KEYNOTE INTERVIEW

Why selectivity is key in a downturn

African dealflow has defied a global slump, but selecting investments in the right sectors and geographies remains imperative, says African Infrastructure Investment Managers' co-managing director Olusola Lawson

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Q Can you describe today's PE dealflow in Africa?
According to the African Private Equity and Venture Capital Association's *African Private Capital Activity Report 2022*, last year's deal volume was up 46 percent on 2021, in contrast to the dampened activity levels seen across much of the rest of the world. However, the macroeconomic backdrop in much of Africa remains challenging in the context of rising inflation, rising rates and deteriorating sovereign balance sheets. Notwithstanding these factors, we continue to see pockets of compelling value in the right sectors – those with strong secular tailwinds driving demand, and a focus on a handful of specific countries.

We have seen strong growth in the digital infrastructure space, having backed a pan-African build-to-suit towers platform in the Democratic Republic of the Congo last year. We continue to see consolidation within the South Africa fibre-to-the home sector, and the data centre space remains very active with interest from both strategics and financial investors.

The energy transition story is currently centred around liberalisation of the commercial and industrial markets in South Africa, resulting in what we believe to be one of the most compelling renewable energy stories in global emerging markets.

We have also seen several trades on cold chain logistics assets. Consolidation within the bulk logistics sector has been building pace, particularly within the critical minerals industry.

I would describe the current dealmaking environment as highly selective, with the right assets in the right countries offering compelling value propositions.

Q What types of opportunity are the most attractive?

We believe that the most compelling opportunities exist in spaces where underlying secular tailwinds driving demand are disconnected, to some extent, from broader macroeconomic cycles. When it comes to digital infrastructure, for example, smartphone penetration is driving growth in mobile data consumption. That is a trend that is likely to accelerate as whole ecosystems and enterprise workloads move online.

South Africa's energy transition is also extremely compelling to investors. South Africa is the continent's most industrialised country, yet over the past few years it has suffered from an acute shortage of generation capacity, and load-shedding has become the norm for the average citizen for the first time in its history. This is compounded by the fact that South Africa is a global top 10 carbon emitter on a per capita basis.

To meet current and future energy generation shortfalls, and coupled with the fact that much of the legacy coal fleet will need to be retired over the next decade, we believe that up to 50GW of renewable energy capacity will need to be built in the next 10 years.

The urgency surrounding the need to increase capacity, together with the imperative to decarbonise, is being supported by government policy. The combination of those factors has created what we believe to be a once-in-a-generation opportunity to deploy clean energy infrastructure into that market.

The African logistics space, meanwhile, is being supported by a trend towards mass urbanisation. According to a 2023 report by McKinsey & Company, the African population will become majority urban over the next two decades as more than 500 million people migrate to its cities. This phenomenon is throwing up some very interesting opportunities to provide essential services and solutions targeting the movement of both people and goods.

Within that theme, we believe there are interesting opportunities within the temperature-controlled logistics space. African Postharvest Losses Information System data shows that African countries lose more than 30 percent of their fresh fruits and vegetables due to inefficient post-harvest management, with a lack of storage infrastructure as a main cause. Finally, I would point to the opportunities that exist around critical minerals. A 2019 World Economic Forum report projected that $440 billion in cumulative investments will be required across the battery value chain by 2030 to create a reliable base of renewable energy. In order to create the necessary battery manufacturing capacity, a series of critical minerals are required, and Africa is endowed with quite a few of them. We therefore see a real opportunity to invest in logistics solutions for those mineral producers.

In short, we are deliberately selecting themes that are disconnected from what we feel is a challenging global macro economy – and Africa is no exception. In that environment, selectivity is paramount: specifically, selectivity around themes, assets and geographies.

Q How would you describe competitive dynamics in the region?

Of the six deals in our latest fund, five were proprietary transactions. We find that having local networks and a strategic origination approach continues to deliver off-the-run dealflow. We do, however, see strong competition for high-quality assets in tender situations. The nature of that competition varies by subsector; we see significant global strategic interest in data centres and in the renewables space, for example. Our orientation is to play in the mid-market space with a view to scale or aggregate assets to the point that they become attractive to those strategic buyers.

Q What are some of the key challenges that African investments can present?

Firstly, Africa is a highly diverse continent made up of 54 different countries and hundreds of different ethnicities and languages. This is not a homogenous investment landscape, which is why it is so important to have a selective approach from the perspective of theme, geography and asset class in order to mitigate risk.

Chief among those risks is foreign exchange risk, as local currency exposure tends to be quite volatile. We look to alleviate that risk by investing the majority of our capital in assets that have explicit hard currency protections, or in geographies where the underlying currencies have some kind of link to hard currency.

The second key risk involves government balance sheets that have been placed under pressure in the wake of the pandemic. We are seeing situations where governments are suffering deteriorating balance sheets, and dealing with the twin problems of the rising cost of debt and spiralling inflation.

These factors have led to a number of countries discussing restructurings with the International Monetary Fund. Again, risk mitigation comes down to discipline and selectivity. We choose to primarily work with private sector counterparties and, as such, currently have very little direct government exposure in our AIIF4 portfolio.

Q Which trends will shape the future of private markets investment in Africa?

We believe the most compelling way to invest in infrastructure and essential services in Africa involves a buy-and-build or growth capital strategy. We are also leaning into reduced government exposure and exposure to single-asset greenfield projects.

We are increasingly circumspect about taking decisions on early-stage development risk and are more interested in doing this within the construct of diversified platforms. We believe this is appropriate tactical positioning given the challenges presented by the current macroeconomic environment. ■