Expert Viewpoint

Private equity investment in Africa is changing. Fund managers are adopting facilities that are used in developing markets, such as subscription credit.

Private equity: subscription credit facilities on the rise

Private equity deals in Africa totalled $8.1bn last year, according to the African Private Equity and Venture Capital Association (AVCA). This is the second highest on record after the $8.3bn posted in 2007. Today, investing in Africa is increasingly seen as a necessary part of a balanced investment portfolio as investors look to the continent – home to many of the world's fastest growing economies and a growing middle class – for higher returns. As capital that is looking to be deployed in Africa

increases and competition for Africa PE deals hots up, financing techniques and instruments used by private equity (PE) in developed markets are now being utilised by African PE funds. Whilst it will be a while before we see a true PE leveraged finance deal, we are increasingly seeing the emergence of the "subscription credit facility". These facilities are perceived by many US and European alternative asset fund managers as a staple components of the fund administration process.

The PE fund manager perspective
Subscription credit facilities (also known as investor bridge facilities or capital call facilities) have been utilised by US and European PE fund managers for over a decade because of the multitude of benefits they bring. They include:

- *giving the fund manager fast and reliable access to liquidity (typically within a couple of business days) which can help facilitate the speed and certainty of deal execution;*
- *lowering the cost of capital and therefore enhancing a PE fund manager's return strategy; and*
- *allowing a fund to more efficiently manage its drawdown process by consolidating* drawings.

The lender's perspective
From a lender's perspective, the relatively low risk profile of this type of product and its strong track record has made this one of the fastest growing debt products in Europe and the US. However, the saturation of these markets resulting from an abundance of new providers in recent years is driving lenders to look outside of their traditional geographies to emerging markets.

Africa is an increasingly popular destination for PE fund managers. It is now a clear focus for banks and other financial institutions that offer this type of product, and increasingly African PE fund managers are getting the significant benefits that their European and US counterparts have been enjoying for over a decade.

'The IMF/ World Bank considered Islamic modes of financing, as ideal for financing infra-structure and development'

What's the difference?
What is it that distinguishes this type of facility from other types of debt products? The main differentiator is that the facility is either put in place directly at fund level or otherwise involves some form of recourse to the fund, as opposed to the PE asset that the fund is investing in.

This recourse could be by way of guarantee. This means that the underlying credit/security for the facility is the contractually committed but uncalled capital of the limited partners (LPs)/investors in the fund.

Competition drives lower pricing
These facilities are often put in place early in the life cycle of the fund to allow fund managers to enjoy the benefits described above. However, they can also be put in place much later in the life of the fund to allow PE fund managers to accelerate distributions. This is an important tool for PE fund managers in a competitive market where speed of returns to investors can be a critical differentiator. Depending on the level of diversification and quality of the underlying LP/investor base that comprises the credit/security for this type of facility, these products generally attract relatively low pricing compared to other types of debt product including leveraged debt.

This low pricing is in no small part due to the increasing levels of competition amongst lenders in the subscription credit market. However, whilst the pool of banks and financial institutions able to offer this type of product has expanded significantly over the past few years, there can be significant variations between the terms offered by lenders. As terms are driven by lenders' internal credit policies and credit criteria, it pays to understand this market properly and the different terms on offer.

Price is not the only criterion
Whilst pricing is clearly important, our experience is that it is often not the most important factor for a PE fund manager in determining which lender should be chosen for the mandate. Factors such as the provider's track record and experience in the subscription credit market and the type of collateral package required are equally (if not more) important factors.

Understanding what these terms will mean in practice in terms of the day-to-day administration of one of these types of facilities is crucial for a PE fund manager in identifying the right credit subscription facility lender. The answers to questions such as the following will help identify which lender will be suitable for a PE fund:

- *how often will the fund be required to call capital during the life of the facility;*
- *what level of control over the LP/investor base will the lender require; and*
- *whether the LP/investors will be required to directly acknowledge the debt package.*

Make a plan and the benefits will come through
As always, early planning is critical. For a PE fund manager, this planning starts during the fund formation process in terms of initial discussions with LPs/investors and ensuring that the fund documentation adequately provides for the facility and associated collateral security package to be implemented.

However, the benefits are clear, as evidenced by the increasing popularity of this type of product across all asset classes, geographies, industries and fund sizes. In the story that is the subscription credit facility, Africa looks set to be the next chapter. Just remember to get an adviser who understands the market – from both the lender and borrower perspective – to make sure that the deal that is reached is the right one for both parties.

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