



# Doing deals in Nigeria

**Key insights from dealmakers**

August 2017

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UNION BANK



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# Survey methodology

In Q1 2017, 50 senior business executives based outside of Nigeria were surveyed, based on their dealmaking experience. In order to qualify for selection, respondents had to have attempted at least one inbound acquisition since 2013.

What is your firm's ownership structure?



**74%**  
Publicly  
traded



**26%**  
Privately  
owned



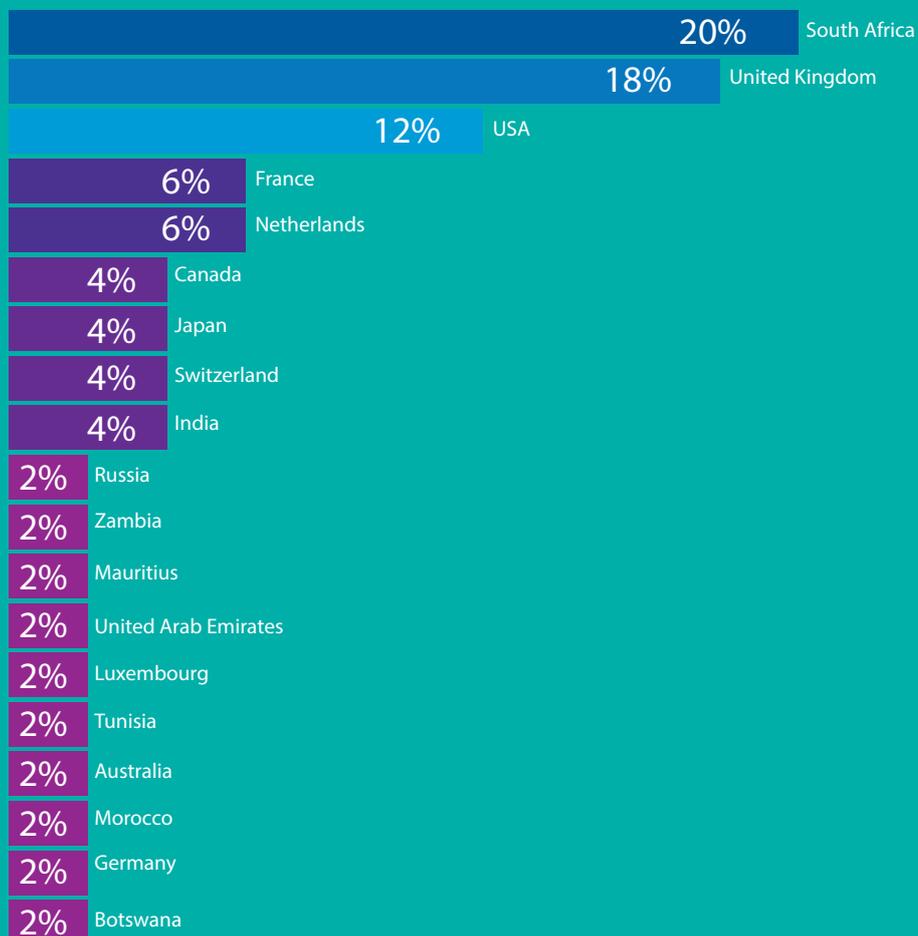
**70%**  
Yes



**30%**  
No

Did you have previous operations in Nigeria?

In which country is your company based?



# Foreword

While the global downturn in oil prices hit Nigeria hard, the country is still very much open for business. Investors are seeing new growth opportunities across a variety of sectors in the country. And for those companies willing to take a more long-term approach, there are outstanding opportunities in Africa's largest economy.

As the continent's most populous country, international corporates and private equity firms see Nigeria as an attractive destination not only in itself but also as a base for expansion across the West African region.

The country's population is young and fast-growing and companies are seeking to capture rising consumer spend. Nigeria is expected to remain Africa's largest consumer market as incomes continue to rise, with fast-moving consumer goods and food and beverages companies set to benefit. Meanwhile, an under-developed financial services sector also holds significant growth potential.

Beyond demographics, there are other advantages for foreign businesses investing in Nigeria. Domestic companies trade at appealing valuations and export-based businesses have become more competitive as a result of the naira's weakness.

However, there still exist challenges that need to be overcome. Under-developed infrastructure serves to push up operating costs, while a lack of transparency can cause unwanted delays in the dealmaking process. Despite these obstacles, the country offers huge potential for investors willing to navigate the risk.

This report brings together unique insights from global acquirers who have conducted M&A deals in Nigeria. The survey analysed experiences of senior business executives in key industries who have been involved with one or more deals in the country over the past four years. The findings of the report reveal key learnings from the dealmaking process, the challenges that dealmakers have had to overcome, and the practices that have delivered success.



**Dapo Okubadejo**

Partner & Africa Head  
Deal Advisory and Private Equity  
KPMG in Nigeria

# Executive summary

## 1 Promising growth potential

Nigeria has a large, fast-growing and young population. This is a huge attraction for businesses looking to capture rising consumer spend. In a sense, Nigeria has already proven itself by becoming the largest economy in Africa. However, growth has been predicated on the country's vast oil reserves and the fall in the oil price has derailed the growth trajectory. However, despite a slow speed of implementation, government policies to stabilise and diversify the economy appear to be moving in the right direction. Overall, the long-term view of Nigeria is that of a country with growing disposable income, improving governance of public services and internal revenue collection, and a shrinking grey economy as a percentage of GDP.

## 2 Beyond the oil wells

Consumer goods and financial services are prime target sectors among foreign investors. Consumption in Nigeria is high due to its demographic profile and continues to grow in lockstep with its population. The country is expected to remain Africa's largest consumer market as incomes continue to rise. This will mean that businesses selling products including fast-moving consumer goods and food and beverages are likely to benefit.

In addition, much of the country remains underbanked. The mass roll-out of telecoms infrastructure over the last decade has enabled the introduction of digital services in the sector and, as Nigerians' wealth accumulates, there will be greater demand for bank accounts, credit products and payment services.

## 3 Political and infrastructure challenges remain

Much of Nigeria's potential for economic development remains untapped due to the chronic lack of electricity. Around half of the population live without electricity, which increases the cost of domestic production. Transport infrastructure and maintenance is also lacking despite the majority of goods being transported by road. These infrastructure inadequacies pose significant challenges for businesses by adding a substantial amount of time and increasing overall operating costs. However, there is plenty of upside to be gained as the country's infrastructure standards modernise and the cost of doing business falls. Political trends are also a concern for investors, with policy changes coming with the handover of political power in 2015. In particular, there are concerns over the government's management of the economy and foreign exchange control measures.

Nonetheless, efforts to stamp out government corruption appear to be moving in the right direction.

## 4 Transparency is an issue

There is a notable low level of transparency in Nigeria's business environment, which is a challenge for investors, particularly at the due diligence stage. Such opacity can make investing risky by clouding accurate forecasting and valuations. This is less of an issue in the public markets, which have high reporting standards. However, private markets are more opaque than those to which foreign acquirers are accustomed.

## 5 Use of experienced local advisers

Nigeria's diverse working culture can cause challenges in the post-deal integration process – an issue which is often overlooked. To ensure that potential synergies are successfully realised, investors should consider planning how to successfully merge their acquisition into the existing businesses prior to negotiations. A greater emphasis on the use of experienced local advisers will help investors to understand the market. Due to the complexity of legal, tax and financial reporting issues, an understanding of deep-rooted cultural nuances and a strong consideration for optimal deal structure are critical for tax efficiency and speedy execution.



# Chapter 1: Nigeria on the agenda

While the fall in oil prices and political challenges pulled the deal market down in 2016, Nigeria is still an attractive location for foreign investors



The appeal of Nigeria for international companies pursuing growth outside of their home markets is clear. Not only is the country Africa's most populous, with over 190 million people, many of whom are being drawn to Lagos and the country's major cities, it is also the largest economy on the continent. At the same time, its GDP per capita of US\$2,758 is relatively low, potentially creating headroom for growth as Nigeria converges with similar economies on the continent such as South Africa and Angola. For those companies with a long-term approach, there are outstanding opportunities to capture this growth potential, particularly in consumer spending.

However, more recently, Nigeria was hit hard by the downturn in crude oil price – unsurprising, given that the country is among the largest oil producers in Africa and crude oil accounts for more than 90% of export earnings. This prompted the government to curb foreign exchange trading to prevent capital flight and depreciation of the naira, which nonetheless lost around a third of its value in 2016, following the central bank's decision to devalue the currency. Nigeria's economy also contracted in 2016 for the first time in 25 years.

#### Driving deals

Despite the country's ongoing economic challenges and the resulting impact on employment and wages, Nigeria is still a comparatively attractive destination for inbound M&A. Companies trade at appealing valuations and export-based businesses have become more

competitive as a result of the naira's weakness. However, in 2016, this did not translate into deals.

Nigeria's M&A market abated as deal volume fell from 33 deals in 2014 (a five-year high) to 23 in 2015, and to 19 in 2016. Deal flow was much in line with global M&A movements which reached startling heights in 2014 and 2015.

At the same time, combined disclosed deal value in Nigeria has plummeted, from US\$9.6bn two years ago (again, a five-year high) to less than US\$1.6bn in 2016.

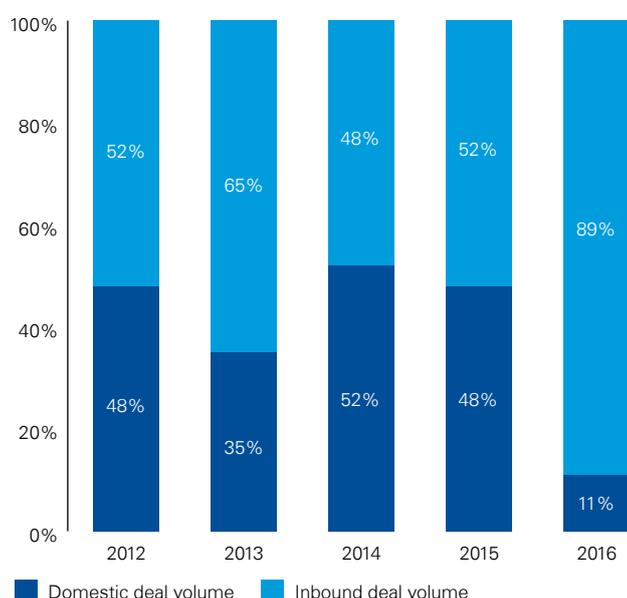
However, according to a number of respondents in our survey, lower valuations and the purchasing power of the dollar over the naira formed a vital part of their investment rationale.

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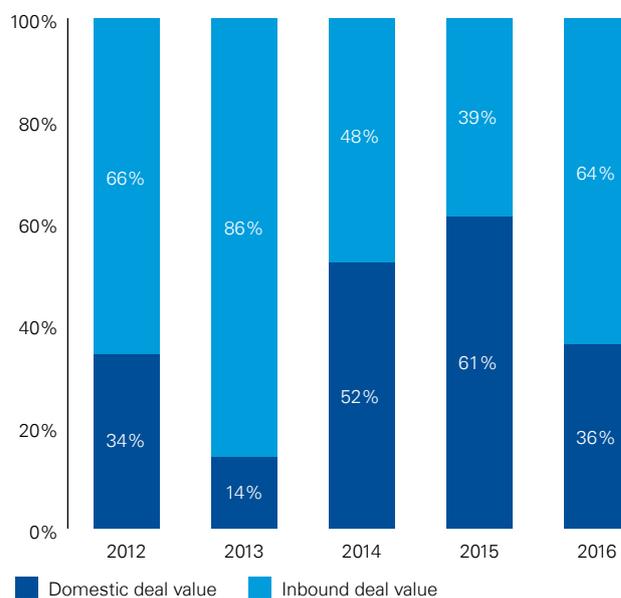
Total M&A targeting Nigeria



Deal volume, percentage of inbound deals



Deal value, percentage of inbound deals



“We were focused on acquiring in fast-growth markets and considered Nigeria to be the preferred location because of its rapid development, significant growth potential and attractive valuations that are driven by their currency value as compared to the valuations in other developing markets,” says the CFO of a UK-based corporate that has previously acquired a Nigerian consumer goods business.

The results of our survey show that Nigeria is an attractive destination for foreign investors, with 62% considering an acquisition in Nigeria over the next two years, while 86% say previous M&A experience has made them more likely to invest in the country again.

Taking a more granular look, all private equity (PE) firms in our survey say they are likely to invest in Nigeria again based on their previous experience.

#### Expansion and exit opportunities

Both strategic buyers and PE firms are increasingly looking to Africa for growth and Nigeria is a prime staging post. Its economic potential, large population, inexpensive labour and English-speaking corporates

ensure a degree of familiarity and ease of doing business for inbound acquirers.

An executive at Convergence Partners Management, a South African PE firm, explains: “Nigeria is a growing market and the level of return-generating opportunities is increasing across various sectors. This is attracting new investors from across the globe, which is also triggering a development in the country’s infrastructure – a sign of rapid development.”

Another PE executive from Europe points out that because of investor interest in the market, they are confident in finding a buyer for the fund’s eventual exit when it is time to divest. “We want to expand in the African subcontinent and we feel Nigeria will be one of the best markets to move into, since it is developing at a very fast pace, and getting investors in the Nigerian market is relatively simple. The domestic market also has a large number of buyers, making it simple to exit in the future.”

“Nigeria is a growing market and the level of return-generating opportunities is increasing across various sectors. This is attracting new investors from across the globe, which is also triggering a development of the country’s infrastructure – a sign of rapid development.”

**Executive, Convergence Partners Management**

#### Obstacles to dealmaking

The country is not without its challenges, and 38% of respondents say they are not looking to invest in the country over the next two years. However, this is generally not because of past dealings in the country – only 14% said that they were less likely to invest in Nigeria again based on their previous experience.

An executive at a Luxembourg-based corporate which plans on making further investments in the country over the next two years, cited corruption issues as a significant hurdle.

“Bribery and corruption regulations are not well developed in Nigeria and this exposes our business to risks. The real estate sector is dominated by these negative business aspects, and in order to avoid these situations, stricter controls and regulations that protect businesses in such conditions need to be implemented,” says the executive.

President Muhammadu Buhari took office in May 2015 on a pledge to

stamp out corruption, which has plagued Nigeria for years. The arrest of former government officials for the embezzlement of billions of dollars showed early promise, but the government still needs to do a great deal more work in applying the same scrutiny from the top down before Nigeria can improve its standing.

Another concern is the stability of the naira. Following the decision to unpeg the currency from the dollar in 2016, it is unclear if further policy decisions will be made to devalue the naira, which the IMF has said is overvalued by up to 20%. Any further devaluation could erode the expected returns of investors who have exposure to the country. Encouragingly, this year, the central bank has taken successful steps to narrow the spread of the value of the naira between the official window and the parallel markets, stabilising the currency and offering investors some certainty. In addition, the government has articulated an economic recovery and growth plan. In view of the above, the interest in Nigeria’s M&A among foreign investors is only likely to increase.

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



62%  
Yes



38%  
No

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



86%  
More likely to invest in Nigeria again



14%  
Less likely to invest in Nigeria again

# Chapter 2: Deal dynamics

Deals in Nigeria are often concluded in bilateral negotiations but identifying a suitable target isn't always easy. We explore the targets, deal structure, drivers and sectors that are attracting foreign buyers into the country



Unlike the US and Western Europe where deep, developed investment banking and corporate finance networks mediate highly competitive auctions, dealmaking in Nigeria operates through a different dynamic. The majority of deals are negotiated “off-market” and are the result of buyers, often acting alone, identifying potential targets rather than being invited into broad sales processes. Our survey shows that 74% of respondents concluded their most recent deal through such bilateral negotiations.

An executive at Net1 UEPS Technologies, a South African corporate that initiated a bilateral deal, describes the process: “We identified the target through our regular targeting procedures. We then negotiated the deal with the buyer with the help of financial and legal advisors, who helped us gauge the potential opportunities to drive performance within the target’s operating model.”

Was your most recent acquisition done through an auction or a bilateral negotiation?



**74%**

Bilateral  
negotiation



**26%**

Auction

### Strategic stakes

Pursuing minority positions over buyouts and takeovers is a common strategy among inbound buyers in the Nigerian market. Almost half of participants state that they have taken a minority stake, compared with 40% who opted for a majority. Given the relative immaturity of the M&A market, many investments are made in private businesses with first-generation owners who have not previously sold to PE firms or corporates. The survey reveals that as much as 70% of deal activity involves privately owned businesses compared with 18% that trade on the stock market and just 10% that are already backed by PE.

Further, nearly two-thirds (64%) of transactions involve independent target companies. For this reason, international companies seeking acquisitions in Nigeria should “warm up” potential deals by getting to know the owners and their working culture, and communicating how a deal would benefit the future of the company.

Minority deals offer a compromise for business owners who have not yet been involved in the acquisition process. They give both buyers and vendors a chance to test the water before committing fully to a sale.

Anis Kallel, partner at Tunisia-based PE firm AfricInvest Group, which bought a minority stake in an independent Nigerian company, explains the benefits they perceived in the transaction.

“We wanted to invest in an independent company because it was simpler to execute the deal, getting

What type of business did you acquire in your most recent deal? (Please select only one)



What type of transaction was your last deal? (Please select only one)



Was the target an independent company, a subsidiary or a carve-out of certain business lines? (Please select one)



paybacks would also be simpler and it would help us get direct access to the returns they made. We wanted to expand trading in commodities in the agricultural sector and felt this was the best way forward," Kallel says.

For new market entrants this allows them to de-risk their exposure by requiring a smaller investment outlay, although this typically comes with a trade-off of lack of control and a lower level of influence.

Where vendors are unwilling to sell a majority of their business for fear of underselling the asset or losing out on future growth, it is becoming increasingly common for international buyers to negotiate veto and other control rights. In this way, even minority shareholders can ensure a greater say over share capital changes, asset sales or the removal of directors.

#### Deal drivers

There are a number of rationale for acquisitions. The target company's domestic distribution channels and its existing customer base are the key drivers for the majority of respondents (54% each). According to an executive at Net1 UEPS Technologies, the attraction of their target company in the financial services sector was that it presented a well-established, proven route to market and the opportunity to scale up by adding untapped strategies.

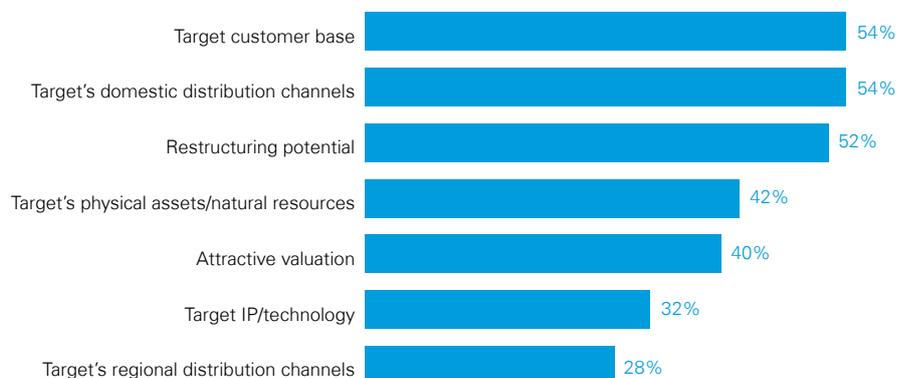
"The target's market reputation and their domestic reach was significant," says the executive. "And there was also scope to target new consumers through effective digital strategies, which we could use our expertise to deploy."

Given that the majority of deals involve independent, privately owned businesses, many acquirers see opportunities to transform the operations of companies in order to capture more sales and profits. Our survey finds that 52% of respondents cite restructuring potential as a key driver for making their Nigerian investment.

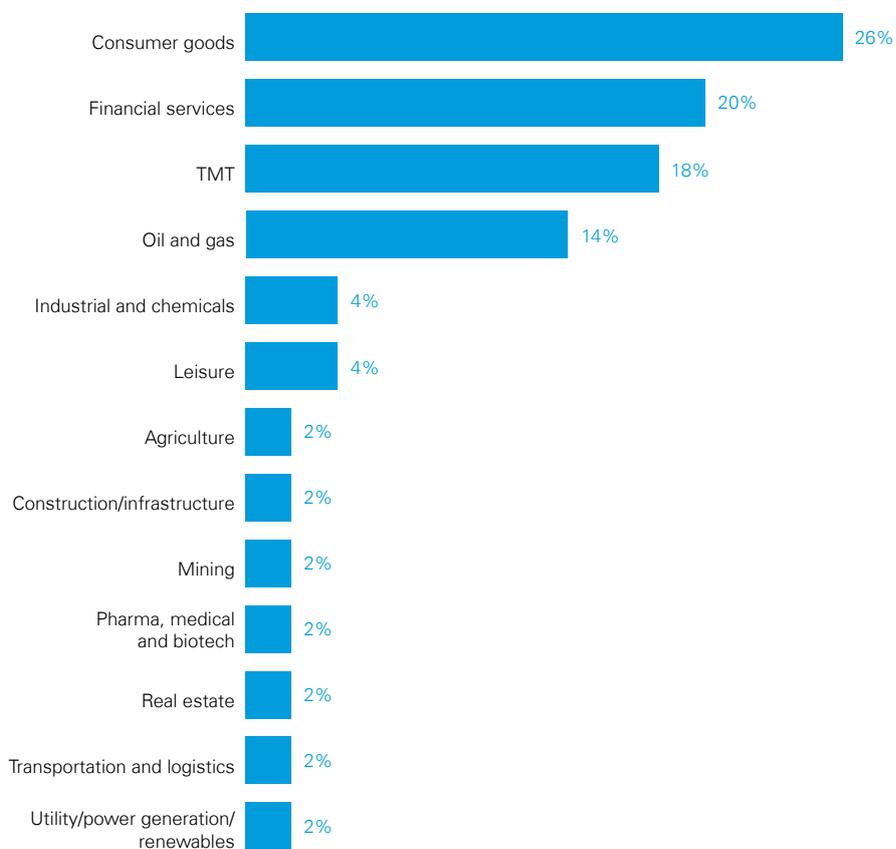
One PE partner at a UK-based PE firm observes that such transformation can be capital-intensive and this is where an investor can add real value. "The target was to address significant unmet demand in its domestic region and to increase the distribution presence across other parts of western Africa," he says. "These restructuring opportunities required heavy capital investments which were funded by a consortium of businesses, including ours, and this will help us gain significant profit by improving the revenue of the business."

## Minority deals offer a compromise for business owners who have not yet been involved in the acquisition process

#### What was the most important driver for your Nigerian acquisition?



**In which sector was your most recent investment/acquisition?  
(Please select only one)**



**Sector scrutiny**

On a sectoral level, our survey proves that Nigeria is about much more than oil and gas. Inbound buyers have taken a notable interest in the consumer and financial services industries. The country has a large, increasingly urbanised population and is in the top-quartile of the fastest-growing populations in the world. Further, with a median age of 18.3 years, Nigeria is also one of the youngest countries globally.

This represents a significant consumer opportunity and companies have seen the benefits of moving into Nigeria. For example, Diageo sells more Guinness in Nigeria than in any other country and Heineken’s largest brewery outside of Europe is in the country. In 2016, Africa’s biggest economy was also the fourth-largest soft drinks market in the world after the US, China and Mexico.

“The consumer goods industry is showing a multiplier effect and there are significant returns to be gained through investments in the right product categories and markets,” says a Europe-based PE partner. “We identified the target as having significant growth potential and decided to invest in this sector.”

In 2015, South African Pioneer Food Group made a majority-stake acquisition in Nigerian Butterfield Bakeries, tapping into an emerging consumer segment. Hannes Visser, Pioneer’s head of mergers and acquisitions, comments on the underlying acquisition strategy: “We are the largest bakery company in

South Africa. So it is our exportable intellectual property (IP) that we thought we could bring to Nigeria, coupled with the distribution. That was the main reason we went ahead with this transaction.”

At the same time, much of the country’s population remains unbanked or underserved, particularly in rural regions. Little over a third of the adult population has a bank account or access to financial services, although significant progress is being made and the mass roll-out of telecoms infrastructure over the past decade has enabled digital services in retail and finance.

The managing director of a US-based PE firm explains that this trend prompted an investment in the sector: “The financial sector in Nigeria is fairly

underdeveloped and has significant growth potential. This is attractive to us as we can reap future rewards once we have managed to invest significant capital to facilitate growth and raise [the acquisition’s] position in the market, making it one of the most preferred tier-1 banks in Nigeria.”

Robin Ling, CEO of Swiss media group Ringier AG for Africa and Asia, is also optimistic about the Nigerian market in the long run and says the company is likely to invest again, and is considering companies in the TMT sector, including publishing and e-commerce businesses. “I see market consolidation happening in our industry, and as we are driving consolidation this is more likely to happen,” he comments on potential future acquisitions, but adds that,

## In 2016, Africa's biggest economy was also the fourth-largest soft drinks market in the world after the US, China and Mexico

"At the moment, the economic situation and currency issues are the biggest obstacles."

With relatively low GDP per capita and much economic potential, Nigeria's middle class will continue to grow and there is plenty of headroom for wage growth, which will result in greater demand for consumer goods and financial services.

Our survey shows that more than a quarter (26%) of respondents' most recent acquisition in Nigeria was in the consumer goods segment, with 20% saying they struck a deal in the financial services sector. By contrast, only 14% of participants say their last deal in Nigeria was in oil and gas, making it the fourth most popular sector among respondents despite the scale of the oil industry.

# Leading practices

**1** **Minority deals are a good way to test the water**  
The prevalence of minority stake deals in Nigeria is the result of most deal opportunities being relatively small, independent businesses often run by families. In most cases, these business owners have no previous experience of selling to foreign acquirers. Many choose only to sell a minority stake in their company to avoid underselling and missing out on future growth. Investors should be prepared for a lack of majority positions and negotiate veto and other control rights to protect their investment. As vendors become more accustomed to M&A with foreign corporates and PE funds, there will be more majority-stake opportunities available in the market.

**2** **Get to know the seller – particularly family businesses**  
It is important in any M&A market to get to know the seller, but this is especially true of Nigeria. Given the attraction of the country because of its demographic fundamentals, there is a huge amount of interest in Nigerian companies, making it a seller's market. This means vendors are looking for more than just readily available capital. They want to know how any deal will benefit them and their business. This requires getting to know Nigerian sellers and articulating your value-add proposition in advance of negotiating a deal.

**3** **Pursue the consumer**  
Consumer-facing sectors are of particular interest to foreign acquirers because of Nigeria's demographics. With a large, young, fast-growing population, there is huge consumer demand in the country and there is much potential for this to rise as GDP per capita increases and Nigerians enjoy ever more discretionary income. This is prompting investment into fast-moving consumer goods, retail, telecoms and financial services, the latter being comparatively attractive due to its regulated nature, which reduces corruption risks. More specifically, companies in the fintech sector of the financial services industry, which provide mobile payments platforms and other technologies that improve convenience and efficiencies at a lower cost, have huge growth potential.

# Chapter 3: Processes and challenges

From due diligence to integration, the process of getting the deal done and then merging the businesses successfully is fraught with challenges, from broader political considerations to a lack of corporate transparency

Nigeria's political trends are hampering the country's investment prospects. That's according to 76% of our respondents who chose the political situation as one of the top three challenges to investing in the country. This may be expected given the All Progressives Congress (APC) party's recent rise to power in the 2015 elections following the merger of a number of opposition parties, and the policy changes that come with any transition of power.

Government monetary policy regarding the naira, which was artificially pegged to the US dollar before being devalued in 2016, has been met with criticism by some investors. This uncertainty surrounding the value of the currency may give pause to some investors, but reforms targeting corruption and economic stability and growth should in the meantime prove beneficial if effectively executed, while the central bank's steps to narrow the spread of the naira on the official and the parallel market appear to be yielding positive results.

According to 76% of our respondents the political situation is one of the top challenges to investing in Nigeria

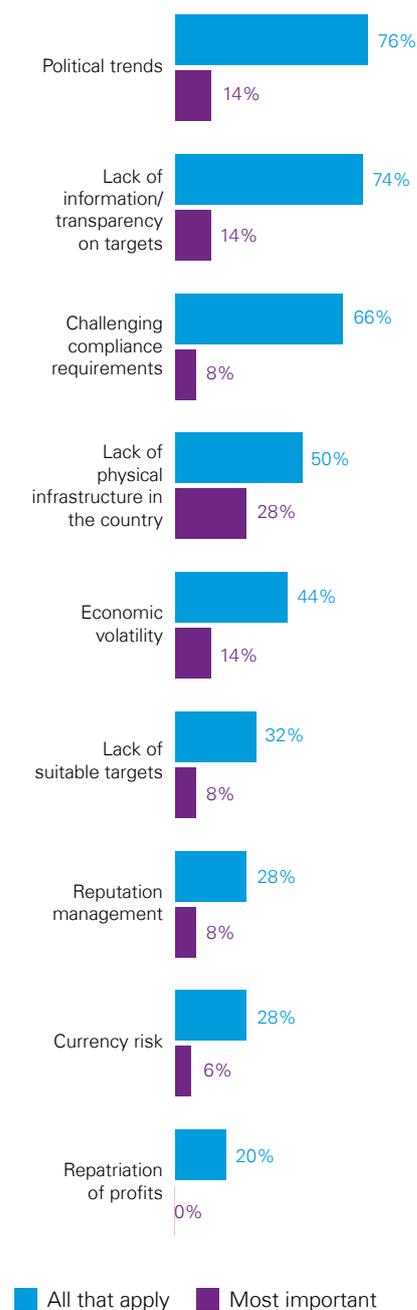
### Pre-deal investment challenges

However, when asked to select the single biggest challenge to investing in Nigeria, a small majority (28%) cited the lack of physical infrastructure. Despite its vast oil and gas reserves, the country lacks power generation capabilities and must import refined fossil fuels to power its economy.

Business growth is also hindered by the infancy of the country's transport infrastructure, with only 20% of roads being paved despite road transportation being the means of movement for 80% of goods in the country. Much of Nigeria's potential for economic development remains untapped due to the chronic lack of electricity, which increases the cost of domestic production.

However, it is worth noting that these constraints represent an investment opportunity as the government continues to look to private capital to develop vital infrastructure assets. Infrastructure upgrades will also eventually help to accelerate businesses' growth projections as telecoms and transport efficiencies are achieved.

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



**“Transparency issues are the most challenging to overcome once discussions to acquire the business have begun, mainly because it creates inaccurate forecasts and can completely hamper the business objectives.”**

**Group financial director, South Africa-based corporate**

#### **Not enough information**

The lack of transparency regarding target companies is another major obstacle for investors. Nearly three-quarters (74%) indicate that this is the biggest challenge to investing in Nigeria, with an executive at an international firm saying that such opacity leaves room for corruption.

“Operating in Nigeria has many different risks associated with it but the most difficult to manage are the transparency issues. Corruption is very high and, because of this, delays in obtaining permits is a regular occurrence.”

However, with a longstanding presence in Nigeria, the company is confident its experience will facilitate future acquisitions.

“We are aware of how business is done and have an understanding of the complexities, rules and regulations which will help us make an acquisition later with fewer problems,” says an executive at the company.

The group financial director of a South African corporate adds that the paucity of information is curbing the volume of deals being secured. “Transparency issues are the most challenging to overcome once discussions to acquire the business have begun, mainly because it creates inaccurate forecasts and can completely hamper the business objectives,” he says. “Insufficient information also disrupts the due diligence processes and, unless the data is reliable, investors are unable to move forward, resulting in slow deal growth.”

This lack of transparency and information have a direct impact on the mechanics of M&A processes by making due diligence more difficult to conduct. Indeed, we found that 84% say that initial due diligence is the most challenging part of the M&A cycle to complete in Nigeria. This will be less problematic for buyers pursuing deals on the stock exchange, which requires information disclosures and quarterly earnings reports. However, Jared Rosenbaum, the director of corporate

development and strategy of US food giant Kellogg Company, which entered into a joint venture with Nigerian company Tolaram in 2015 to expand its offering in the African market, highlights the challenges of investing in the private market, which represents the majority of deal flow.

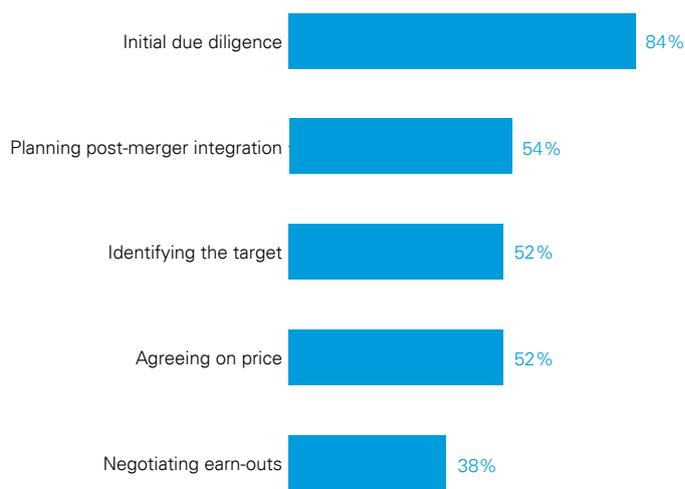
“Doing business in Africa is quite risky and there is a need to make sure we do not invest in a company which has a lot of debt and other issues. Companies tend not to make their information public and this adds to complexities when trying to carry out a due diligence process. The lack of information delays the deal and increases risks,” explains Rosenbaum.

#### Announcement strategies

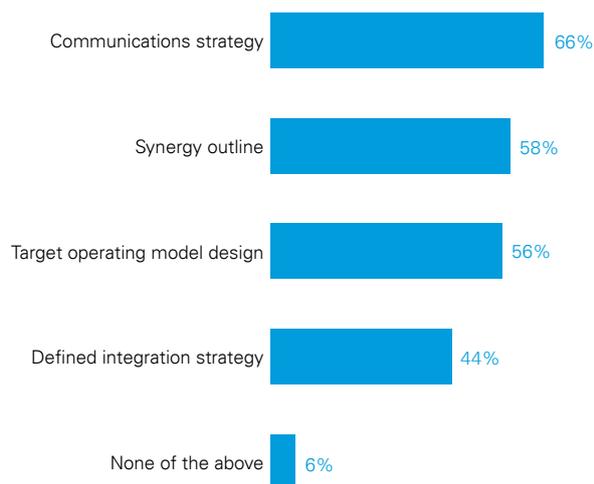
Moving beyond the initial phase of sourcing potential deals, negotiations and the challenges of diligence, two-thirds of respondents say they had a communications strategy in place at the time of announcing their deal. This shows a proactiveness on the part of investors, and an understanding that the success of a deal hinges on effectively communicating the future strategy to all stakeholders, from shareholders to suppliers and employees.

However, there is evidence that investors are not prioritising integration post-deal – a common oversight in M&A processes. Only 44% say they had a defined integration strategy at the time they announced their deal, which indicates that more work is needed to plan for smoothly merging the enlarged group at the earliest stages of the deal. PE firms are not bound

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

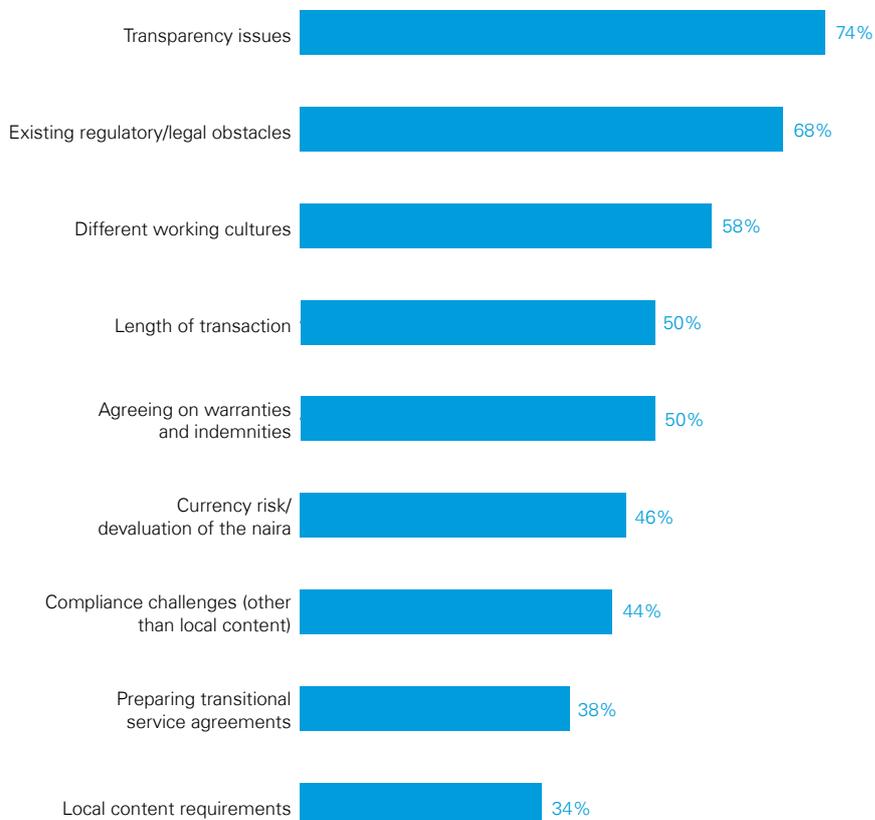


#### Which of the following did you have in place at the deal announcement stage? (Please select all that apply)





What were the challenges in completing your most recent deal in Nigeria?  
(Please select all that apply)

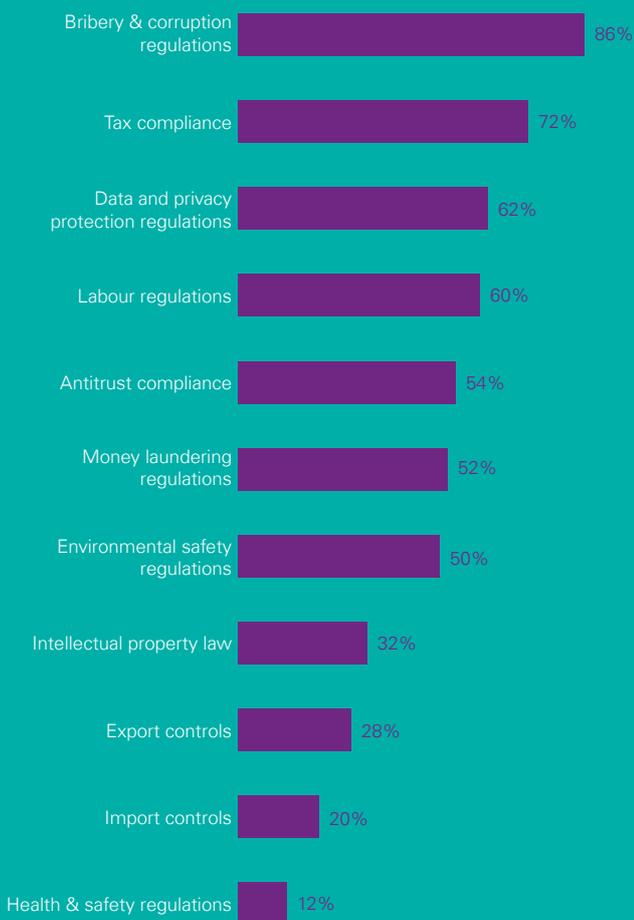


Only 44% say they had a defined integration strategy at the time they announced their deal

by the same integration imperatives unless pursuing bolt-on acquisitions.

However, having a precise strategy beforehand pays out as it can hasten market entry and prepare for security risks, says Jared Rosenbaum, director of corporate development and strategy at Kellogg. "We had developed a strong integration plan to allow us to integrate our business and, at the same time, enter the market without any problems. It enabled us to transfer information and update our systems without any risks from hackers or malware. Having a concise integration plan also helped us manage our employees better while developing and improving our supply chain," he says.

Which compliance/regulatory processes do you consider to be the most challenging to manage in Nigeria? (Please select all that apply)



Did you work with a local or foreign advisor in your most recent acquisition?



57%

Local



43%

Foreign

### Regulatory hurdles

Looking at the specifics of compliance and regulation, a clear majority (86%) say that it is rules around bribery and corruption that are of the most concern. Nigeria has long struggled with this problem, being cited among the most corrupt countries in Africa due to its significant natural resources and insufficient penalties and prosecution for fraudulent activities.

President Buhari has made efforts to stamp out this behaviour, which should improve governance of the country's finances and help to protect investor capital.

However, as the group director of commercial finance at a UK-based corporate notes, efforts to eliminate corruption are putting a greater regulatory burden upon businesses. "Anti-corruption regulation and legislation have become complex as the government strives to reduce the level of corruption that is restricting economic growth throughout the country, and therefore the level of compliance has increased considerably."

A representative of a Russian oil major says he also considers bribery and corruption regulations in Nigeria among the most challenging regulations to manage in Nigeria.

"We had secured professional advice from local legal teams on how to carry out the transaction as we wanted to be most compliant to protect our future business

# PE challenges in Nigeria

Red tape and administrative challenges feature at the top of the biggest challenges for PE firms in Nigeria, cited by 30% of participants as the single greatest hurdle.

However, one of the more PE-centric dampeners to dealmaking is the immaturity of capital markets in Nigeria, which 25% say is problematic. Clearly the country's debt liquidity is shallow compared with Western Europe and the US, however, this should not deter investors.

First, while Nigeria is some distance behind South Africa, it has had the second highest volume of bond issuance of any African country over the last five years.

In spite of the country's more recent economic challenges and notable lack of financing, over the long-term, international investors will take a growing interest in Nigerian bond issuances, with familiar European eurobond and US high-yield offerings growing in popularity in Africa in recent years.

A government bond that was repeatedly shelved due to weak investor demand was eight times oversubscribed at the beginning of 2017, a sign that investor sentiment is already beginning to turn. What is more, given the scale of available private companies in Nigeria, deals are often small enough for international funds to finance entirely with equity. This gives PE firms the option to refinance at a later date when the market is more receptive, or through a leveraged bank loan.

What do you consider the biggest challenge for PE firms in Nigeria? (Please select the most important)



intentions in the country, considering the vast opportunities and abundance of resources that could help us increase our international output levels," he says.

### Going global? Think local

Addressing the opacity of businesses and the challenges of due diligence and heightened regulatory obligations requires bringing on advisors who understand the local market. However, we found that only 57% of respondents worked with a local advisor on their most recent acquisition. Of those who used a local firm, the majority stressed the importance of working with advisors who have an intimate knowledge of Nigerian laws and regulations.

"We had local legal assistance to enable us to successfully complete our due diligence and licensing agreements," says an executive at Net1 UEPS Technologies. "We did not have sufficient knowledge of the target's jurisdiction and their processes, so opted for a third-party legal provider to manage all our legal advisory and compliance."

Given that more than 43% of respondents worked with foreign advisors suggests that more research is required on the part of inbound acquirers to identify relevant advisors with the requisite knowledge to assist their M&A needs. This is especially important given the incumbent government's measures to prevent corruption, which could result in a shifting and more onerous regulatory landscape.

# Leading practices

**1 Engage the right advisor – preferably local**  
Tapping local knowledge is a must in Nigeria. Given the lack of transparency and information, it can be challenging to conduct comprehensive and effective due diligence on an investment opportunity. It is important to engage with a credible advisor who understands the local market and how to gain an accurate picture of a company's liabilities, growth and overall health by benchmarking it against similar local businesses. In many cases, the person with the most power and sway over a Nigerian company is not part of the management team or even on the board. Therefore, tacit advisor knowledge of industries, individual companies as well as corporate law and tax systems is hugely valuable.

**2 Spend time on the ground**  
The only way to benefit from the value-add of a good local advisor is to understand the local advisor network and this requires spending time in the market. This allows acquirers to meet with vendors in person to warm them up to deals and will help develop a familiarity with the idiosyncrasies of dealmaking in Nigeria. Since many deals are negotiated bilaterally it pays to have developed good relationships and built trust with prospective sellers, and the only way to do this is by spending time on the ground.

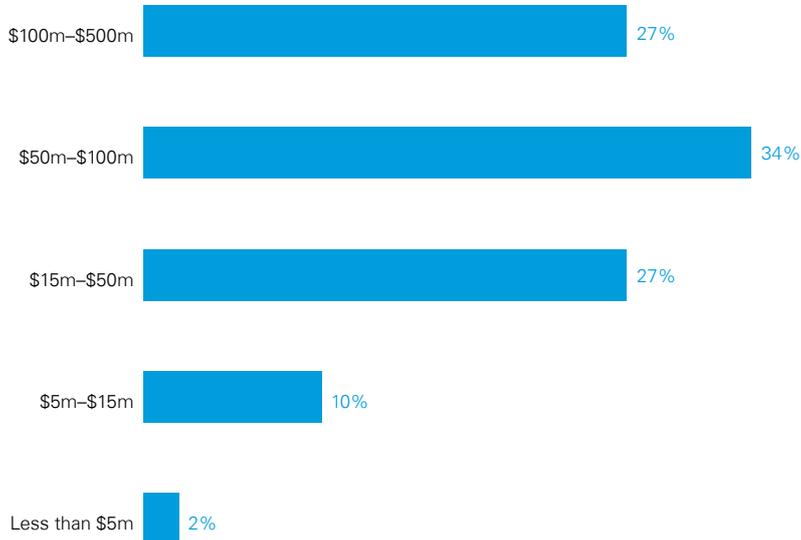
**3 Be conscious of culture**  
There are around 500 ethnic groups in Nigeria, with approximately two-thirds of the population represented by the Hausa, Yoruba and Igbo tribes. This cultural diversity can pose challenges to the dealmaking process. For example, an advisor from one tribe engaging with a vendor from an opposing tribe may disadvantage the deal, and these cultural sensitivities and nuances need to be taken into consideration. What is more, when it comes to integrating a new business, buyers must think carefully about the potential mismatching of working cultures and how to overcome this challenge ahead of closing a deal.

# Chapter 4: Financing the deal

With deal sizes in Nigeria relatively small, most are financed with cash. But acquirers should investigate the alternatives before doing the deal



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



Megadeals are not on the M&A menu in Nigeria just yet. Our survey finds that one-third (34%) of respondents' most recent acquisitions were in the US\$50m-US\$100m bracket. Meanwhile, 39% of deals fall below the US\$50m mark. Consequently, there is less need for external debt financing and many cash-rich corporates, which have benefitted from a recovery in their earnings and a lift in stock markets in recent years, have ample reserves to deploy into Nigerian M&A. The head of M&A at South African Pioneer Food Group, Hannes Visser, comments on the acquisition of a carve-out in a Nigerian consumer goods company in the US\$5m-US\$15m range: "It wasn't a big acquisition; we specifically went for a smaller entry into the market. Therefore, we didn't need to go external."

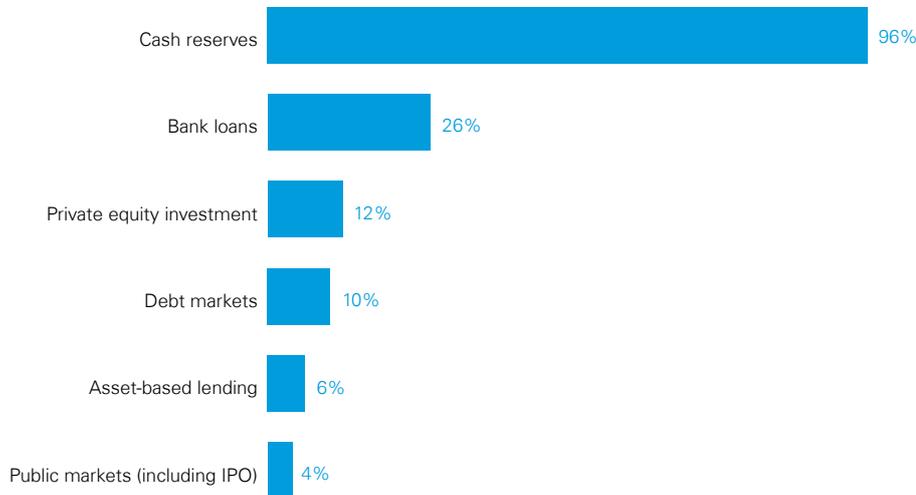
Our survey shows that cash reserves were the main payment method for 96% of participants in their last deal, with many citing a preference to use excess capital in order to avoid paying eye-watering interest rates

that can exceed 20%. Only 10% say they tapped into debt markets.

"We decided to utilise our cash reserves to fund our acquisition in light of high interest rates that would have added to the transaction costs," explains the head of strategy and business development at a German corporate that acquired a majority stake in a consumer goods company. "For us, it was more convenient to use up our cash reserves to fund the deal."

**Our survey shows that cash reserves were the main payment method for 96% of participants in their last deal**

**How did you finance your most recent Nigerian acquisition?  
(Please select all that apply)**



**Alternative financing**

Of those who opted to use debt financing, a clear 60% majority say they used unitranche loans – a blend of both senior and junior debt with a single price point. One-fifth (20%) used PIK notes which, though small, have been growing in popularity. These instruments allow borrowers to pay interest “in kind” by rolling it over into the outstanding principal payment, often with an option to toggle such payments on and off to suit the borrower.

One of the hindrances to liquidity in Nigeria’s capital markets is the lack of a robust regulatory and legal framework to accommodate the idiosyncrasies of derivatives trading. This means that the majority of derivatives transactions are bilateral. However, liquidity is expected to deepen as more investors participate in the market. Meanwhile, the CEO of the Nigerian Stock Exchange, Oscar Onyema, has said the exchange is looking to fast-track efforts towards developing innovative products such as exchange-traded

**If your most recent Nigerian acquisition was financed through debt markets, please specify the debt instrument used. (Please select the most important)**



**Of those who opted to use debt financing, a clear 60% majority say they used unitranche loans**

derivatives and will encourage policymakers to make regulation more conducive to structured investment products.

### Offshore vehicles

A significant minority (20%) of respondents say they used an offshore special purpose vehicle (SPV) for their most recent deal. Of these, the majority chose to offshore the vehicle in Nigeria (34%), followed by South Africa (22%) and the Netherlands (22%); further, 90% of these SPV users say its location impacted positively upon the transaction.

Such vehicles are structured to insulate them from the bankruptcy of their parent, a significant advantage for inbound investment into Nigeria.

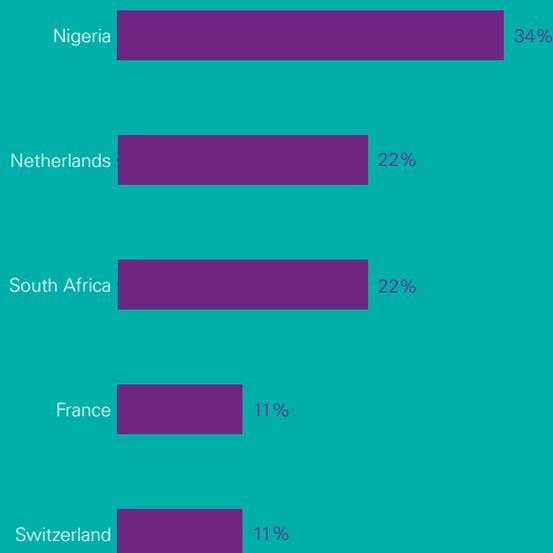
As an executive at an international firm explains, this can help buyers to ringfence and protect an asset when securing a deal in what is a high-risk market. "It was a large deal and the Nigerian market can be very risky to invest in. We used an SPV to secure our stake in the company we had acquired."

While only one in five participants used an SPV, all inbound investors should consider how such a vehicle may help to de-risk their next Nigerian deal.

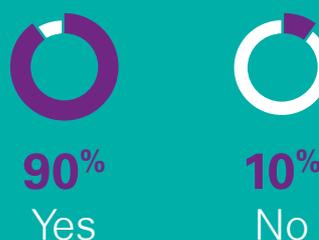
Did your deal involve an offshore special purpose vehicle (SPV)?



If yes, where is your offshore SPV located?



If yes, did your SPV location impact positively on your acquisition in Nigeria?





# Leading practices

## 1 Originate at entry level

International acquirers should be cognisant of the fact that the majority of available deals fall under the US\$100m mark. This can make finding a suitable target difficult for the very largest PE funds and corporates. However, as the economy grows there will be more large businesses in the ecosystem and as the M&A market matures and vendors become more comfortable and familiar with selling to foreign investors, there are likely to be more majority-stake opportunities, which will increase the availability of larger deal sizes over time.

## 2 Overcome the lack of liquidity

There is limited liquidity in Nigeria's debt capital markets. Banks and other investors have piled into comparatively safe government bonds rather than into corporate paper. And limited liquidity makes it harder for investors to trade out of bonds on the secondary market, making it more difficult for corporates to attract investors to debt issuances. This low demand is compounded by high financing costs, which in naira terms can exceed 20%; the interest rate in Nigeria is 14% as the central bank pushes to curb high inflation.

Workarounds include financing deals with dollar-denominated bonds or loans, either sourced from local banks and investors or outside of the domestic market. Meanwhile, some PE funds have opted to structure their investments with quasi-debt financing, such as mezzanine, rather than pure equity.

## 3 Consider using an offshore SPV

SPVs offer significant advantages for foreign buyers. Nigeria has double-taxation treaties with a number of countries and so offshoring an SPV in the appropriate jurisdiction for the purpose of an acquisition can have significant tax incentives. Second, it can be easier to attract international debt financing, and often at a lower cost, to offshore structures. Other advantages include the SPV's insulation from the potential bankruptcy of its parent, as well as reducing regulatory burdens such as the acquisition and disposal approvals imposed on Nigerian companies. Any inbound acquirer weighing up a deal in Nigeria should consider the advantages of using such a structure.

# About Us

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

Businesses today are under more pressure than ever to deliver better and more sustainable results for stakeholders. At KPMG, we think like an investor, looking at how opportunities to buy, sell, partner, fund or fix a company can preserve and enhance value.

Today's deals do not happen in a vacuum. So from your business to acquisition strategy, your plans for divestments or for raising funds, or even your need to restructure, every decision must be made in the light of your entire business, your sector and the global economy.

Our team of specialists combine a global mindset and local

experience with deep sector knowledge and superior analytic tools to help you navigate a complex, fragmented process.

From helping to plan and implement strategic change to measurably increasing portfolio value, we focus on delivering tangible results. The kind of results that let you clearly see what you gained from the deal at hand, and what you want to bring to the next deal down the road.

KPMG Deal Advisory in Nigeria is the largest, most experienced fully dedicated deal advisory practice in the West African region with deep industry skills and experience.

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