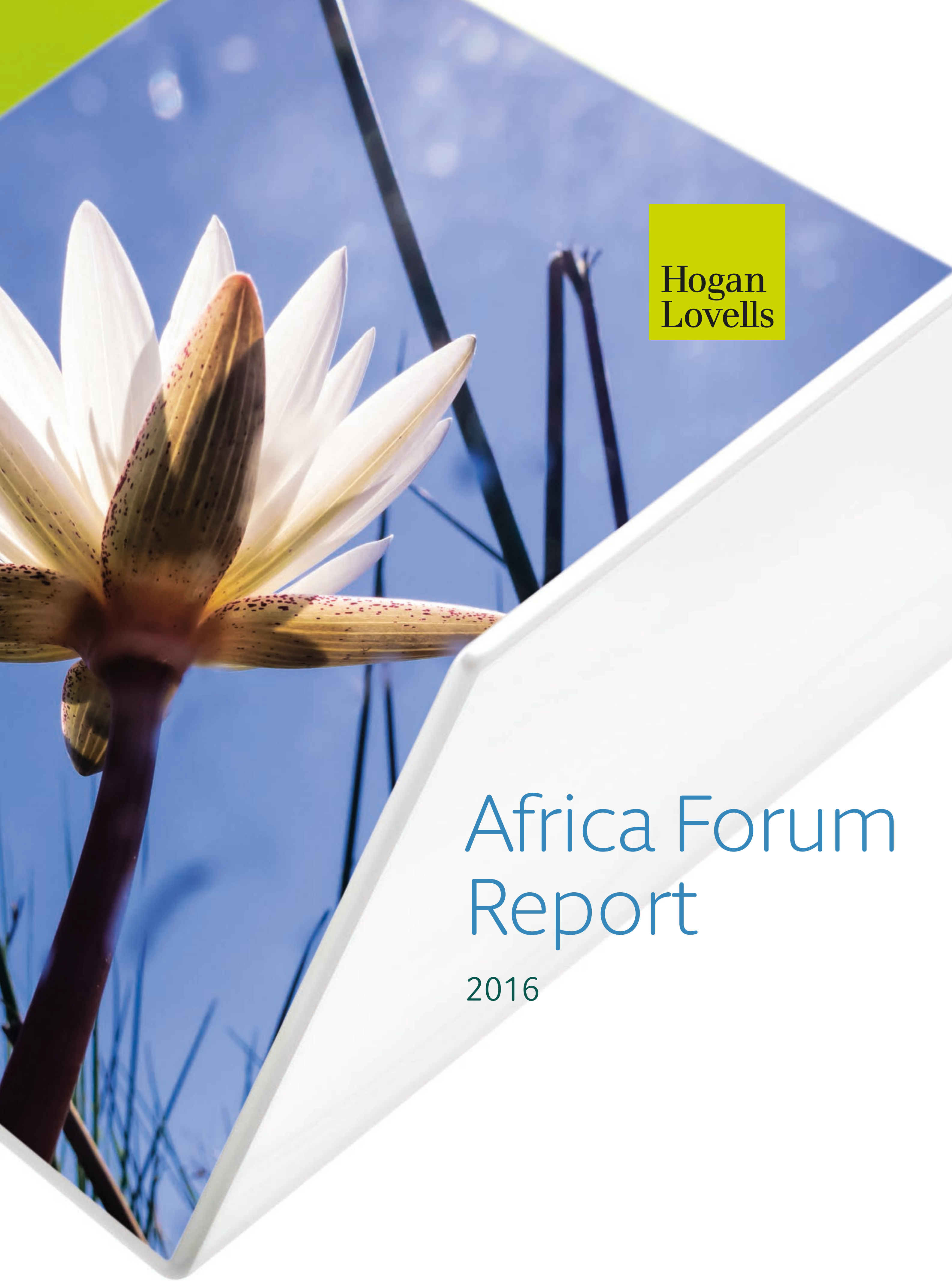

Hogan Lovells

# Africa Forum Report

2016

# Transforming African economies

As we know, falling commodity prices have hindered economic activity in sub-Saharan Africa, but they have also prompted governments in the region to reassess and reposition their economies. While there is still a long way to go, the investment landscape in Africa is improving.

Nicholas Cheffings, Chair of Hogan Lovells, expertly navigated a panel of key industry players including Franck Behiblo, Head of Corporate Development at Quantum Global; Olusola Lawson, Investment Director for West Africa at African Infrastructure Investment Managers (AIIM), a subsidiary of Old Mutual and Andrew Skipper, Head of Africa at Hogan Lovells.

"Africa is not what it used to be a few years ago," says Franck. "Working with governments remains a complex matter as each country is very specific and success requires in-depth assimilation of these local markets; but compared with 10-15 years ago there has been much improvement across Africa, with confidence and trust being built up."

The government sector plays an important part in creating confidence – by building the right framework and providing support, governments can create an environment that is attractive to investors not only within Africa but also from outside. "As an infrastructure investor, working in partnership with governments is central to everything we do," says Lawson. It is a developing story and there are encouraging signs of progress. An Economist Intelligence Unit survey of the top 15 economies in Africa showed that the top 10 all have public-private partnership [PPP] enabling legislation. Among the others, laws are going through parliaments and only two do not yet have a clear framework for PPP. "During the past six years," he adds, "there has been a significant push by governments across sub-Saharan Africa to set up enabling environments for investors. The creation of an enabling environment is very important for private equity investors; much more so than incentives," Lawson adds.

Franck adds that building trust is particularly important in doing business in Africa as we speak of long-term projects and potential to be realized through the development of Africa-specific solutions as opposed to the application of an investment framework that worked elsewhere.

Such are the opportunities in the region that Quantum Global remains very positive on the market despite the drop in commodities prices; it strongly believes there are gaps and inefficiencies that can be addressed. "There are many sectors we believe we can help to support, including infrastructure and agriculture. With the right environment and working in partnership with governments, we know we can bring in the right partners to Africa to support development in these sectors; co-investors and businesses that previously have been reluctant to enter the market."

## Growth markets

Infrastructure and agriculture are considered the two areas of greatest promise for investors in the region and, with oil prices remaining low, investors are attracted to alternative sectors such as these. But in order to get the most out of their investment, a number of issues must first be addressed. Andrew Skipper, Head of Africa at Hogan Lovells, says investors need three things: certainty, corruption to be dealt with and currency to be stabilised. While Nigeria has stabilised its currency, there are still issues in repatriating funds, he says. There are also challenges in some countries around the certainty of who owns land and how crop yields can be exported. "Often, breaking of contracts make it challenging for external investment in Africa", he says.

Lawson says infrastructure has the potential to play a significant role in boosting GDP in Africa. "Power represents around 40% of the cost of most businesses in Africa. Greater efficiencies in the power supply chain will drive GDP growth. Nigeria, with 180 million people and one of the largest countries in the world, generates less electricity than the city of Bradford. It generates 4 gigawatts of power; imagine what the country could do if it generated 30 gigawatts," he says.

Franck agrees on the importance of power generation to sub-Saharan Africa. "Without power, goods can't be transported, labs can't be built – progress can't be made. Power must be the number one priority for every African country," he says. The international entities are there to invest in power infrastructure funds, provided that favourable, enabling regulation and business environments exist," he adds. "If an investor can't get money out of a country, it will think twice about going into it. Power infrastructure projects are long-term and investors need certainty of the tax scenario, political regime and business laws. Many African countries rely on short-term funding, which is more expensive than long-term capital. Many investors, particularly from Asia, want to enter the African power market but the conditions are not always encouraging."

Lawson says AIIM has invested more than $1bn in African energy projects, with one of the largest being the renewables sector in South Africa. "There are risks to be mitigated in Africa, but our approach is not to sit on the side lines and hope for change. We actively figure out how currency and other risks can be mitigated – there are various ways this can be done. For example, power purchase agreements (PPAs) can be linked to the USD or to a basket of currencies. "The power market in Africa has never been hotter and returns in certain market segments (such as renewables) are being pushed to dangerously low levels. There is a strong demand from investors, but comparatively few well-structured projects and when one emerges, it the competition to get into it is very high," says Lawson.

## Investment vehicles

The main investment vehicles in the region are PPPs or joint ventures. Skipper says most clients with whom he works prefer joint ventures, sometimes because local content investment rules in some countries require such an approach. Again, the key to a joint venture is certainty and clear arrangements that are acceptable to all parties. "Coming from outside a country a joint venture makes sense because you really need to know local people," he says.

PPPs require government underwriting and the acceptance of responsibility. Skipper notes that some African governments viewed PPPs as a way of putting all of the risk of a project on to the private sector. "Governments need to understand risk allocation between the public and private sector and underpin that on a long-term basis," he says.

Lawson agrees, pointing out that PPP programmes that have been successful have involved input from high-quality sell side advisors on the government side. "Deals that are not well-structured will not gain international investment and are likely to fail," he adds.

"PPP deals are fairly complex and require a certain degree of expertise at country level to discuss what the ideal investment structure should be in light of the country's planned economic development in the long run" says Frank. "But I would ask are they practical for Africa? Locking a country into a deal for 20-30 years would assume such agreements stretch across various governments that should honor the commitments sealed by previous governments. Are we ready for that? PPPs are a good concept, but they have to be fair and equal for all sides."

## Disruption and innovation in African investment

One of the areas that could prove to be transformative for Africa is that of power generation. While investors may be focused on traditional, long-term infrastructure projects for power generation, there are interesting off-grid developments occurring in Africa.

"In Africa people need power, but there is a complex web of the value chain to navigate. Increasingly, people are trying to bypass that web and get power delivered directly, via rooftop solar, for example," says Lawson.

Franck agrees this is a "very exciting" area. "Whatever sector you choose, it needs power. In Africa, around 30% of post-harvest production is lost because there isn't the right storage capacity. If that 30% could be recouped, a community could fund a school or a small hospital. Having power delivered where people need it is very important and much of the investment here is focused on young entrepreneurs. The opportunities in agriculture will continue to grow as the world's population grows", he adds.

Encouraging pension funds in African countries to invest in infrastructure is also an area that has great potential, although in some cases it would require sensible changes in legislation with regards to pensions investment policies. At present, significant sums are locked in pension funds and are not put to use. While there is a risk of investing in projects, Franck points out that there is a bigger risk in doing nothing with the money.