Entry to Exit:
How a Toll Road Delivered Benefits for Investors, Society, and Infrastructure in Africa

preqin

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Contents

Infrastructure Takes Time to Build

Private partners can bring great value to infrastructure projects, as African Infrastructure Investment Managers has shown

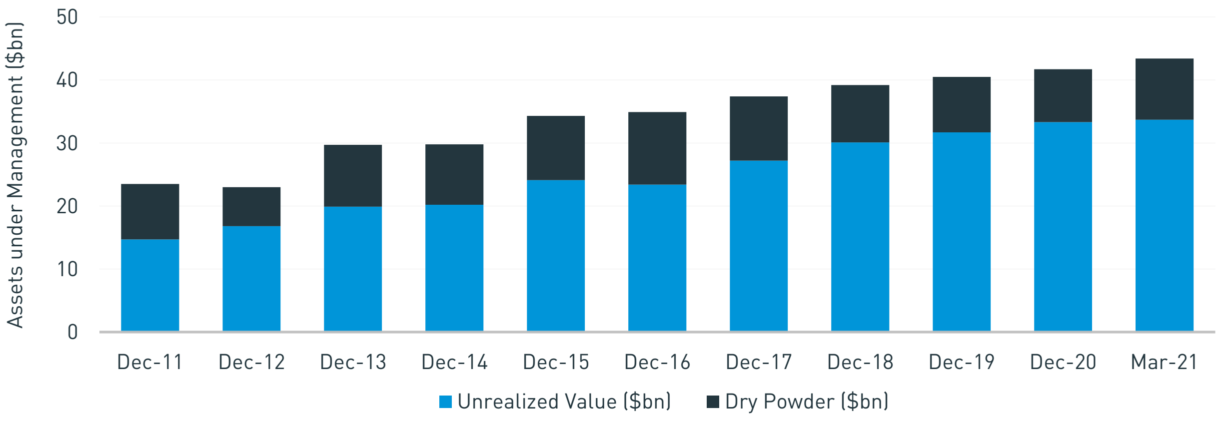
Infrastructure is essential. It's defined as the basic physical and organizational structures, and facilities needed for, the operation of a society or enterprise. The Global Infrastructure Hub, a G20 initiative, estimates it will take $94tn of infrastructure spending through 2040 to meet the world's development needs. There's a current funding shortfall of $15tn.[1]

Africa accounts for $6tn of this investment gap[2] – equivalent to 6.4% of global development needed – with a projected funding shortfall of $1.7tn, or 11.3% of global shortfall. This gap, between current and projected investment and investment needed, is one of the highest in the world. High levels of public debt constrain the ability of governments to finance infrastructure. Meanwhile, investor interest has been lukewarm and capital markets haven't been receptive to Africa-based projects, which has led to a reliance on debt finance, according to G20 Insights[3].

There has been a steady increase in private capital targeting infrastructure in Africa, but the market remains in its infancy. Africa-focused private infrastructure assets under management (AUM) have increased from $24bn at the end of 2011 to $44bn

[1] *https://outlook.gihub.org/region/World*
[2] *https://outlook.gihub.org/region/Africa*
[3] *https://www.g20-insights.org/policy_briefs/africas-infrastructure-finance/*

Fig. 1: Africa-Focused Unlisted Infrastructure Assets under Management



Source: Preqin Pro

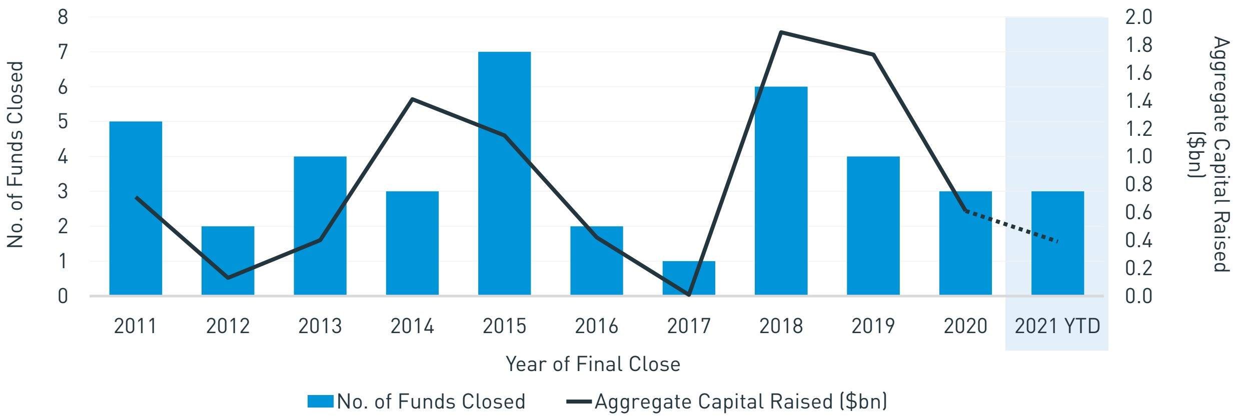
at the end of 2020 (Fig. 1). The compound annual growth rate of 6.4% is considerably lower than the 14.2% seen for infrastructure globally.

Unsurprisingly for such an emergent market, fundraising is lumpy when measured by vintage year. Preqin Pro has recorded between one and seven fund closes each year between 2011 and the present, with the aggregate value ranging from less than $100mn to $1.9bn (Fig. 2).

There is, however, a considerable opportunity for private investors. The relatively low penetration of private capital, scale of infrastructure needs, and constraints on public sector finance create an environment where private fund managers can be selective. The success of investments such as that of African Infrastructure Investment Managers (AIIM) in toll roads in South Africa (see page 6) shows that good financial returns can go hand-in-hand with socioeconomic benefits.

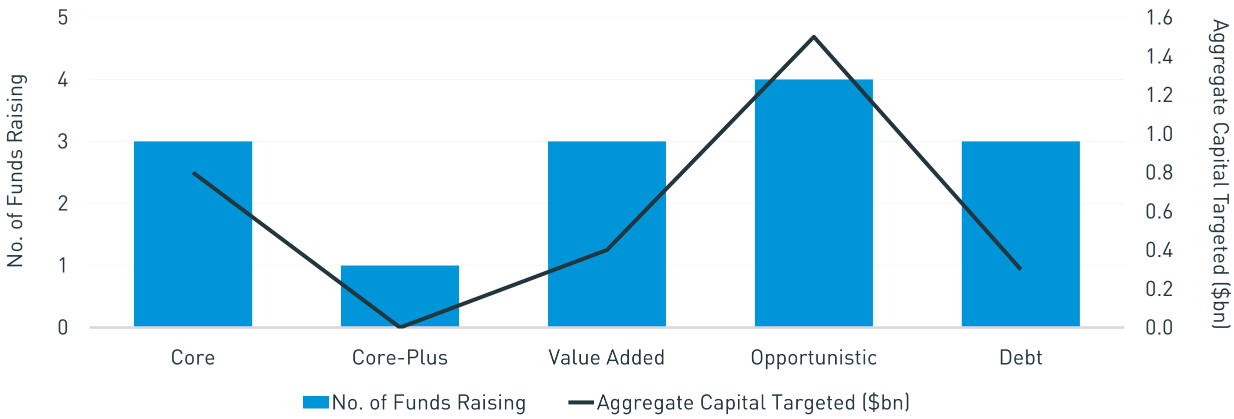
An increasing number of fund managers are looking to capitalize on this opportunity. Preqin is currently tracking 14 Africa-focused infrastructure funds in market, which are seeking to raise a combined $3.0bn (Fig. 3). Ed Stumpf, Investment Director at AIIM, says the projects show that "infrastructure has now become a highly investable asset class, not just in South Africa, but also more broadly in the region."

Fig. 2: Africa-Focused Unlisted Infrastructure Fundraising, 2011 - 2021 YTD



Source: Preqin Pro. Data as of October 2021

Fig. 3: Africa-Focused Unlisted Infrastructure Funds in Market by Strategy



Source: Preqin Pro. Data as of October 2021

Bakwena Shows How Infrastructure in South Africa Is Highly Investable

Private partners can bring great value to infrastructure projects, as African Infrastructure Investment Managers has shown

How do you measure the success of an infrastructure investment? In the past, at least for private infrastructure projects, the answer really depended on whom you asked. Institutional investors and fund managers prioritized financial returns, while commissioning authorities focused on delivery, and the economic and social benefits that flowed from a project. While the reality is that both metrics have always been important, the current focus on responsible investing means that for a project to be successful it must deliver on both fronts.

A series of toll road developments in South Africa by African Infrastructure Investment Managers (AIIM), a member of Old Mutual Alternative Investments, perfectly illustrate the value a private partner can bring to a project, and how careful consideration and focus on the needs of all stakeholder groups delivers on multiple fronts.

AIIM's story, which is not finished yet, begins a long time ago. At the turn of the millennium, the South African Government, in conjunction with regional roads agencies, developed a strategy for an East-West axis between Maputo in the East and Walvis Bay in the West, connecting South Africa with its neighbors and stimulating agriculture, manufacturing, and mining flows along the corridor, The government also launched a road privatization program, which included the concession of three strategic routes in South Africa:

- Trans Africa Concessions Company (TRAC) is a 570km highway under a 30-year concession with SANRAL and the Mozambican roads authority until 2028. The road links Gauteng to the port of Maputo in neighboring Mozambique.
- N3 Toll Concession (N3TC) is a 418km highway managed under a 30-year concession contract from the South African National Roads Agency (SANRAL) until 2029. The road connects South Africa's main port in Durban to its economic hub of Gauteng.
- Bakwena Platinum Concession Company (Bakwena) is a 385km highway under a 30-year concession with SANRAL until 2031. The road connects South Africa's capital of Pretoria to the border with Botswana, a key commodity and export route.

AIIM took control of a portfolio of toll road assets owned and operated by the South Africa Infrastructure Fund (SAIF) in a series of primary and secondary transactions. Ed Stumpf, Investment Director at AIIM, explains the attraction: "We built a lot of insight into the road sector through our existing investments in the three private toll roads in South Africa – TRAC, N3TC, and Bakwena – and were able to take advantage of proprietary opportunities in the market to increase the scale of our roads exposure through secondary acquisitions in these assets over a protracted period of time."

This strengthened the fund manager's conviction that the road infrastructure in Southern Africa was an attractive market segment. Chanine Williams, who's is responsible for optimizing and managing portfolio assets at AIIM, adds: "We like the road sector and the fact that it's a GDP-linked investment. Revenue growth is driven by inflation and traffic growth which is linked to GDP growth. What we tend to see is that with robust operational management, revenues can grow at a faster rate than operational expenditure over time, leading to improved EBITDA margins."

Bakwena: Breaking New Ground

The exposure to, and experience in, toll roads gave AIIM crucial insight into the sector ahead of a public tender process run by the SANRAL. On the table was a 30-year concession to upgrade and maintain existing roads on a 385km section of the N4 corridor, plus the construction of two new sections of road. The routes would include two toll sections: 90km on the N1 from Pretoria to Bela Bela, and 295km on the N4 between Pretoria and the Botswana border. The roads around Pretoria carry a high base level of commuter traffic, while the rural corridor was conceived to stimulate agriculture, manufacturing, mining, and tourism along the route.

AIIM was instrumental in building a consortium of reputable and experienced construction contractors, financial sponsors, and lenders. Bakwena entered into a 30-year concession with SANRAL in October 2000. The contract was to upgrade, maintain, and operate the roads, including 24/7 route patrols to assist incident scenes, routine road maintenance, the collection of tolls through 17 toll plazas, maintenance of roadside infrastructure and signage, vegetation management, and the upkeep of storm water drainage systems.

The Changing Nature of Risk and Return

Infrastructure projects have two principal areas of risk. First, there's predicting future demand which, while increasingly sophisticated, is still a relatively emergent area. Second is construction risk, which is extensive on any greenfield project. "These are both risks and opportunities," says Stumpf. "By coming in early and using our experience in road construction management, we were able to ensure on-time, on-budget performance. De-risking the assets over the course of their life supports the long-term value creation for our funds and feeds into the eventual exit once the assets have achieved a track record of mature operations."

As a long-term investor, AIIM was able to stay with the assets through their development cycle. "At the outset there was a wide range of investors, including construction companies, many of whom you would not expect to be strategic, long-term holders of this type of equity," says Stumpf. "Our funds are perfectly suited to this type of investment, as we look for long-term yield. Having experience in the sector, proprietary access, and the right type of capital are the key components of being able to access these opportunities."

The changing nature of risks, and impact of that on financing needs, is crucial to successful investment in road projects, as well as a potential source of value. With the initial construction phases completed, operations commenced in 2001. "This was hugely important because it meant there were measurable results, in the form of established traffic patterns, while construction risk had been managed and eliminated, or at least greatly reduced," explains Williams.

Financing in a Crisis

In 2006, AIIM took the lead role in arranging a refinancing, which having developed an operating track record for the road was possible on more favorable terms because of the changed nature of the risk profile. With construction-related risks having largely reduced or been eliminated, Bakwena achieving traffic volumes as planned, and data on usage patterns feeding into more accurate forecasts of future demand, the process for a refinancing was commenced.

The ZAR 3.7bn refinancing of Bakwena's debt, which was concluded in 2009 following the Global Financial Crisis and amid South Africa's first economic recession since the early 1990s, was the largest arranged for an infrastructure project in South Africa at the time and included a record-breaking inflation-linked tranche with interest payments linked to the South African Consumer Price Index (CPI). By aligning the debt with actual, post-construction cash flow forecasts of the roads over the remainder of the project term, the capital structure was strengthened with robust covenant coverage.

Further to this, through the accumulation of a controlling shareholding in Bakwena by way of secondary market acquisitions from construction consortium partners, AIIM was able to consolidate the Bakwena holdings through the creation of the South African Toll Road Company (SATRC) to hold its direct and indirect holdings in Bakwena. This was subsequently regeared, providing a holding company restructuring solution that generated a robust infrastructure investment return for its fund investors. The transaction resulted in the issuance of a ZAR 400mn preference share, and an accelerated distribution to SATRC shareholders.

There's More to Value than Capital

While capital and financial structuring are at the core of any private capital investor's offering, they aren't the only source of value a top-tier investor brings. In this case, AIIM also provided strategic input into the roll-out of electronic toll collection, ensuring faster processing of toll transactions and management of road capacity and capital expenditure. It has also helped Bakwena with its risk management approach, which supported the establishment of traffic control centers on behalf of SANRAL to monitor overloading, a serious issue that has negative consequences for road surfaces and accident rates. The success of the first control center on the N1 and R101 led to a contract to carry out the same function on the N4.

"Our experience in the sector means we were very well placed to create synergies in the businesses," says Stumpf. "This included the implementation of electronic toll systems at the roads and ensuring that consistent approaches were deployed across the roads, and the market in general. We were able to use our knowledge of maintenance capital expenditure and cross-fertilize the capabilities generated in one asset against other assets, to ensure effective operation and cost efficiency."

The project has had – and continues to have – a positive impact on the local communities. During the construction phase, Bakwena created more than 3,300 jobs, with a further 1,500 people employed in the continued operation of the roads, including at the toll operations, and routine maintenance contractors. Bakwena itself employs 108 people, 55% of whom are female and 82% of whom are Historically Disadvantaged South Africans (HDSA).

Furthermore, AIIM has been influential in appointing independent board members to the toll roads in its portfolio, enabling cross-pollination of skills, experience, and expertise. Investment impacts were considered at the outset of the project and integrated into the tender bid and concession contract. Williams says: "Socioeconomic development impact on communities was an important feature of the investment thesis and commitments were made at tender stage and captured in the concession agreement. Over the term of our investment, our assets have shown commitment to going beyond what was required by the contract terms in terms of socioeconomic development programs. Yes, there's a cost to looking at environmental, social, and governance (ESG) issues, but there's also value and it's important from a license-to-operate perspective, particularly in the current environment and for ensuring the sustainability of the project."

An Investment with a Legacy

In 2016, AIIM ran an international auction process for SAIF's interests in the three toll roads. The exit marked a transformative moment in the evolution of the infrastructure asset class in South Africa, with investors in SAIF being leaders in the establishment of the asset class and the exit representing the culmination of AIIM's efforts to deliver value for these investors, first through the restructuring of the portfolio, and subsequently through taking advantage of opportunities to build a world-class portfolio of toll road interests with first-class operations and governance.

The sale, which was ultimately pursued through a competitive sale process, attracted significant interest from local and international financial and strategic buyers based on the diversified nature of the assets and the size of the consolidated portfolio. The exit reached close in July 2016 in what we believe is the largest private toll road transaction concluded in Africa to date. While the final sale was to a consortium of principally South African investors, the substantial interest in the process demonstrated the considerable appetite of both local and international investors for mature operating infrastructure assets of scale in Africa.

AIIM's contribution to the success of the project beyond the capital it provided is recognized by Graeme Blewitt, former CEO of Bakwena. He says: "Our private equity partner plays a strategic role through its expertise and experience in the corporate and organizational structure of the concession, as well as in traffic engineering and toll road operations, project finance, hedging, procurement, risk management, corporate governance, and social responsibility."

Certain elements of the Bakwena project's legacy are immediately apparent. The roads can be seen and touched, while the salaries taken home by the many workers still employed – even after the construction phase – stimulate the local economies. Stumpf says that there's an additional legacy for investors: "The investors behind this project were pioneers in the establishment of the infrastructure sector in South Africa. They were the first major projects of their kind financed by private equity infrastructure capital, and I think the exits, especially with good return outcomes, were crucial to facilitate the further development of the infrastructure asset class which has now become a highly investable asset class, not just in South Africa, but also more broadly in the region."

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