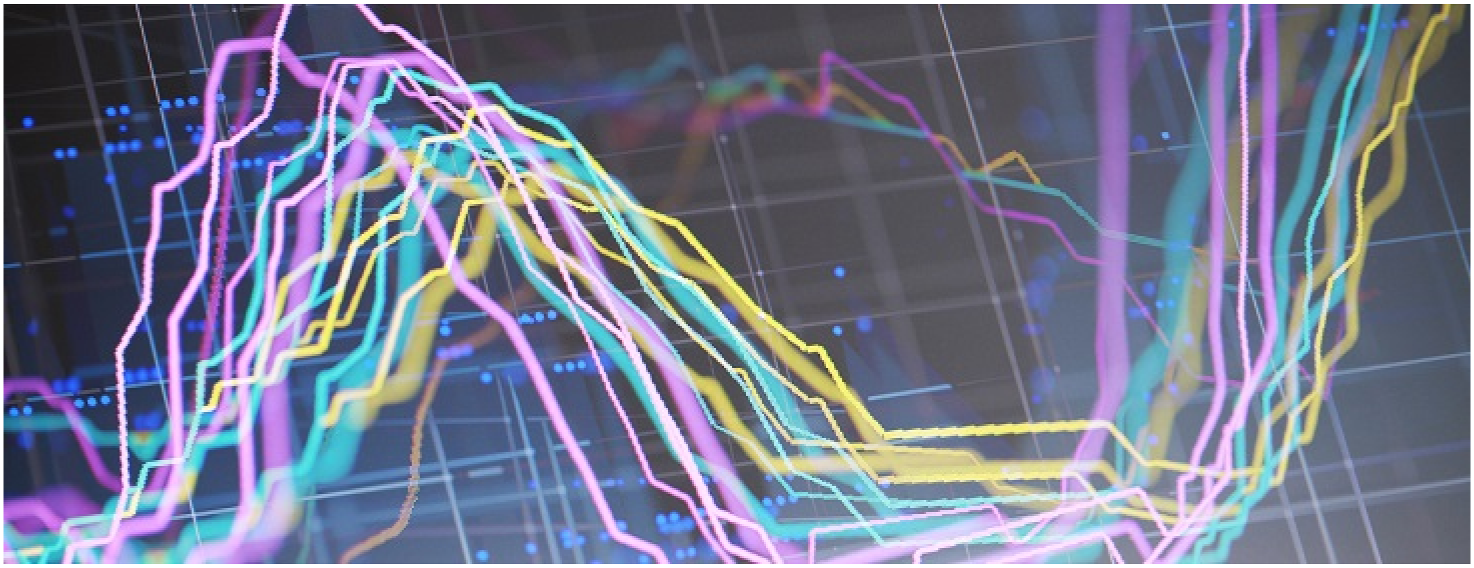
The drivers of investment in Africa post Covid-19

Published 24/11/2020 on africanlawbusiness.com - African Law & Business



Weyinmi Popo, private equity partner at Akin Gump Strauss Hauer & Feld in London, considers the challenges and opportunities for private equity investment across Africa after the pandemic.

It is not an understatement to say that the Covid-19 pandemic has upended the world in 2020. A health crisis has quickly morphed into one of the largest economic crises the world has seen this century.

Initially, it was feared that Africa would be badly affected by the pandemic given its relatively underdeveloped health infrastructure and the large numbers of people that live closely together in Africa's largest cities. So far, thankfully, Africa has been spared the worst of the crisis as the numbers of people who have died or been hospitalised by the disease across the continent has been considerably smaller than the numbers in Europe and the Americas.

However, Africa has not been spared the worst of the slowly unfolding adverse economic impact of the pandemic. As is the norm in emerging markets during financial crises, shorter term international investors have sought safe havens for their capital and repatriated capital from Africa back to more developed and 'safer havens' in industrialised nations.

Coupled with a drop in demand for Africa's key exports (for example fossil fuels, copper and tourism) and a drastic reduction in domestic demand due to lockdowns and reduced domestic economic activity, Africa's economies and currencies have been hit very hard.

It is clear that there is a real risk of the pandemic resulting in sovereign debt crises for many African nations (and indeed companies) that have borrowed heavily in United States dollars as their ability to service and repay these debts has been – and continues to be – impaired by slow economic growth. Witness Zambia's recent request to suspend interest payments on its US dollar bonds.

WHAT DOES THIS MEAN FOR PRIVATE EQUITY IN AFRICA?

The immediate and short term consideration for private equity funds in Africa (and elsewhere) was to assess the impact of the pandemic on their existing portfolio companies and to take steps to stabilise those companies and make sure that they had sufficient liquidity to survive the short to medium term impacts of the crisis. Funds with portfolio companies focused on non-essential retail, hospitality and leisure and travel will have had major adverse liquidity effects, and have been the most exposed.

In the medium and long term, private equity investors in Africa will likely look beyond the pandemic to diversify their investment targets in search of businesses that will be more resilient to the post-Covid economy.

One of the biggest issues that private equity investors have faced in Africa, which has been exacerbated by the pandemic, is the decline in the major African currencies relative to the US dollar. Given that most funds are raised in US dollars, invest in dollars and need to return capital to their investors in dollars, a decline in local currencies often always translates to a decline in portfolio performance.

In the short term, local currency declines could see more attractive valuations for companies that had hitherto been viewed as overvalued by private equity investors, and may lead to opportunistic investments.

However, in the medium to long term, investors will likely look to businesses that have reduced domestic currency exposure or US dollar earning potential such as export driven businesses or businesses that earn in dollars or other foreign currency. The West African Monetary Union region, for example, might well also become more attractive to investors given the CFA franc peg to the euro, covering as it does 14 West and Central African nations.

Businesses that are technology driven or enabled, such as those focused on financial payments and processing, data centres and telecoms infrastructure, will also likely see increased investor interest. Other areas likely to see increased investment are likely to be transport and delivery logistics businesses, agriculture and health infrastructure.

Demand for financial services and insurance is less likely to be adversely affected by the pandemic in the long term and should continue to see steady investment from private equity. One African export that has quietly grown in importance and stature is media, entertainment and culture. Film (for example Nollywood) and music (such as Afrobeats) are some of the continent's largest cultural exports and have huge dollar earning potential. **Netflix** has recently invested in creating African content. With the rise in internet penetration, the earning potential for this sector will grow. Private equity has so far been cautious about investing in this sector but I expect to see more interest as the sector grows in economic importance.

The currency volatility issue might also see private equity investors look to hold onto investments for longer to smooth out returns adversely affected by short term currency drops. Permanent capital vehicles have been talked about for a long time in African investment circles as a solution to this issue – and there will likely be a rise in the number of permanent capital vehicles investing in African private equity. Some of these might have a local currency component or look to attract local currency investors via listings on local African stock exchanges.

Another medium term development that is likely to have a positive effect on African private equity is the implementation of the African Continental Free Trade Area. In summary, this would see the creation of a single economic market for goods and services across the entire African continent, similar to that seen in the European Union. The ability to trade tariff free and unimpeded across the continent provides an opportunity to create genuine pan-African businesses with a broad continental footprint. Private equity investors in Africa have often been constrained by the lack of scaleable businesses in which to invest given the limits imposed by national borders. The ability to sell goods tariff free to 1.2 billion people rather than tens of millions in a single country will be a massive boost to foreign direct investment in Africa, including private equity.

CONCLUSION

The pandemic has no doubt created short term adverse impacts for African private equity investment. However, it will likely be a catalyst for further changes in the African private equity investment landscape that were underway prior to Covid-19. The rise in technology adaptation and the dynamic youth of a continent with an average age of 19 and a growing population, will inevitably drive long term economic growth that private equity investors will find attractive. They might just have to adapt to fully reap the benefits of these new opportunities.

Weyinmi Popo is a partner in the London private equity practice of Akin Gump Strauss Hauer & Feld. He advises various Africa-focused private equity sponsors, strategic investors and family offices on complex cross-border investments.