

# Capital Alliance Private Equity Investment in GS Telecom of Nigeria: A Case Study

Summary of the Harvard Business School Publishing Case (#800104): "Capital Alliance Private Equity: Creating a Private Equity Leader in Nigeria"

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## PEOPLE & ORGANIZATIONS

**Capital Alliance Private Equity (CAPE)** CAPE is a start-up private equity fund in Nigeria. The initial fund of \$30 million is targeting four investments per year over the next three years at roughly \$2.5 million each. CAPE is considering GS Telecom for its first investment.

**Okechukwu Enelamah, CEO** – Enelamah, a Nigerian, worked for 4 years in various positions at Arthur Anderson in Nigeria and London. After graduating from Harvard with an MBA, he worked for Thomas Barry in the South Africa Capital Growth Fund, first in New York and then in South Africa. He is a CFA-charter holder.

**Richard (Dick) Kramer, Chairman** – Kramer, an American, prior to establishing Arthur Anderson's Nigeria office in 1978, was Managing Partner of AA's practices in Benelux and Argentina/Uruguay. He is Founder and Principal of Strategic Research and Investments (Nigeria) and Pioneer Vice Chairman of the Nigerian Economic Summit Group and Technical Advisor for Vision 2010. He is a Harvard MBA and a CPA.

**Thomas Barry, Director** – Barry has over 25 years of investment management experience. He spent 13 years at T. Rowe Price, 11 years as CEO of Rockefeller & Co, and is Founder and CEO of Zephyr Management, LP and South Africa Capital Growth Fund. He is an American and a graduate of Yale University and Harvard Business School.

**GS Telecom (GST)** GS Telecom is a small telecommunications firm in Nigeria. It is four years old and profitable. GST was formed through the purchase of SPAR Nigeria and its related service contracts for \$750,000 in the mid-1990s. SPAR was a satellite technology provider with service contracts to NITEL (Nigeria's state owned telcom company responsible for all wired telecommunications in Nigeria) and five international oil companies that formed a private TDMA satellite network called BIZNET. The founders' vision is to build GST into a niche leader providing private satellite and wireless services within Nigeria and neighboring Ghana and Tanzania, with plans to expand further into West Africa. Three core business segments: *Operation and Maintenance* – Building and operating custom networks, mainly to BIZNET clients, with contract fees of over \$1 MM per year; *Project Sales and Services* – Designing and installing private networks for large corporate customers; *Network Services* – Leasing network space and providing access to clients who do not want or need an exclusive physical network

**John Neville, Chairman & Co-Founder** – Neville has 25 years of experience in shipping, aerospace and telecommunications with a background in finance, business development and marketing. He is the Chairman of Questar Tangent Corp. and his former positions include Sr. VP of SPAR Aerospace Ltd., Director MDA Ltd., Chairman of MIL Industries Ltd., VP Melville Shipping Co. Ltd., and Consultant with McKinsey, who helped reorganize the Central Bank of Nigeria in 1976. He is a Stanford MBA and resides in Canada.

**Steve Chapman, Managing Director & Co-Founder** – Chapman is a Canadian engineer who has worked 10 years in Europe and 10 years in Africa, with twenty years experience in International Oil Field Services and telecommunications. He is a former Business Development Manager for Schlumberger and helped develop the original SPAR network.

## OPPORTUNITY

GST is seeking to establish a domestic and international service known as frame relay, offering its customers high-speed data links between offices at a much lower cost than the existing VSAT service. The cost-effectiveness of frame relay's use of bandwidth lifts margins, as long as 10-20 customers buy the service in 70 or more locations. Introduction of the service would cost upwards of \$2 MM. GST's perceived window of opportunity to capture a first mover advantage may last only into early 1999. In serious need of capital and unlikely to find many alternative sources, GST learns of CAPE through a former British pilot who lives in Nigeria and runs a local newsletter.

## VALUATION

In the second half of 1998, GST approaches CAPE in hopes of raising \$2 MM to fund its long-term future.

### Pre-Money Valuations

**GST: \$6 MM**

**CAPE: \$2 MM**

### Investment Considerations

+ Recent public telecom M&A transactions in developed countries valued at 3x-5x revenue  
+ Quality client base with estimated annual growth of 25%-30% with opportunities for cross-border customer growth  
+ Future opportunities from deregulation  
+ Management is confident in its revenue and cost projections

- Lax financial controls and complex accounting  
- High and expensive staff turnover  
- Reliance on NITEL monopoly and Nigerian oil companies  
- Vulnerability to potential privatization  
- Exposure to volatile Nigerian currency  
- Exit strategy unclear: IPO on domestic exchange, IPO on foreign exchange, or trade sale

Source: Harvard Business School Publishing, "Capital Alliance Private Equity: Creating a Private Equity Leader in Nigeria" pp. 1-11

## QUESTIONS

From the perspective of the entrepreneur, the investor or the board member:

- 1) What do you find attractive about the opportunity?
- 2) What risks would you consider?
- 3) What would be the terms you would need to make the investment?

## CONTEXT

### Nigeria Background

Location: Western Africa

Population: Approx. 110 – 120 MM people, largest in Africa and composed of 250 ethnic groups

Exports: Over 95% oil

Political Development: Ethnic and political conflict have hindered development of political stability.

1960: Independence from Britain

Late 1960's: Civil War

1970 – 1990's: Series of military coups due to disputes over allocation of Nigeria's rapidly growing oil revenues, persistent demand for greater autonomy of regions and growing military forces. Brief period of civilian rule.

June 1998: General Abdulsalami Abubakar announces new democratization program and free elections

October 1998: Allegations of irregularities during voter registration and ethnic discontent in the oil producing Niger Delta region explode into violent unrest, cutting oil production by 28%

Source: Harvard Business School Publishing, "Capital Alliance Private Equity: Creating a Private Equity Leader in Nigeria" p. 16

### Telecommunication Terms

**Frame Relay** – Form of packet switching that uses smaller packets (frames) and requires less error checking than other forms of packet switching. It is designed for data transfer only, so it's not well suited to videoconferencing or any other voice application. Frame relay is very good at efficiently handling distribution over wide area networks of high-speed data that are transmitted in short, uneven bursts.

**LAN** – Local Area Network. A local area network is a short-distance network used to link a group of computers together within a building.

**TDMA**- Time Division Multiple Access. A method of digital wireless communications transmissions allowing a number of users to access a single radio-frequency channel without interference. Each user is given a unique time slot within each channel.

**VSAT**- Very Small Aperture Terminal. A kind of ground station (or small satellite dish) used to contact a communications satellite.

Source: Harvard Business School Publishing, "Capital Alliance Private Equity: Creating a Private Equity Leader in Nigeria" p. 24

### GST Financials

	Actual		Projected					
	1996	1997	1998	1999	2000	2001	2002	2003
Turnover	5,819	5,197	9,591	17,503	25,800	31,000	37,200	44,640
% growth		-11%	85%	82%	47%	20%	20%	20%
Capital Expenditure			1,000	2,000	1,020	1,240	1,488	1,786
Working Capital Requirement		950	3,155	2,781	4,100	4,926	5,911	7,093
Δ Working Capital			2,205	(374)	1,318	826	985	1,182

Source: Harvard Business School Publishing, "Capital Alliance Private Equity: Creating a Private Equity Leader in Nigeria" pp. 12-13

Assumptions: (1) 1998 CAPEX = \$1 Million

NOTE: All material presented in this case summary is the property of Harvard Business School Publishing, and was originally published in the case "Capital Alliance Private Equity: Creating a Private Equity Leader in Nigeria" (Case #800104)