour should result in a pay-off for M&A activity. "[The Bill] will maintain the competitive nature of the Nigerian market and attract foreign investment," says the CFO of an energy company. "There is also the consumer protection [element of the] bill that could lead to a string of M&A transactions in the consumer sector as quality businesses will be promoted within the country now."

There is considerable uncertainty regarding the legislation, however. As only 8% say they expect the Bill to make Nigerian dealmaking less attractive, nearly a quarter (22%) remain unsure about its impact.

For you, how will the attractiveness of deal-making in Nigeria be affected once the Federal Competition and Consumer Protection Bill 2017 is passed into law? (Please select one)



In the scope of Nigerian M&A, which of the following sectors do you think will be the most attractive over the next four years? (Please select up to three)



The consumer sector looks set to continue dominating Nigerian M&A – more than three-quarter (76%) agree that it will be the country’s most attractive industry for M&A over the next two years.

Financial services is also expected to be a big driver of Nigerian M&A. According to an IMF report on Nigeria in March 2018, the Nigerian Stock Exchange gained 60% in value from end-2016 to mid-January 2018 – led by financial sector stocks (+70%).

Respondents feel demographics and growing customer base will play a major role in driving M&A in the banking arena. “We targeted a banking organisation that provided for the working population rather than for an elite few,” says the managing director of a private equity firm. “This section of the population would provide access to a wider base that we felt would expand over time. We wanted to grow a culture that serves the domestic market with better processes.”

A number of Nigerian banks are struggling with their capital and reserve ratios caused by a rise in non-performing loans associated with challenges in the oil and gas sector and a slow recovery in the domestic economy. The need to strengthen balance sheets may put pressure on banks to consolidate, although it remains to be seen whether capital

“We targeted a banking organisation that provided for the working population rather than for an elite few.”

Managing director of a private equity firm

ratio shortfalls will result in a boost to banking M&A.

The government has demonstrated that it is prepared to intervene, where necessary. In September 2018, CBN took over struggling Skye Bank, rebranding it Polaris Bank.

In line with its guardianship role over the banking system, the CBN is further strengthening its supervisory oversight and deployment of early warning systems to identify vulnerabilities and manage emerging risks in the financial system.

This coincides with a potential mobile banking revolution. Nigeria has opened up its financial services sector to non-financial companies such as telecom operators. The CBN recently introduced regulations and guidelines for the licensing of Payment Service Banks (PSBs) in the country. The initiative is in furtherance of the apex bank's efforts to leverage technology to promote financial inclusion and enhance access to financial services for the unbanked and underserved segments of the population. The vision of the CBN is for 80% of Nigerian adults to be financially included by the year 2020, in view of the World Bank's estimate of 60% of Nigeria's adult population remaining unbanked. South African telco MTN, Nigeria's largest carrier, intends to apply for a PSB licence under the new regime, with a minimum capital requirement of N5 billion (c. \$14 million). A recent KPMG publication on PSBs attempts to identify critical profitability levers for PSBs, leveraging on lessons from India and other climes.

Key insights

1 Take time to understand the Nigerian consumer

It is important to approach the Nigerian market with an awareness of the domestic consumer given the scale of the opportunity within the consumer sector. A one-size-fits-all approach may not always be effective. For instance, Dutch multinational Unilever, which opened a US\$12 million Blue Band margarine factory in the southwestern state of Ogun last year, tailored its operations to the local market by offering smaller sizes of a range of products, including teabags and stock cubes, to appeal to more customers in the mass-market category. Understanding the purchasing power and specific needs of the Nigerian consumer is an absolute must.

2 Nigeria is not the place for a short-term mindset

Going into Nigeria with a view to making a quick profit is not appropriate. The reality is that improvements to the business environment in Nigeria are implemented over a relatively longer period of time. For example, the government had talked about improving the ease of business for years before taking action on the matter. Moreover, many of the M&A drivers that make Nigeria so attractive – for example, its young and rapidly growing population, the expansion of the country's middle class – are long-term by nature. The country will reward patient investors.

3 Foreign exchange liberalisation offers opportunities

The instability of the Naira has understandably concerned investors, after the currency was unpegged from the Dollar in June 2016 and lost nearly 40% in value. However, the introduction of the I&E fx window in April 2017 has allowed investors to engage in foreign exchange trading at rates set by buyers and sellers, a move that has increased the amount of Dollars available in Africa's biggest economy by expanding forex liquidity. This liberalisation of foreign exchange policies is a boon for foreign investors seeking deals in the country.

Chapter 2: Dissecting deal activity

Here we examine the key measures of deal activity in Nigeria – from deal drivers to the need for local advisors



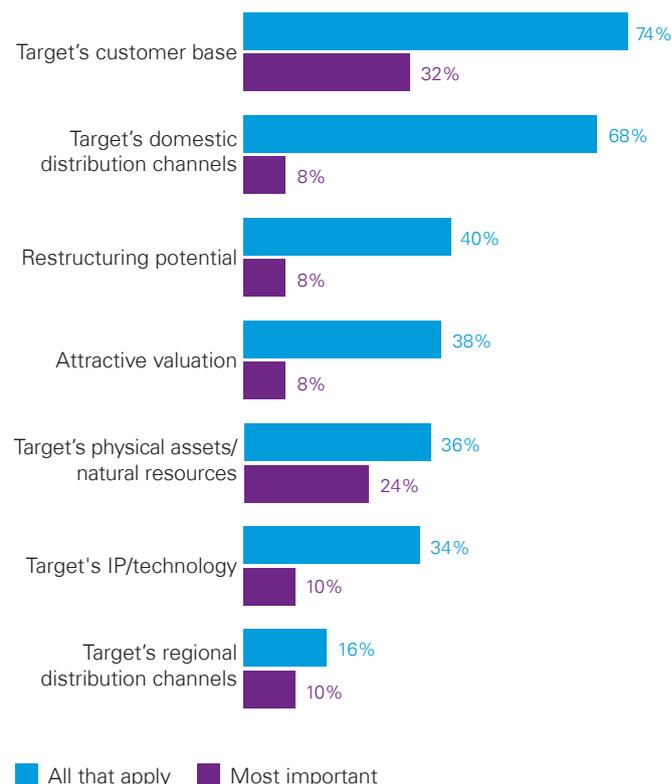


The customer is key for acquisitions in Nigeria. Three-quarters of respondents say that the target's customer base was one of the more important drivers for their most recent Nigerian acquisition. This is closely followed by the target's distribution channels (68%).

Furthermore, of those that are considering an acquisition in Nigeria over the next two years, the same percentage say that the target's customer base will remain one of the most important drivers, with 32% saying it will be the single most important driver.

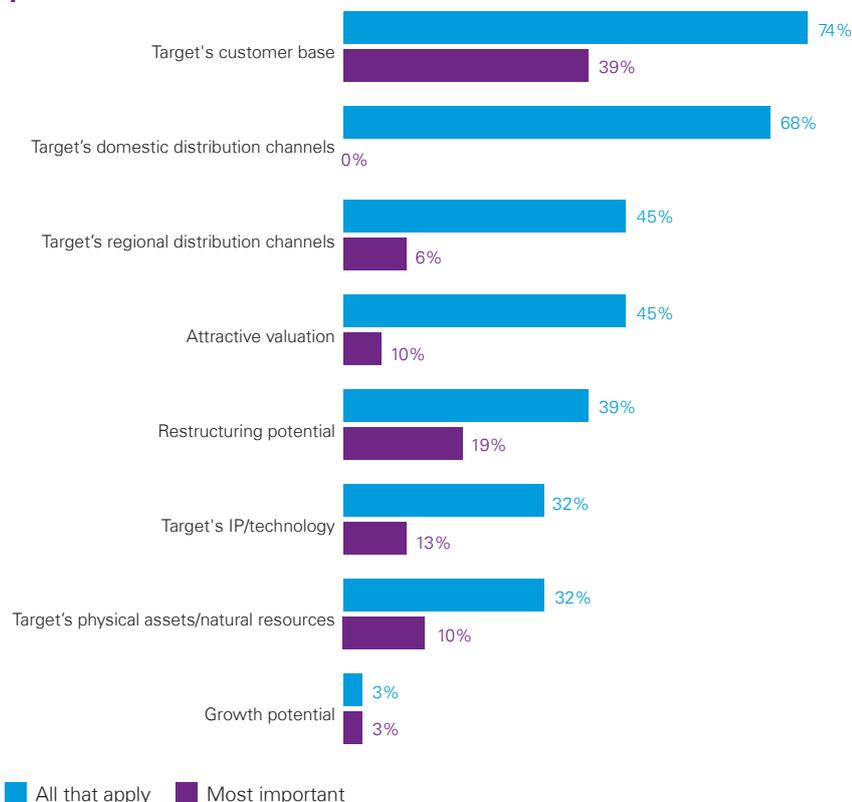
Respondents appreciate Nigeria's large, diverse and growing customer base. According to the CEO of a technology company: "In a market like Nigeria, customer demographics are changing fast and the high pace of demand is shaping growth. So for us, expanding our customer base is critical and we consider acquisition a key method of doing just that." Another clear motivating factor for having pursued a recent deal is harnessing the deal target's domestic distribution channels, cited by 68%, just behind targeting the customer base. A number of respondents commented on this, including the CFO of a Nigerian consumer goods company. "The main driver of this deal was the manufacturer's distribution routes in Nigeria," he says. "Acquiring our competitor created a wider and stronger network for our brand."

What were the most important drivers for your most recent Nigerian acquisition?



**"Expanding our customer base is critical and we consider acquisition a key method of doing just that."
CEO of a technology company**

What will be the most important drivers for your next Nigerian acquisition?



However, the same cannot be said for Nigeria's regional distribution channels, with only 16% stating that this was one of the most important drivers for M&A. This may reflect the inherently ambitious nature of M&A, which offers the potential to scale up across any given country rather than focus sights regionally.

It is worth noting that the practicalities of accessing a company's national distribution channels may be constrained by Nigeria's infrastructure, which can limit producers and firms' ability to reach wider markets. Currently only 16% of Nigeria's roads are paved, compared on average with half the roads in the world's lower middle-income countries. In a report from the World Bank in May 2018, Somik Lall, Global Lead, Territorial Development, stated: "This lack of connectivity dampens

economic collaboration and co-operation among the country's regions, limiting market integration and reducing producers and firms' ability to reach wider markets." Improvements to infrastructure over the coming years will serve to unlock additional economic growth.

Deal specifics

In terms of the types of deals that were undertaken, for the most part, investors opt for majority holdings – 63% of respondents said their last deal was a majority share deal – reflecting their desire for a more hands-on running of the business.

A third of respondents have taken minority stakes in Nigerian businesses. Some may feel that this type of deal delivers a lack of control and influence. However, one solution is to reinforce minority rights through a series of

protections, such as taking a seat on the board, or nominating the CFO, which gives them an insight into financial reporting issues. This improves transparency and comfort levels too.

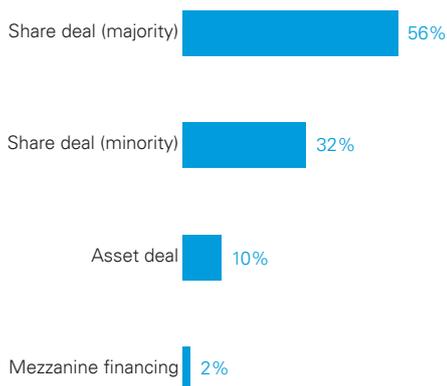
Forming strong relationships, based on trust with the vendors, also plays into the Nigerian M&A market's trend towards bilateral deals. Almost all acquisitions in our survey (94%) were via a bilateral process. In respect of private or family-owned businesses, bilateral deals are favoured over auction processes – with most family-owned firms unwilling to go through a process that is viewed as having a higher chance of not going through. Those respondents that commented on the deal structure backed this point. "When you are looking at specialised family-owned businesses in Nigeria, you rarely run into a bidding process," says the head of corporate finance at a healthcare company.

Financing the deal

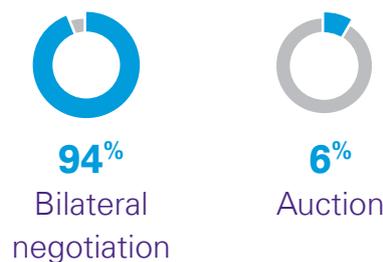
When asked about funding the deal, over three-quarters (76%) of respondents financed their most recent Nigerian acquisition using their cash reserves, with 40% picking this out as their most important source of funding. However, many also supplemented their funding using debt markets (54%), bank loans (44%) and private equity investment (40%). These results differ from the previous year's survey, in which only 26% said they would use bank loans and 10% that they would use debt markets. This discrepancy can be explained by investor sentiment improving

Special Purpose Vehicles

What type of transaction was your last deal?



Was this acquisition done through an auction or a bilateral negotiation?



What deal-size was your most recent acquisition in Nigeria? (Please select only one)



“When you are looking at specialised family-owned businesses in Nigeria, you rarely run into a bidding process.”

Head of corporate finance at a healthcare company

While only a minority use these, they are worth exploring

In their last Nigerian acquisition, a minority (14%) of respondents used an offshore special purpose vehicle (SPV) – a subsidiary formed with the aim of acquiring and holding certain assets for the sole benefit of noteholders in the asset-backed security. Of this small proportion, the SPV was most commonly located within Nigeria. This is marginally down from 20% last year.

SPVs can have certain advantages for prospective dealmakers in Nigeria – primarily for tax reasons but also for contract enforcement purposes. Nigeria’s judicial processes and systems can be very onerous, and those that have invested in SPVs can protect their investment contractually, and also for tax purposes, to avoid the multiple taxation in Nigeria.

Did your deal involve an offshore special purpose vehicle (SPV)?



between 2017 and 2018. According to figures from the country's Debt Management Office, only three corporate entities accessed the domestic bonds market in 2017 with a total issuance of N23.15 billion (c.\$64.3 million), a year-on-year decrease of more than 78%. With the economy in recovery mode, it is to be expected that investors are now more willing to access debt.

It is worth noting that inflation in Nigeria is very high, running at above 11%. Commensurately, this means the CBN has to set hawkish monetary policy, the base rate being 14% at the time of the report. Therefore, debt is expensive and can be a challenge to service, particularly for Nigerian businesses

that are exposed to currency fluctuations, such as having non-Naira-denominated input costs while selling products in Naira. "Inflation is high in this country and we have to make payments that seem unusually large on paper and in reality," says an insurance company executive. "It also creates an imbalance in the operations as the currency fluctuates, putting most of our calculations and considerations off track."

Local versus foreign advisors

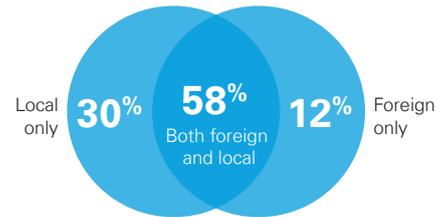
All deals need a multi-disciplinary team of advisors for all transaction areas from financial to legal, commercial and marketing issues. When doing deals in Nigeria, respondents most commonly used a

For each area, please say whether you worked with a local or foreign adviser or both

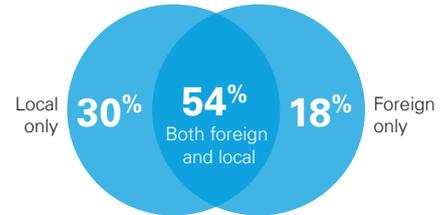
Legal advisors



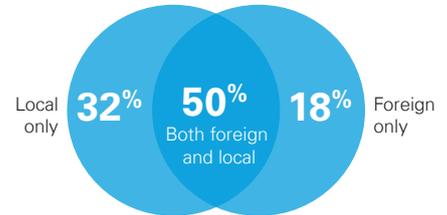
Tax advisors



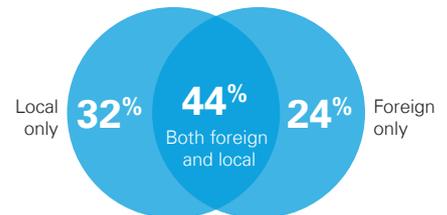
Technical advisors



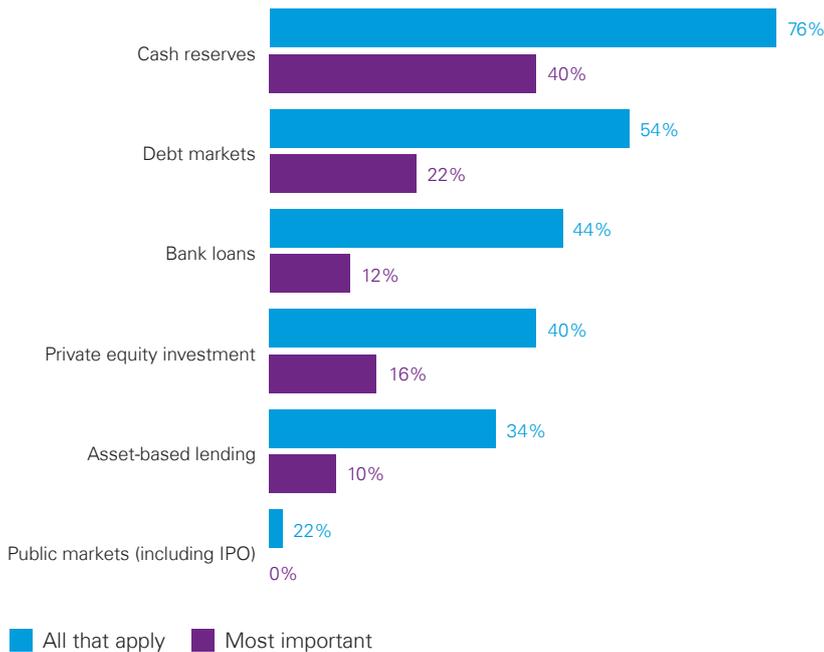
Financial advisors



Commercial advisors



How did you finance your most recent Nigerian acquisition?



Key insights

mixture of foreign and local advisors across most due diligence areas including financial, legal, tax and technical. However, a third stuck to local services when it came to advice on these areas, as well as for financial and commercial advice.

One reason for not using external advisors on Nigerian transactions are additional barriers to entry, says one private equity partner. "Introducing outside advisors adds to the time taken, as we have to conduct a compliance check on every advisor to get assurances of the services that will be provided and that there is no possibility of corruption."

Potential buyers are encouraged to take on experienced local advisors early in the process, to ensure that problems can be ironed out before they become a hindrance to the transaction.

There are also cultural considerations which acquirers need to consider. Despite English being Nigeria's first language, the country comprises more than 370 tribes. While the working culture is broadly homogenous, buyers tend to be mindful of the multi-ethnic and culturally diverse nature of Nigeria's society and workforce. Working with local advisors will help investors to understand the lay of the land, and they can offer cultural insights on the suitability of investment targets, which is particularly relevant for strategic acquirers who may seek to merge and integrate the two businesses.

1 The importance of working with local advisors

Many private businesses in Nigeria are not subject to full-scale auditing processes, and the quality, or lack thereof, of financial reporting can be a challenge for prospective acquirers. Improvements in financial reporting are under way with the recent launch of the Nigerian code of Corporate Governance in January 2018. The government's voluntary assets and income declaration scheme also availed many businesses the opportunity to clean up their financial records. Companies and individuals that have potentially not paid the right amount of taxes in prior years took advantage of the scheme to renegotiate settlements with a viable payment timeline. This is why it is vital to work with Nigerian advisors, who are familiar with common business practices and can help diligence/audit accounts to give acquirers comfort.

2 Nigeria can serve as a regional platform

Nigeria is not the easiest market from which to penetrate others in the region, due to the massive size of its domestic market and its general lack of integration with neighbouring economies. Yet, this should not deter companies from considering it as a viable regional hub. For example, the director of strategic investments at a consumer goods firm says: "Our target is one of the biggest producers and suppliers of consumables in Nigeria and the Sub-Saharan region, with good supply and distribution channels within the country and in the regions along its border. We needed to acquire a company that was strategically and geographically important in the region and has a lot of areas of expansion, so this company was perfect for us."

3 Going bilateral can be the best approach

Many private owner managed firms are generally wary of auction processes and prefer to deal on a one-on-one basis with potential buyers. Bilateral deals tend to have a higher chance of reaching successful completion. Targets are often reluctant or lack capacity to deal with multiple parties or with excessive due diligence requirements. That, in turn, can play to the advantage of going with a single advisor. Indeed, some of the more savvy family-owned businesses like to appoint certified advisors who will work with any potential buyer.

Chapter 3: Overcoming obstacles

While there is reason for optimism in the Nigerian M&A market, challenges still await prospective bidders



Even outside of the idiosyncrasies of Nigerian dealmaking, the country presents challenges at this juncture. In February, the population will head to the polls to elect the country's next president, national assembly and state governors. Nigeria's general elections often create a period of uncertainty, particularly in a keenly contested process. This is what many see as the reason for Nigeria's poor stock market performance in 2018, despite the country returning to growth following its recent downturn.

Biggest challenges

Given that in 2016 the country fell into its first recession in 25 years, it is unsurprising that the majority see the economy as the biggest challenge to investing in the country. While Nigeria has now emerged from this recession, it has gone into a bear market, with the NGSE Index losing more than 16% since the beginning of the year. Oil prices have softened considerably since September 2018, the price of West Texas crude falling from an annual high of \$76.41 per barrel to close the year at \$45.41. This may have a meaningful impact on Nigeria if the downturn is prolonged.

Economic concerns are shared by an executive in the consumer goods industry. "If the economic volatility goes up, the demand for products and the purchasing power of the population can change instantly," he says. "This means investors will take a hit and liabilities and debt management become difficult."

Other major concerns include challenging compliance requirements, together with a lack of information/transparency on the targets.

When discussing compliance requirements, the CEO of a TMT company says: "It's the compliance requirements from the regulators that are most challenging in Nigeria. The regulators have multiple approvals that are needed in order to confirm a deal and this confirmation from the SEC of Nigeria and the NSE take longer because they conduct respective compliance checks to identify any coercion in the deal."

The lack of information is noted by a number of executives. For example, one director at an energy firm based in Nigeria says of their last transaction that "when we requested details of their business model, we did not receive enough data and clarity that would help us make necessary checks."

The CEO at a telecommunication company agrees with this assessment. "There is lack of data that makes compliance procedures difficult and challenges our ability to probe deeper into the business and conduct the compliance checks so that we are assured of finalising the transaction," says the CEO, based in Nigeria.

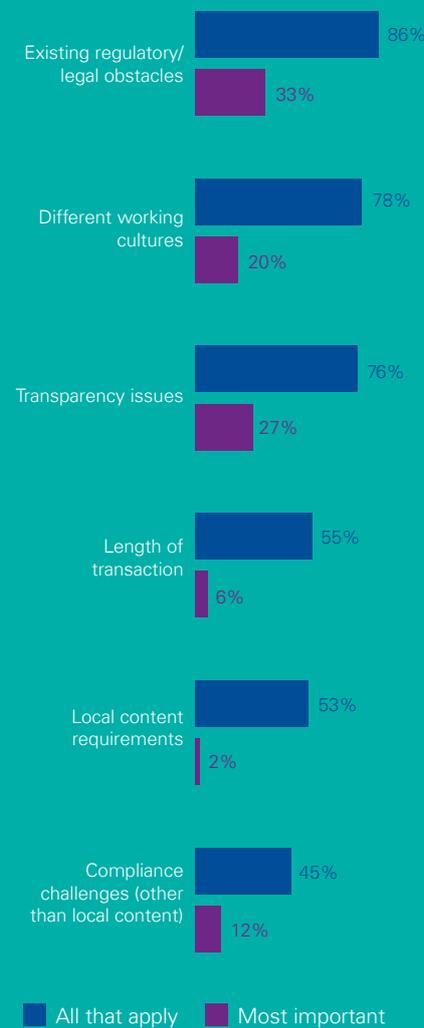
In addition, a majority of respondents also see political trends (60%), a lack of local physical infrastructure (54%) and reputation management (52%) as being significant obstacles.

With regard to Nigerian investments by private equity firms specifically, red tape and/or administration challenges is seen as the toughest obstacle by some distance, cited by 63% of respondents.

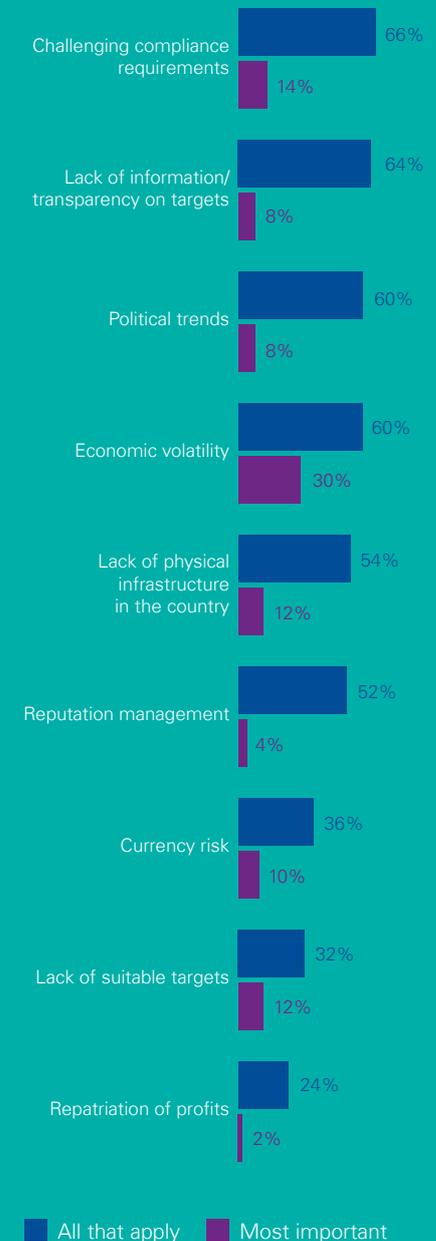
Have you attempted a Nigerian acquisition that failed to complete over the past four years?



What were the challenges in completing your most recent deal in Nigeria?



What do you perceive as the biggest challenges to investing in Nigeria?





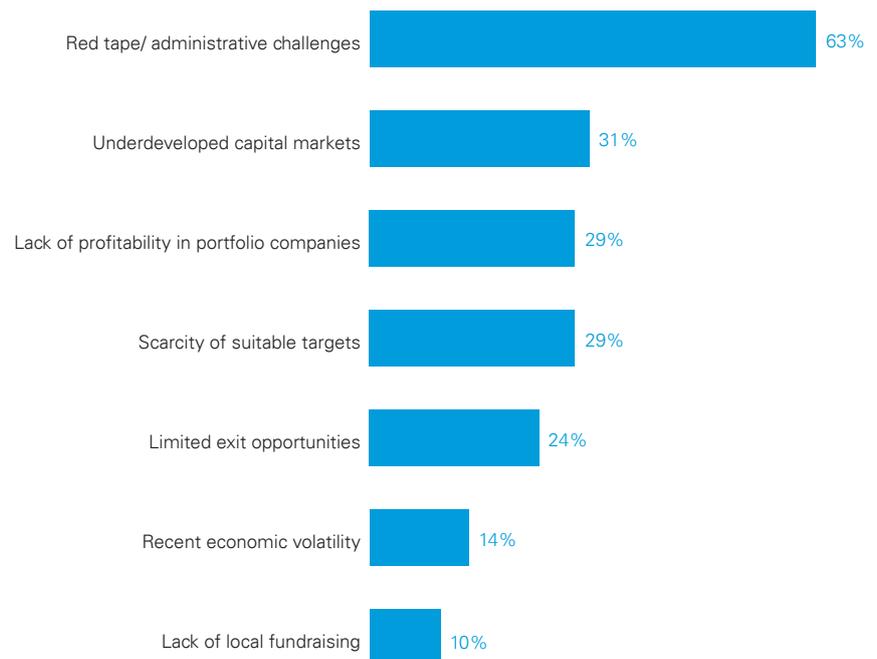
Getting deals over the finishing line

With these challenges in mind, respondents noted that 22% of those that have attempted an acquisition in the past four years have had it fail to complete.

The reasons for failure, or at least the challenges to completion, are similar to the key obstacles to investment – namely, regulatory/legal obstacles (86%), different working cultures (78%) and transparency issues (76%).

These regulatory issues range from antitrust legislation to issues around data protection. However, in some cases, they can be sector-specific, as the director of corporate finance at an energy company says: “There are a lot of legal obstacles in the oil and gas sector,” he says. “When we were participating in the deal, regulators increased the number of restrictions.”

What do you consider to be the biggest challenges for PE firms in Nigeria? (Please select two)





Again, when it comes to the challenge of working cultures, some respondents spoke of a “lack of dynamism and robustness” and “outdated management methods” in general, while others were more sector-specific, including the head of strategy at an insurance company, who says: “The insurance sector works differently in each country. We had to adapt the office culture and we needed a major technology overhaul – which meant spending a large amount on IT training.”

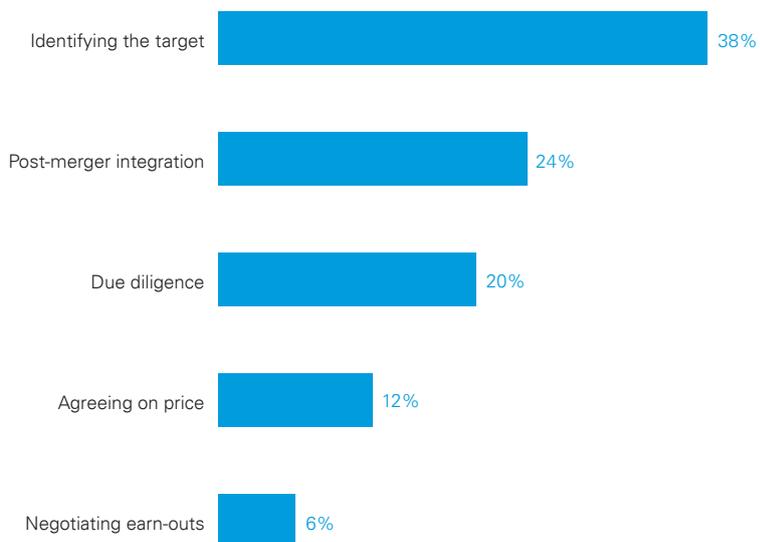
Process challenges

When it comes to the actual process itself, respondents most commonly find that the hardest part of the M&A transaction cycle is the initial identification of a suitable target (rather than the later stages of agreeing a price and even post-merger integration).

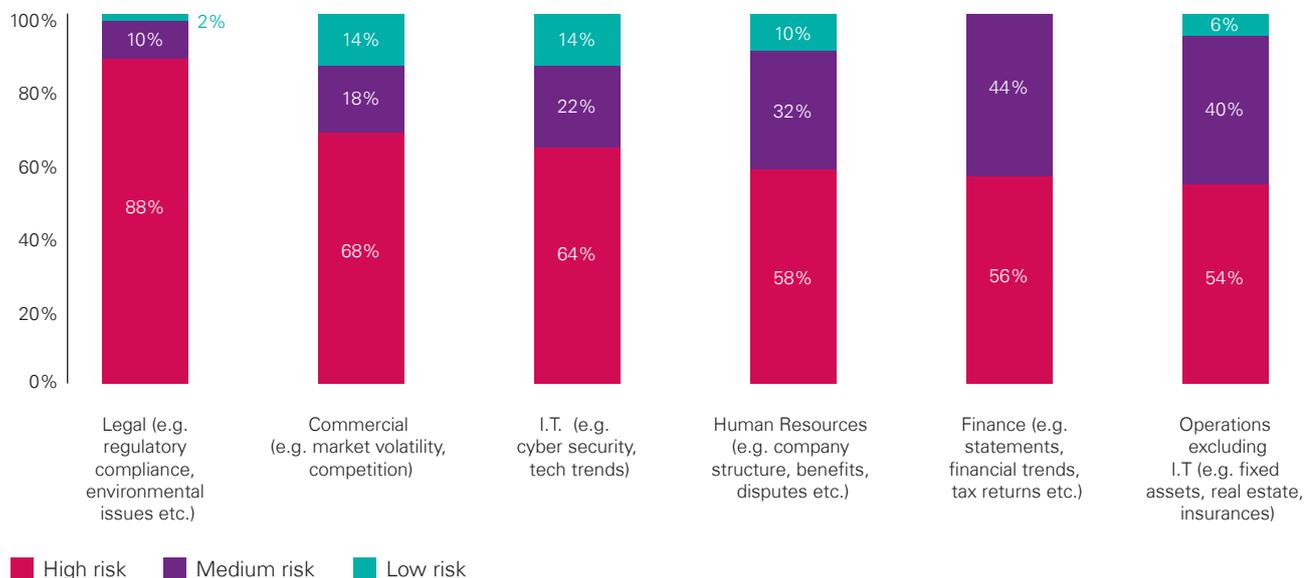
“The challenge lies in identifying the right target which meets investment goals and has the potential to participate in a deal without any external competition for their assets,” says a partner based in EMEA.

The same is true for private equity firms – nearly a third (29%) say that their biggest challenge in Nigeria is the scarcity of suitable targets. Part of the problem is that many successful Nigerian companies fly under the radar. They may have significant revenues, in billions of Naira, but do not have a website and do not feature in the media. This is where mandating local advisors can help in the origination of deals. Those familiar with the domestic market can introduce acquirers to growth companies that may otherwise go unnoticed.

When doing a deal in Nigeria, which part of the M&A transaction cycle do you feel is most difficult to complete? (Please select one)



Looking back on your most recent acquisition/investment in Nigeria, please give a ranking for the level of risk identified during the due diligence process associated with the target in the following areas:



Difficulties in diligence

When it comes to the due diligence process in their last Nigerian investment, a majority of respondents identified high risk (i.e department not functioning to expected standards) in all the major areas including legal, commercial, IT, finance, HR and operations. The targets’ legal teams stood out against other areas, being ranked as high risk by as much as 88% of respondents.

IT departments were seen as medium to high risk by 86% of respondents, with nearly two-thirds reporting IT as high risk. This is likely to rise as cyber attacks increase in size and volume the world over. Nigeria’s ministry of Communications, estimates that Nigerian businesses and government parastatals and agencies lose around N127 billion (c.\$353 million) every year to cybercrime.

An IT head of strategy insurance says: “The largest risk for us was in the IT department. We were faced with legacy technology and needed a fresh start. The cybersecurity was also weak and outdated here

and we had to bring in a list of new features to keep data and operations safe.”

While just over half (56%) of respondents said that finance operations were high risk, all respondents said they were medium to high risk. According to one director of M&A for a consumer goods company: “Financial statements were a high risk situation for us. With certain political influences in the company, we did have specific cash flow details taking time to reach us.”

Pre-emptive strategies

Turning to strategies that are in place before deals are even announced, more than three-quarters of respondents had a target operating model design (78%) and/or a communications strategy (76%) in place before their deal was announced.

Operating model design is of course critical in any country, but arguably even more so in Nigeria. The country is home to extreme wealth and cultural disparity across its six

“Financial statements were a high risk situation for us. With certain political influences in the company, we did have specific cash flow details taking time to reach us.”

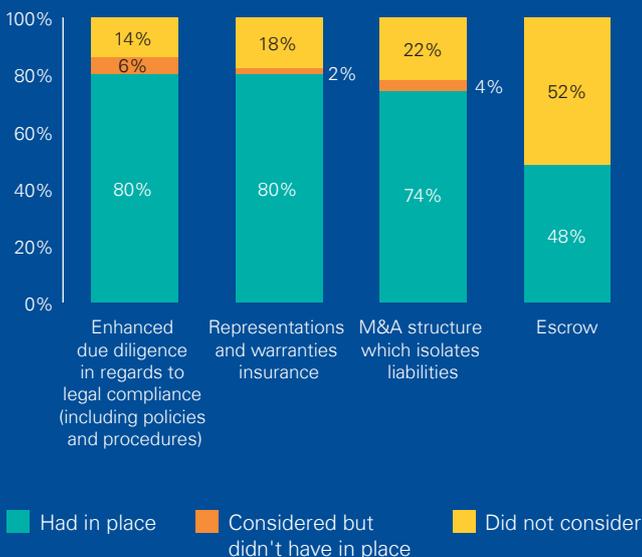
Director of M&A for a consumer goods company

Protecting against risk

To help mitigate risks associated with the target, four out of five respondents conducted enhanced due diligence regarding legal compliance and took out representations and warranties insurance. Almost three-quarters also had an M&A structure which isolated liabilities. However, just over half (52%) of respondents did not consider using an escrow account to reduce risk in their most recent Nigerian transaction.

One partner in a private equity firm says it would in future have a larger set of members participating in the due diligence segment of the deal: "There would be an earlier start to the process and we would segregate them into two different units, one that works on target due diligence and the other on advisors and related third-party due diligence."

Did you either have in place, consider only, or not consider the following in the approach of mitigating risks associated with the target in your most recent Nigerian acquisition?

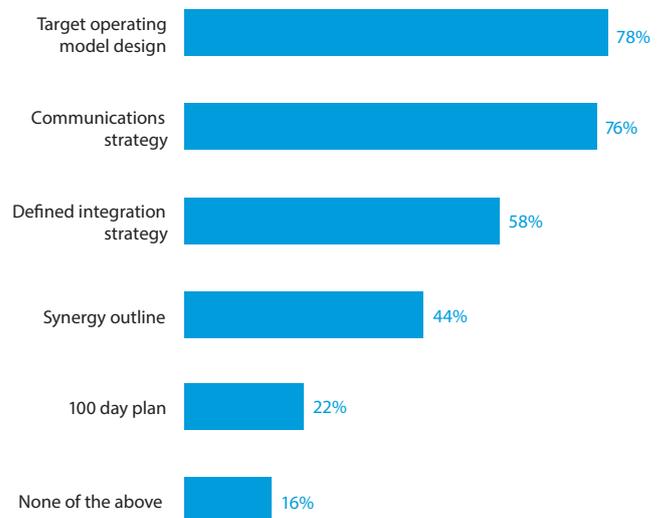


geopolitical regions. This means that an operating model design has to be tailored to the specific dynamics of each region. It is important, therefore, to have a clear strategy early on for how the company will operate regionally.

Only a slim majority of 58% had a defined integration strategy at this stage. This may suggest that a fair proportion of corporates may be putting integration on the back burner, which could be a mistake considering almost a quarter (24%) saw it as the most difficult part of the dealmaking process.

Overall, a worryingly high 16% had none of the strategies in place at the time of deal announcement, which seems like a foolhardy move in a country where dealmaking can be notoriously unpredictable.

Which of the following did you have in place at the deal announcement stage? (Please select all that apply)



Lessons learned

Looking back on deals that respondents had done, we asked what they would have done differently at two particular stages of the deal – due diligence and integration.

Due diligence learnings

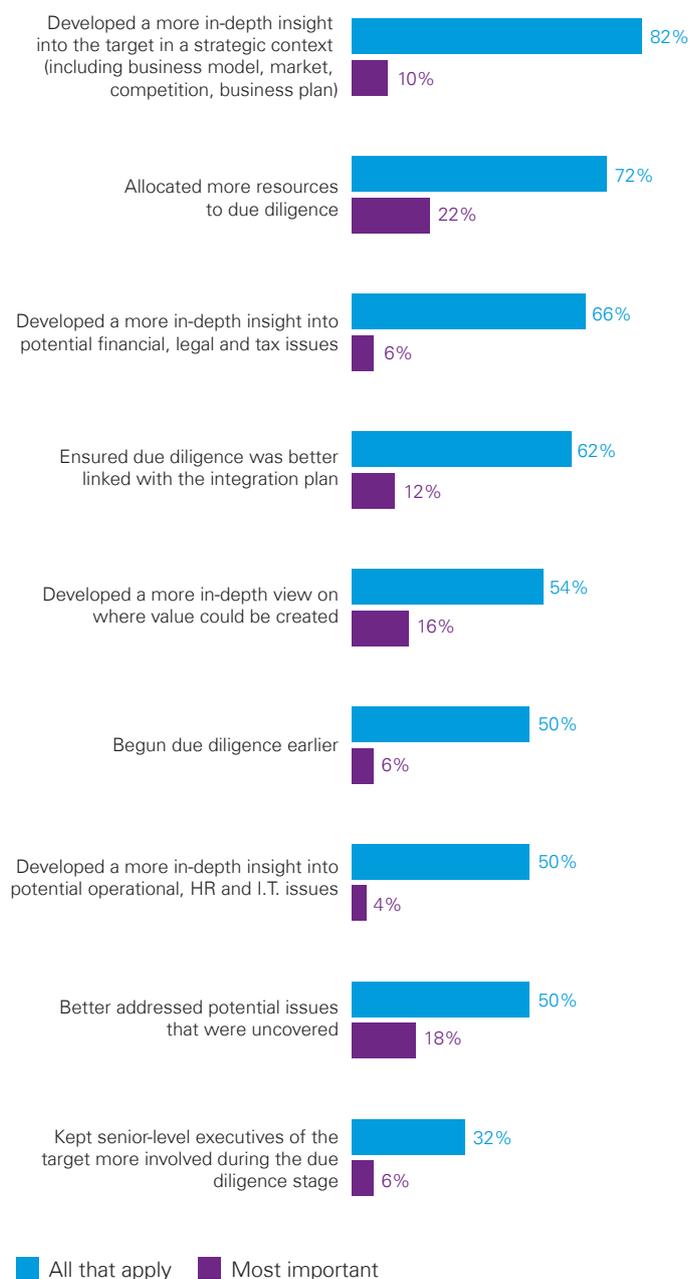
When asked for all answers that apply, a clear majority (82%) of respondents would want to develop a more in-depth insight into the target in a strategic context. This was followed by 72% who would want to allocate more resources to due diligence, with this chosen by the highest percentage (22%) when asked for the most important answer. Two-thirds (66%) would want to develop a more in-depth insight into the potential financial, legal and tax issues that were to come.

Integration learnings

There are also a large number of things that respondents would have done differently in regard to the integration process with their most recent Nigerian investment. When asked about all answers that apply, around two-thirds of respondents point to a desire to ensure more effective communication with stakeholders (68%); to ensure that value creation remains a more prominent focus of the deal (66%); to allocate more resources to integration (64%); and to be better disciplined when it comes to value tracking (62%).

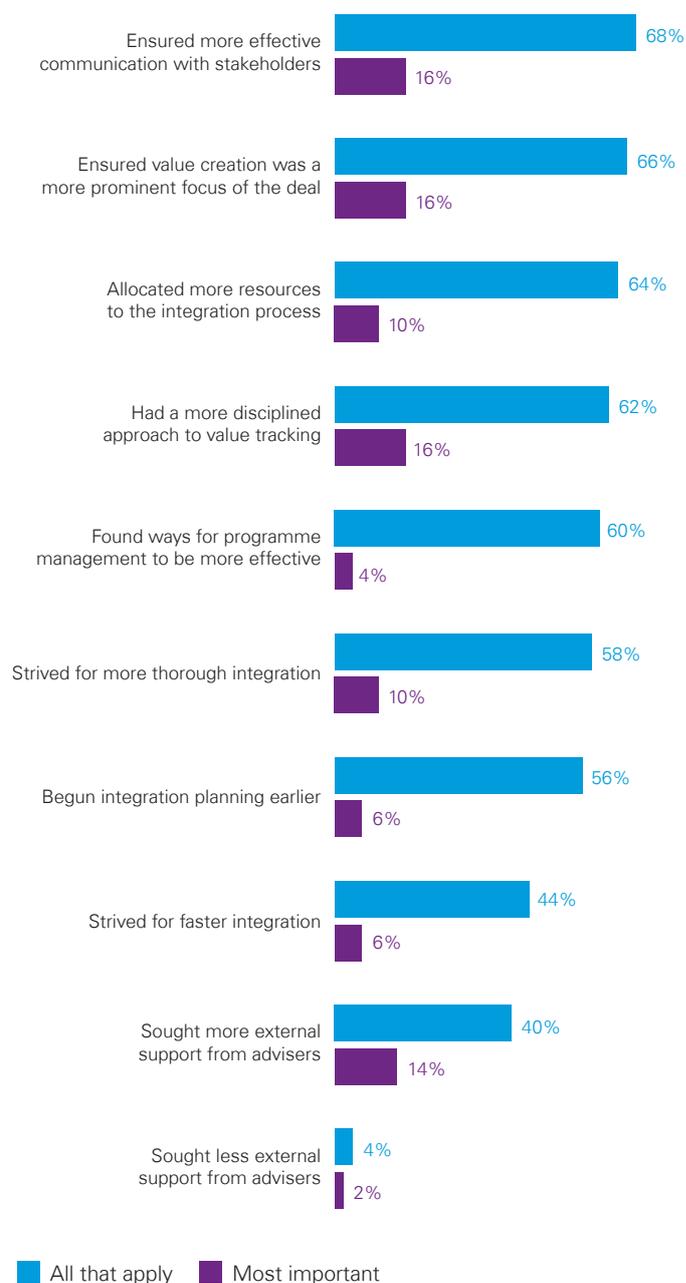
However, examining the most important answers, we find that the second and fourth answers come

Looking back on your most recent acquisition/ investment in Nigeria, what, if anything, would you have done differently with regards to due diligence?





Looking back on your most recent acquisition/ investment in Nigeria, what, if anything, would you have done differently with regards to integration?



out equal with the top answer on more effective communication (at 16% each), meaning that numerous respondents feel they may be losing value in the integration phase of their deal.

However, respondents still feel that communication is the key. As a managing director based in the Americas says: “Stakeholders hold the key in any organisation. They have a certain level of influence on operations and other related aspects. Better communication would have made it easier for us to execute some integration decisions better and at a higher comfort level.”

Key insights

1 Identifying suitable M&A targets

While the case for investing in Africa’s largest economy and capitalising on one of the most compelling consumer markets is obvious, it is not always easy to find suitable investment targets. It is not that there is a shortage of assets, but many private Nigerian companies have successfully expanded with what may seem like very little or no media presence. This can be especially challenging for foreign acquirers who are not familiar with the domestic market.

In addition to assisting with regulatory and legal matters, local advisors are critical to deal origination efforts. This is especially true for acquirers seeking to avoid competitive auctions for high-profile companies, by sourcing off-market deals. Local buy-side advisors are able to introduce acquirers to attractive companies that may have otherwise flown under the radar. Therefore, one of the first steps in pursuing a Nigerian M&A strategy is to get familiar with the country’s advisor networks.

2 Data concerns

Data quality continues to be an issue in Nigeria. Indeed, nearly two-thirds (64%) of respondents regard a lack of information and transparency on target companies as one of the biggest challenges to investing in Nigeria. Data may be inaccurate, unintentionally misanalysed, or manipulated to obfuscate issues in the business.

It is not uncommon to find a lack of transparency in reporting processes, which can harm investors’ confidence in the company’s fundamental numbers. At the same time, weak data and reporting may be used as a bargaining tool to bring down the asking price in M&A transactions and reduce investors’ risk exposure. It pays to have local advisors who can benchmark the company’s reporting standards against other Nigerian businesses and give a valid second opinion on an appropriate valuation.

3 Have an operations team to monitor progress

There has been a trend in Nigeria, noted among private equity firms, for them to set up an operations team to monitor portfolio companies. This can show what the companies are doing right, what they are doing wrong, and whether they are also working in line with the business plan.

In effect, this means having a more hands-on approach than in some other markets. So be prepared to work closely with the businesses to upgrade the business plan, their go-to-market strategies and every other aspect of the business. Even if you do not have a majority holding, people can be appointed to sit on the board to ensure that you have the level of oversight you need.

About Us

KPMG Deal Advisory helps clients to add or preserve value in the decision to buy, sell, partner, fund or fix a company.

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