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Africa *Bulletin*

Gas-to-Power in Africa: An Overview of Opportunities and Challenges

Ask the Expert: Investment Flows from the Gulf Cooperation Council (GCC) to Africa

Adapting Effective Models: How Lessons Learned from the GCC Could Increase Foreign Investment Opportunities in Egypt

Maghreb Countries: Is the Global Slowdown an Opportunity for Transformation? Investment Trends in Algeria, Morocco and Tunisia

PRIVATE CREDIT/DEBT

Ask the Expert:

Macky O'Sullivan and Ebele Okeke discuss Dubai as the gateway to Africa and the outlook for private credit in Africa.

WE HAVE SEEN SIGNIFICANT INVESTMENT FLOWS FROM THE GULF COOPERATION COUNCIL (GCC) TO AFRICA, AND DUBAI IS OFTEN REFERRED TO AS A GATEWAY TO AFRICA. TO WHAT EXTENT IS THIS TRUE, AND IF SO, WHY DO YOU THINK THAT IS THE CASE?

There is no doubt that GCC-Africa investment flows are strong. In fact, I would argue that we are witnessing the revival of historic trading links similar to the ancient Silk Road. Middle Eastern investors have injected some US$100 billion into African infrastructure in the past decade. The United Arab Emirates (UAE), for example, was the second-largest investing country into Africa in 2016, with a capex of US$11 billion, a rise of 161% from 2015. Non-oil trade with Africa has risen steadily by more than 700% since 2002, according to the Dubai Chamber of Commerce & Industry.

When we talk to investors in the region, they see Sub-Saharan Africa (SSA) as a natural transition from the Middle East and North Africa region, which is increasingly saturated. They have questions, and they need support to identify and access the right opportunities. Creating the right fund products, including Sharia-compliant structures, with strong regulatory oversight is critical. We also see investors in Egypt and Morocco looking south for new growth opportunities. Equally, investors in South Africa want to diversify their portfolios and are more willing to invest northbound into Sub-Saharan Africa. The governments here have done a great job creating an environment where GCC-Africa trade can thrive.

Specifically, we see a lot of African companies that want to access the Saudi market or leverage the connectivity of the UAE (Emirates, Etihad, Flydubai, Ports and free zones) to accelerate their growth.

I think you will see a trend where GCC institutional investors and family offices increasingly target both direct and fund investments in specific industries such as agriculture, healthcare, education, fast-moving consumer goods, financial services and logistics.

There is room for a new global trade hub linking investors, particularly from Asia and Europe, into Africa. The trend towards more open markets is in stark contrast to the protectionist tendencies in the “developed” world. Indeed, I see no reason why we won’t see African companies listing on Nasdaq Dubai or any of the other exchanges in the region in a few years.

WHAT IS THE OUTLOOK FOR PRIVATE CREDIT/ DEBT IN AFRICA, AND WHERE ARE THE OPPORTUNITIES AND RISKS?

In recent years, private credit has become recognised as a strategic, mainstream asset class in international portfolios. Diversification via private credit strategies can help optimise the efficiency of investors’ portfolios. Its appeal centres around attractive risk-adjusted returns with a built-in liquidity premium and a cash yield. It is important to remember that unlike private equity, private credit returns are contractual, so the investor has more visibility over the timing and quantum of return repayments over the life of the investment. Again, unlike in private equity, there is less reliance on an “exit” to lock in returns.

If things go wrong, debt has priority over equity in order of claims, and with adequate monitoring and covenant protection, your downside risk can be limited. These contractual returns, combined with downside capital protection, can act as a capital buffer in adverse market environments. You also have less duration sensitivity than competing credit sub-asset classes, as loans are typically based on floating rates.

The private debt opportunity in Africa is exciting. At the core of this is a fundamental demand/supply credit

imbalance: a shortage of adequate finance to mid-market corporate and financial institutions. The small and medium-sized enterprises (SME) credit gap in Sub-Saharan Africa is estimated by the International Finance Corporation to be US$140 billion. The World Economic Forum has estimated that SMEs comprise 80% of the continent's employment. Empirical studies have shown that the relative size of the SME sector and a country's economic growth are positively correlated.

Private equity (PE) alone cannot fill this gap – in fact, I would argue that many African companies lack the maturity to take on significant PE or are reluctant to sell equity stakes. They know the potential of their business, and an early sale would be premature.

At Altica Partners, we believe the best opportunities lie in the middle market. We see many companies with ambitions to be the next MTN or Dangote Group, but they are profoundly constrained in their ability to access capital that generates private-sector growth and jobs. These companies, including many local financial institutions, find US dollar funding a challenge due to high costs of local borrowing and a range of barriers to accessing international capital. They also often lack the flexibility to provide the right tenors and structures for the mid-market.

This opportunity is augmented by Africa's structurally superior investment and growth prospects. Sub-Saharan Africa has consistently been the second-fastest-growing global region after developing Asia since 2000. A structural demographic dividend and a growing labour force underpin higher and sustained long-term demand for goods and services. By 2034, Africa will have a larger workforce than either China or India. Burgeoning consumer markets are driven by urbanisation, with the UN forecasting SSA's urbanisation rate to reach 46% by 2030, up from 36% in 2010.

WHAT COUNTRIES AND SECTORS OFFER THE MOST POTENTIAL?

Africa now stands out as a continent of transition and reform. We find it encouraging to see more leaders focused on developing and executing market-orientated policy. 2018 witnessed the establishment of the Single African Air Transport Market, which will enhance connectivity between nations. The formation of the Continental Free Trade Area, currently comprising 44 of the 55 African Union states, creates a market of 1.2 billion people, with a GDP of US$2.5 trillion, which will raise competitiveness and facilitate trade integration. Only 12% of Africa's trade is intra-regional (versus 40% for North America, 50% for Asia and 70% for Europe).

We employ a comprehensive sovereign framework when selecting our target countries. Right now, we are looking at deals in countries like Rwanda, Kenya, Botswana, Ethiopia and Senegal, which score favourably on various ease-of-doing-business metrics and low corruption perception indices. Indeed, they score more highly than mainstream emerging markets like China, India, Brazil and Indonesia. Equally, the demographic and economic giants like Nigeria simply cannot be ignored. Ghana and Tanzania are also current favourites. We continuously monitor economic and political events across the continent to protect our investors. A presidential election cycle can easily derail efforts or cause economic paralysis. An on-the-ground network is critical here.

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WHAT ARE THE MAIN BARRIERS TO ENTRY FOR INTERNATIONAL INVESTORS LOOKING TO DO DEALS IN AFRICA?

The continent is not without its challenges, including: infrastructure, power generation/distribution, financial market development/liberalisation, to name but a few. But the directionality is in stark contrast to protectionist tendencies in the developed world, as I mentioned earlier with the emergence of the free trade area.

Due diligence is critical when evaluating deals and potential partners. Once you are invested, intensive portfolio monitoring is important to ensure you safeguard your investments. Currency fluctuations, regulatory changes and commodity price volatility can have significant positive and negative effects on your investments. Selecting an investment manager who understands local nuances and can execute risk management techniques can go a long way.

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Macky O'Sullivan is a senior associate at King & Spalding. He has extensive experience advising asset managers, multilaterals and sovereign wealth funds in connection with their fund formation, capital raising and co-investment activities across the GCC and Africa. He has worked in the United Kingdom's House of Lords for Rt Hon Baroness Scotland of Asthal QC (Secretary-General of the Commonwealth and former UK Attorney General), where he advised on UK-to-Africa trade relations and foreign direct investment issues. He has been recognised by *Who's Who Legal* as a leading private funds lawyer.

Ebele Okeke Ebele Okeke is managing partner of Altica Partners. He joined Altica as a Managing Director in 2016 and has 18 years' experience across developed and emerging markets including over a decade structuring and deploying financial products across Sub-Saharan Africa. Prior to Altica Partners, Ebele was Head of Middle East & Africa Commodities & Sub-Saharan Africa Cross Asset Origination within the Investment Banking division of Credit Suisse. From 2010-2013, Ebele was Executive Director, Africa at Goldman Sachs within the Fixed Income, Currencies & Commodities division in London and Dubai, where he was responsible for corporates, financial institutions and sovereigns. Ebele holds an MBA from London Business School.