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Think Ahead: Investing in Nigeria's New Economy

Yasmin Kumi
Yasmin.Kumi@africaforesight.com
Managing Director
Africa Foresight Group

Foreword by Africa Foresight Group

As Africa's largest and most populous country, Nigeria attracts considerable global investor interest. *Think Ahead: Investing in Nigeria's New Economy* seeks to demystify the investment process in Nigeria by highlighting key trends and best practices to enable investors to successfully invest in Nigeria.

Historically a commodity-driven market with challenging economic risks for investors, the Nigerian investment landscape has shifted over the past decade, with investor success stories increasing in new sectors. Our team has identified five such attractive 'new economy' sectors and embarked on a thorough process to analyse and deconstruct them. In the course of this work, we were particularly impressed by the creativity of successful investors in identifying specific opportunities and harnessing their value. And while certain investors adopt a high-risk approach to achieve outstanding returns, other financiers manage to achieve satisfactory performance based on more conservative strategies.

Think Ahead: Investing in Nigeria's New Economy draws on key investor insights to derive best practices for those seeking successful deal-making in Nigeria. Having worked in this exciting country for several years, Africa Foresight Group (AFG) has witnessed the breadth of unmet market demand the private sector has to satisfy across industries, many of which have potential that reaches beyond the national borders. Our most important learn from completing the work on this report is that Nigeria has suitable investment opportunities for most types of investors, *if the strategy employed is right*. We do hope that this report will encourage more institutional and private financiers to look at Nigeria from this angle to unlock the hidden potential of the country.

Foreword by David Law (MD, Standard Chartered Bank)

With a population of just over 190 million people and GDP of over USD 375bn, Nigeria is an unparalleled economic livewire within Africa. We have partnered with AFG on this report to explore the investment landscape and opportunities in the Nigerian economy, highlighting the key trends, and best practices to enable investors to successfully invest in Nigeria.

Standard Chartered Bank has been operating in Nigeria since 1965. Encouraged by the significant interest of international emerging markets investors and corporate clients in the Nigerian economy, we were delighted to support the creation of this report by AFG to help with the demystification and unveiling of the opportunities at hand.

Through its research AFG has identified five attractive 'new economy' sectors and embarked on a thorough process to analyse and deconstruct these opportunities. The objective of Think Ahead: Investing in Nigeria's New Economy is to take an investor-informed approach to determine the recipe of successful investment returns in Nigeria. The report provides detailed historical transaction information, direct investor experience and legal and corporate best practice. Together these can be followed step-by-step to arrive at investments best matched to experience and risk appetite.

It is my hope that through this report, we have enabled you to learn more about the dynamics and different elements at play within Africa's largest economy.

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Executive summary

Nigeria has started to recover from the 2016 recession, and its GDP is currently estimated at USD 375.77bn[1]. It is crucial that investors consider this in terms of increasing economic diversification, stable anticipated GDP growth over the next 10 years and new regional opportunities evolving across the country. Nigeria's historic growth, size and expected trajectory mean that it plays a critical regional and pan-African role.

Prior to the 2016 recession, Nigeria's investment traction had recovered to 2007 pre-global financial crisis (GFC) levels, with transaction volume at USD 11bn in 2015. While investment as a proportion of GDP has yet to recover fully to pre-GFC levels, the investment recovery profile is different since the GFC. Investors have diversified away from oil & gas and financial services, with investment in the latter dropping by c.40% versus other sectors. M&A has become the most attractive transaction type over the past decade, accounting for 83% of Nigeria's investment value in 2015. More than 60% of all deals in Nigeria are minority share acquisitions, mainly by foreign investors.

Sector stories begin to emerge when analysing investment value and the number of deals over the past decade. Local and foreign investment trends have improved for consumer goods, oil & gas, and power. Healthcare and TMT saw the strongest uplift in ticket sizes between 2007-11 and 2012-16; consumer goods and power saw the strongest increase in average number of deals per year.

Investors view FMCG, non-banking financial services, basic services (healthcare, education, off-grid power), business services and real estate as the top five 'new economy' sectors in Nigeria, based on demographic opportunity, regulatory environment and market entry opportunity. These new economy sectors are the focus of this report, due to the size of their domestic target markets, the low level of associated sector red tape, and manageable barriers to entry in the sector. For each of these new economy sectors, investors identified between three and eight particularly promising opportunities that are 'hot', if their value drivers are well understood.

According to investors interviewed and surveyed for this report, returns in Nigeria can be attractive, at 20-30% internal rate of return (IRR). However, the ability to achieve this level of investment success is driven by the type of investment strategy chosen and the risk appetite of respective investors. Investment strategies can either be sector-driven top-down approaches starting with the identification of industries with attractive sector dynamics, or target-driven bottom-up approaches based on a company's growth potential, management capability and operational strengths. The strategies have different risk-return profiles and their level of attractiveness depends on the type of individual investor.

The deal process in Nigeria is the same as anywhere else in the world: deal sourcing, due diligence, bidding, value generation, and exit. However, specific best-practices for each step provide investors with the highest likelihood of success in Nigeria. Most emphasise on-the-ground verification of potential and assumptions, focusing strongly on the people behind a business and on being a patient investor.

Executive summary
Introduction/ Methodology
The investment landscape
Exploring opportunities
Finding the right investment
Best practices from the experts
Appendices

[1] Nigeria was worth USD 375.77bn in 2017 - *https://tradingeconomics.com/nigeria/gdp*

Introduction: Objectives and methodology of this report

Objectives

With a mega population approaching 200mn, Nigeria is a key focus for global businesses and investors. Back in 2015, investment transactions amounted to USD 11bn. Total FDI in Nigeria amounted to USD 5.12bn in 2016, and the country remained the #2 destination for FDI across Africa[2]. Most investment comes from the United States, Canada, UK, China, France and India. While Nigeria is among the top destinations for private equity investment in Africa, the contribution of FDI to total GDP is still below 5% due to perceived difficulties in sourcing targets and understanding exit time frames.

The effects of the 2008 GFC were exacerbated by an economy predominantly reliant on the oil & gas sector. The devaluation of the Naira in 2016 and the ensuing recession, the opaqueness and lack of data on current and past transactions, plus regulatory barriers paint a picture of a very challenging and potentially unattractive place to do business. Indeed, Nigeria ranks 145 out of 190 countries (2017) for ease of doing business.[3] Despite this, investors have closed transactions amounting to c.USD 64bn over the past decade, indicating that Nigeria remains a very attractive destination for investors in Africa. Tenable investment in Nigeria requires accurate information and a pragmatic approach to investment decisions, while accepting recommendations and adopting best practice from experienced Nigeria investors.

The objective of *Think Ahead: Investing in Nigeria's New Economy* is to take an investor-informed and focused approach to determine the requirements for the greatest probability of successful investment returns in Nigeria. It provides detailed historical information, plus investor, legal and corporate best practice. Investors will be able to follow a step-by-step process to arrive at the investment best matched to their experience and risk appetite. In addition, this report seeks to provide an informed understanding of both the composition of Nigeria's dynamic investment market, and of the investment strategies that have proven successful.

The report begins with an analysis of the investment landscape, and considers overall investment transactions, analysed by sector type, transaction type (i.e., public offering vs private placement vs M&A), and shareholder acquisition type. Chapter 2 explores Nigeria's five new economy sectors – FMCG, non-bank financial services, basic services[4], business services and real estate – focusing on understanding the dynamics within each. Chapter 3 outlines the risk-return profiles of investment strategies to suit given investor profiles in an effort to source successful opportunities in Nigeria. Chapter 4 follows the deal-making process from sourcing targets to exiting investments, providing best-practice for investors at each stage.

Methodology

The three main collection methodologies used were deal-flow analysis, an investor monitor survey, and in-depth expert interviews.

[2] Nigeria National Bureau of Statistics
[3] The World Bank and IFC: Doing Business
[4] Healthcare, education, off-grid power

First, a careful triangulation of **Capital-IQ transaction data** (in addition to publicly available sources) was performed to arrive at reliable estimates for 10-year investment activity. Sector-specific investment trends and league tables informed our selection of case studies for further analysis.

We used a **multiple-choice investor survey** to identify current perspectives and key success factors for investing in Nigeria; 29 Nigeria- and non-Nigeria-based investors responded in 2017. Those who responded had considered at least one investment transaction in Nigeria since 2010. Additionally, **1:1 interviews** were conducted with 27 investment professionals, legal firms and subject experts who agreed to contribute detailed information on their experience of investing and doing business in Nigeria.

Figure 1: Summary of research methodology

1:1 interviews with 27 investment professionals, legal firms and subject experts who agreed to contribute detailed information on their experience of investing and doing business in Nigeria.

Diligent triangulation of **Capital-IQ transaction data** (in addition to publicly available sources) to arrive at reliable estimates for 10-year investment activity, sector-specific investment trends, and league tables that informed our selection of *case studies for further analysis*.

Multiple choice survey of 29 investors to provide a contemporary picture of current perspectives and key success factors for investment in Nigeria.

1. Understanding Nigeria's investment landscape

1.1. Doing business in Nigeria

Nigeria has become a more challenging place to do business, dropping from 108 in 2007 to 169 in 2016 out of a total of 190 countries, according to the World Bank and IFC ease of doing business rankings (Figure 3). Over the same period, average value per investment transaction decreased by a CAGR of 8%. Even though Nigeria has recovered slightly in the more recent 'Doing Business' publication (now ranked 145), key contributing factors to its low ranking certainly include: very limited access to electricity (only available to 45% of the population); the FX risks associated with investing in the country and trading across borders; and the amount of red tape around company registration and tax compliance.

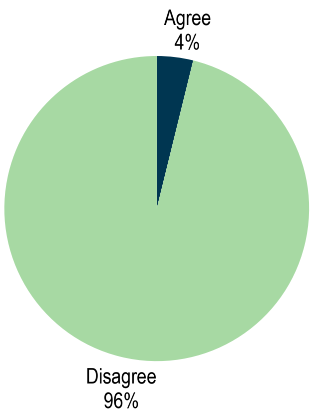
Even though only 4% of investors in the survey monitor believe it is an easy place to do business, 88% of the same respondents would be willing to invest in Nigeria (Figure 2). These numbers illustrate the conundrum of doing business in Nigeria, namely that a majority of investors would invest there if they could envisage a profitable way of doing so.

The remainder of this chapter provides insight into deal-flow over the past decade, highlighting where investors have previously concentrated, and where they are currently focusing.

Figure 2: Ease of doing business in Nigeria, survey results

Nigeria is an easy place to do business

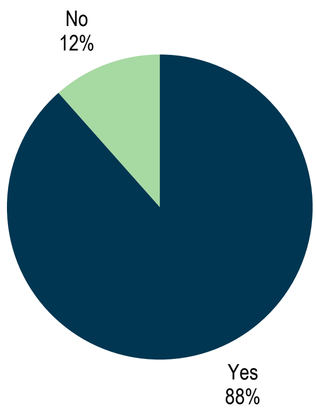
% of respondents



Source: Investor monitor survey conducted for this report (2017)

Would you currently invest in Nigeria?

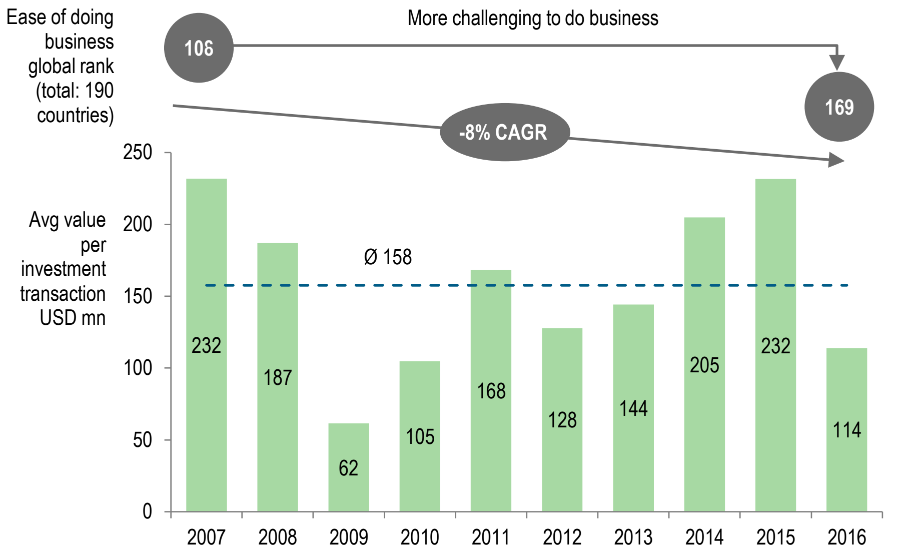
% of respondents



Source: Investor monitor survey conducted for this report (2017)

Figure 3: Doing business ranking and ticket sizes in Nigeria

Evolution of doing business ranking and investment ticket sizes in Nigeria



Source: The World Bank, Economy Rankings; The World Bank and IFC: Doing Business; S&P Global Market Intelligence - Capital IQ

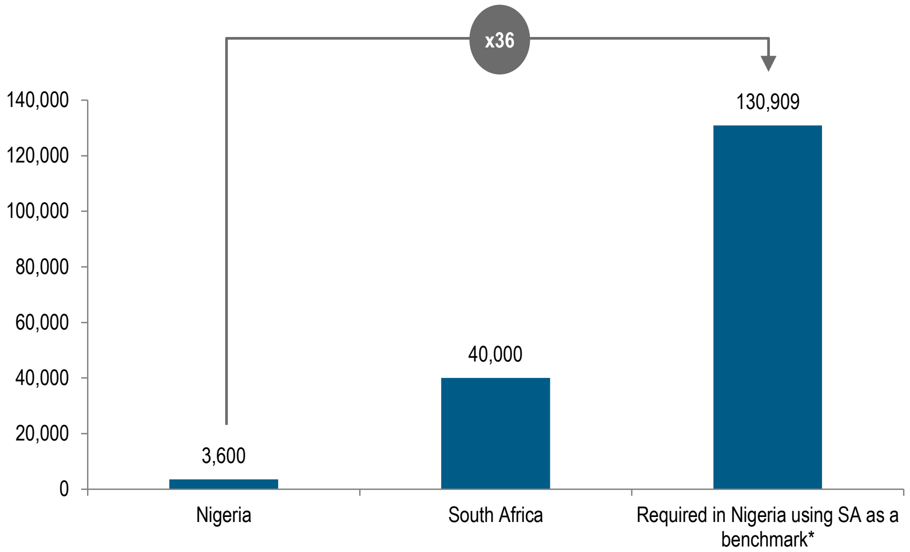
Figure 4: Access to power, Nigeria versus South Africa

Daily power generation, in MW

Access to power is a barrier to doing business in Nigeria

Hours of power outage experienced by companies per month

196



* Extrapolated value based on population sizes; Source: Power Africa; The World Bank and IFC: Doing Business

1.2. 10-year review of investment activity

Private equity and M&A-type deals accelerated in the early 2000s on the back of the global commodities boom, liberalisation and privatisation of key sectors of the Nigerian economy such as telecommunications, and increased political stability following the adoption of democracy. In 2007, 42 deals totalling USD 10bn were completed across all sectors. However, contraction in the global economy due to the GFC saw deal-flow decline significantly and almost cease in 2009, with only 18 deals totalling USD 1bn completed. Average deal size fell to USD 62mn in 2009 from USD 232mn in 2007 (Figure 5). Government U-turns such as the reversal of important deals – notably the USD 750mn oil refinery investment by Dangote – and the vacuum created by the prolonged absence of President Umaru Yar'Adua forced investors to adopt a 'wait and see' approach.

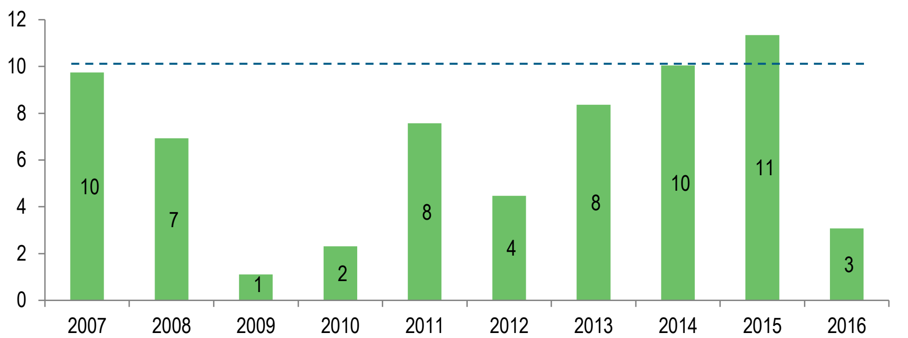
As of 2015, investment activity had recovered to pre-GFC levels

The 2016 recession saw a slump in both the number and value of investment transactions in Nigeria

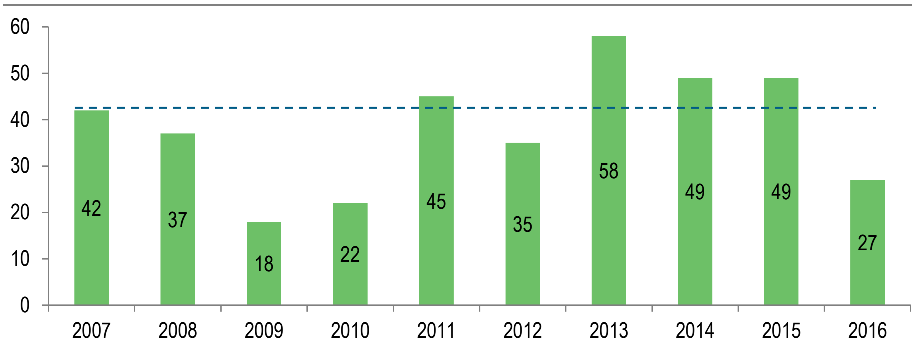
After the recession and related FX crisis, the recorded average value of investment transactions dropped by over 50%

Figure 5: 10-year investment activity in Nigeria

Total value of all investment transactions *(USD bn)*

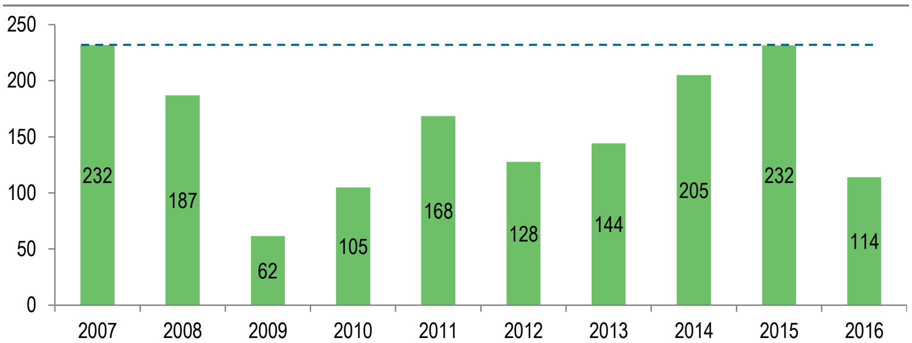


Number of investment transactions



Average value per investment transaction

USD mn



Source: S&P Global Market Intelligence - Capital IQ

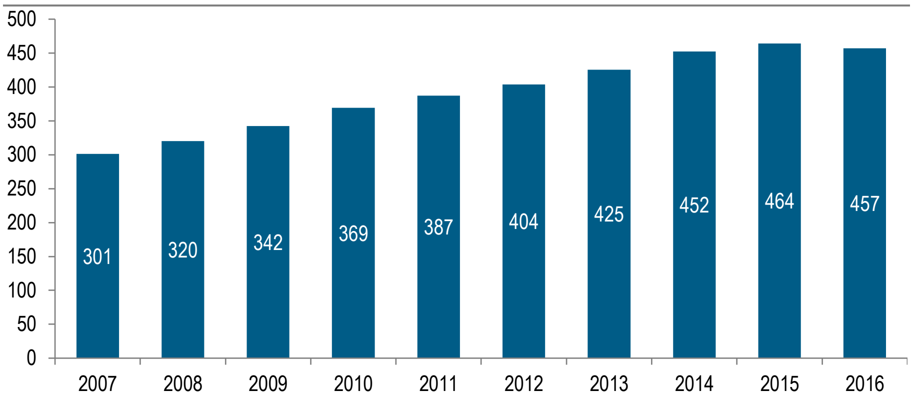
After the death of President Yar'Adua, Goodluck Jonathan took office in May 2010; investment activity rebounded, with renewed investor interest buoyed by strengthening market confidence and fiscal stability. Following the rebasing of the country's GDP in 2014, Nigeria emerged as the largest economy in Sub-Saharan Africa. In the same year, the country held a hotly contested election that saw the first peaceful transfer of power from the People's Democratic Party to the APC under President Muhammadu Buhari. The peaceful transition of power further boosted investor confidence and deal volume began to grow, exceeding 2007 levels to peak at USD 11bn in 2015. However, delays in forming a cabinet as well as the decline in crude oil prices created a situation of strained FX revenues and inconsistent regulation to control FX flows.

The 2016 devaluation of the Naira and subsequent volatility created a challenging situation for import-dependent industries and an environment where investors were hesitant to bring money into Nigeria. This led to a steep decline in total transaction value to USD 3bn in 2016. The number of transactions declined from 49 in 2015 – which exceeded the 42 transactions in 2007 – to 27 in 2016. Average value per transaction value declined by 51% from 2015 to 2016 (Figure 5).

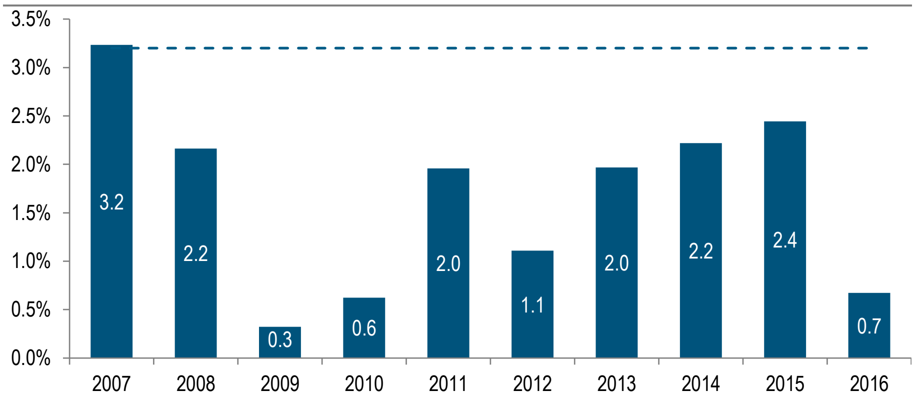
Prior to the 2016 recession, investment activity in Nigeria had recovered to pre-GFC levels; however, investment as a proportion of GDP has not. In 2009, total transaction value accounted for only 0.3% of GDP, down from 3.2% of GDP in 2007. While the value of transactions as percentage of GDP continued to rise through 2015, it has not recovered to pre-GFC levels (Figure 6).

Figure 6: Value of investment transactions

% of annual GDP (USD bn)



Value of transactions, *as % of GDP*



*For analytical purposes, the rebasing of Nigerian GDP in 2013 has not been accounted for in the annual GDP figures; Source: S&P Global Market Intelligence - Capital IQ

M&A[5] has become a more attractive transaction type than public offerings[6] and private placements[7] over the past decade. Public offerings and private placements jointly constituted 59% of transaction values in 2007; but the Nigerian investment landscape has since shifted towards M&A, which made up 83% of transaction values by 2015 (Figure 7). This can be explained by disenchantment with public markets in favour of reliance on networks and trust-based relationships as a fundraising method.

The fact that public offerings accounted for 71% of transactions in 2008 shows the relative ease of financing via public markets even into the beginning of the GFC, albeit this was limited to certain sectors such as banking. Reduced funding from this source after the GFC meant that companies had to seek funds elsewhere. The decreasing prominence of public offerings in Nigeria between 2008-12 highlights the lack of trust in public markets as a way of financing projects, as well as a lack of faith in the broader market's ability to support larger offerings.

As global investment activity began to accelerate between 2010-15, one would have expected a corresponding acceleration in public offering activity, but instead it was replaced by a sharp increase in M&A activity and a revitalisation of private placements to pre-2008 levels.

In 2007, M&A constituted 41% of investment activity, close to the 45% made up by public offerings. This represents an approximate equal preference for raising funds via public and private methods. By 2015, M&A represented 83% of the USD 11bn value of investment transactions. Between 2012-16, M&A had a weighted average of more than 70% of all transaction value, with private placements averaging 14% over the same period. The transaction data shows investors' and corporates' distinct preference for private financing.

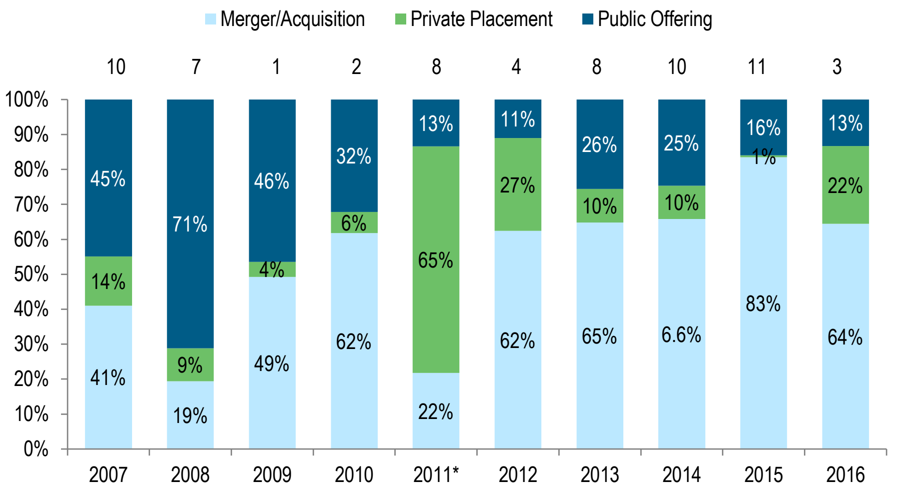
Public offering refers to both the initial public offering and follow-on issuance in public markets

Private placement refers to a funding round via a private offering to a small number of investors

Merger/Acquisition refers to the bilateral purchasing and/or joining of two or more companies

Figure 7: Contribution of investment types to total investment value

USD mn



* AMCON purchases of Keystone and Mainstreet Banks in 2011 are two of the top five deals by value over the past decade, both private placements; Source: S&P Global Market Intelligence - Capital IQ

[5] **Merger/Acquisition** (M&A): A merger means that a company acquires another company and folds it into itself completely, so that the acquired company ceases to exist. Under this transaction the buyer purchases existing securities, equity or debt, of the company being acquired.

[6] **Public Offerings** (PO): Public sale of newly issued securities sold by the issuing company or its existing shareholders for a variety of reasons, such as raising funds for future growth and expansion, without having to incur any kind of debt. The securities are sold in the public market for purchase by retail and institutional investors.

[7] **Private Placement** (PP): Private sale of newly issued equity or debt securities by a company to a selected investor or a selected group of investors to raise funds for a general or specific purpose. The stakes that buyers take in private placements are often minority stakes (under 50%), although it is possible to take control of a company through a private placement as well. The new securities issued in the transaction are not immediately tradable. If they are, then such trades are captured as a Public Offerings Transaction.

Despite an increase in the availability of capital since the GFC (transaction values rose to USD 11bn in 2015 from USD 1bn in 2009), investors and corporates have favoured M&A private financing to public markets. Investors prefer private transactions because of the greater sense of trust generated in such business relationships, even though they are more onerous and time-consuming to source, perform due diligence on, and close.

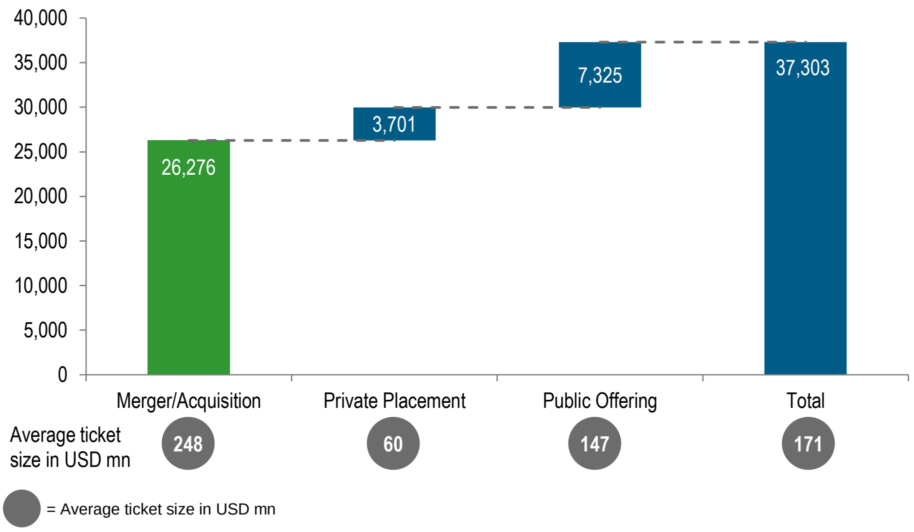
M&A represented more than 70% of the value of transactions between 2012-16, totalling USD 26bn; M&A also had the largest average transaction value of USD 248mn over the same period (Figure 8). Bilateral M&A deals became more popular and larger than more easily accessible public offerings despite greater availability of capital in the market. In terms of transaction types, 2007 looks conspicuously different to 2015-16.

Both M&A and private placements gained market share from public offerings following the GFC; however, private placements have been most consistent and were impervious to the recent recession (Figure 9). As private placements rely on small networks of investors rather than bilateral M&A, their structure may provide a more diversified risk portfolio that is attractive to investors regardless of market volatility. Private placements provide a more resilient form of fundraising than M&A or public offerings.

More than 60% of all deals in Nigeria are minority share acquisitions, meaning that – on the whole – investors are content to take a non-controlling stake in a deal. This is particularly true of foreign investment, where 64% of all deals between 2007-16 were minority acquisitions (Figure 10). Minority deals are typically characterised by confidence in the current management and trajectory of the company, compared to a majority acquisition deal where an investor may intend to play a more active role in designating the company strategy.

Figure 8: Value contribution by transaction type, 2012-16

USD mn



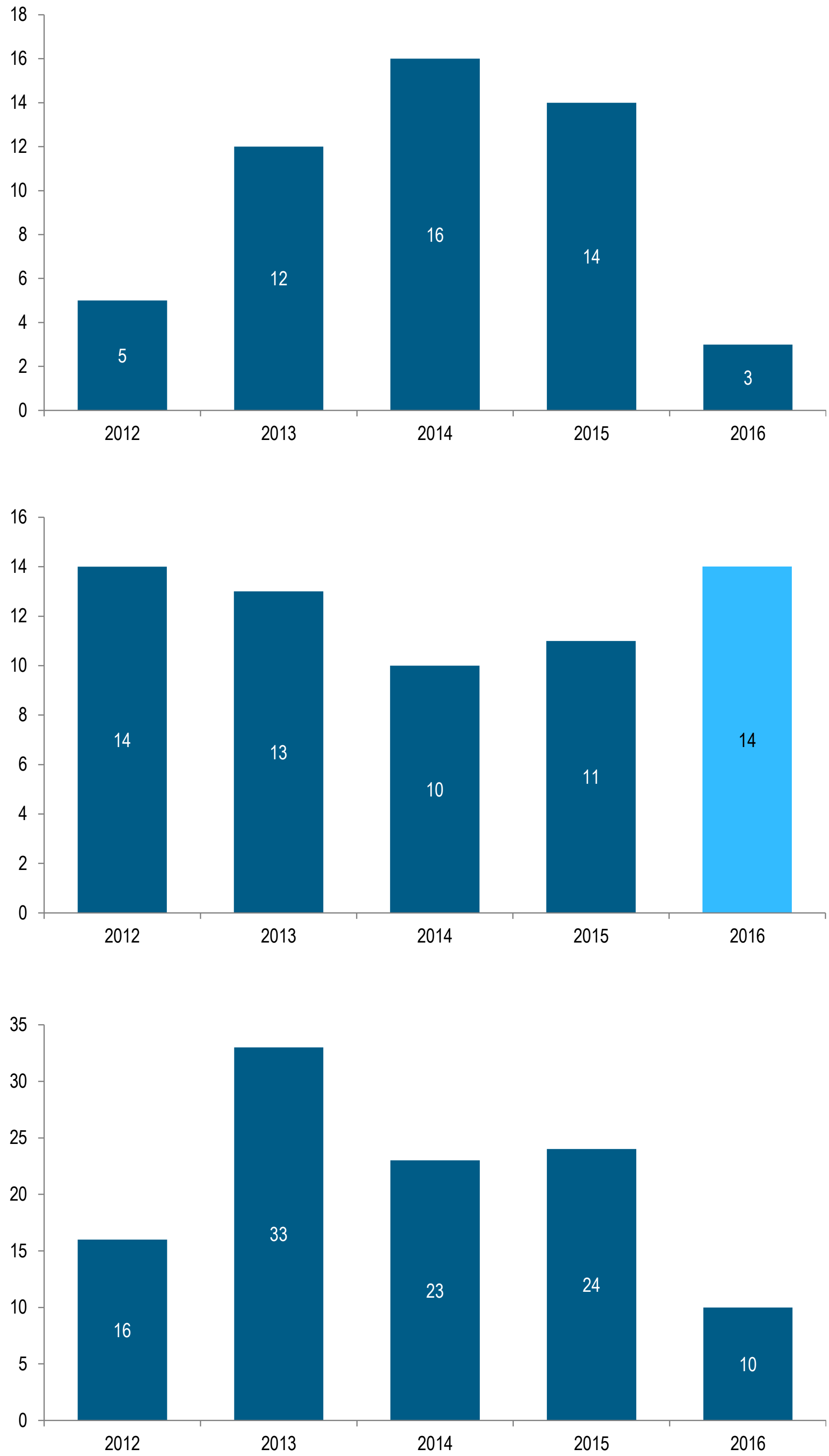
Source: S&P Global Market Intelligence - Capital IQ

Figure 9: Number of investments per transaction type, 2012-16

Public offering
Total = 50

Private placement
Total = 62

Merger/Acquisition
Total = 106



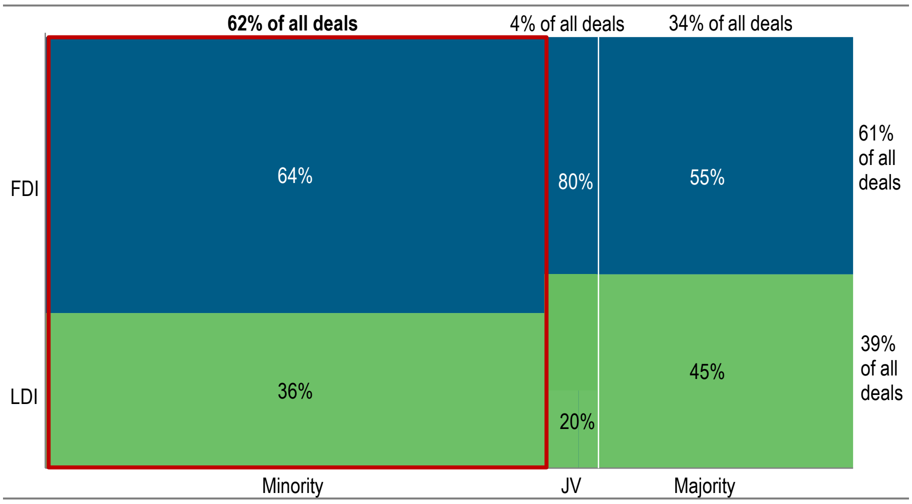
Source: S&P Global Market Intelligence - Capital IQ

Deal size is a determining factor for the likely type of shareholder acquisition. Majority share acquisitions account for 62% of all deals larger than USD 50mn (Figure 11). While most deals are minority acquisitions, smaller deals tend to be minority share acquisitions or joint ventures (JVs); majority share acquisitions are generally larger.

The profile of investment transaction growth since the GFC is characterised by the transition from mostly public offerings to a majority of M&A, and an increasing preference for minority deal acquisitions.

Figure 10: Type of shareholding acquired: LDI vs FDI in %

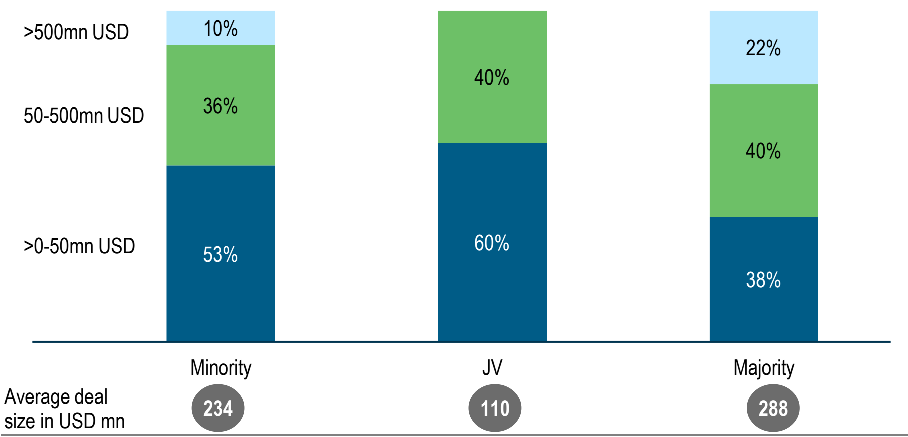
2007-16



Source: S&P Global Market Intelligence - Capital IQ

Figure 11: Type of shareholding acquired by deal size segments

2007-16



Source: S&P Global Market Intelligence - Capital IQ

1.3. Sector-specific investment trends

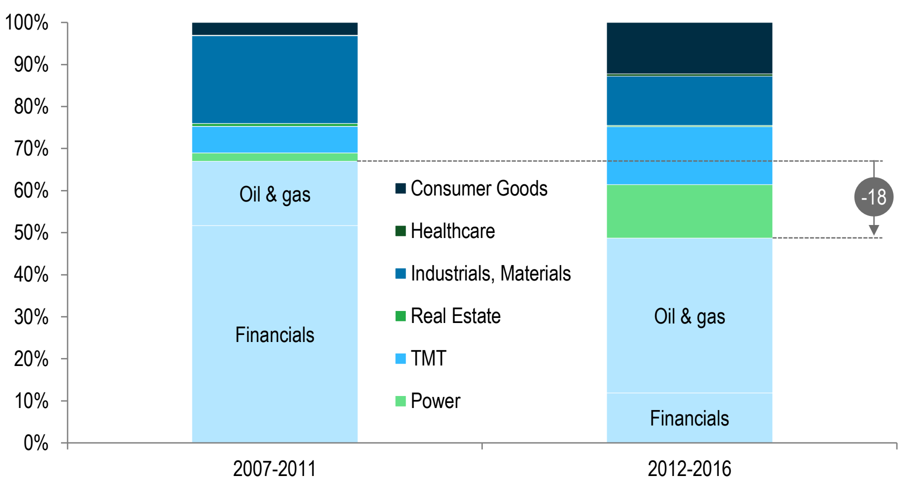
Investment diversification by sector has been increasingly evident since 2012. Investment in the traditionally large financial services and oil & gas sectors has fallen by 18% when comparing 2007-11 data to 2012-16 (Figure 12). At the same time, renewed investment activity indicates higher average transaction numbers and values in several key sectors.

Consumer goods, TMT, oil & gas, and power are all characterised by increases in both LDI (local direct investment) and FDI (foreign direct investment) flows. Healthcare and RE/industrials/materials also saw increased FDI; indeed, all sectors except financials saw higher FDI in the latter period. Demand from Nigeria's growing consumer class continues to attract foreign investment into the consumer goods sector; it experienced noticeably large LDI and FDI increases between 2007-11 and 2012-16. Healthcare, industrials, and real estate saw very little LDI activity between 2007 and 2011, but a considerable percentage uptick in FDI, indicating that these are potentially new and growing favourites for foreign investors. Real estate and industrials/materials both indicate higher levels of FDI than LDI. This suggests that foreign investors are increasingly interested in more long-term investment plays (Figure 13).

Healthcare and TMT saw the strongest uplift in ticket sizes in the five years between 2012 and 2016 versus the previous five years, up 233% and 79%, respectively (Figure 14). Investment in oil and gas rose 73%, boosted by the Nigerian government's local content regulation and the divestiture of marginal oil fields by international oil companies. Excluding financials, all sectors saw higher average transaction values between 2007-11 and 2012-16. This marks the beginning of a diversification story away from the commodity-driven sectors that contributed to Nigeria's pre-GFC growth.

Significant bank mergers in years immediately after 2008 contributed to a relatively high average transaction value of USD 230mn. However, investors interviewed for this report expressed scepticism about the accuracy of the valuations struck for these bank deals. Many of those interviewed believe these deals to have been mispriced.

Figure 12: Sector contribution to cumulative value of transactions
%

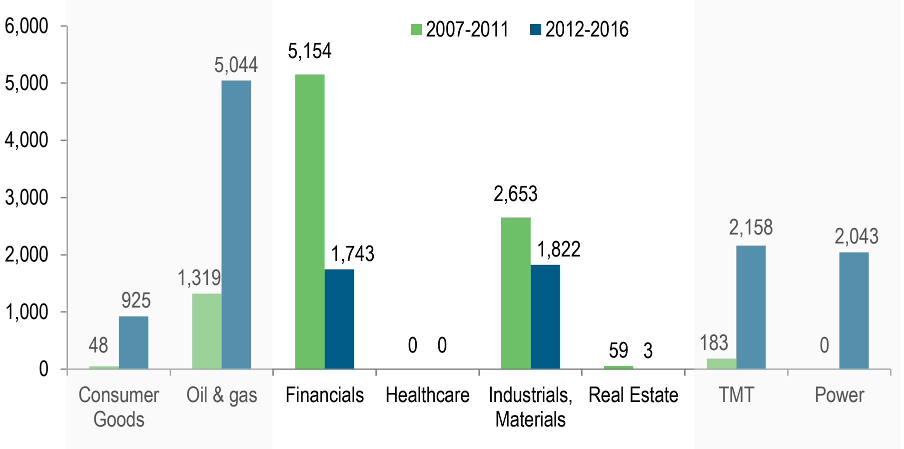


Source: S&P Global Market Intelligence - Capital IQ

Figure 13: Sector breakdown: Cumulative value of transactions, 2007-11 vs 2012-16

USD mn

*Local direct investment**

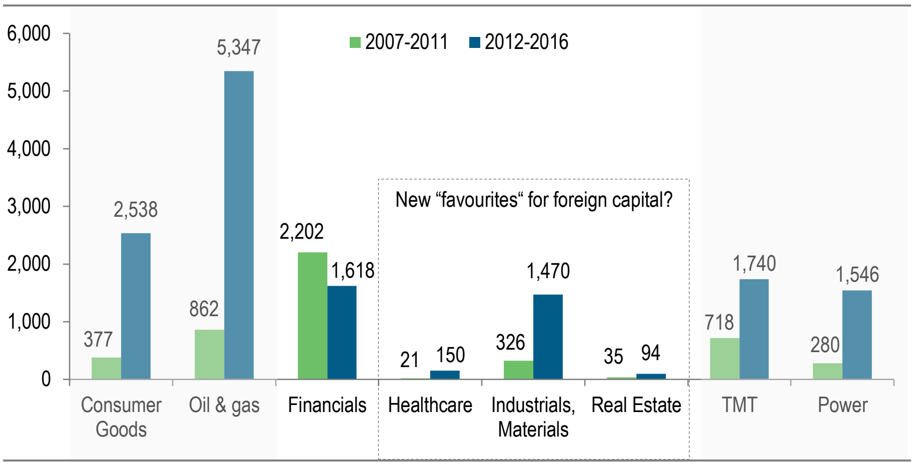


* Only accounting for public placements and M&A deals, public offerings have been excluded; Source: S&P Global Market Intelligence - Capital IQ

Sector breakdown: Cumulative value of transactions, 2007-11 vs 2012-16

USD mn

*Foreign direct investment**

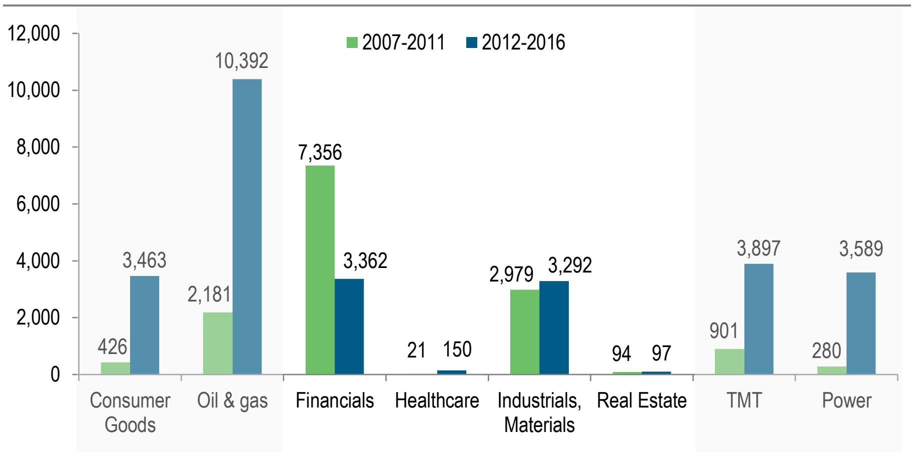


* Only accounting for public placements and M&A deals, public offerings have been excluded; Source: S&P Global Market Intelligence - Capital IQ

Sector breakdown: Cumulative value of transactions, 2007-11 vs 2012-16

USD mn

Total investment



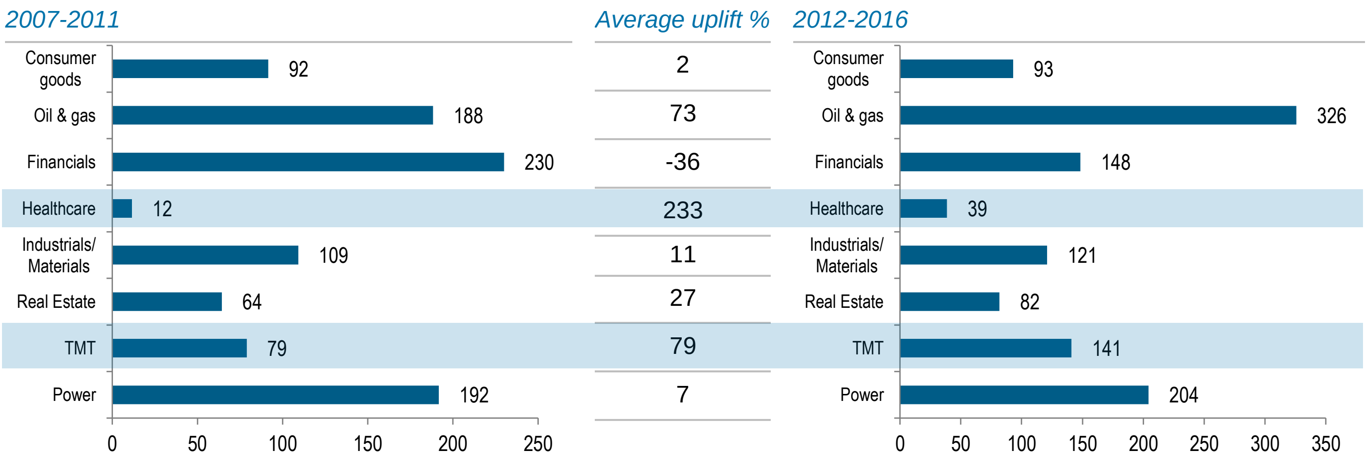
Source: S&P Global Market Intelligence - Capital IQ

Consumer goods and power saw the strongest increase in average number of deals per year, up 67% and 300%, respectively, between the two five-year periods (Figure 15). The healthcare sector recorded the lowest number of transactions: only eight for the 10-year period, and none recorded in 2008, 2010, 2011 and 2013. This dearth of transactions is despite an enormous need for healthcare and growing demand for higher-quality healthcare services. Scarcity of quality assets and a high level of fragmentation in the sector are often cited as barriers to private investment, according to one of the investors interviewed.

The energy sector maintained a prominent position in the recovery post-2009, with the largest average transaction value and the second-highest average number of investment transactions per year. While energy continues to play an important role in driving overall transaction activity, diversified sectors with high investment levels have emerged post-2009.

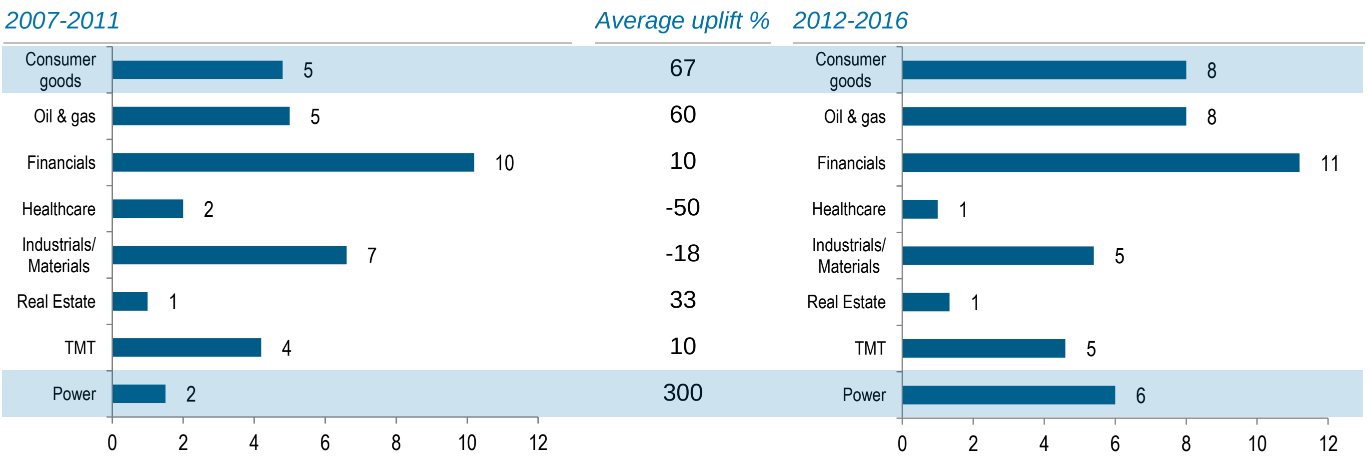
The average number of private placement transactions has surged in the consumer goods space while public offerings have only increased in financials. The number of private placements increased from 3 to 20 between the two five-year periods. Public offerings either decreased or stayed the same in all sectors except financials, which increased from 15 to 27 over the same period.

Figure 14: Sector breakdown, average value per investment transaction *(USD mn)*



Source: S&P Global Market Intelligence - Capital IQ

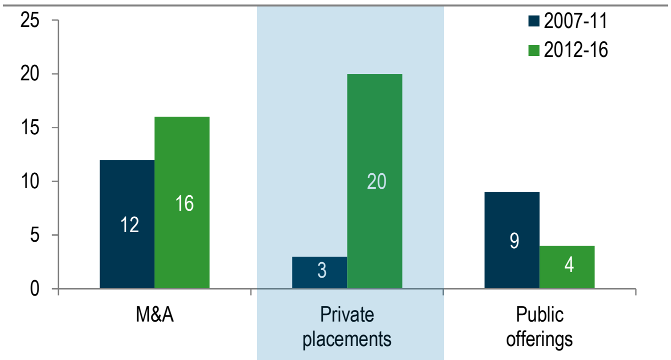
Figure 15: Sector breakdown, average number of investment transactions *(USD mn)*



Source: S&P Global Market Intelligence - Capital IQ

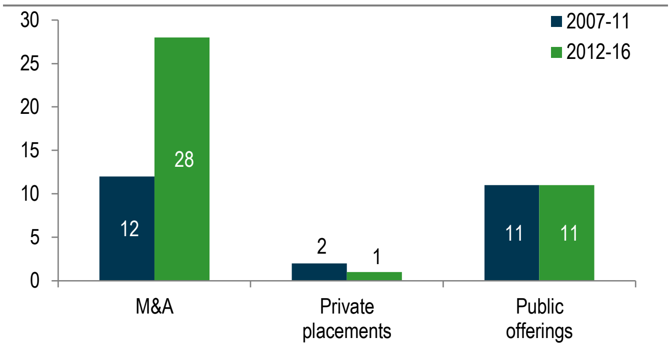
Figure 16: Sector breakdown, number of transactions per transaction type

Consumer goods



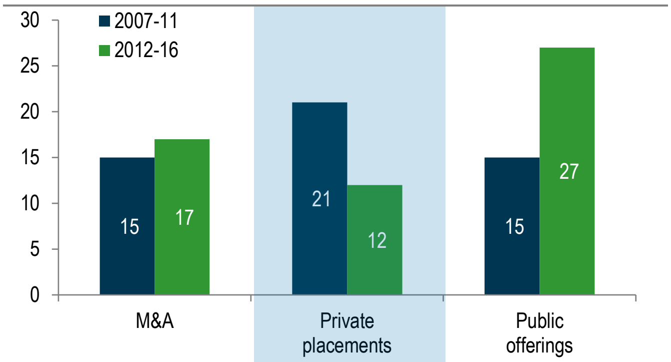
Source: S&P Global Market Intelligence - Capital IQ

Oil & gas



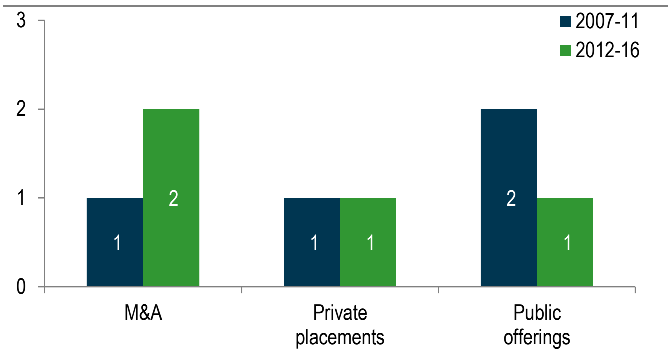
Source: S&P Global Market Intelligence - Capital IQ

Financials



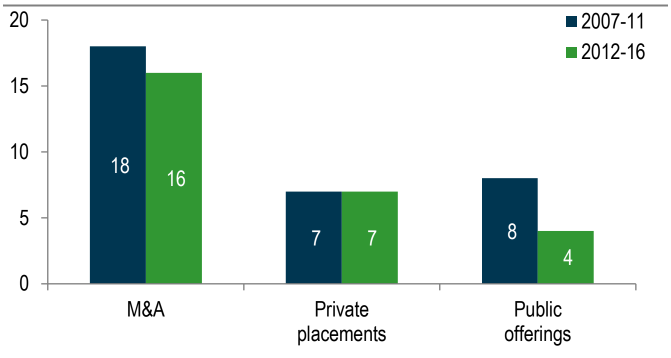
Source: S&P Global Market Intelligence - Capital IQ

Healthcare



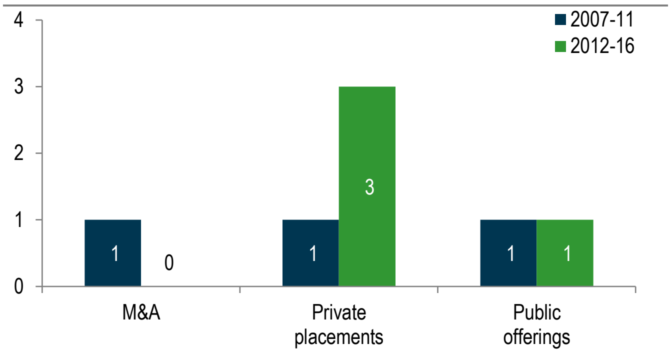
Source: S&P Global Market Intelligence - Capital IQ

Industrials/materials



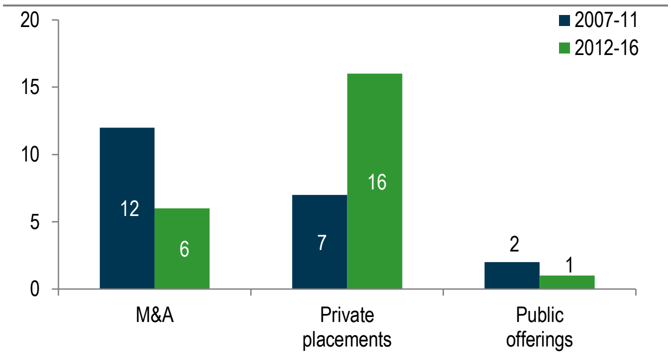
Source: S&P Global Market Intelligence - Capital IQ

Real estate



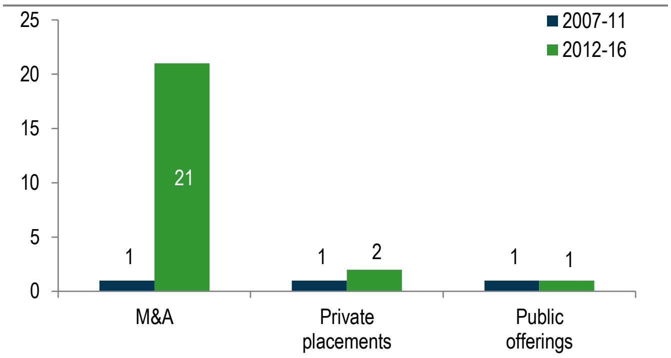
Source: S&P Global Market Intelligence - Capital IQ

TMT



Source: S&P Global Market Intelligence - Capital IQ

Power



Source: S&P Global Market Intelligence - Capital IQ

2. Exploring opportunities in Nigeria’s ‘new economy’

We have identified five Nigerian 'new economy' sectors that were cited as the most attractive to investors in the course of our research, based on specific decision parameters. This chapter further outlines the thought process behind shortlisting these five industries and offers a detailed view on the specific pockets of opportunity in each sector.

The identified new economy sectors are:

- Fast-moving consumer goods (FMCG)
- Non-banking financial services
- Real estate
- Business services
- Basic services (healthcare, education, and off-grid power)

These sectors are characterised by specific traits and are driven by discrete factors important to investors. Three investor-driven criteria were used to determine if a sector qualified as a 'new economy' sector:

- Demographic opportunity
- Regulatory environment
- Market entry opportunity

Figure 17: Nigeria's 'new economy' sectors

We have identified five 'new economy' sectors through our research that are particularly attractive for investment

	Demographic opportunity	Regulatory environment	Market entry opportunity	Reasoning based on expert interviews conducted
Sector	*Size of domestic target market*	*Level of sector red tape*	*Manageable entry barriers*	
FMCG	High	High	High	Rapid urbanisation and large number of untapped consumer product opportunities; comparatively low level of regulation
Non-banking fin. services	High	High	High	Scalable sub-opportunities as financial inclusion increases and incomes rise, often through the leveraging of technology
Basic services*	High	High	High	Traditional publicly provided services are not provided in Nigeria, opening up substantial private-sector opportunities
Business services	Medium	High	High	Providing outsourced or vendor functions to the growing company base in Nigeria, lower risk compared to B2C opportunities
Real estate	High	Medium	High	Urbanisation is driving up land prices and demand for commercial and non-commercial development (office space, housing …)
TMT	High	Medium	Medium	Larger numbers of consumers with large infrastructure and high regulatory barriers to entry; strong incumbent players
Banking	High	Medium	Medium	Industry is likely awaiting more consolidation, yet comparatively low returns and high level of regulatory risk
On-grid power	High	Low	Medium	Heavily regulated industry with government ownership of grid power companies; high barriers to entry
Oil & gas	Medium	Low	Low	Heavily regulated industry with very high barriers to entry and strong dependency on international prices

Attractiveness of opportunity: High | Medium | Low

'New economy' sectors: Focus of this report

Source: * Basic services: Healthcare, education, off-grid power

With respect to the demographic opportunity, our research team asked investors for their assessment of the size of the domestic target market, effectively how large or scalable opportunities are in this sector. In terms of the regulatory environment, investors were asked to assess the level of bureaucratic challenges within each sector. Market entry relates to investor perspective on the level of barriers to entry in an industry, namely, how challenging it is for potential entrants to begin operations (Figure 17).

Figure 18: Three dimensions of analysis for each target sector

- Demographic opportunity
- Regulatory environment
- Market entry opportunity

- Demographic opportunity
- Regulatory environment
- Market entry opportunity

- Demographic opportunity
- Regulatory environment
- Market entry opportunity

Five sectors under analysis:
FMCG, non-banking financial services, basic services, business services, real estate

For each new economy sector – FMCG, non-banking financial services, real estate, business services, basic services – we assessed its attractiveness for investment; mapped opportunities within the sector identified by investors; and delved into the specific value drivers to achieve returns. Analysis of each new economy sector was based on the criteria set out above, namely demographic opportunity, regulatory environment and market entry opportunity.

2.1. Snapshot of real estate

According to investors, real estate is generally an organically expanding sector due to company growth and serves as a unique asset class given the debt structure of many investments. Tremendous opportunities exist for expansion in Nigeria's commercial and residential real estate sectors; the primary drivers being rising urbanisation, available Public Finance Authority (PFA) money to invest, and low commercial penetration. While the stock of office buildings has increased recently, market growth over the past few years has made this stock too expensive and utilisation rates low, but investors expect more deal opportunities over the next few years.

Land in Nigeria is often owned by regional governors. Stamps of approval are required for land acquisition and bureaucracy creates confusion and challenges over title ownership. That said, the process is more straightforward and transparent in urban areas, where more attractive opportunities can be found.

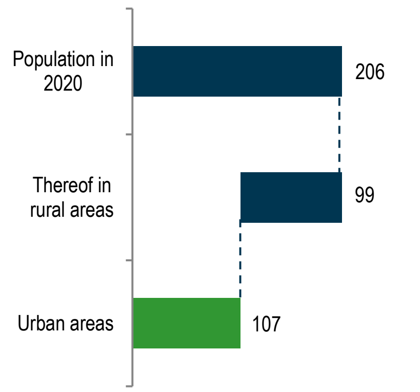
Given the effects of recent FX volatility and the capital- and debt-intensive nature of real estate, there has not been significant interest in Nigerian real estate development and transactions recently. While there are important players active in all real estate-development areas, these alone will be unable to meet the future demand for property in Nigeria (Figure 19).

Real estate is divided into commercial and residential. Investors identified office buildings and retail space as sub-sectors to focus on. Retail space provides an attractive opportunity as investors believe urban areas are currently underdeveloped in terms of retail space penetration. With urbanisation and a cultural interest in local and international brands, shopping malls have become very attractive to many Nigerian consumers.

Investors highlighted mass-market affordable homes as an attractive sub-segment. According to an interviewed investor, there is a need for 70mn housing units, and developers who can create an attractive operating model could reap considerable returns in the years to come. University housing is an important sub-sector because the question of land ownership is solved in advance while the demand is steady and stable. Payment collection can also be facilitated through the university system, therefore one of the most cumbersome issues of undertaking a development is already resolved (Figure 20).

Figure 19: Assessment of attractiveness for investment, real estate

Demographic opportunity
Nigerian population in mn



Urbanisation has created considerable demand for property. Nigeria currently has 500,000sqm in retail space compared to 390,000sqm in Nairobi.

Regulatory environment
Anecdote

Private equity investor, commercial real estate in Lagos:

"After obtaining all the relevant land titles from the local government, we had to ***work through permits while securing financing.*** *It was a balancing act, ensuring that all our debt and financing was secured while simultaneously acquiring the local construction permits and concession to begin building on time. You have to* ***account for delays in your business plan from the start*** *to make sure you raise enough money."*

Obtaining permits and land ownership is a lengthy process and can easily interfere with the fundraising for a deal, leading to higher cost of financing.

Market entry opportunity
Key players

Residential development	• AirCom • UPDC
Commercial development	• Actis • RMB • Novare UPDC • Landmark Group
Large-scale development	• Capital Alliance • Resilient Africa
Industrial development	• Stanbic IBTC

There are important players who are active at scale in all areas of real estate development, yet these alone will not fill the large future demand for property.

Source: United Nations World Urbanization Prospects, Stanbic IBTC, Ubosi Eleh + Co

Interviewed real estate investors focused more on commercial opportunities than residential. As FX rates stabilise they expect interest to shift in favour of residential opportunities. Overall, in the next 2-3 years investors expect there will be significantly more investment in the below highlighted real estate opportunities.

Three of the main value drivers in real estate are: securing ownership/lets early in the process; obtaining local construction permits in a timely manner; and modelling utilisation scenarios that will impact cashflow. Investors believe issues will arise if these factors are not executed appropriately.

Figure 20: Opportunity map: Real estate

Commercial real estate	Residential real estate
Office buildings	Luxury residential towers
PE investor: *"The market has slowed down because of the recession, but the long-term drivers of this opportunity remain unchanged; you can expect 2-2.5x return over a 6-year period."*	Detached houses
Warehouses	**Affordable mass housing**
Retail spaces	Real estate expert: *"Places such as Ikoyi and Victoria Island are saturated when it comes to luxury apartments. The big challenge of housing in Lagos is affordability for the masses – if you can make that happen, you will win returns in a few years."*
PE investor: *"All urban areas in Nigeria, including Lagos, are very underdeveloped in terms of retail space penetration in comparison to other mega cities in Africa (less than 10%)."*	
Hospitality	**Institutional housing**
Industrial facilities	Institutional investor: *"We think there is a big affordable housing opportunity, but it should be anchored around existing institutions such as universities – land is sorted there already and payment collection is easy through their existing systems."*

Top opportunities mentioned by investors; Source: Interview results

Figure 21: Value drivers, real estate

	Key value drivers in real estate	Anecdotes
Revenue	• Securing lets early to ensure that there is some utilisation upon finishing the project • Making use of realistic listing periods for new buildings (2 years is best practice)	**Real estate investor:** *"Prior to any project we determine the different scenarios that get us to 100% utilization where cash flows cover costs."*
Operations	• Obtaining local construction permits in timely manner to avoid project delays • Attaining relevant land titles from the government • All equity investments and debt need to be 100% secured before starting a real estate project • Taking time to fully engage the regulator	**Nigerian PE investor:** *"We have shied away from real estate, even though it can be attractive, because the project execution risk and debt leverage are just too high in Nigeria."*
Valuation	• Factoring in different utilisation scenarios that will significantly impact free cashflow • Accounting for delays that will affect the execution timeline and corresponding capital requirement	**PE investor:** *"We had to build a large number of different scenarios to arrive at the right valuation and capital need for this project."*

Source: Interview results

2.2. Snapshot of FMCG

The FMCG sector is driven by what an investor described as the "emerging African consumer story."[8] FMCG constitutes part of the new economy because of extensive market opportunities, liberal regulatory oversight, and low industry rivalry. Demographics, rising household incomes, and cultural pressures create potentially lucrative opportunities in the FMCG space. With an expected population of 206mn by 2020, there should be 47mn Nigerians in the middle- or upper-class income brackets (Figure 22). Nigeria's rapidly growing population, paired with increasing income, positions FMCG as an attractive sector that is, according to investors, capable of surviving recessions.

While all intermediate and large mergers (>NGN 250 million) must seek approval of the Nigerian Securities and Exchange Commission (SEC) per the Investments and Securities Act of 2007, there are no specific regulations in the FMCG space. This means that there may be various licences and consents needed from an operational perspective, but not from an investment perspective. For example, an investor might have to obtain concessions for aspects of their growth plan (e.g., building new factories), but no approvals or notifications are required beyond the SEC.

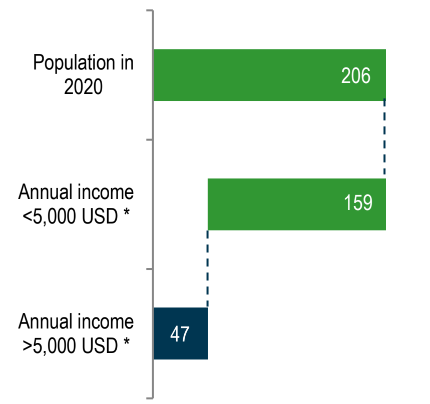
Outside of regulatory bodies, import/export policy specifically in the FMCG space can make certain sub-sectors more, or less, attractive. For instance, an import ban on either a product or machinery essential to the value chain would have an impact on potential opportunities.

Conceptualised in terms of a master pyramid, the biggest opportunities are the ones at the lowest segments of the pyramid. Many items (or varieties) are not yet accessible to Nigerians; the more basic the consumer goods product the bigger the potential market appears.[9]

FMCG opportunities fall into two buckets based on client type: those that are direct to consumer (B2C), and those that support industry (B2B).

Figure 22: Assessment of attractiveness for investment, FMCG

Demographic opportunity
Nigerian population in mn



Considerable opportunities in FMCG due to the increasing disposable income of close to 25% of the population who are looking to improve their lifestyle.

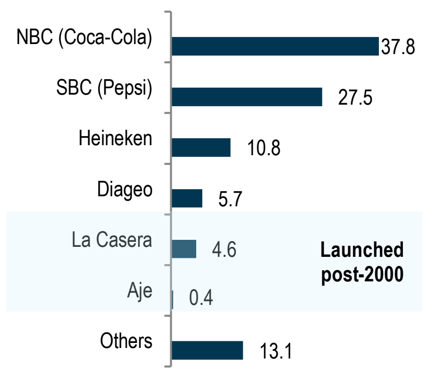
Regulatory environment
Anecdote

Private equity investor, consumer goods:

*"There is **no specific consumer goods regulator in Nigeria**, so once we had SEC approval we were on course to begin construction and initiate the project – or so we thought. After all financing and deal contracts were signed, we still had not been granted the permit to drill a borehole necessary to operate our bottling company. Access to water is a key input to our operations, and as such this permit delayed and almost caused the entire project to fall through."*

There is no sector regulator in Nigeria for the consumer goods industry, yet non-sector-specific regulatory risk has to be accounted for in operational planning.

Market entry opportunity
% of market share, soft drinks, 2015



Example: Soft drinks market – Even though there are leaders in the market, new entrants show that it is possible to capture share with the right products.

* Middle- and upper class defined as annual income level of at least 5,000 USD per person
Source: McKinsey & Company Africa's growing giant: Nigeria's new retail economy, Canadean

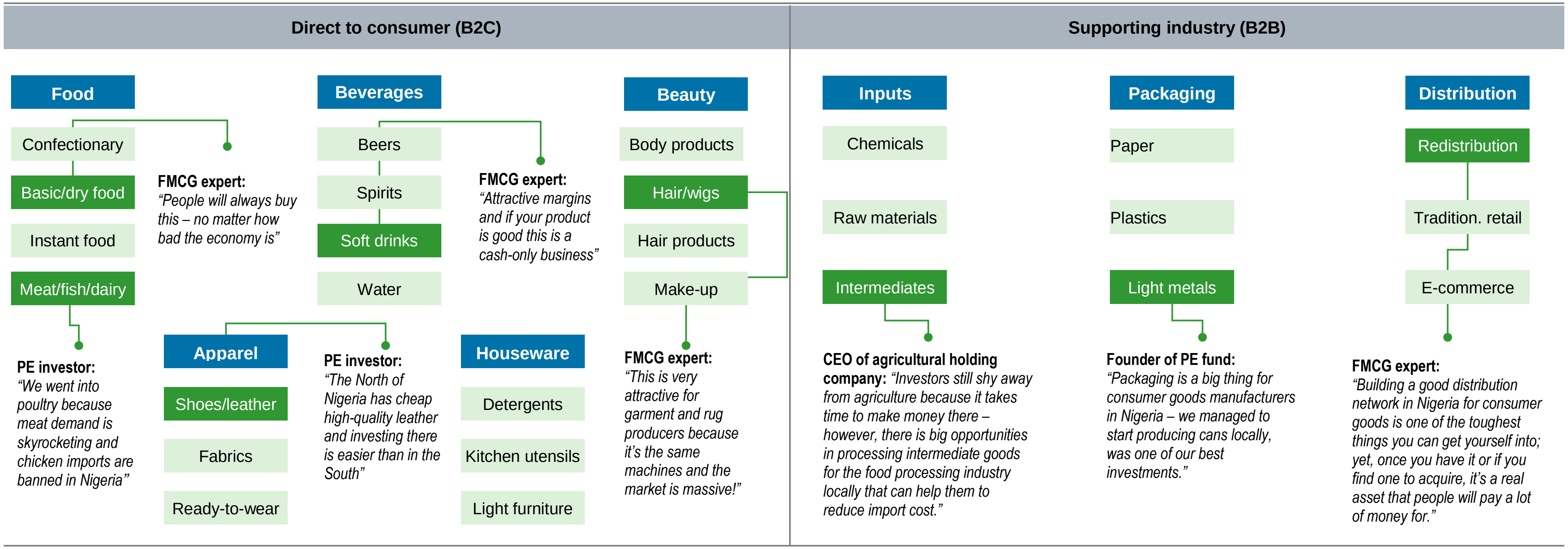
[8] Investor interview
[9] Investor interview

B2C categorisations are based on product type and include foods, beverages, apparel, housewares, and beauty. Within food, interviewed investors recommend opportunities with low-input products, such as basic foods/dry good and meat/fish, or products that people will always buy independent of the economic climate. These products cater to the largest consumer segment, can be locally sourced, and have few inputs. Soft drinks, similarly, cater to the broadest potential market share in Nigeria with attractive margins (Figure 23).

Recent regulatory action has prohibited the importation of all types of footwear (excluding certain types of safety shoes, sports shoes, and canvas shoes) to Nigeria.[10] Similarly, there is a ban on basic furniture imports, with several specific exceptions. These bans have made local shoe and furniture manufacturing attractive new opportunities for investors given the protection from international competition.

[10] www.customs.gov.ng

Figure 23: Opportunity map: FMCG



Top opportunities mentioned by investors; Source: Interview results

Figure 24: Value drivers: FMCG

	Key value drivers in FMCG	Anecdotes
Revenue	• Ability of a company to set prices and pass price increases on to the consumer • Well-designed route-to-market with healthy margins for the company and down the chain • Core products that still have high market potential	**PE investor:** "*It is fun to think of new product innovations for an FMCG company, but often the magic lies in fully squeezing out the potential of the existing product portfolio.*"
Operations	• Full or category exclusivity with distributors • Improving the operations of production plants to ensure full utilisation of capacity • Building out salesforce excellence in the organisation • Minimising out-of-stock along the route to market	**Nigerian consumer goods player:** *"Distribution is one of the hardest things to build in Nigeria. We built our network for more than 20 years and it's like a military operation."*
Valuation	• Factoring in the impact of inflation on imported inputs for the company • Focusing on existing products for the valuation	**FMCG player:** *"We had to strike a lot of special deals with banks during the recession to get hold of dollars."*

Source: Interview results

Within hair and cosmetics, investors highlighted wigs and extensions as a specific sub-opportunity of interest. This is a particularly sticky industry, according to interviewed investors, which uses the same machines as making carpets, and the market is large in Nigeria owing to specific beauty standards of female consumers in the country.

B2B sub-categories include input materials, packaging, and distribution. Investors highlighted proximity to raw materials on the value chain as the main factor for B2B opportunities. Investors seek sub-sectors where raw materials are available locally. Within inputs, interviews highlighted investments in processing agricultural intermediates, which help reduce the input costs along the value chain.

Investors highlighted three of the main value drivers: the ability of a company to act as a price setter and pass increases on to the consumer; maintaining operational efficiencies; and factoring in input/FX costs. Potential market size can be so large that designing an effective route-to-market, paired with factories operating at full utilisation, can offer sizeable rewards.

2.3. Snapshot of non-bank financial services

Nigeria is poised for a proliferation of non-banking financial service opportunities. Close to half of the population is still unbanked, yet most Nigerians are in possession of mobile phones, highlighting one of several driving forces behind opportunities in non-banking financial services.[11]

Investment activity the non-banking financial services sector is overseen by several regulators.

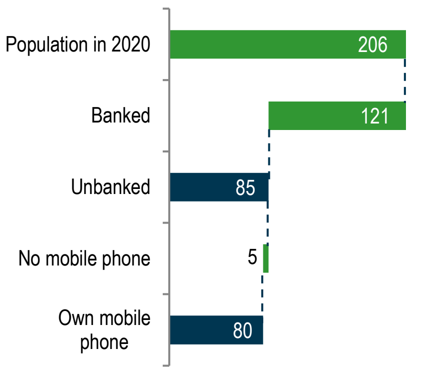
The SEC is responsible for approving all transactions, irrespective of industry, making it a ubiquitous regulator – that is, making no transaction more or less challenging than another from an SEC perspective.

The Central Bank of Nigeria (CBN), whose approval is required for acquisitions of banks or assurance providers. Our focus on the *non*-banking financial services sector puts the CBN largely out of scope for transactions. Both the SEC and the CBN are considered well-run organisations, with criticism that the SEC lacks transparency around what is required for approval as well as an understanding around approval response times. These criticisms are relevant for transactions in all sectors, not specifically non-banking financial services.

The National Insurance Commission (NAICOM) is the insurance sector regulator, responsible for ensuring the effective administration, supervision, regulation, and control of insurance businesses in Nigeria. According to an interviewed insurance company, new insurance providers and acquisitions of insurance providers must be approved by NAICOM. Both interviewed investors and companies who completed deals in the insurance space referred to NAICOM as a transparent organisation that did not increase impediments to deal closures.

Figure 25: Assessment of attractiveness for investment, non-banking financial services

Demographic opportunity
Nigerian population in mn



Close to half of Nigeria's population is still unbanked, yet most are in possession of mobile phones – large opportunity for payments and fintech services.

Regulatory environment
Anecdote

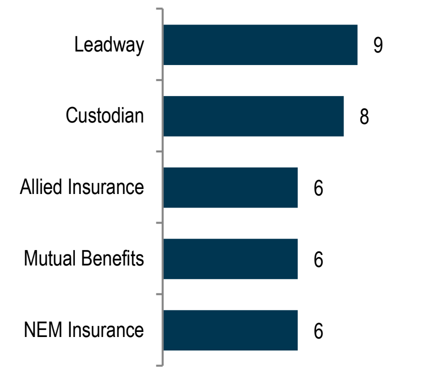
Corporate representative, international insurer, on investment in local partner:

*"As with other transactions we needed SEC approval and as an insurance company we also needed NAICOM to review the deal. They are an **effective regulator**, main issue was transparency around approval times."*

Fintech investor, Nigeria:
*"Regulation in the **financial technology** space is **still in its early days** in Nigeria, which gives room to act more flexibly."*

In contrast to banking, regulation in other financial services sectors is perceived as effective and lean when it comes to financial technology products.

Market entry opportunity
% market shares of top 5 non-life insurers, 2015



Example: Insurance market – No dominant players with more than 10% market share, allowing for new entrants with a fit value proposition.

Populationpyramid.net, 2015 Insurance Digest; Central Bank of Nigeria – Financial Inclusion Projections;

Source: Nigeria Fixed Broadband Market Statistics and Analysis (Biddle.com)

[11] Central Bank of Nigeria – Financial inclusion projections

The non-banking financial services sector is opening the market to more players, creating an attractive investment proposition. This, at a time the traditional banking sector is undergoing consolidation. The insurance market, for example, has no current dominant player with over 10% market share, making it an attractive opportunity from a market entrant perspective (Figure 25).

The opportunity buckets in the non-banking financial services sector include payments, insurance, lending, and wealth management. Of these, one of the most visible and attractive payments opportunities is in the digital transaction services space. Digital transaction services are well-suited to leverage platform technology, making these solutions highly scalable. Accordingly, digital transaction services – companies like Interswitch, Flutterwave, etc – and e-commerce are sectors that investors have highlighted as particularly attractive.

As financial inclusion expands in Nigeria, local insurance is an attractive opportunity for investors. Data-driven risk profiles will allow insurance providers to reliably scale their operations. Investors in non-banking financial services highlighted more consistent monthly incomes as a driver behind both insurance and micro-finance opportunities (Figure 26).

Figure 26: Opportunity map, non-bank financial services

Opportunity map: Non-bank financial services			
Payments	**Insurance**	**Lending**	**Wealth management**
Digital transaction services	Casualty	Pay-day	**Pensions**
PE Director: *"Only 1% of transactions in Nigeria are non-cash. As financial inclusion increases – and it will – digital transactions infrastructure will need investment due to the sheer volume of transactions."*	**Life/death/funeral**	**Micro-finance**	PE Investor: *"There is USD 20bn in pension funds in Nigeria; as the market stabilizes we expect these funds to look for diversification options."*
Switching	CEO of African insurance company: *"Every one of the nearly 200 million Nigerians is a potential life-long insurance customer for us. This is a large strategic opportunity, and in 20 years we expect to have a very big business in Nigeria."*	PE Investor: *"With public and private sector efforts to increase financial inclusion – and more Nigerians with consistent monthly income – there are opportunities to create reliable risk profiles for scalable lending across the country."*	**Institutions**
Mobile money	Assets	Saving and loan associations	Legal firm: *"Companies have begun to amass large cash balances and are looking for strategies to employ those assets."*
	Business		Private wealth

Top opportunities mentioned by investors (shown in bold); Source: Interview results

Figure 27: Value drivers, non-banking financial services

	Key value drivers in non-banking financial services	Anecdotes
Revenue	• Leveraging technology to drive down operational cost and reach the unbanked population • Partnerships to increase financial inclusion, both on the B2C and B2B side • Ability to scale early fintech firms based on proof of concept	**PE investor:** "We are actually willing to go down to USD 5-10mn investment volume when we see a good fintech opportunity because we are certain that it will pay off."
Operations	• Managing transactions and currency risk • Understanding the technology side of the company as much as possible to identify potential weaknesses that will hinder scaling • Understanding cost to serve for distribution through traditional or tech-enabled networks	**US-based investment firm:** *"We are dollar investors, and it was very difficult to understand the currency and risk we were actually investing in."*
Valuation	• Accounting for contingencies when valuing the business – especially with regards to transactions, default and currency risks – with great care	**UK-based corporate investor:** *"We know that we need to be patient with seeing returns in insurance."*

Source: Interview results

The key value driver for revenue generation in non-banking financial services is leveraging technology to increase operational efficiency by partnering with relevant companies in the sector and investing in early stage fintech firms that have proved scalable. The importance of technology further extends into operations as a value driver because it can be used to identify weaknesses, among other drivers (Figure 27). Lastly, accounting for contingencies is important when valuing the business opportunity.

The baseline factors necessary for non-banking financial services opportunities to be attractive include finding partnerships on both the B2C and B2B sides to increase financial inclusion; managing transaction/currency risk; and understanding the technology supporting the specific companies and opportunities. Local companies with access to potential customers that can be leveraged as distribution networks are essential to successful investments in this sector.

2.4. Basic services

Basic services represent investment opportunities in areas traditionally run by public institutions and government. According to investors, services such as electricity generation, education, and healthcare are not currently provided for in sufficient quantity or quality to support Nigeria's burgeoning population. This has created space for private investors to enter. Of the projected 206mn population in 2020, only 52mn will have on-grid power supplied more than four hours a day; 75% of Nigerians will not have access to reliable on-grid power. This represents an enormous potential opportunity for off-grid power provision (Figure 28).

Investors view basic services as attractive from a regulatory perspective, as there are no sector regulators relevant for off-grid power, healthcare, or education; any required permits and licences relate to real estate. To highlight the potential market opportunity in healthcare, as of 2017 there is one primary healthcare institution for every 49,000 Nigerians (Figure 28).

Healthcare sub-categories include health service provision, risk pooling, retail and distribution, medical education, pharmaceutical and medical products. Referencing an example of a Nigerian middle-class individual with poor health habits and some disposable income, a healthcare investor highlighted diagnostic as an attractive area of interest.

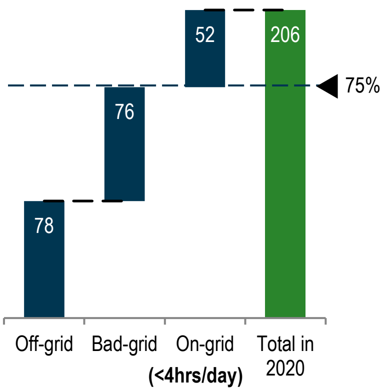
In a similar vein to mass market residential real estate opportunities, several interviews referenced high-volume, low-cost hospitals. Increasing urbanisation and a growing middle and upper-middle class with poor health habits creates demand for affordable care; developers able to create scalable solutions should benefit greatly.

Two linked opportunities in the retail and distribution space are pharmacy chains and supply-chain management. Investors stated that pharmacies need to be owned by licensed pharmacists, creating some bureaucratic hurdles, but with the right management and scaling model, creating pharmacy chains and also the supply chains to support them represent attractive sub-sectors.

Figure 28: Assessment of attractiveness for investment, basic services

Demographic opportunity

Grid coverage of Nigerian population in mn*



Example: Off-grid energy – 75% of Nigerians do not have access to reliable on-grid energy, making off-grid power generation a huge market opportunity.

Regulatory environment

Anecdote

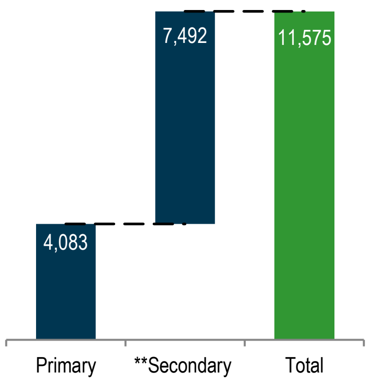
Nigerian senior lawyer on healthcare:

*"There is **no sector regulator for healthcare in Nigeria**, so no approvals needed on that side for proceeding with a deal. Post-acquisition, you would then be dealing directly with the Ministry of Health."*

No sector regulators in basic services – most important permits and licenses will be around real estate and infrastructure required for the service provision.

Market entry opportunity

No. of accredited healthcare providers, 2017



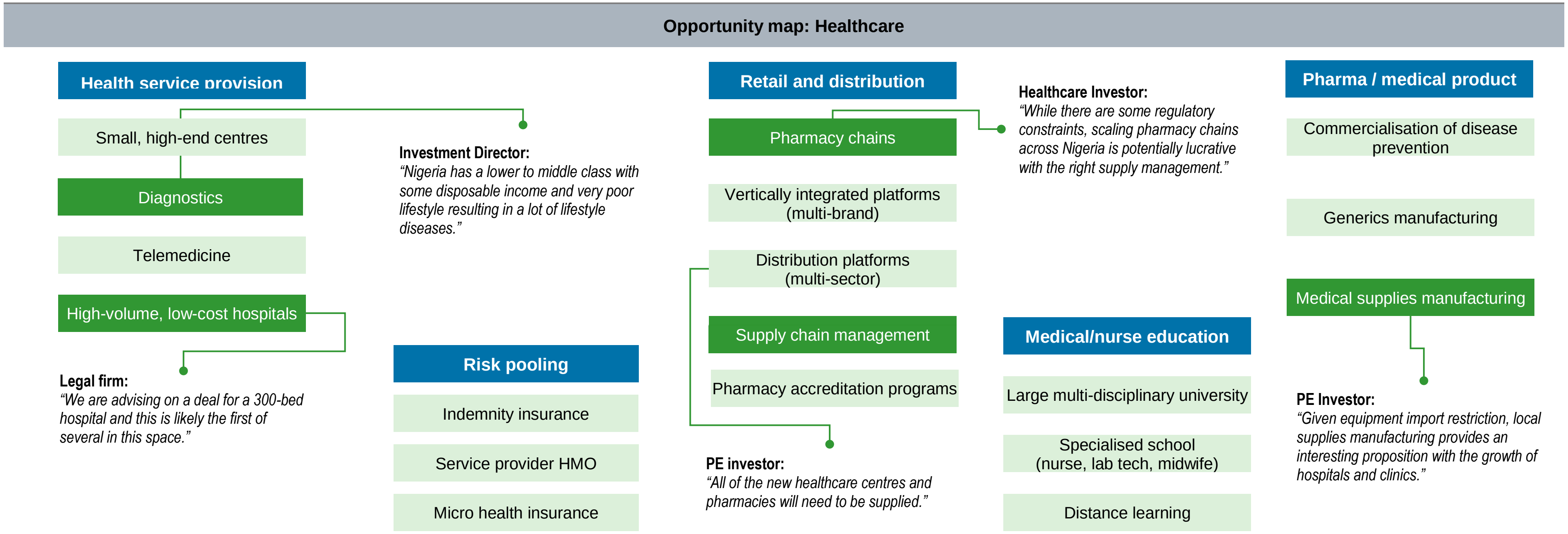
Example: Healthcare – there is one primary healthcare institution for every ~49,000 Nigerians, making the sector very open for new scaled entrants.

* Analysis extrapolated to 2020 population size ** Specialist institutions (e.g. eyecare) and pharmacies; Source: NHIS Nigeria; All On

Key revenue drivers across off-grid, healthcare and education include focusing on specific well-priced services; balancing the need for expat and locals hires to optimise expertise and cost levels; and developing efficient operating models for the service opportunities.

The market potential for basic services is very high; these are sectors not traditionally serviced by the private sector and often overlooked by investors. Interviewed investors active in these sectors highlighted how quickly value became apparent once they understood the scale of the demand.

Figure 29: Opportunity map, healthcare



Top opportunities mentioned by investors; Source: Based on The Business of Health in Africa (IFC)

Figure 30: Value drivers, basic services

	Key value drivers in basic services	Anecdotes
Revenue	• Ability to reach a quality level that convinces Nigerian health and education tourists to use the local service instead of going abroad • Off-grid energy: Securing sufficient cashflow on a constant basis to absorb fast adoption of service • Focus on specific services that are well-priced	**UK-based PE investor:** *"We invested in healthcare and underestimated the complexity of it. Every disease is its own business."* *US-based investor: "We invested in diagnostics – less complicated."*
Operations	• Developing an efficient operations model that relies on well-structured service processes • Finding the right balance of expat and local hires to optimise costs and knowledge	**PE investor:** *"You need the right staff and patient capital to build out the operations of a multi-service hospital properly."*
Valuation	• Market potential is very high for basic services because of large supply gap – realistic assumptions on pace of capturing the market are key	**Energy investor:** *"We invested in off-grid last year and the value of our equity had doubled in 9 months."*

Source: Interview results

2.5. Snapshot of business services

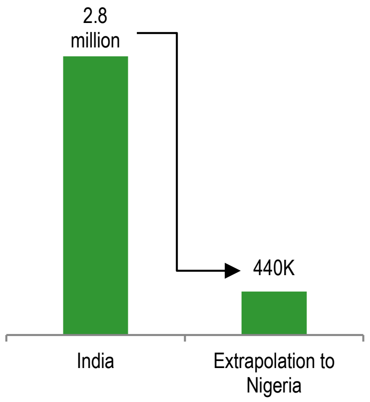
Business services covers outsourced or vendor functions provided to companies such that they can run their core functions. As more businesses develop in Nigeria and as sectors continue to specialise, investors are focusing on business services, especially given the high density of businesses in urban areas such as Lagos and Abuja. There are opportunities in Nigeria to create IT and other business services for both domestic and international clients. Investors and legal experts note that service industries are less operationally challenging and have fewer regulatory challenges than consumer-facing industries.

Three non-exhaustive business services opportunity buckets are professional services, logistics services, and administrative/support services. Within professional services, investors focus on IT services due to the growing demand for automation in both private- and public-sector operations. Currently all data centres for the Nigerian market are located offshore[12] but demand is growing for local information provision. Investors also mentioned domestic data centres as an untapped opportunity moving forward.

The ability to diversify service portfolios and client bases quickly is one of the key revenue sources, overall value drivers, and success factors in business services. In this way business service companies can better protect themselves in challenging economic times. An important operational value driver in business services is keeping overhead structures lean and focusing on the main revenue drivers.

Figure 31: Assessment of attractiveness for investment, business services

Demographic opportunity
No of jobs that could be created in Nigeria in IT services, using India as a benchmark



Nigeria has a job creation opportunity from building out IT and other business services – serving both a domestic and international target market.

Regulatory environment
Anecdote

Institutional investor, London:

"B2B is often a less ***operationally challenging*** *opportunity than consumer goods, for example, because the distribution challenge is smaller and capital leverage much higher."*

Lawyer, Lagos:

"Surely, sectors that are focused on the B2B level, especially if it is services, come ***with much fewer regulatory challenges*** *than directly consumer-facing ones."*

B2B-focused service organisations often deal with less operational complexity, resulting in fewer permits and licences required to run the business.

Market entry opportunity
Local key players in IT services

IT services	• Weco Systems • Resourcery • Layer3 • Computer Warehouse Group
IT and internet infrastructure	• Main One • Galaxy Backbone
Programming services	• Andela

Example: IT services – Nigeria has an active sector of well-established local players, combined with tech start-ups that are starting to scale.

Source: Web search

[12] Corporate interview

Figure 32: Opportunity map: Business services

Professional services	Logistics services	Administrative / support services
IT services	Building maintenance	Travel agencies
Nigerian investor: *"The future of the Nigerian economic growth lies in technology – and, on the corporate side (including governmental departments) there is a lot of potential for automation and even the use of AI."*	Transportation services	CRM services / call centres
	Data centre	Cleaning services
Consulting and advisory	**CEO of a strategic holding**: *"We realized that all data centres in the Nigerian market are off-shore. Clearly there is a massive opportunity to do this in-country – however, you need a good strategy for switching customers from their existing providers."*	**Recruiting services**
Accounting services		**PE investor**: *"Everyone is looking for good management talent in Nigeria and willing to pay for support in finding it. If there is someone who can make this a scaled business, I'd invest."*
Research services		
		Security services

Top opportunities mentioned by investors; Source: Interview results

Figure 33: Value drivers, business services

	Key value drivers in basic services	Anecdotes
Revenue	• Well-connected local managers or partners who can make introductions to big-ticket clients • Ability to diversify service portfolio and client base quickly to be robust in times of economic slowdown	**US-based PE investor:** *"Business services tend to be very profitable, recurring, sticky forms of revenue as long as the economy is doing well."*
Operations	• Ability to manage late or delinquent payments for services • Managing high cost of skilled labour of service companies • Keeping overhead structure as lean and flexible as possible to accommodate income volatility	**CFO, local FMCG company:** *"Getting services at affordable cost, acceptable quality, and available locally is essential for us in Nigeria."*
Valuation	• Assessing the robustness and value of key accounts • Forecasting key account growth	**UK-based institutional investor:** "*It is very difficult to come up with a valuation for a service business."*

Source: Interview results

3. Finding the right investment for each type of investor

Investors have articulated that high-impact deals are available in Nigeria's new economy sectors, but there are considerable difficulties in finding and harnessing the right opportunities. The top three reasons why investors find it difficult to identify deal opportunities in Nigeria are (1) few identified companies meet investor requirements; (2) entering the Nigerian market is operationally difficult; and (3) investors are not able to identify investment opportunities (Figure 34).

This chapter provides strategies for investors to identify deal opportunities that best fit their investment profile. Collating investor interviews with the investor survey, our team defined four key questions focused on improving investor success in sourcing opportunities in Nigeria (Figure 36). These questions constitute the subsections of this chapter:

1. What investment strategies have worked well for investors in Nigeria?
2. How can these strategies be mapped when it comes to risk and return?
3. What type of investor are you in terms of your readiness to invest in Nigeria?
4. Which investment strategies would be the most promising for your type of investor?

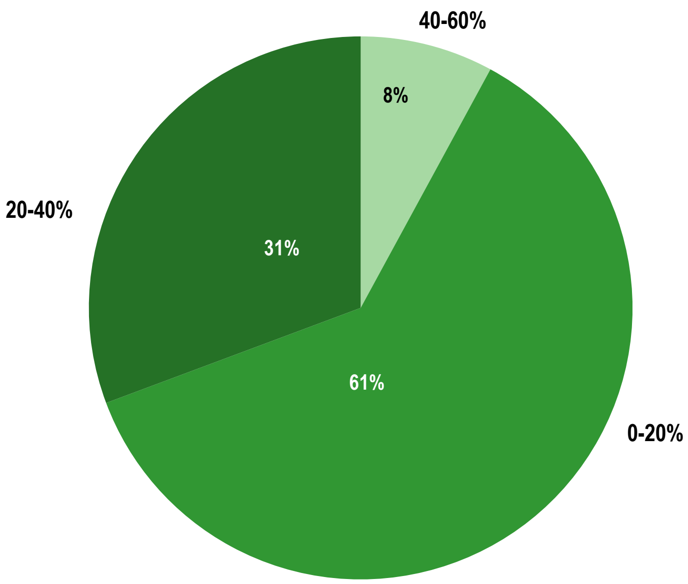
Working through these investor-driven questions should help investors establish a more informed view of the most appropriate opportunity match in Nigeria.

Figure 34: Investor-ranked challenges identifying deals in Nigeria

Why investors find it difficult to identify deal opportunities in Nigeria, top five reasons mentioned in interviews

Source: Investor monitor survey

Figure 35: What percentage of deals reach closure in Nigeria?

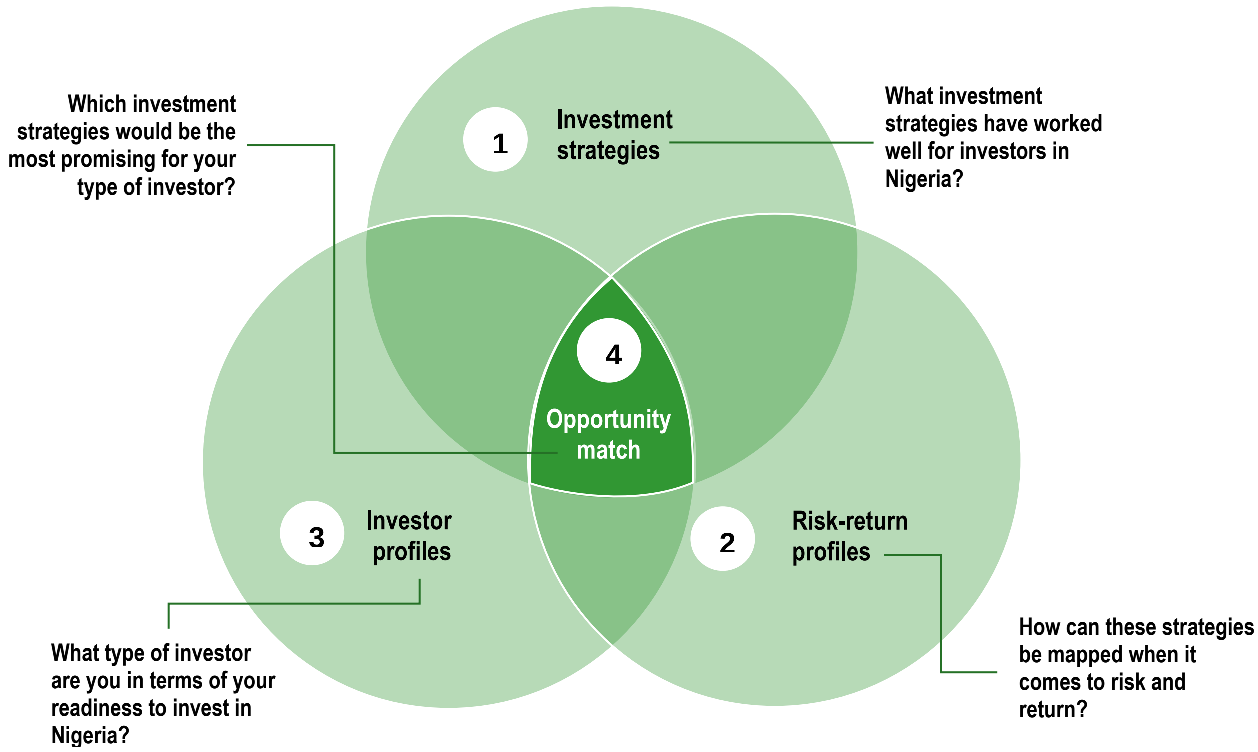


- **The top reason mentioned by investors for deals not reaching closure is the** *failure to agree on price*, **closely followed by the** *inability to agree on the equity shareholding* **to be acquired**
- **While this indicates the early stage of the investment environment in Nigeria, it also shows that there might be a** *mismatch between investors' expectations and what they find on the ground*

Nigerian investment expert, UK/Portugal: "If you want to come to Nigeria, you need to be willing to pay the value for the long-term opportunity."

Source: Interview monitor survey

Figure 36: Improving success in sourcing opportunities in Nigeria



3.1. Investment strategies

Interviewed investors mentioned two different types of strategies for sourcing promising deals: sector-driven and target-driven ones. Top-down sector-driven approaches rely on seeking industries based on the demographic, regulatory, or market-entry attractiveness discussed in Chapter 2. Once identified, the top-down approach considers an array of available companies active in that industry. Inversely, a target-driven bottom-up investment approach begins by identifying companies of interest, with less initial focus on the industry or driving forces. Focusing primarily on managerial capability and operational strengths, this strategy looks for attractive growth potential based on a company of interest (Figure 37).

Top-down approaches involve identifying first-mover opportunities; for example, the integrated digital payments and commerce company, Interswitch, leveraged regulatory input barriers in a straightforward sector-driven approach by determining sectors with import bans or high tariffs (e.g., shoes/leather, Figure 23), then started a business in that sector. Investors who favour sector approaches, such as an interviewed investor who invested in aluminium packaging cans, favour identifying low-cost input opportunities and homing in on the upscale value-chain opportunities (Figure 38).

A bottom-up approach would be finding market leaders and paying a premium to invest in the top players with strong market share, seeking to strengthen their position by raising capital. A London-based investor detailed a strategy of investing in capital-hungry financial institutions where they have existing relationships via debt investments and in which the investor can then take larger collateral. Another target-driven strategy includes investing in strategic market access. Certain distribution networks or customer access might be beneficial to the target as well as companies in the portfolio of the investor, creating a more symbiotic relationship.

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Figure 37: Strategies for sourcing deals in Nigeria

Source: Interviews

Based on interviews with investors, we have grouped strategies utilised by investors to identify targets into sector-driven strategies and target-driven strategies (Figure 38). The sector-driven strategies include approaches like identifying first-mover opportunities and leveraging regulatory import barriers; these strategies seek out systemic opportunities. The target-driven strategies include investing in strategic market access and focusing on turnaround opportunities; these strategies seek individual companies based on certain attractive criteria. The eight strategies identified in Figure 38 are utilised by different types of investors and are associated with different risk and reward characteristics, which are discussed for the rest of this chapter.

Figure 38: Sector-driven and target-driven strategies to identify investment opportunities

(Not exhaustive)

Investment strategies in Nigeria revealed: What investors focus on to find attractive deals

Sector-driven strategies	Target-driven strategies
Identifying first-mover opportunities: Focusing on products and services that are new 'white spaces' in the Nigerian market and have promising growth potential	**Paying a premium for market leadership:** Looking for the top players with significant market share who seek to diversify or strengthen their position through investment
Leveraging regulatory import barriers: Looking for sectors where the regulatory environment enables the growth of domestic opportunities, especially because of import tariffs	**Investing in strategic market access:** Identifying players with attractive access to consumers or distributors that can be advantageous for the buyer's existing portfolio
Finding low-cost input opportunities: Zeroing in on the upstream value-chain opportunities where inputs can be sourced entirely locally to minimise FX risk exposure	**Scouting safe capital havens:** Putting money into well-established capital-hungry companies where the investor can benefit from more complex vehicles that leverage debt
Betting on price changes in the sector: Taking advantage of acquisition opportunities during times of devaluation where prices are likely to increase in the near future	**Focusing on turnaround opportunities:** Finding companies with an attractive asset base that can be scaled by introducing technology and operational efficiency levers

Source: Interviews

3.2. Risk-return profiles

Based on interviews with investors, Nigeria can be very attractive in terms of returns. From collated return expectations based on exits, our research indicates an internal rate of returns (IRR) of approximately 20-30%, return on equity (RoE) at 30-40%, and a multiple of money (M/M) in the range of 2x-2.5x (Figure 39) on average. While these estimates will be attractive to many investors, the challenge is how to assess the actual investment opportunities by risk and return profile.

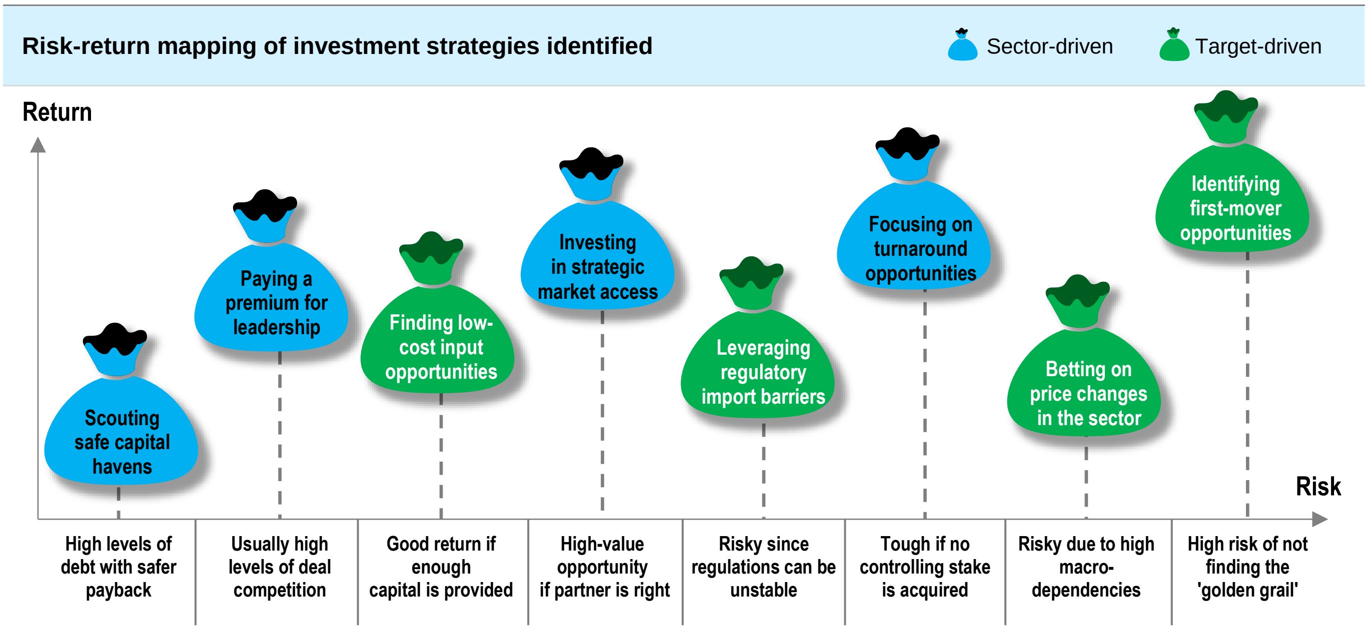
Taking the non-exhaustive illustrative sector-driven (top-down) and target-driven (bottom-up) strategies discussed, we can begin to create a risk-return map of strategies based on what investors told us in interviews (Figure 40). While this graph is an estimate, we have drawn out comments along the risk axis to identify what makes these strategies particularly risky, or what enhances the likelihood of strong returns. Logically, the opportunities towards the lower left with lower risk and low return have more competition as they are less challenging operationally, and the opportunities towards the upper right are more complex, with greater inter-dependencies.

Figure 39: Expected risk-return profiles

Return expectations of investors based on past exits in Nigeria		
IRR	RoE	M/M
20-30%	30-40%	2x-2.5x
Nigeria has an attractive risk-return profile if the investor is able to realise the value after deal closure.		

Source: Interviews

Figure 40: Risk-return mapping of identified investment strategies *(Illustrative)*



3.3. Investor profiles

Our research revealed different types of potential investors in Nigeria with variable risk appetite. We profiled each type and created a self-assessment tool for investors to determine which is most closely aligned with them. The investor types and tool are illustrative examples to assist current and future investors in identifying deal-sourcing opportunities with the highest personal probability of success.

Seasoned investors are characterised by a high focus on Nigeria, with a local presence and networks in Nigeria. They understand the Nigerian cultural context and have longstanding local partners who are also well-versed in Nigerian market operations. These seasoned Nigeria investors can focus on the high risk-return opportunities (top right in Figure 40) and consider majority stake acquisitions.

Emerging investors have limited experience in Nigeria but have begun to build local teams and networks to support sourcing deal targets; they have successfully exited deals in Nigeria or are comfortable operating businesses there. They have expertise in the sectors in which they do business or in other emerging markets and have found Nigeria-specific partners with which to co-invest (potentially seasoned investors).

Fly-in investors are based overseas with no local presence, but with good sector-specific knowledge in other emerging markets. They seek opportunities with attractive return profiles and focus on minority deals and recapitalisation efforts (Figure 41).

Using these investor categorisations, our team developed a self-assessment tool based on five crucial success criteria delineated by experienced investors. Based on the simple assessment in Figure 42, an investor can determine which type of investor bucket most closely resembles their situation. Each of the five corners of the pentagon represents an investor-type determining criterion: deep sector experience, patient capital (7+ year exit), fully on the ground in Nigeria, strong local partners, high cultural understanding. By rating an organisation for each of these criteria, and summing the total, the investor will be able to identify which bucket they are most closely aligned with. Likewise, they will be able to determine investment opportunities where they are most likely to succeed.

Figure 41: Investor types in Nigeria, illustrative examples

(Illustrative)

Seasoned investors

- Investors with high focus on the Nigerian or African market
- Local presence and strong networks in Nigeria
- Understand cultural environment of the country
- Can focus on deals with higher risk-return profile
- Have local partners who understand the dynamics of the Nigerian market
- Focus on controlling stakes

Emerging investor

- New to the market, but have successfully divested from deals in Nigeria
- Starting to build out a local team and networks to support deal generation
- Have built out a strong understanding of a handful of sectors and their dynamics
- Found strong allies for co-investing

Fly-in investors

- Investors based overseas who are looking for new opportunities with a good return profile
- No local presence in Nigeria, but potentially good understanding of specific sectors from experience in other emerging markets
- Local partners with limited understanding of exit times and returns in Nigeria
- Focus on minority deals

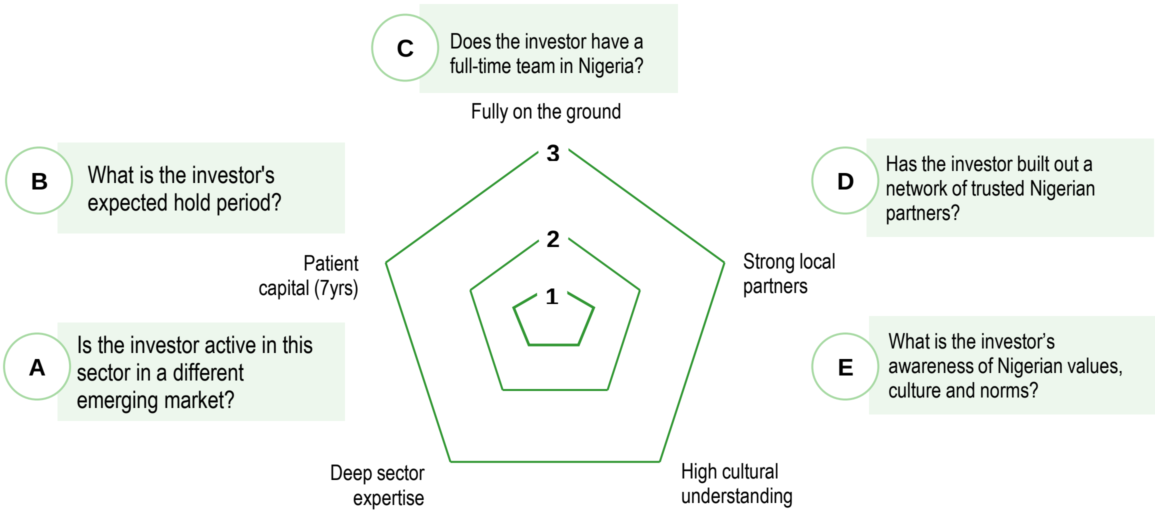
Ability to harness high-risk opportunities in Nigeria

Number of investors

Source: Interviews

Figure 42: Investor type self-assessment

Self-assessment: What type of investor are you?



For each of the five corners, rate your organisation 1 = does not hold; 2 = somewhat holds; or 3 = fully holds. Count your number of points.	1-6 points: Fly-in investor 7-12 points: Emerging investor >12 points: Seasoned investor

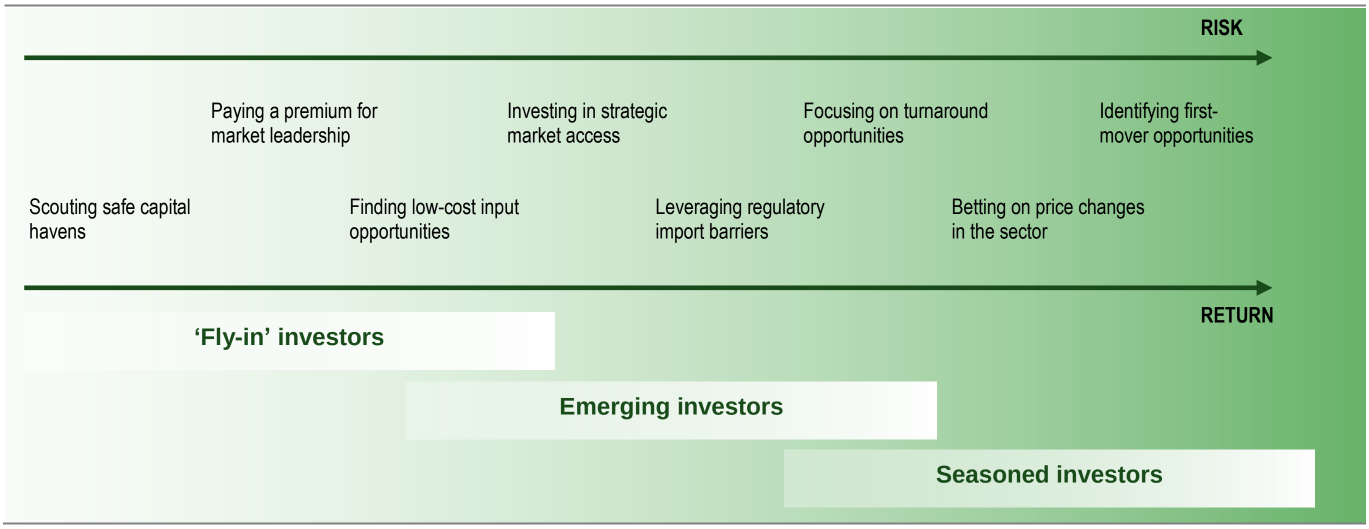
Source: Interviews

3.4. Opportunity match

Superimposing the investor types on the risk-return map, we can see that – unsurprisingly – the more seasoned the investor, the more likely the success potential for high risk-return investments. Fly-in investors with less Nigeria-specific experience and no local presence are more likely to be successful with investing in market leaders (including secondary sales) and low-cost input opportunities high on the value chain. Emerging investors with their local partnerships and sector expertise operate most effectively by finding strategic market access investments and leveraging import barriers as they have the local experience to identify attractive opportunities. Seasoned investors can operate across the gamut of the risk-return map; although the higher return and less crowded opportunities such as white-space first-mover opportunities may be more attractive.

For investors to invest effectively in Nigeria, they need to have an idea of which investor category they currently align with. The team developed an illustrative map below (Figure 43) to assist investors in matching their profile to the right investments in Nigeria.

Figure 43: Investor type risk-return mapping
(Illustrative)



4. Best practice according to the experts

This final chapter provides investor-sourced best practice for players operating, or seeking to operate, in Nigeria. It is organised by: deal sourcing; due diligence for an investment; bidding on the deal; generating value post-close; and successfully divesting or exiting deals in Nigeria.

Each of these steps in the deal process will be familiar to seasoned investors from every discipline; the value-add in these final pages comes from insights that we have gleaned and collated from investors with extensive experience in Nigeria (Figure 44). From our investor interviews we have filtered best practices to equip readers of this report with the tools to position themselves for the highest likelihood of success in their investing endeavours.

Figure 44: Deal process best practice

	Deal sourcing	Due diligence	Bidding	Value generation	Exit
Highlights from expert interviews	• Leveraging brokers, banks and local partners to assist with scouting for targets is crucial • Building pipeline of targets of interest is helpful, even if they might need another 1-2 years to be ready	• Due diligence needs to be invested in and has to be done on the ground, not remotely • Primary data collection is nearly always necessary • Extensive people due diligence is highly important	• Negotiating with the main decision maker from the start is critical • Directional price should be discussed early on to avoid disappointment and waste of resources	• Most companies have just scratched the surface of their core businesses; focus on expanding core businesses • Ensure that KPIs are agreed and that their achievement is tracked	• Secondary sales are the most attractive exit model • Exits happening earlier than 5+ years are very unusual

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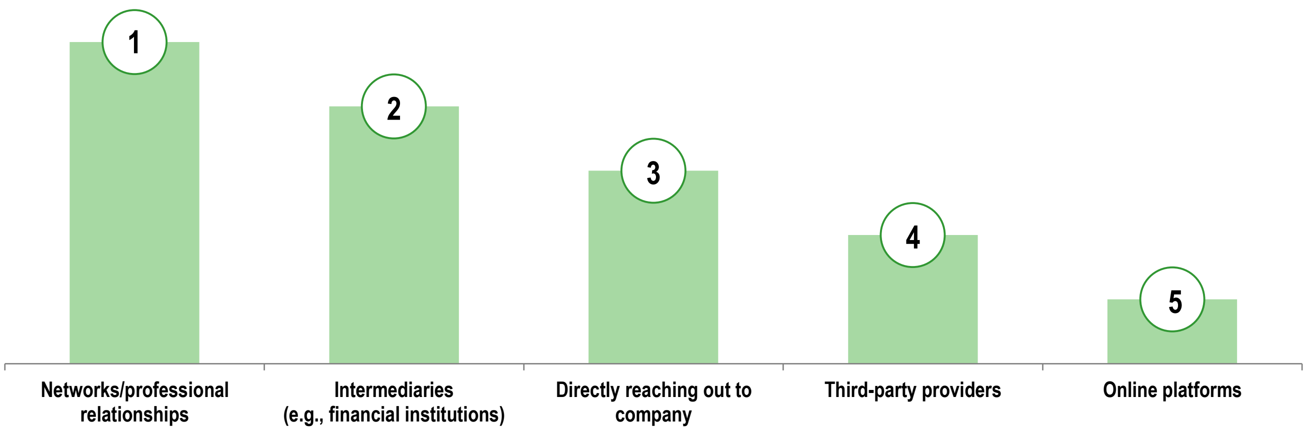
4.1. How investors have sourced deals in Nigeria

Leveraging local advisors and brokers is key to successfully sourcing deals in Nigeria. Local advisors are usually experts in a particular field (banks, consultants, independent experts). They are also usually well connected within and across sectors. Full-time deal brokers (individuals or companies) in Nigeria are well situated to advise and make introductions to companies seeking capital. Interviewed investors referenced meeting with their investment banking counterparts to determine where the best opportunities could be found.

Many interviewed investors leveraged brokers for the first few opportunities they researched. As relationships developed and their local footprint grew, they reached a point where deal information was incoming. This allowed investors to be reactive rather than proactive in seeking opportunities.

Figure 45: Deal sourcing

Sources of deal origination in Nigeria; *1= most important, 5 = least important*



Source: Investor monitor survey

Figure 46: Deal sourcing

Best-practice to source deal opportunities in Nigeria

Success strategies	• **Leveraging deal-brokers in Nigeria** to determine which secular growth drivers for sectors and companies are currently attractive • **Closely observing sectors of interest** in Nigeria and how they evolve in **terms of regulation** • Following **trusted investors by executing secondary sales** or **co-investing alongside them** • Researching **which companies did well during the recession**	**Institutional investor from the UK:** *"3rd-party fund managers are important in our network because they might find deals they can't do that are interesting for us or we might co-invest in a round"*
Common mistakes	• **Underestimating the time it takes** on the ground to source the right deal for the investor • Attempting **debt-heavy or hostile deals** • Looking at sectors that appear attractive but where the investor has **limited sector and/or Nigeria experience** • **Only considering deals that "have made their way to London";** deals are shopped around Nigeria before reaching foreign markets	

Source: Interviews

4.1.1. Successful approaches to sourcing investment targets

Leveraging brokers – In addition to adding colour to views on sector climate, asking the opinions of local advisors early in the sourcing process can save investor time.

Secondary sales – Top-down approaches can be used for investors seeking secondary sales. Once an investor isolates their preferred sector they can pull a history of deals in that sector, speak with brokers, and determine if any are up for sale. The league tables in Appendix I could be leveraged to this end.

Partnerships – Starting with a product or sector, the investor/company can map out what a strategic local partnership could look like. The first step would be to pull local potential partner companies in that sector (independently or with the assistance of an advisor/broker). Then through matching them against a set of criteria, the investor can short-list potentials and begin outreach. An insurance company interviewed for this report leveraged this approach to find their local bank partner for product distribution.[13] First, they selected a market with low insurance penetration (product). They then sought a local partner with the distribution network they required (large bank), as well as customers already primed to talk about financial products. Through this combination they were able to source a target efficiently.

Creating a broad investment thesis helps to combat the risk of sunk due diligence capital. This means taking the holistic approach of investing in a sector and then building out a pipeline of opportunities such that if any individual prospect fails to close a deal there are alternatives. International private equity firms interviewed for this report advise "building a funnel for the future"[14] by advising businesses for a few years until they are ready for investment. Taking a long-term pipeline development approach diversifies options and combats the protracted learning curve inherent to investing in Nigeria.

Advice from investors states that Nigerian deals are often shopped around locally before they reach London or other investor hubs. This may give the impression that companies seek investment internationally only when they are poorly financially positioned locally rather than seeking growth financing. Additionally, seeking to invest in distressed assets to obtain a majority position is currently not an attractive proposition. Overwhelming consensus from investors is to **never do a hostile deal in Nigeria**. This puts greater onus on the due diligence to separate the wheat from the chaff.

Irrespective of the type of investment made, once a potential target is identified the goal is to determine the future of the company. This entails research not just on the sector but on the macro environment as well.

4.1.2. Timetable and conversion

Long-term investors will take as long as it takes to source the correct deal, and strategic companies will do the same. A law firm involved with many high-profile deals across sectors in Nigeria noted "the falloff in PE investment in Nigeria over the past 24 months has been stark" but that has not impacted the focus on or dedication to Nigeria; it is rather a product of the current macro environment.[15]

[13] Investor interview
[14] Investor interview
[15] Key expert interview

Investors interviewed for this report gave an approximate conversion rate of closing 5-10% of the deals they reviewed. That closure rate goes up to 75% for deals after due diligence has been conducted. [16] It is relevant to note is that ramp-up time can be considerable. One investor we spoke to started looking in 2013 but did not make their first investment until 2015.[17]

[16] Investor interview
[17] Investor interview

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4.2. Due diligence and associated risks

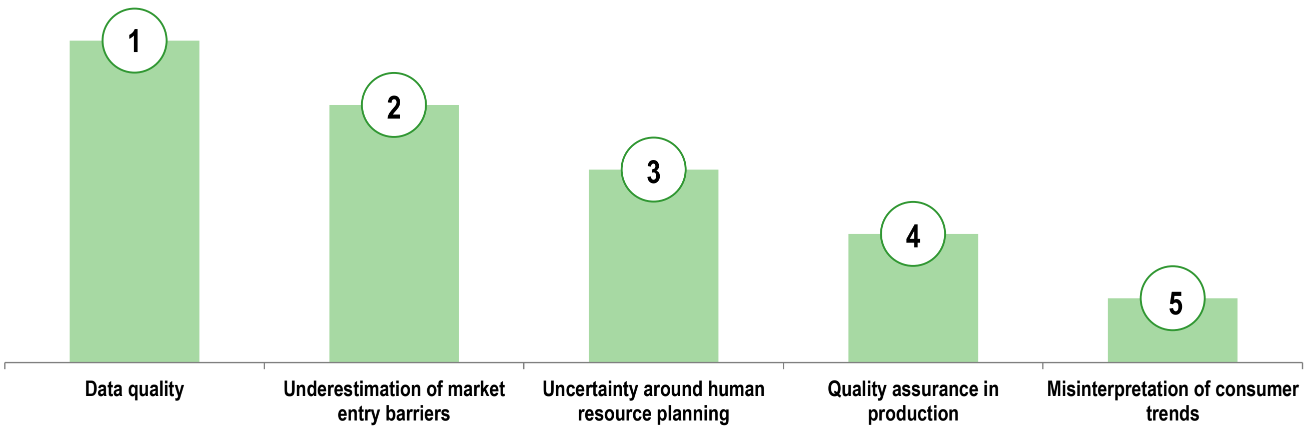
Rigorous due diligence is vital to investing in any deal, but even more so in the Nigerian context. Misrepresentation of provided data and misunderstanding of the cultural nuances can result in stark losses for investors. Figure 47 illustrates success strategies for undertaking well formulated due diligence, as well as common mistakes made in this process. The key insight is to undertake thorough due diligence on the people behind the venture and to only trust information collected from primary sources.

Once a deal has been sourced, investors face five main risks during the due diligence process (Figure 47). The following are both general categories and more specific examples of potential risks.

Data quality was noted as the most prominent risk. Companies often portray a more favourable image of their company than the reality, with highly positive projections. Furthermore, industry research for comparisons may not be available to the degree needed to make informed decisions.

Figure 47: Due diligence

Risks when conducting a due diligence in Nigeria; *1= most important, 5 = least important*



Source: Investor monitor survey

Figure 48: Due diligence

Principles of due diligence

Success strategies	• Initiating **people due diligence** at an early stage, and focusing on **the rainmakers** of the business • Sourcing **informal opinions on the key stakeholders beyond company**, customers and investors to explore what is said about their character • Taking a very detailed approach to analysing and questioning the **governance framework** of the target • Conducting all diligence work **on the ground** and collecting **fresh data** • Having the **target contribute financially to the due diligence** effort	**Investment expert:** *"I am really surprised when people say they have issues to find talent in Nigeria. In my opinion the education level of people is pretty good. The harder thing to do is finding the people with the right level of integrity"*
Common mistakes	• **Reliance on materials provided by the target** and failure to cast the due diligence net wide enough • **Not verifying financials provided by the target** on the ground, and failure to track cashflows correctly through the company • **Underinvesting in commercial due diligence**, putting investors in an information vacuum post-investment • Failing to undertake **due diligence on local auditors/consultants** who just 'follow instructions' rather than look for potential red flags	

Source: Interviews

Human resource planning may pose a challenge, as international investors often want immigrant labour or internationally educated people. These may be in short supply, but high demand. It is necessary for investors to balance the requirement for such staff and be genuinely prepared to employ local talent.

The fourth and fifth risks are quality assurance in production and misinterpretation of consumer trends, both of which relate to the ongoing operation of the invested venture.

4.2.1. Due diligence: FX

One of the biggest mistakes made by investors and corporates entering the Nigerian market is forgetting – or failing to properly prepare for – future currency movements. An international bank active in Nigeria believes the "biggest mistake is mismatch between funding currencies and revenue cash flow of the invested company."[18]

For example, deals funded 100% in USD can cause problems as returns are measured in USD and it may seem that the company is underperforming, while in fact gains are eroded by Naira depreciation.

Corporates may be less sensitive to FX risk – Corporates can generally take a much longer view and might not be as sensitive to FX risk as investors. If corporates take a 10-20-year perspective on long-term growth and structure their local operations well within the parent corporation, they can mitigate the effects of currency fluctuations.

An FMCG company invested heavily in Nigerian operations and discussed its approach to currency risk: "Every country has its challenges but given the relationships we have with the [Nigerian] banks and the support we have from our parent company – a series of holding companies – we can manage forex amongst our global value chain."[19]

In practice, this effectively means putting a hold on repatriating profits during times of currency volatility and, at times, financing operations through holding company loans. This option may be available to corporates, whereas private investors might have to determine other approaches to currency risk.

Investors must be creative in handling currency risk – Private equity and other investors may be more sensitive to currency movements due to shorter investment horizons. Even if investors view Nigeria as a strategic long-term play, target hold periods for any investment – based on primary data collected for this report – are rarely longer than 4-7 years. Investors have developed clever methods of approaching currency risk that fit their investment horizons.

A highlighted method for making an investment in Naira is to take out a Naira loan from a Nigerian bank and put the dollar equivalent of the investment in a bank abroad to guard against currency devaluation. For example, the investor may take out a USD 10mn loan in Naira from a Nigerian bank, and then simultaneously deposit USD 10mn in a London bank to hedge the investment. The investment can be made locally while the money is – on the investor's balance sheet – domiciled elsewhere.[20]

This approach effectively locks in currency risk at the interest rate on the loan, a cost of capital that can be baked into the deal.

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[18] Investor interview
[19] Corporate interview
[20] Key expert interview

4.2.2. Due diligence: Individuals

While FX risk may be the most critical deterrent to investing in Nigeria, the main reason that deals fail once they have been sourced is due diligence on individuals. The challenge here is that it is difficult to estimate character until something goes wrong and decision making requires integrity.[21]

Undertaking people due diligence at an early stage is critical so that it is not done in a superficial fashion. Investors mention that multiple rounds of people due diligence may have to be completed to gain a full picture of business, political and personal networks.

Local presence – An effective due diligence process will require a team on the ground to elicit useful information. While some aspects of the due diligence can be done remotely, it would be ill-advised to conduct people due diligence in Nigeria without a local presence.

Building a trusted local network – Even firms that do not have a local presence themselves build networks of trusted advisors and researchers to assist in Nigeria. In one form or another, it is essential to have analysts on the ground with the necessary the access to perform deep investigative research.

Steps such as confirming the existence of shareholders and the security of assets of a target with the Corporate Affairs Commission in Abuja can be facilitated and expedited through leveraging local trusted partners.

Focus on the rainmakers – Instead of a holistic approach, focus on core individuals running the business. In Nigeria, control is often centred on one executive, given an 'ask the MD' culture. If these core CEO/CFO roles do not match set criteria or if they raise red flags, then assessing the people around them is irrelevant.

News and public information – News sources and public records all need to be checked for business dealings, political contributions, and personal endeavours.

References – "Even though Nigeria is huge, the business environment is a village" and nobody wants to badmouth others within the small business community.[22] As such, conducting in-person interviews in informal environments is essential if you really want to find out something untoward.

An individual's character doesn't change – A final note on individual due diligence is that irrespective of commercial viability or company strength, investors advise not to go ahead with a deal if the result of the personal due diligence is not fully satisfactory.

4.2.3. Due diligence: Financial

Financial due diligence focuses on verifying financial information provided by the target and assessing the historic and current performance of the business. Criticisms of Nigerian businesses are that companies have multiple sets of financial records that are shown to investors, used for taxes, used operationally, shown to management, or any combination therein.

21 Investor interview
22 Investor interview

On the ground understanding of the business – For both corporates and investors acquiring a venture, the financial due diligence team needs to be on the ground for a deep dive of the target's operations. Many aspects of Nigerian businesses will not be documented and relying on financial statements will not give a true understanding of how the company operates financially.

Factors noted by investors as challenges during financial due diligence:

- Records do not allow for determination of accurate EBITDA or valuation
- Accurate numbers are available but SKU level figures are impossible to collect
- Management lack of understanding of financial concepts like cash generation or valuation best practices[23]

Two items highlighted as particularly important that are often overlooked are checking on outstanding indemnifications that may or may not be on the books, and estimations of potential tax liabilities. To mitigate these risks and gain a proper understanding of a company's financial position, investigations need to be done in Nigeria. At times it is necessary to investigate how cash flows through the company and how the financial reports are generated.

Looking beyond the financial statements – Given concerns about multiple sets of financial statements and/or cooked books, investors need to assume that they will have to 'kick the financial tyres' of the organisation.

Beyond financial statements that may or may not be accurate, prudent investors will analyse how the company has fared through economic cycles as a way of understanding performance. Essentially, resistance to economic downturns, or the actions a company takes to shore up cash in a downturn, may be helpful in understanding how the company operates financially. This is despite the fact that obtaining accurate numbers may be difficult.

Integrity of the auditor – If contracting the financial due diligence to a third-party, investors recommend verifying the integrity and reputation of the auditor – a type of 'mini due-diligence'. Many small Nigerian auditors simply follow instructions rather than perform the agile research investors should seek that results in useful findings.

4.2.4. Due diligence: Commercial

Investors often underinvest in commercial due diligence, positioning themselves in an information vacuum post-investment. [24] This section addresses commercial due diligence risks and approaches to mitigate them.

Understanding the macro environment – Once an attractive target is identified, one pitfall is to ignore the importance of a true understanding of the macro environment. We have discussed FX risk, but an additional risk is a lack of understanding Nigerian trends.

A private equity firm that closed a large fintech deal in 2017 relates that after sourcing a target they spent a lot of time and energy trying to truly understand the financial services and technology sector in Nigeria. Beyond large-scale factors driving growth (i.e., demographics), this meant delving into the forces specifically at work in the use of technology in the banking sector.[25]

[23] Key expert interview
[24] Key expert interview
[25] Investor interview

Difficulties in assessing market potential – The Nigerian government has made a concerted effort to increase access to customer-focused information (e.g., quarterly published GDP, unemployment, CPI, population) through the National Bureau of Statistics.[26] That said, any information beyond top-line numbers (those that are scanned and uploaded online in pdf format) is challenging to obtain.

Primary data collection is often needed to verify investment hypothesis and valuation assumptions. Investors either have local teams to conduct their data collection, or leverage expert firms if no in-house capacity exists.

If viable in terms of expertise and team capacity, in-house due diligence is much more attractive as data collection can be more closely monitored and costs can be controlled. A private equity firm commented that the due diligence they performed in-house on a manufacturing company cost them USD 12,000; upon exit, the buyout team purchasing the asset from the original PE firm paid USD 660,000 for outsourced due diligence.[27]

Know your customer – In addition to the macro perspective and market sizing, there is an element of the 'Nigerian factor' of on-the-ground consumer trends and forces that needs to be assessed, especially in the B2C space (e.g., FMCG, insurance, etc.). A skewed understanding of customer sentiment can be catastrophic, even given the most optimistic of business propositions.

Thus, while Chapter 2 discussed long-term factors such as urbanisation and increasing median incomes driving sector opportunities, it is essential to look to the actual viable customer base and understand its needs. For instance, the insurance space is understood to be an under-penetrated market from a macro perspective, making it very attractive recently. That said, companies expressed concern that at present customers are being squeezed because wages are not rising as much as their cost of living. While this does not invalidate the long-term investment thesis, it could contribute to an over-estimation of the consumer opportunity on a short- to mid-term horizon.[28]

Know the competition – Underestimating the market barriers to entry or expansion caused by competition is a risk to be considered. Part of understanding the commercial viability of a target is the competitive landscape and the performance of other players in the industry.

For instance, an investor cited a due diligence process that included interviewing a series of their target's competitors to gain a better picture of the broader fintech story in Nigeria. They found that all similar companies were performing well even during a time of macro upheaval in Nigeria. This information, unattainable except through on-the-ground collection, proved very useful to the investor in making their ultimate decision.[29]

Each type of due diligence is a piece of the puzzle that will reveal more of the true picture of a company and its contextual environment in Nigeria. Investors described literal white boards where they attempt to visually depict putting the pieces together and identify areas of concern.

26 *http://www.nigerianstat.gov.ng/*
27 Investor interview
28 Corporate interview
29 Investor interview

4.3. Bidding

4.3.1. Making the right offer for the deal

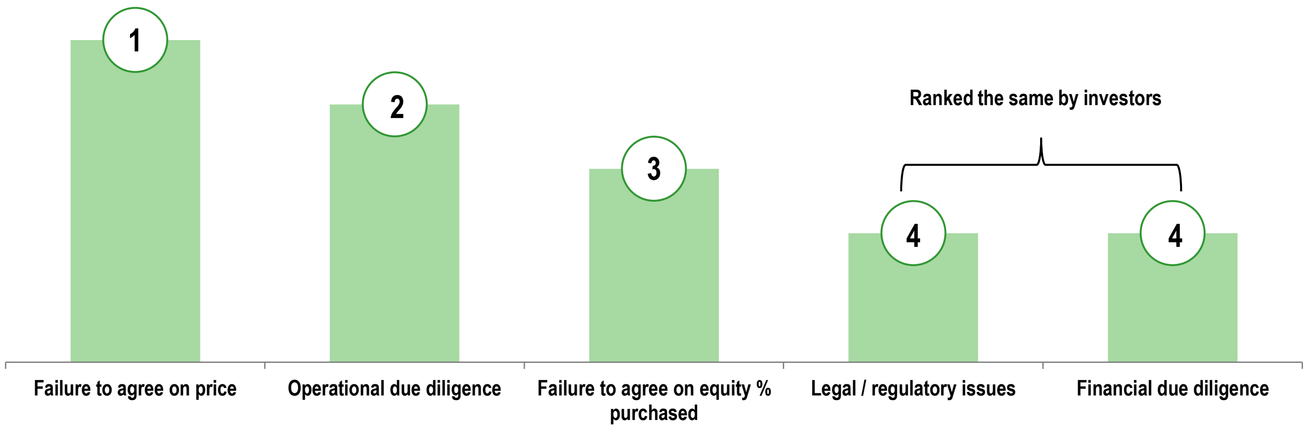
Execution risk is considered the risk of completing the due diligence and then having the deal fall through when negotiating the terms.

Negotiating with the relevant parties

Closing a deal effectively depends on speaking to the right decision-maker from the outset of negotiations. Execution risk increases if there are multiple intermediaries with vested interests between the investor and the ultimate decision-maker (especially for family-owned businesses).

Figure 49: Bidding

Reasons deals do not reach closure, *1= most important, 5 = least important*



Source: Investor monitor survey

Figure 50: Bidding

Bidding best practice

Success strategies	• Clearly **outlining the respective roles and responsibilities** of a minority vs. majority acquisition • Very **tangible KPIs to indicate milestones and the release of funds** • Investing in commercial due diligence to **derive local benchmarks from which to draw multiples**/valuation • **Co-investing with reliable counterparts** to share investment risk and due diligence responsibility • Focus on **equity investments**	**CEO of Nigerian holding company:** *"Nigerian businesses like foreign money but not foreign investors and ideas"*
Common mistakes	• **Negotiating with intermediaries** initially rather than the ultimate decision-maker for a deal • **Failing to secure all debt or financing sources** before a deal is concluded • **Trying to over-engineer and fine-tune financial terms** of a deal (e.g., complex debt and financial instruments rather than equity) • **Underestimating currency fluctuations** and the effects they may have on the release of funds or the value of the business	

Source: Interviews

4.3.2. Political and regulatory risks

Investors in the new economy stay away from politically connected players – Part of the individual due diligence addresses political affiliations, and interviewed investors recommended staying away from businesses with close political connections. While government and infrastructure deals can seem lucrative, an association with one political party can be dangerous for long-term investors or corporates. Indeed, corporates that had successfully obtained funding said that their political neutrality had made them appealing to investors as this added no political risk to the deal prospect.[30]

Uncertainty around policy decisions abounds in Nigeria – Uncertainty around institutions and their policy decisions makes Nigeria a challenging place to invest.

Lack of governmental infrastructure and process makes public sector work particularly challenging. Anecdotally, an interviewed investor committed capital for a large-scale infrastructure project in conjunction with state and federal governments in Nigeria. After bureaucratic delays for four years, the investor was forced to pull out of the deal.[31]

The CBN set up the import-export FX window to ensure investors could access FX when they want to repatriate funds, making it easier for them to move money to and from Nigeria. However, investors remain concerned that the government still makes it quite challenging to do so.

FX policy notwithstanding, some investors may find it prudent to avoid sectors that rely heavily on policy decisions or government approvals.

Regulatory bodies by sector

This section includes information on the relevant regulatory bodies where approval is needed by sector.

- Insurance – The main regulator in the insurance space is NAICOM[32], which ensures the safety and soundness of insurance institutions in Nigeria.
- Real estate – Land is generally owned by the regional governor; since the governor's consent is needed for land deals, this can lead to bureaucratic hurdles.
- Financial services – Financial services deals need the approval of both the Central Bank of Nigeria and the SEC. Fintech deals potentially require CBN approval depending on where the company fits in relation to the banking sector.
- Telecommunications – The Nigerian Communications Commission is the main regulator in the telecommunications space.
- Healthcare – No regulatory approvals are needed for investments in the healthcare space (unless insurance related, in which case NAICOM). State and federal ministries of health guidelines must be complied with operationally, but there are no acquisition regulators.

The SEC is the main regulator for M&A in Nigeria and is considered a well-run regulator. That said, there is a lack of proscription regarding what is needed for approval, as well a lack of guidance on how long approvals will take. There is limited clarity surrounding circumstances under which approval must be granted from the SEC.[33]

[30] Corporate interview
[31] Investor interview
[32] Nigerian Insurance Commission
[33] Key expert interview

Investors must incorporate policy into their due diligence

Keeping track of and predicting future changes in the regulatory environment for the sector is important, and understanding what that will mean practically for the customer.

For example, if the government implements an import ban, will that really lead to imports being stopped if the ports have yet to be reformed and the black market is flourishing?[34] These are considerations that need to be weighed when performing due diligence.

[34] Investor interview

4.4. Value generation

After making an investment, investors can employ various strategies to realise returns as the deal matures.

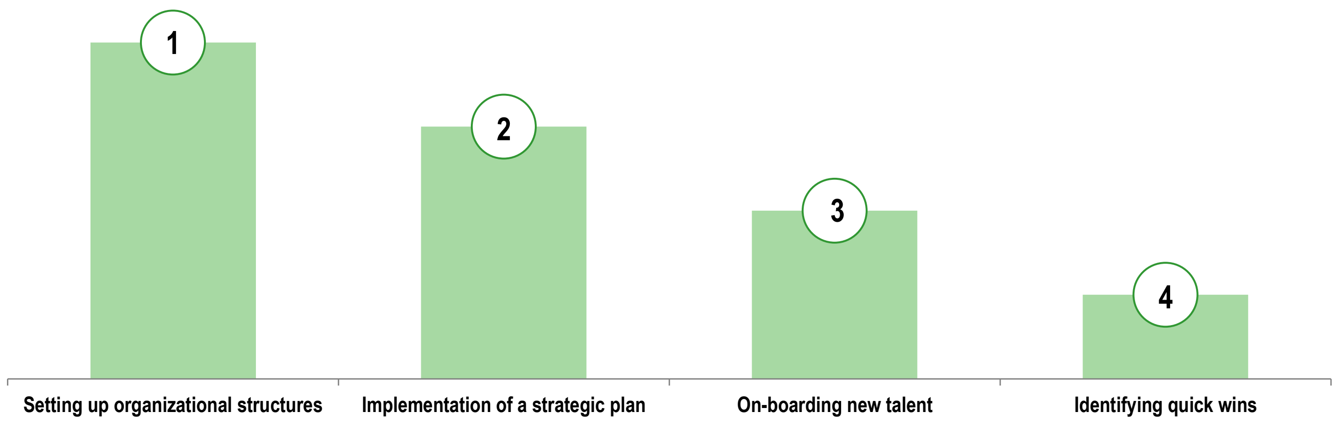
4.4.1. Post-investment planning

Prioritising people in the first 100 days – When asked, investors and corporates did not highlight 100-day plans as particularly important or feasible in the Nigerian context. Securing the teams and putting the correct management roles in place was deemed more important.[35]

Post-investment, investors described challenges with incumbent management, necessitating managerial change sooner rather than later. Nigeria is all about the people; the priority as an investor is to assess the team, review it, and then quickly strengthen the decision-making ability of leaders and dismiss employees who are dragging the others.

Figure 51: Value generation

Factors determining deal success during the first 100 days post-investment, *1= most important, 4 = least important*



Source: Investor monitor survey

Figure 52: Value generation

Value generation best practice

Success strategies	• **Use measurable KPIs** to align management and track success • **Track closely whether people are working well together** and make quick decisions • **Build on what is working for the company**; focus on trying to scale and expand core functions before adding new offerings • Team up with management to develop and enhance RTM strategies that plan for **multiple ways of accessing the customer base** • **Collect and incorporate feedback from customers** and agents	**Seasoned PE-investor:** *"It's always exciting to think about new products, but you should focus on doing well with the existing business."*
Common mistakes	• **Tracking business success in hard currency** in the early days does not make sense – be ready to absorb FX losses in the short term • **100-day plans do not work** because the three-months timeline is unrealistic for the Nigerian context • **Failure to localise new product offerings** to the Nigeria-specific market (what can be tweaked to make the product attractive to Nigerians?) • **Waiting too long to replace non-performing employees** and management	

Source: Interviews

[35] Investor interview

Mid- to long-term strategies – "It's always exciting to think about new products, but you should focus on doing well with the existing business" by building on what is working, according to an interviewed investor.[36] Most Nigerian companies are just scratching the surface in their core business. Planning for new products makes sense in the long-term business plan, but with capital injections investors see the best wins from the core business that makes the company attractive.

RTM – Investors recommend teaming up with management to develop and enhance route-to-market strategies to generate value in the short and long term.

Particularly in the FMCG space, businesses need to focus on building their distribution relationships and networks, which takes time in Nigeria. A specific insight from a foreign FMCG company was to leverage regional distributors rather than large national networks.[37]

An insurance provider recommended building a multi-distribution channel business with different "ways in which they will be able to reach their customers and grow their business."[38] Given Nigeria's rapidly changing consumer landscape, companies should plan for multiple ways of accessing their base.

Product development – Localisation of products is highly important. Ventures need to ensure that they incorporate local tastes and appeal into their product development; failing to do so may result in a less than optimal outcome.

Strategies for successful implementation include structured feedback from customers and agents on the ground. Consider what tweaks can be made to product design to appeal most to Nigerians. An insurance provider gave an example of how in the UK, people might be worried about the financial future of their children if something happens to them. In Nigeria and West Africa, a more prevalent need might be how to cover the costs if someone close to them dies. Products need to be tailored accordingly. Post-investment and expansion planning must adequately cater to the local market requirements to ensure success in the mid to long term.

[36] Investor interview
[37] Corporate interview
[38] Corporate interview

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4.5. Exits

4.5.1. Methods of exiting investments

For investors looking to exit, there are two primary approaches to consider – IPOs and secondary sales.

IPO – As evident in Chapter 1 and from discussions with investors and corporates alike, IPOs have not been and are not currently a particularly viable or attractive form of exit. Public markets in Nigeria are notoriously hard to plan for.

Strong companies could explore the London Stock Exchange or other international exchanges if they are able to meet corporate governance standards. However, the potential price competition these companies would face and the pressure this would put on their market capitalisation is a concern here.

While some companies opt for the public route, investors do not generally envisage this as a viable or attractive outcome at the time of investment.

Figure 53: Exit

Preferred exit opportunity for deals in Nigeria, *1= most important, 4 = least important*

Source: Investor monitor survey

Figure 54: Exit

Exit best practice

Success strategies	• Focusing on **secondary sales** to investors looking to enter the Nigerian market, and developing a pipeline of these relationships early • Taking a **flexible and pragmatic approach in terms of exit timing;** wait for the right time for the company as well as the investor • **Working with the target to identify the exit structure** and future investors that work best to support the target as well as the investor • Planning for a **hold period of no less than 5 years**	**Local Nigerian PE investor:** *"If cashflows are right, management is strong, and the company is doing well in an industry with high barriers to entry, the business will sell"*
Common mistakes	• **Underestimating how long the investment** cycle in Nigeria can take • **Forgetting the macro-climate** that may affect the viability of exits • Ignoring the **reputational impact of the performance of the target** on the investor **post-exit** • Following the investor **'herd mentality' of entering and exiting Nigeria** rather than making a long-term commitment • Facing **challenges with repatriating proceeds** from sale of the stake	

Source: Interviews

Secondary sale – This is the sale of a vested venture from one private investor to another. Subsequent rounds usually have larger ticket sizes.

Successful secondary sales

- Begin the search for investors early; the investment cycle in Nigeria is long and, as discussed, due diligence can be a drawn-out process so investors recommend starting the search for strategic investors early.

- Investors buy good businesses. If cashflows are right, management is strong, and the company is doing well in an industry with high barriers to entry the business will sell.[39] That is to say, if the business is growing then finding an investor will not be an issue.

A Nigerian company that has undergone two large investment rounds in the past decade (both local and international private equity investments) related that while they will have to exit at some point, their main goal is to find an exit model that best supports the operation of their business. Accordingly, they are "not preparing for IPO, they are just preparing to grow the business best and supporting clients and services."[40]

Secondary sales were the most attractive exit for most investors.

4.5.2. Expected exit times

Strategy and planning differs between corporates and investors, with corporates generally referencing 10-year time horizons whereas investors spoke of 5-year holding periods.

Standard exit times for investments in Nigeria, among investors interviewed for this report, were 4-6 years. Based on the research for this report, exit times did not vary by sector.

Specifically, investors warned not to expect to exit anywhere near the 2-3-year range. Even using this in models or scenario planning is unwise as it is not a realistic option in Nigeria. Exacerbated by the current FX situation, investors say that even before the recent recession, expected exits were in the 4-6-year range.

[39] Investor interview
[40] Corporate interview

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Appendix I: Selected deal league tables

Figure 55: The top-10 deals over the last 10 years

Nigeria top-10 investment deals by deal size 2007-2016

Target	Deal size (USD mn)	Transaction type	Buyers/Investors	Primary sector	Target state	Year
OML 29 and Nembe Creek Trunkline	2,700	Merger/Acquisition	Aiteo Ltd; Taleveras Group Company; Tempo Energy Resources	Energy	Lagos State	2015
OML 138 Block in Nigeria	2,460	Merger/Acquisition	Addax Petroleum Corporation	Energy	Lagos State	2013
MTN Nigeria Communications Limited, 9151 Towers in Nigeria	2,004	Merger/Acquisition	IHS Nigeria Plc	TMT	Lagos State	2015
MainStreet Bank Limited	1,860	Private Placement	AMCON, Inc.	Financials	Lagos State	2011
Keystone Bank Limited	1,847	Private Placement	AMCON, Inc.	Financials	Lagos State	2011
Onigbolo Cement Company	1,780	Merger/Acquisition	Dangote Industries Limited	Industrials, Materials	Ogun State	2007
Nigerian Businesses of ConocoPhillips	1,660	Merger/Acquisition	Oando Energy Resources Inc.	Energy	Lagos State	2014
Stanbic IBTC Holdings PLC	1,515	Merger/Acquisition	Stanbic Africa Holdings Limited	Financials	Lagos State	2007
Oceanic Bank International Plc	1,403	Public Offering	-	Financials	Lagos State	2007
Stake in 4 Companies	1,170	Merger/Acquisition	Lafarge Africa Plc (NGSE:WAPCO)	Industrials, Materials	Ogun State	2014

Source: S&P Global Market Intelligence - Capital IQ

Figure 56: Sector snapshot: The largest consumer goods deals over the past decade almost all occurred in the past 5 years

Nigeria top-10 consumer goods investment deals by deal size 2007-2016

Target	Deal size (USD mn)	Transaction type	Buyers/Investors	Primary sector	Target state	Year
Dangote Flour Mills Plc	506	Merger/Acquisition	Tiger Brands Limited (JSE:TBS)	Consumer Goods	Lagos State	2012
49% Stake in 5 Companies	461	Merger/Acquisition	Vitol Holding B.V.; Helios Investment Partners LLP	Consumer Goods	Lagos State	2016
Multi-pro Enterprise Limited	450	Merger/Acquisition	Kellogg Company (NYSE:K)	Consumer Goods	Lagos State	2015
Dangote Sugar Refinery Plc	421	Public Offering	-	Consumer Goods	Lagos State	2007
Consolidated Breweries Plc	367	Merger/Acquisition	Nigerian Breweries Plc (NGSE:NB)	Consumer Goods	Lagos State	2014
Africa Internet Group	328	Private Placement	MTN Group; AXA Partners Limited; Rocket Internet; Goldman Sachs	Consumer Goods	Lagos State	2016
Amber Foods Limited	275	Merger/Acquisition	Olam International Limited (SGX:O32)	Consumer Goods	Lagos State	2016
Flour Mills of Nigeria PLC	247	Public Offering	-	Consumer Goods	Lagos State	2010
Flour Mills of Nigeria PLC	179	Public Offering	-	Consumer Goods	Lagos State	2012
Titanium Holding Company SA	167	Merger/Acquisition	Olam International Limited (SGX:O32)	Consumer Goods	Ogun State	2012

Source: S&P Global Market Intelligence - Capital IQ

Figure 57: Sector snapshot: Largest financial services deals over the past decade took place more than 5 years ago

Nigeria top-10 financial services investment deals by deal size 2007-2016

Target	Deal size (USD mn)	Transaction type	Buyers/Investors	Primary sector	Target state	Year
MainStreet Bank Limited	1,860	Private Placement	AMCON, Inc.	Financials	Lagos State	2011
Keystone Bank Limited	1,847	Private Placement	AMCON, Inc.	Financials	Lagos State	2011
Stanbic IBTC Holdings PLC	1,515	Merger/Acquisition	Stanbic Africa Holdings Limited	Financials	Lagos State	2007
Oceanic Bank International Plc	1,403	Public Offering	-	Financials	Lagos State	2007
Zenith Bank Plc	1,104	Public Offering	-	Financials	Lagos State	2008
First Bank of Nigeria Plc, Performing and Non-Performing Loans	847	Merger/Acquisition	AMCON, Inc.	Financials	Lagos State	2012
Union Bank of Nigeria Plc	800	Private Placement	Corsair Capital LLC; Standard Chartered*	Financials	Lagos State	2012
MainStreet Bank Limited	773	Merger/Acquisition	Skye Bank Plc (NGSE:SKYEBANK)	Financials	Lagos State	2014
Guaranty Trust Bank Plc	750	Public Offering	-	Financials	Lagos State	2007
Africa Finance Corporation	743	Public Offering	-	Financials	Lagos State	2015

Source: S&P Global Market Intelligence - Capital IQ

N.B. Additional buyers/investors in this deal included African Capital Alliance; Altira ADC Management GmbH; Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.; Chandler Corporation; AMCON

Figure 58: Healthcare deals over the last decade all took place in Lagos State – size has increased in recent years

Nigeria top-10 healthcare investment deals by deal size 2007-2016

Target	Deal size (USD mn)	Transaction type	Buyers/Investors	Primary sector	Target state	Year
Eco Health Limited	74	Merger/Acquisition	Imperial Logistics (Pty) Ltd	Healthcare	Lagos State	2014
Hygeia Nigeria Limited	67	Private Placement	IFC; Swiss Re Ltd; African Health Systems Management; CIEL Healthcare Ltd	Healthcare	Lagos State	2016
Hygeia Nigeria Limited	18	Private Placement	IFC; Satya Capital LLP; Nederlandse Financierings	Healthcare	Lagos State	2009
Fidson Healthcare Plc	17	Public Offering	-	Healthcare	Lagos State	2007
Total Health Trust Limited	9	Merger/Acquisition	Liberty Group Limited	Healthcare	Lagos State	2015
Union Diagnostic and Clinical Services Plc	8	Public Offering	-	Healthcare	Lagos State	2007
Neimeth International Pharmaceuticals Plc	5	Public Offering	-	Healthcare	Lagos State	2012
Total Health Trust Limited	3	Merger/Acquisition	Liberty Group Limited	Healthcare	Lagos State	2009

Source: S&P Global Market Intelligence - Capital IQ

N.B. Additional buyers/investors in this deal included African Capital Alliance; Altira ADC Management GmbH; Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V.; Chandler Corporation; AMCON

Appendix II: Profile of Investor monitor survey respondents

Figure 59: Profile of survey respondents (1/4)

Geographical breakdown of respondents

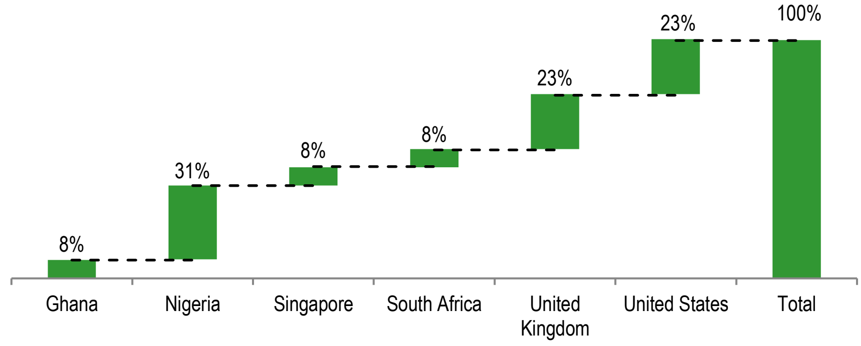


Figure 60: Profile of survey respondents (2/4)

Have you been involved with transactions in Nigeria?

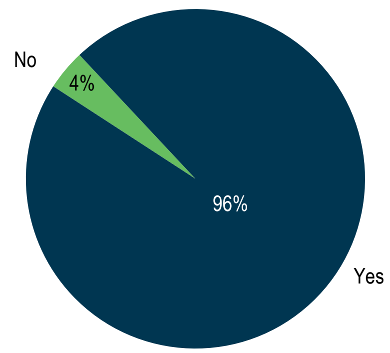


Figure 61: Profile of survey respondents (3/4)

Types of respondents

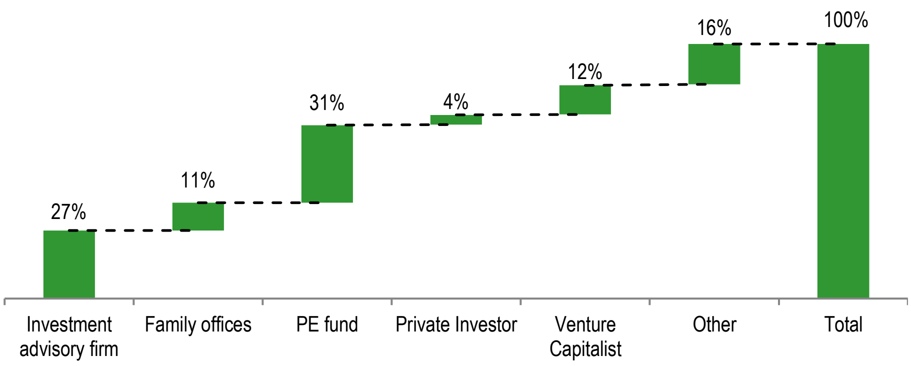
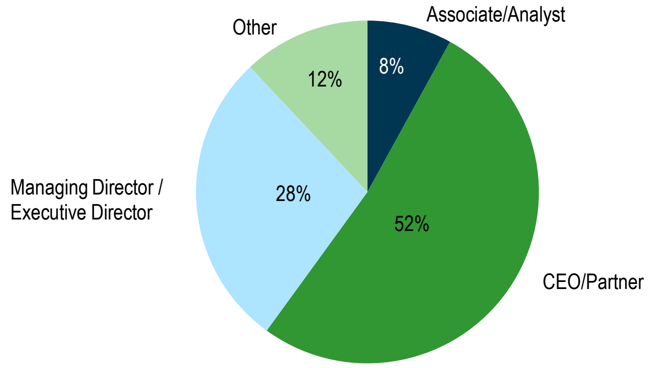


Figure 62: Profile of survey respondents (4/4)

What is your role in the organisation?



Source: Investor monitor survey

Authors

Yasmin Kumi
Yasmin.Kumi@africaforesight.com
Managing Director
Africa Foresight Group

Lanre Akintujoye
Lanre.Akintujoye@africaforesight.com
Africa Foresight Group

Tochi Okoronkwo
Tochi.Okoronkwo@africaforesight.com
Africa Foresight Group

Lesego Letlape
Lesego.Letlape@africaforesight.com
Africa Foresight Group

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