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Africa Focus

Financing Africa:
Challenges and opportunities

Contents

Financing Africa: Challenges and opportunities

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We are pleased to introduce the second edition of *Africa Focus*. The feedback we received for our inaugural edition from clients and friends whose work involves the African continent has been fantastic, and it inspired us to explore new ideas in our second edition. Although our first edition focused on funding Africa's infrastructure deficit, the second edition broadens the scope to consider a number of different challenges and opportunities in financings across Africa.

On the eve of Mining Indaba, we provide a summary of White & Case's annual mining survey in the article "Outlook for mining in Africa," including questions on the risk/reward assessment with respect to the potential nationalization of mining resources across the continent. In the article "The IMF in sub-Saharan Africa," we examine the historical role of the IMF in sub-Saharan Africa and analyze the impact of IMF program participation on sovereign bonds issued by African countries. In light of the long history between China and Africa, we investigate the impact of Chinese investment and trade, discuss recent trends and contemplate the future of this interesting and complex relationship in "'Belt and Road'" in Africa". Following our inaugural edition's analysis of opportunities for private equity investment in African infrastructure, the article "Exiting African PE investments" in this edition reviews exit strategies for private equity investors. In "Storm clouds or clearer skies for African airlines?" we identify growth opportunities and challenges for African airlines. Reminding African sovereigns of their commitments in the Paris Agreement, we make a case for going green in "Green finance in Africa." Finally, "Angola and Mozambique: Oil & gas and mining" examines the challenges that Angola and Mozambique will face if they consolidate their positions in the oil & gas and mining sectors while discussing how investors can use existing legal frameworks in those countries to mitigate legal risk.

As we continue our journey to explore new opportunities in Africa and understand the challenges that accompany those opportunities, we hope you enjoy our second edition of *Africa Focus*. To help *Africa Focus* continue to grow and become a regular fixture for those looking for African content, we welcome any feedback you may have on this edition.

> **"Although our first edition focused on funding Africa's infrastructure deficit, the second edition broadens the scope to consider a number of different challenges and opportunities in financings across Africa.**

Architectural detail of Menara Airport in Marrakech, Morocco.

Outlook for mining in Africa

Demand for commodities is strengthening, but challenges persist

By Rebecca Campbell and John Tivey

Resource-rich Africa has long been targeted by international investors and perhaps no more so than today. New technologies linked to the development of electric vehicles and rechargeable batteries have increasingly turned the spotlight on metals such as cobalt and copper, mined in a number of African countries.

Given that Africa is also a major producer of gold, diamonds, bauxite and platinum, the continent holds a preeminent position in the global resources industry. And as 2017 saw a strong rebound in the price of most metals, many African governments received more in taxes and royalties to help spur economic growth.

The resources sector around the world benefited from robust global GDP, as well as strong demand for minerals related to new technologies. It has been a year that has seen significant price recovery, almost across the board.

A big story has been cobalt, with the price up an astonishing 100 percent on the year. Cobalt is used in lithium-ion batteries that power EVs—and about 60 percent of global output is from the Democratic Republic of the Congo (DRC). Analysts at UBS have forecast that cobalt demand will double by 2020 to approximately 200,000 tons a year; new projects are required over the longer term to avoid a deficit.

Copper, too, is linked to electric vehicles and renewable energy—not to mention global growth. Enough copper goes into electric vehicles and their charging units that it could lift demand by a quarter in the years ahead, according to analysts at Bernstein Research. Again, this is good news for African producers of copper, which includes DRC, Zambia, Botswana and South Africa.

Goldman Sachs, previously a copper bear, has said the metal's bull run in 2017 (prices are up about 25 percent) to more than US$7,000 a ton in October was grounded in fundamentals and not speculation. The bank has forecast a 130,000-ton copper market deficit in 2018.[1]

Q: How much of a problem is resource nationalism in Africa today?

12.90%	41.94%	45.16%
Potential returns often outweigh the risks	Manageable, no worse than in recent past	Heightened risk means difficult to justify investment

Source: White & Case annual mining survey

Miners are keenly searching for new sources of copper and cobalt in minerals-rich DRC.

Additionally, Africa accounts for more than 20 percent of global gold output, and London-listed Randgold is a key player with operations in Senegal, Mali, DRC and Côte d'Ivoire. Its shares were up 16 percent in 2017, against a gold price rise of 10 percent.

And while we are not in the grips of another commodities super-cycle, fueled by a Chinese boom of the kind we saw up until 2012, the prospects for 2018 are promising.

Mining in Africa is not without its challenges, though. The DRC is a case in point. A humanitarian crisis brought about by civil unrest and political instability means there is significant country risk. A new mining code is on the horizon that aims to bring in more taxes, and this has alarmed mining groups.

South Africa has faced uncertainty brought about by a new mining charter that hit dividends and saw the market capitalization of SA-listed entities drop to June 2015 levels. But improved prices brought the SA industry back into profitability, showing the first substantial increase in revenue—ZAR 43 billion—in more than five years.

200,000

Analysts at UBS have forecast that cobalt demand will double by 2020 to approximately 200,000 tons a year.

UBS

In White & Case's annual mining survey, about 45.1 percent of respondents said that heightened risk of resource nationalism across Africa made it difficult to justify investment, but nearly 42 percent said the risk was manageable and no worse than in the recent past. And almost 13 percent believed the potential returns outweighed the risks.

A related question about the biggest challenge in Africa highlighted country/political risk, i.e., the possibility of government interference. About 64.5 percent of respondents named it as the chief obstacle. By contrast, the problem of inadequate infrastructure was only mentioned by almost 10 percent of respondents.

Congolese workers stand beside bags of a mixture of cobalt and copper at the Société pour le traitement du terril de Lubumbashi processing plant.


GTL
GTL
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GTL

Q: What is Africa's biggest challenge in terms of unlocking its resources?

64.52%
Country/political risk (government interference)

22.58%
Country/legal risk (doubts about sanctity of contracts, etc.)

9.68%
Infrastructure

Source: White & Case annual mining survey

Q: What macro events do you think would aid Africa's minerals development?

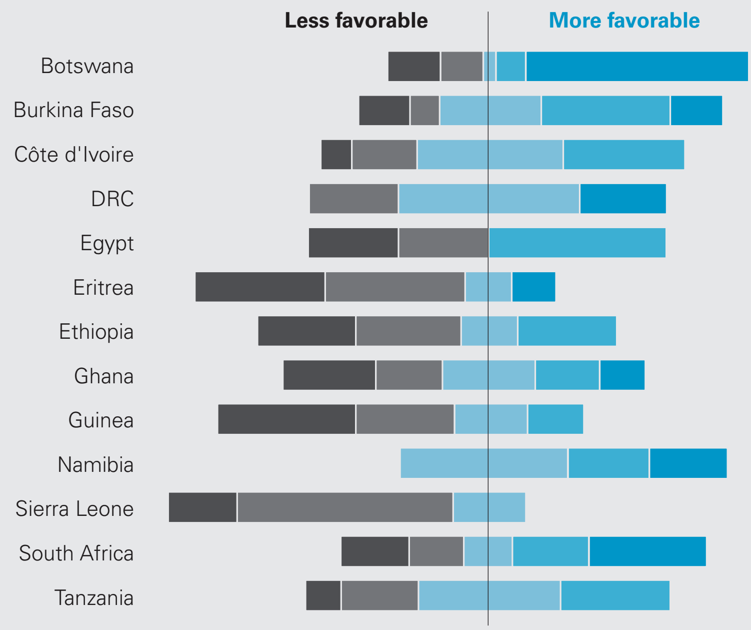
61.29%
Accelerating economic development in Africa

19.35%
Growth of pan-African institutions

12.90%
Electrification of transport/ Green energy

Source: White & Case annual mining survey

Q: Which African jurisdictions do you think are most favorable for Western business?



Source: White & Case annual mining survey

In a year that saw Acacia Mining in conflict with the government of Tanzania over disputed tax payments, such a reaction is not surprising. Barrick—Acacia's largest shareholder—agreed to cede 16 percent of Acacia's three gold mines in Tanzania to the government and pay US$300 million toward resolving a row that ultimately saw the resignation of Acacia's CEO Brad Gordon and finance director Andrew Wray.

A not dissimilar dispute blew up in Zambia in 2015 when the government announced a steep increase in royalties for both deep and open pit mining, but eventually backpedaled after warnings of mine closures and thousands of job losses.

According to White & Case's survey, accelerating economic development in Africa is key to unlocking Africa's potential for minerals development in the future. The IMF, incidentally, still forecasts that Africa will be the second-fastest growing region in the world between 2016 and 2020, with annual growth of 4.3 percent.

The respondents were also asked about African jurisdictions they considered most favorable for Western business. Botswana, Egypt, South Africa, Namibia and Ghana all scored highly. Countries scoring poorly included Eritrea, Sierra Leone, Ethiopia and Guinea.

Impediments to business still need to be removed, according to the World Bank's Ease of Doing Business report in 2016. This showed only seven African states were placed in the top half of the ranking: Botswana, Mauritius, Morocco, Rwanda, Seychelles, South Africa and Tunisia.

Looking to 2018, miners will be privately hoping that cobalt prices do not go too much higher for fear of killing off electric vehicle demand. Carmakers have said they are shifting to higher nickel batteries that use less cobalt over the next decade. The tightness in the cobalt market today is accelerating the search efforts to find a substitute.

Mining companies saw their share of challenges in their Africa operations in 2017. Rio Tinto suspended one senior executive and accepted the resignation of a second in 2017 after discovering US$10.5 million in unexplained

An employee holds a pile of copper concentrate at a refinery and smelter.


© Bloomberg Creative Photos

payments to a consultant in Guinea. The company also faces fraud allegations over coal assets it once owned in Mozambique.

As the switch to growth gains momentum, M&A activity improved in 2017, with some signs of a shift from largely divestment-led drivers to strategic-led deals focused on growth. China Molybdenum, for instance, secured a 56 percent stake in Tenke Fungurume Mining, one of the world's largest known copper and cobalt resources in Katanga Province, DRC for US$2.65 billion.

The appetite to raise more capital in the sector is expected to grow. While issuing more equity will remain an attractive option, increasingly, industry participants will also consider the efficiency of their overall capital structure.

The bias toward equity funding, which is more expensive than debt, is increasing the sector's weighted average cost of capital. The focus on lowering financial risk will ease going forward, with activity in debt markets picking up once again.

Citigroup said in December that stronger global GDP and the rising oil price had helped drive the amount of money invested in commodities to the highest in more than four years.

Goldman Sachs is also bullish on the overall sector heading into 2018 despite "significant divergences" in its views on metals: "The difference lies in the supply dynamics…while copper supply is likely to become increasingly constrained over the coming years, aluminum supply should become more abundant."

4.3%

Amount of annual growth forecasted for Africa between 2016 and 2020.

IMF

"A positive carry in key commodity markets and already strong global demand growth across the commodity complex reinforces the case for owning commodities, and hence we maintain our 12-month overweight recommendation, now with a forecasted return of almost 10 percent," the bank said in a client note.[2] That would help producers everywhere, not least of all in Africa.

The data quoted in this article is from a December 2017 – January 2018 White & Case survey of 40 senior decision-makers in the mining market.

1. "Rally in copper prices justified by global growth, lower supplies—Goldman," *Financial Times*, October 24, 2017
2. "Goldman bullish on commodities into 2018," *Financial Times*, December 12, 2017

The IMF in sub-Saharan Africa

Evolution and impact on sovereign bond markets

By Melissa Butler, Paul Gallup and Adrien Dumoulin-Smith

For decades, the International Monetary Fund (IMF) has played an important, if at times controversial, role in the economies of sub-Saharan Africa. Its mandate has evolved over the years from a principal focus on ensuring monetary stability and mitigating the effects of liquidity crises toward promotion of long-term macro-economic development and "social" goals. Given its increasingly interventionist approach, the IMF has necessarily played an important role in the development of sovereign debt capital markets in sub-Saharan Africa.

THE IMF'S OBJECTIVES, ROLE AND MANDATE IN SUB-SAHARAN AFRICA

Founded in 1944, the IMF's primary purpose from the outset has been to ensure the stability of the international monetary system. Beginning in the 1970s, the IMF's imposition of strict fiscal and economic conditionality in response to monetary crises such as the 1973 oil shock was met with criticism over what some viewed as the IMF's intrusion into the fiscal and economic affairs of developing economies. Certain commentators blamed the austerity measures required by the IMF for increasing, rather than alleviating, poverty in poorer countries in Africa and beyond. Since the 1980s, the IMF has evolved beyond its original focus on short-term monetary stability and fiscal prudence, emerging into a broader development-focused organization with objectives that occasionally overlap with those of the World Bank and other development-focused international financial institutions. The IMF's mandate was updated further in 2012, largely in response to the vulnerabilities exposed by the 2008/09 financial crisis, to include all macro-economic and financial sector issues that have a bearing on global financial stability.

In the late 1990s, as part of its increased emphasis on "social" goals as a primary component of its mission, the IMF renamed the Enhanced Structural Adjustment Facility, one of its key programs targeted at low-income countries, as the Poverty Reduction and Growth Facility (known since 2010 as the Poverty Reduction and Growth Trust (PRGT)). This was done to emphasize social objectives, specifically economic growth and poverty reduction, rather than short-term fiscal and monetary objectives. Much of the IMF's involvement in sub-Saharan Africa is now conducted through the PRGT (Figure 1).

Today, the three key pillars of the IMF's work are surveillance, technical assistance and lending through the organization's various programs, described below. Additionally, in 1996, the IMF and the World Bank jointly launched the Heavily Indebted Poor Countries (HIPC) Initiative, aimed at addressing the pressing need for debt relief among certain developing countries burdened by unsustainable debt levels. The HIPC Initiative has compelled the international financial community, including multilateral organizations and governments, to work together to reduce to sustainable levels the external debt burdens of the most heavily indebted poor countries. Thirty of the 36 HIPC debt reduction packages approved to date are in Africa.

IMF PROGRAMS IN SUB-SAHARAN AFRICA

The IMF implements various types of programs in sub-Saharan Africa designed to achieve its goals of monetary stability, poverty reduction, economic growth and overall macro-economic and financial health. There are currently 19 IMF programs underway in sub-Saharan Africa, the vast majority of which (more than 80 percent) are medium-term programs at concessionary rates under the IMF's PRGT (Figure 2).

INTERNATIONAL MONETARY FUND

Original aims:

- Promote international monetary cooperation
- Facilitate the expansion and balanced growth of international trade
- Promote exchange stability
- Assist in the establishment of a multilateral system of payments
- Make resources available (with adequate safeguards) to members experiencing balance of payments difficulties

Today the IMF has three core work pillars:

- Loans to members to head off balance of payments and financial crises
- Surveying and monitoring of member economies
- Capacity development (technical assistance)

Source: IMF

> **"The IMF has evolved beyond its narrow focus on short-term monetary stability, emerging into a broader development-focused organization.**

Woman gathering roses in a greenhouse in Kenya.

Figure 1: IMF Chronology

PROGRAM DEVELOPMENT

Early 80s — **IMF Trust Fund** was established to provide lending to developing countries at concessionary rates to address balance of payments problems on a longer time horizon

1987-1999 — **Enhanced Structural Adjustment Facility (ESAF)** was introduced specifically to provide resources to low-income members undertaking strong three-year macro-economic and structural programs to improve their balance of payments and foster growth. Main instruments supported indebted poor countries

1998 — ESAF, renamed as **Poverty Reduction and Growth Facility (PRGF)** (known since 2010 as the the Poverty Reduction adn Growth Trust (PRGT)), brought in social elements such as durable growth and poverty reduction, with less emphasis on loan conditionality and short-term stabilization

1999 — **Heavily Indebted Poor Countries (HIPC)** Initiative. In 1998, Uganda became the first country to receive debt relief under HIPC

2003 — **Exogenous Shocks Facility (ESF)** was introduced as part of PRGF aimed at supporting countries following shocks such as commodity cycle crashes or natural disasters

2005 — IMF partnered with the World Bank to pursue millennium development goals

2000s — PRGF/PRGT programs, and the vast majority of IMF lending in Africa, consists of **Extended Credit Facility (ECF)** loans

Poverty Reduction and Growth Trust (PRGT)

Extended Credit Facility (ECF)	**Standby Credit Facility (SCF)**	**Rapid Credit Facility (RCF)**
medium-term support	short-term/ precautionary support	emergency support

Source: IMF Chronology available at: www.imf.org/external/np/exr/chron/chron.asp

- **Extended Credit Facilities (ECF)**: The most widely implemented program in Africa, the ECF, is the IMF's main tool for medium-term support to low-income countries facing protracted balance of payments problems. The ECF was created under the PRGT as part of reforms undertaken by the IMF to make financial support more flexible and better tailored to the diverse needs of low-income countries. ECF financing, which is extended on concessional terms, is currently interest-free, with a grace period of five-and-a-half years and a final maturity of ten years. ECF loans are accompanied by, among other things, quantitative conditions and targets used to monitor macro-economic policy, structural benchmarks that help monitor macro-critical reforms to achieve program goals, and regular program reviews by the IMF's Executive Board to assess performance under the program.
- **Extended Fund Facilities:** Like the ECF, the Extended Fund Facility (EFF) is a medium-term support instrument for countries facing protracted balance of payments problems. It is not targeted at low-income countries and, accordingly, the financing terms offered are less concessional than under an ECF. The interest charge under an EFF is typically a spread above the IMF's cost of funding. Also, like ECFs, EFFs are designed to address structural weaknesses and include commitments by the sovereign borrower to implement agreed policies and comply with fiscal and other metrics under a program of periodic monitoring by the IMF Executive Board.
- **Stand-By Arrangements:** The IMF's "workhorse" lending instrument since its creation in 1952, the Stand-By Arrangement (SBA), which was upgraded in 2009 to be more flexible and responsive to member countries' needs, has historically been the typical form of IMF assistance for both emerging and advanced economies to meet short-term or potential balance of payments problems. In Africa, only Kenya currently benefits from an active SBA agreement.
- **Standby Credit Facility:** The Standby Credit Facility (SCF) is similar to the SBA, but is targeted at low-income countries with short-term balance of payments needs and is interest-free. Like the ECF, the SCF is part of the PRGT and is subject to its policies.

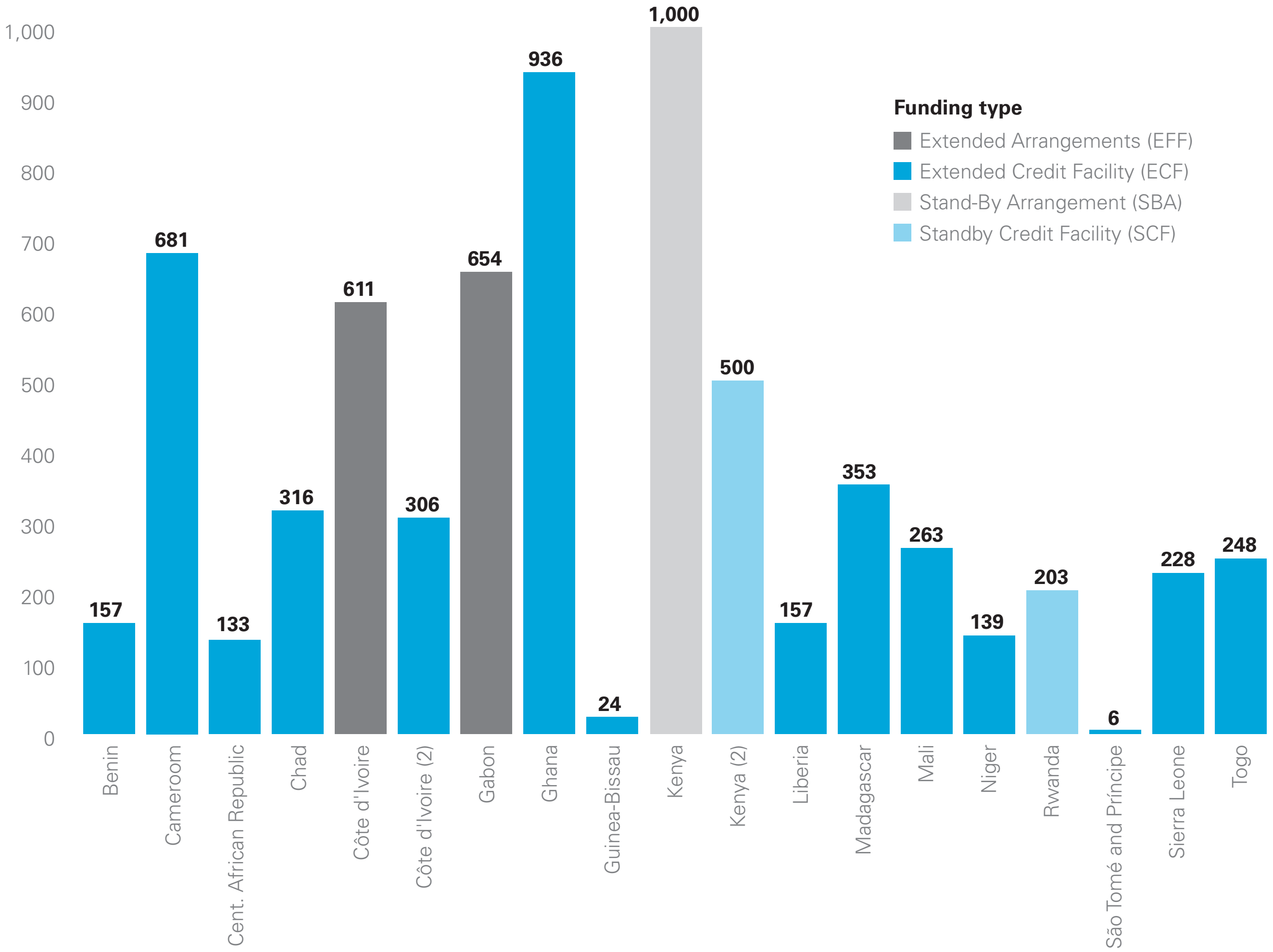
The IMF also offers Flexible Credit Lines (FCLs), Precautionary and Liquidity Lines (PLLs) and Rapid Credit Facilities (RCFs) to countries experiencing crises or in urgent need of more flexible loans. However, none of these programs have been implemented in sub-Saharan Africa to date.

HISTORICAL ROLE OF IMF IN SUB-SAHARAN AFRICA

The format and application of the IMF's programs in sub-Saharan Africa have developed over time to meet changing needs. Over the past half-century, the IMF's influence in sub-Saharan Africa has been impacted by two chief factors: the IMF's policy evolution toward broader social and macro-economic goals; and the economic performance of sub-Saharan Africa. Given that the needs of developing countries have evolved considerably in the decades since the IMF first began offering them financial assistance, in recent years the IMF has had to re-evaluate and modernize its approach to the challenges faced by these countries when fashioning programs for them. As part of this development, IMF programs have shifted from an emphasis on large loans to address short-term balance of payments crises toward an emphasis on longer-term loans to promote development of stable monetary and macro-economic structures. The current prevalence of PRGT programs in sub-Saharan Africa is the culmination of almost four decades of program evolution, from the IMF Trust Fund in the early 1980s to the more recent emergence of ECF loans as the principal instrument of IMF policy in the region.

As would be expected, the IMF's role as "lender of last resort" to sovereigns in times of crisis means that the IMF is more active during periods of economic uncertainty and less active during periods of relative stability. For example, while newly independent African countries broadly enjoyed rapid economic progress

Figure 2: IMF loans by total agreed value
(US$ million)



Source: IMF—Lending arrangements as of 18 Oct 2017. Available at: www.imf.org/external/np/fin/tad/extarr11.aspx?memberKey1=ZZZZ&date1key=2020-02-28

in the 1960s without substantial IMF involvement, the 1973 oil crisis prompted the IMF to step in to help sovereigns across the sub-Saharan region address their consequential balance of payments problems.

Programs agreed by the IMF with sub-Saharan sovereigns in the wake of the 1973 oil crisis introduced the concept of loan conditionality, which served to expand the IMF's influence in the realm of fiscal and economic policy. IMF conditionality has since influenced not only sovereign behavior, but investor sentiment. As a study of IMF programs from 1992 to 2013 concluded, "countries participating in IMF programs with conditions attached, specifically performance criteria conditions, …are associated with an increase in long-term investor sentiment."[1]

However, while assuaging some investors' concerns, the IMF's loan conditions have been a point of contention for others, who have argued that they are excessive, often overly restrictive and ultimately harmful to the poor. Some countries and commentators have also complained that the IMF's conditions are often imperfectly tailored to a country's particular circumstances and political conditions, limiting the ability of countries effectively to control their economic programs and imposing impracticable deadlines. The IMF has made efforts to respond to these concerns through a more tailored approach to program design and implementation.

Between 1999 and 2008, sub-Saharan Africa enjoyed long-term stable growth (approximately 6 percent per annum, according to the IMF World Economic Outlook, October 2017), leading the IMF to take a less hands-on approach to structural adjustment during this period.

While the number of IMF loans to sub-Saharan African countries decreased in the immediate wake of the 2008/09 financial crisis, more recently, weak global commodity prices have placed African economies under heightened pressure, leading to renewed IMF involvement. As global growth slowed after 2008, sub-Saharan Africa's growth remained largely on track,[2] but a prolonged depression in export prices for oil and commodities following the collapse of the super-cycle in 2014 had an adverse impact on commodity-dependant

Market stalls,
Accra, Ghana.


©Tom Cockrem / Getty Images

countries, of which there are several in sub-Saharan Africa.

Growth has slowed substantially since 2015, with sub-Saharan African economies growing, on average, at less than 1.5 percent in 2016, according to the IMF World Economic Outlook, October 2017—the region's worst performance in two decades. As a result, imbalances in exchange payments have resurged,[3] along with the need for IMF intervention. Even non-resource-rich countries have felt the pressure. Countries such as Côte d'Ivoire and Kenya have faced increased borrowing costs, which weigh on loan performance and arrears across the economy. The use of ECFs, which are extended on concessional terms, has, accordingly, increased substantially in sub-Saharan Africa since the 2008/09 global financial crisis, reflecting balance of payments problems engendered by the crisis in the region.

Over time, the existence of IMF lending has become a powerful signal to investors, with research suggesting IMF program participation positively affects sovereign credit risk.[4] Furthermore, the IMF's assessment of government policies has come to influence decision-makers in business and among Western donors.

Notwithstanding the varying degrees of financial support provided by the IMF over the years, the overall influence of the IMF has also manifested itself indirectly in Africa. This has been particularly so during times of relative stability, through the impact of its ongoing technical assistance and surveillance work in African countries—including periodic Article IV consultations. During Article IV consultations, an IMF team of economists visits a country to assess economic and financial developments, discuss the country's economic and financial policies with government and central bank officials, and transmit their views back to the relevant country's government in the form of a comprehensive report. As such, Article IV consultations are designed to enable the views and recommendations of the international community (as embodied by the IMF) to be fed back to a country in the hope that they might have a positive bearing on national policies.

2007

The year of the first major sovereign bond issue of US$750 million, 10-year offering from Ghana.

IMF

CURRENT AND PROSPECTIVE IMF PROGRAMS CURRENTLY IN SUB-SAHARAN AFRICA

There are currently 19 active IMF loan programs in sub-Saharan Africa, the total value of which is US$6.9 billion. This accounts for only 4.2 percent of the total value of IMF loans globally (US$163 billion). The total outstanding amount under these programs is approximately US$5.1 billion. ECFs account for 14 out of the 19 IMF programs currently active in sub-Saharan Africa, while there are currently two similar EFFs (in Côte d'Ivoire and Gabon), one SBA (Kenya) and two SCFs (Kenya and Rwanda) in place. The largest single package, amounting to approximately US$1.5 billion, is a pair of precautionary loan facilities for Kenya, comprising a US$1 billion SBA and a US$0.5 billion interest-free SCF. However, the country is yet to draw on either facility.

The current outlook for sub-Saharan Africa suggests the region will continue to underperform global growth averages in 2018, in contrast to the region's general outperformance prior to the commodities crisis.

IMF PROGRAM PARTICIPATION AND SUB-SAHARAN AFRICAN SOVEREIGN BONDS

Sub-Saharan African countries only started issuing sovereign bonds relatively recently. The first major issue was a US$750 million, ten-year offering from Ghana in 2007. While no strong correlation between sovereign bond performance and a country's participation in IMF programs has been apparent, it would appear that bond performance generally improves with IMF program participation, although this depends largely on the nature of the program involved and the overall debt profile of the country. While research specific to sovereign bonds is still sparse, studies on bond issues in emerging markets more broadly suggest that participation in an IMF program leads to a positive impact on spreads. However, sovereign bond yields are highly sensitive to IMF lending announcements and distress warnings, which in the short term can result in significant sell-offs and higher yields. For instance, the IMF's recent warning that Mozambique was at high risk of debt distress led to a record leap in bond yields to 19 percent, while Zambian eurobond yields briefly rose when it was announced in October 2017 that discussions between Zambia and the IMF on a prospective program had been put on hold.

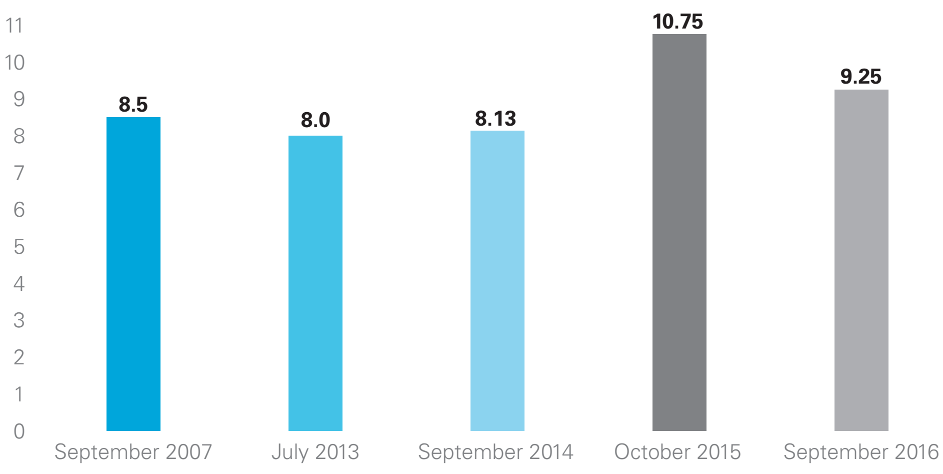
The degree to which IMF program participation may result in a long-term positive effect on bond performance and pricing is influenced by the objectives of the specific program, the circumstances surrounding its implementation and the profile of the particular country. IMF programs vary, and not all programs imply that a country's economy is in trouble. More "routine" pre-crisis interventions to smooth out imbalances in balance of payments arising from external shocks do not typically impact sovereign risk in the same manner as crisis-driven interventions to address problems of debt sustainability and severe economic distress.

The impact of a country's participation in an IMF program on the yield on its sovereign bonds may be more complicated still. Research on bond issues in emerging markets since 1991 has found that spreads are typically lower in countries participating in an IMF program. However, the existence of an IMF program may, rather than mollify investors, instead signal to them that the relevant country's credit is riskier, particularly where debt-to-GDP ratios are high. Indeed, when debt-to-GDP ratios are above 60 percent, the positive impact on spreads has been shown to disappear, even in the presence of IMF lending.[4] The possibility of default is generally considered higher for sovereigns participating in an IMF program with high debt ratios as compared to sovereigns not participating in a program, given countries requiring IMF support already face long-term vulnerability and support programs are not always sufficient to eliminate associated risks of default. By way of example, the coupons on Ghana's sovereign bonds issued before the IMF extended its first ECF to Ghana in 2015 (when the country's gross public debt as a percentage of GDP stood at approximately 71 percent) were actually lower than the coupons on sovereign bonds issued subsequent to the IMF's intervention in the country, including, notably, Ghana's October 2015 eurobond, which benefited from a partial World Bank guarantee. Unsurprisingly, the fact that a country benefits from IMF support is rarely sufficient to lift the rating of its sovereign bond out of sub-investment-grade status. Indeed, every African country with outstanding eurobond issues currently has at least one sub-investment-grade rating from the major rating agencies.

CONCLUSION

The IMF has for years played an important role in the evolving economies of sub-Saharan Africa. However, the specific correlation of IMF program participation to sovereign bond performance and investor sentiment is less clear-cut, in part because of the wide range of factors that must be taken into account, as well as the relative "youth" of the sub-Saharan African sovereign debt market. It is undeniable, however, that IMF involvement has been, and will continue to be, an important consideration for anybody investing in sub-Saharan African sovereign debt.

Figure 3: Ghana—coupon rates on bonds before/after implementation of IMF program
(Percent)



Source: World Bank, International Debt Statistics (average interest on new external debt)

1 K.C. Vadlamannati, "Can IMF Program Design Resurrect Investor Sentiment? An Empirical Investigation" (2017)

2 World Bank, "Africa's Pulse: An Analysis of Issues Shaping Africa's Economic Future" (October 2012) http://siteresources.worldbank.org/INTAFRICA/Resources/Africas-Pulse-brochure_Vol6.pdf

3 IMF's Balance of Payments Statistics Yearbook, available at http://www.imf.org/external/datamapper/datasets/BOP

4 B Eichengreen, K Kletzer, A Mody, "The IMF in a world of private capital markets" (2006), available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.385.6073&rep=rep1&type=pdf

Statue of Admiral Zhang, whose fleet visited East Africa twice during the voyage of discovery.

“Belt and Road” in Africa

Chinese engagement, investment and trade with Africa

By Hallam Chow and Boya Shen

China has a very long association with Africa. Historical records in China, confirmed by archaeological traces in East Africa, show that Admiral Zheng visited Africa twice during his voyages of discovery during the Ming Dynasty (1368 to 1644). According to some sources, trading ties between Africa and China may even extend further back, to the Song Dynasty (960 to 1279). China refers to Africa as the world’s largest region still to be developed. It is determined to play a major role in that development and to maintain close relationships with African nations as they grow.

As a country with a population of more than 1.3 billion people, China interacts with every one of the 54 African countries, which cumulatively have a population of roughly 1 billion. At US$11.2 trillion in 2016, China’s economy dwarfs that of every African country and even Africa as a whole. According to the International Monetary Fund (IMF), the continent’s cumulative GDP in 2014, adjusted for purchasing power parity, was only about US$6.3 billion.

China follows a coordinated, continent-wide strategy in forging its African relationships, anchored by the Forum on China-Africa Cooperation framework, which was established in 2000. Long before that, at the Asian-African Bandung Conference in April 1955,[1] the 29 participating countries embraced China’s Five Principles of Peaceful Coexistence, which remain the cornerstone of Chinese foreign policy to this day. These are:

- Mutual respect for each other’s territorial integrity and sovereignty
- Mutual non-aggression
- Mutual non-interference in each other’s internal affairs
- Equality and cooperation for mutual benefit
- Peaceful coexistence

A number of similar conferences were held over the next few years and, in 1960, China established the China-African People’s Friendship Association. China was always quick to forge diplomatic relationships with African countries as they achieved independence from their former colonial powers.

From December 1963 to February 1964, the Chinese premier Zhou Enlai visited ten African countries and, during this tour, he put forward Eight Principles Governing China’s Economic and Technological Assistance to Foreign Countries. These, too, are part of a small number of formative policy documents that drive China’s foreign policy, not only in Africa but generally. Among other things, the Eight Principles set out the requirement that in the delivery of foreign assistance to a country, the sovereignty of the government receiving such assistance must be respected. This means that the conditions often applied to assistance from western governments cannot be attached to assistance from China. Newly independent African states provided 11 of the 23 co-sponsors of the United Nations resolution recognizing the PRC as the “only lawful representative of China to the United Nations,” and 26 African votes contributed to that motion being passed in 1971, opening the way for the PRC to take over China’s permanent seat on the UN Security Council.

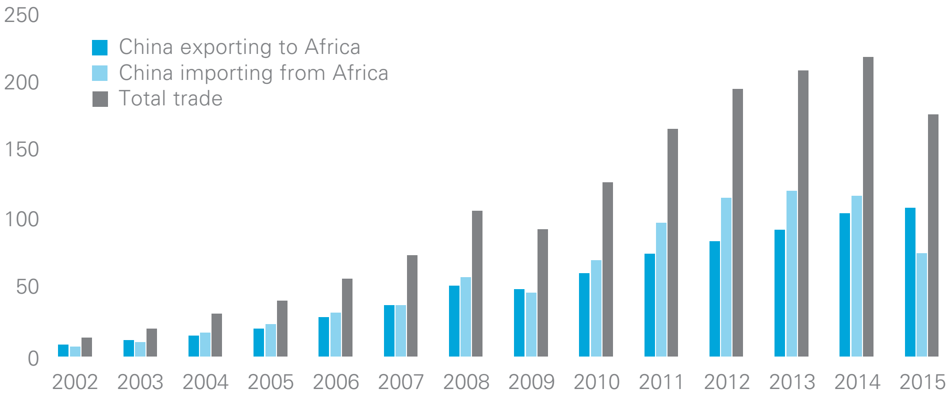
China’s close engagement with Africa continued through the succeeding decade and accelerated toward the end of the 1990s and into the 2000s. By 2008, China’s Export-Import Bank was funding more than 300 projects in 36 countries across Africa. The value of bilateral trade increased from US$6.5 billion in 1999 to US$73.3 billion in 2007 (Figure 1). According to the China-Africa Research Institute at Johns Hopkins University, by 2008 it exceeded US$100 billion, and it peaked at more than US$200 million in 2014, before slipping back in 2015 and 2016 in response to poorer global economic conditions. In 2009, China overtook the United States as Africa’s major trading partner. The largest African exporter to China from Africa in 2015 was South Africa, followed by Angola and Sudan. In the same year, South Africa was the largest African market for Chinese goods, followed by Nigeria and then Egypt.

US$200 billion

The peak value of Chinese-African bilateral trade in 2014.

UNCTAD

Figure 1: China-Africa trade (2002 – 2015)
(US$ billion)



Source: UN COMTRADE 2017

THE IMPACT OF THE BELT AND ROAD INITIATIVE (BRI) ON AFRICA

The BRI, launched by Chinese President Xi Jinping in 2013, has significant implications for Africa. The BRI involves China underwriting hundreds of billions (and perhaps trillions, eventually) of dollars of infrastructure investment across the world, "to promote the connectivity of Asian, European and African continents and their adjacent seas, establish and strengthen partnerships among the countries along the 'Belt and Road,' set up all-dimensional, multi-tiered and composite connectivity networks, and realize diversified, independent, balanced and sustainable development in these countries."[2] BRI consists of two major components:

- **Silk Route Economic Belt:** The "belt'" comprises the ancient land route to Europe via Western China and Central Asia
- **Maritime Silk Route:** Comprises the seaborn trade route ("road") linking China to Europe via South Asia and the Horn of Africa

Additionally, Belt and Road will absorb a range of other "corridor" initiatives already in existence, e.g., the China-Pakistan Economic Corridor (Figure 2).

The early stages of the BRI appear to be focused on projects that enhance linkages across Asia and with Europe. The initial "hot spots" identified include ten ASEAN countries, Russia and five Central Asian countries. Global macro-economic conditions will likely also limit the rate at which the BRI can be implemented, in line with a flattening in projects, M&A activities and foreign assistance in BRI countries generally (and beyond). The agencies that will be primarily responsible for disbursing BRI funding include the state-owned Silk Road Fund, the China Development Bank and the Export-Import Bank of China.

Two multilateral institutions led by China, the Asian Infrastructure Investment Bank (AIIB) and the Shanghai-based New Development Bank, are also major financiers of the BRI. In 2016, for instance, the AIIB approved US$1.7 billion in loans for nine BRI development projects. However, by the end of October 2017, it had made only one set of investments in Africa, namely in Egypt.[3]

> "Hampered by sluggish global economic conditions, China's outward direct investment in Africa stood at US$29.8 billion in 2015, down 7 percent from 2014. Still this places China fourth in the "Top 10" global sources for direct investment in Africa.

China does not intend to undertake the BRI alone, though, and it has expressed active support for the African Union's Agenda 2063 initiative.[4]

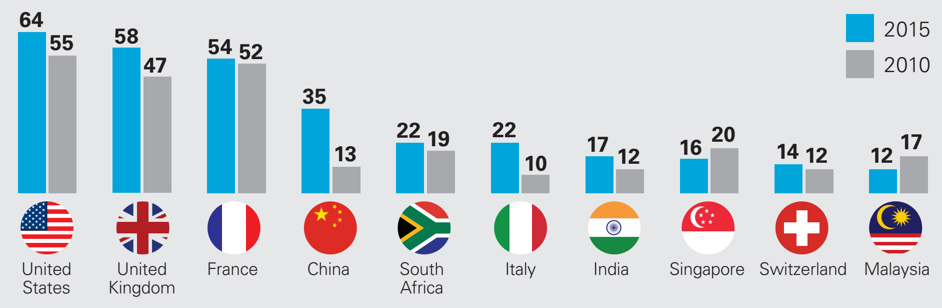
RECENT INVESTMENT TRENDS BETWEEN CHINA AND AFRICA

Hampered by sluggish global economic conditions, China's outward direct investment in Africa stood at US$29.8 billion in 2015, down 7 percent from 2014. China's

Figure 2: The Belt and Road Initiative—Enhancing linkages between Asia, Europe and Africa

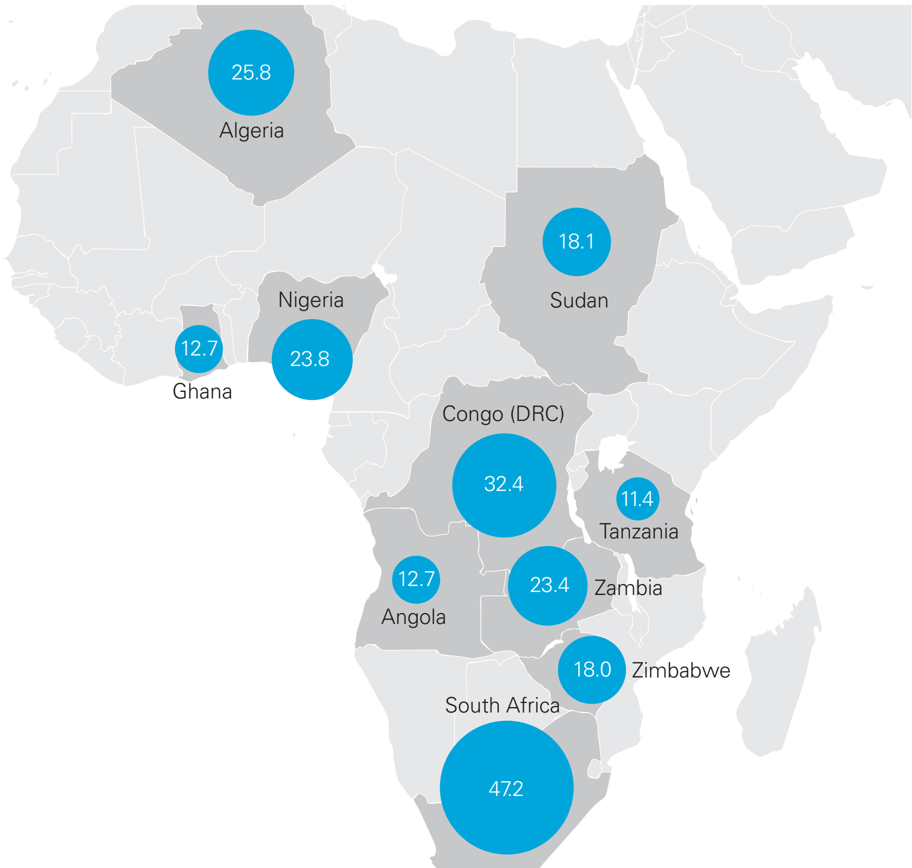
Source: UN COMTRADE 2017

Figure 3: Top 10 countries investing in Africa, by investment stock



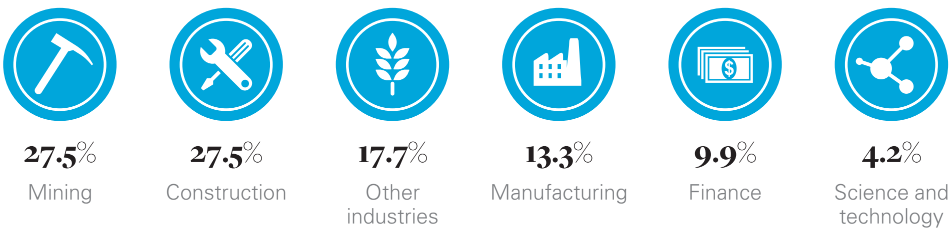
Source: UNCTAD

Figure 4: Top 10 countries and regions in China's direct investment in Africa (2015)
(US$ million)



Source: Ministry of Commerce, National Bureau of Statistics and State Administration of Foreign Exchange, "Statistical Communique on China's Outward FDI in 2015"

Figure 5: China's share of direct investment in Africa's stock portfolio (2015)



Source: Ministry of Commerce, National Bureau of Statistics, State Administration of Foreign Exchange, "Statistical Communique on China's Outward FDI in 2015"

investment stock in Africa stood at US$34.7 billion in 2015, accounting for 3.2 percent of China's foreign investment.[5] Still this places China fourth in the "Top 10" global sources for direct investment in Africa (Figure 3). However, China's stock of FDI in Africa grew at 21.7 percent between 2010 and 2015, while the leading country (the US) grew its stock at only 3.15 percent over the same period. Nearly 3,000 Chinese overseas enterprises accounted for most of this, with operations based mainly in Zambia, Nigeria, South Africa, Ethiopia, Tanzania, Ghana, Kenya, Angola, Uganda and Egypt (Figure 4). The mining and construction industry sectors accounted for 55 percent of China's direct investment into Africa (Figure 5).

Special Economic Zones and expansion of Chinese companies into Africa

One has only to look at the rankings in the World Bank's Ease of Doing Business annual reports to know that many African countries have regulatory frameworks that may not fully encourage foreign direct investment. For this reason, China frequently works with the governments of those countries to establish Special Economic Zones, usually termed Foreign Economic and Trade Cooperation Zones or Overseas Cooperation Zones (OCZs), to promote trade and investment. Such zones are not unusual. According to the International Labour Organization's database, more than 3,500 such zones exist across the world, in more than 130 countries.

The first OCZ established in Africa was the Lusaka South Multi-Facility Economic Zone (MFEZ), announced by the Zambian government in 2005. The total planned area of this zone is 17.28 square kilometers, with an intended development cost of US$500 million. As of 2015, there were 35 companies involved, and the agreement amounted to an investment of US$1.45 billion, with an annual output value of US$1.85 billion. Similar zones have since been established in several other African countries. The primary drivers for these developments include that OCZs are important:

- Platforms for Chinese enterprises to globalize
- Channels for brand-building by Chinese enterprises
- Fulcrums for innovation and technical development of Chinese enterprises
- Ways for Chinese enterprises to reduce risk in opening overseas markets while complying with national legislation in those markets

In 2014, four of China's top ten OCZs by total asset values were located in Africa (see bold entries in Figure 6).

Chinese engineering companies tend to follow the growth and development pattern of many major international engineering companies:

a. It starts as an equipment manufacturer exporting equipment it manufactures.

b. It then gets into the business of an EPC contractor using the equipment it manufactures in order to drive up the revenue of its equipment manufacturing business.

c. Once it grows confident about and better at managing construction risk, it then takes on the role of an investor/sponsor of a greenfield project first driven by the motive to secure its EPC contract and equipment export and then by the long-term investment return. The support of many Chinese commercial and policy banks is instrumental in this process.

In the coming years, Chinese engineering companies will likely move far more quickly into the role of investors/sponsors. A younger generation of Chinese project managers aged 30 to 50 is emerging, who think differently and who are keen to grow and sharpen their skill sets. It is probable that some Chinese industrial leaders will inject the return of their equity investment back to R&D and improve the competitiveness of their equipment, thus completing the full and, in our view, healthy and organic circle of the growth model.

Figure 6: China's Top 10 foreign economic and trade cooperation zones (2014)
By asset value

1	Pakistan Haier & RUBA Economic Zone	PAKISTAN
2	Thai-Chinese Rayong Industrial Park	THAILAND
3	Sihanoukville Special Economic Zone	CAMBODIA
4	Long Jiang Industrial Park	VIETNAM
5	**Zambia-China Economic & Trade Cooperation Zone**	**ZAMBIA**
6	**Suez Economic & Trade Cooperation Zone**	**EGYPT**
7	**Lagos (Lekki) Free Zone**	**NIGERIA**
8	**Ethiopian Oriental Industrial Park**	**ETHIOPIA**
9	Russian Ussuriysk Economic and Trade Cooperation Zone	RUSSIA
10	China-Russia Tomsk Wood Industry and Trade Cooperation Zone	RUSSIA

Source: China Ministry of Commerce's website for foreign economic and trade cooperation

PROSPECTS FOR FUTURE AFRO-CHINESE ENGAGEMENT AND INVESTMENT

In 2015, China investments into African infrastructure projects were three times the sum of those of France, Japan, Germany and India combined (Figure 7). The bulk of Chinese funding has been in the form of government-to-government loans, used then by the borrowing African governments either to develop the project itself, or to leverage it with private capital through a public-private partnership (PPP). As of the date of writing (late 2017), at least 76 PPP projects appear to be in the pipeline in African countries associated with BRI. Not all have values ascribed, but the 14 that do imply a cumulative investment of nearly US$6 billion for them alone. Sixty percent of these projects are in the transport sector.

There is no reason to believe that this trend will change in the foreseeable future. BRI should only be seen as one facet of infrastructure development in Africa. Despite the rapid growth in Chinese investments into Africa over the past decade, China still only accounts for between 4 and 5 percent of global FDI in Africa. However, we have previously noted that according to UNCTAD data, Chinese FDI stocks in Africa grew 21.7 percent from 2010 to 2015, while the US' grew at only 3.15 percent over the same period. Extrapolating those growth rates using the current levels of FDI stock in Africa, China's could surpass that of the US by 2019 (Figure 8).

21.7%
growth

Rate of Chinese FDI stocks in Africa from 2010 to 2015, while the US' grew at only 3.15 percent over the same period.

UNCTAD

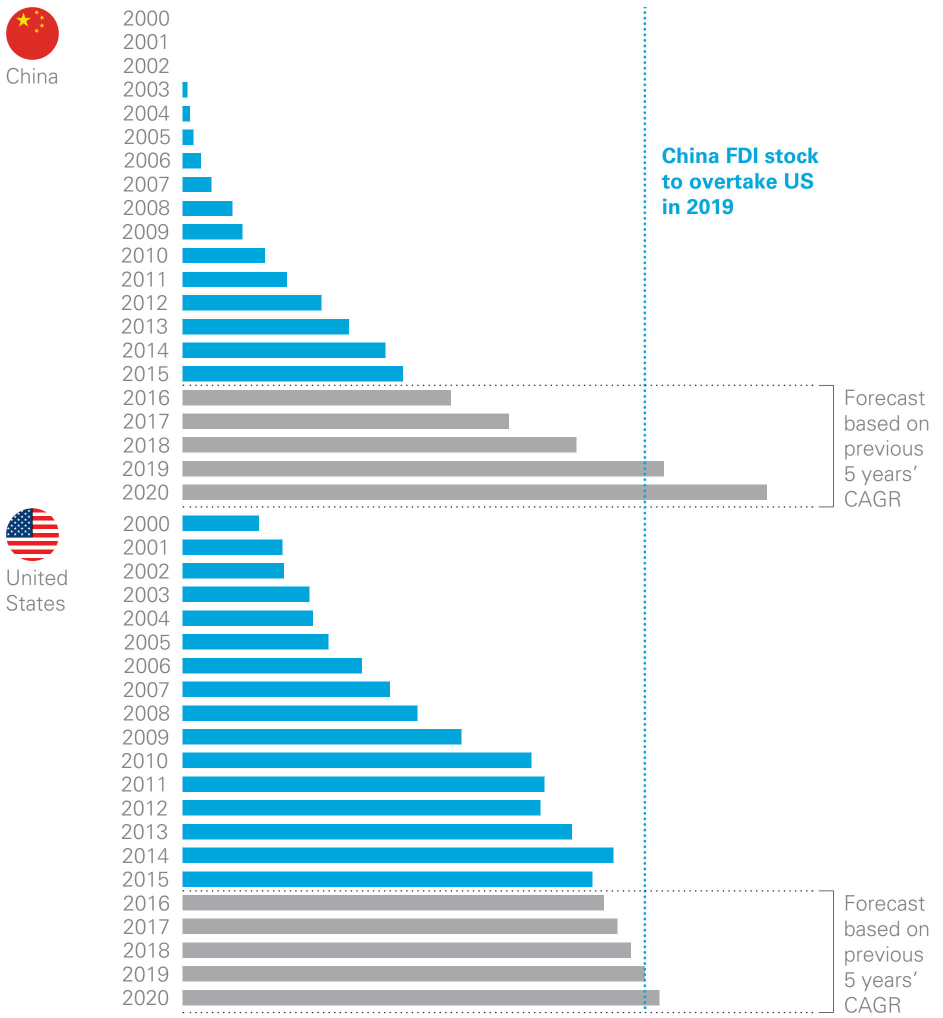
CONCLUSION

China has a long history in Africa, and its friendships with African countries run deep. Many African leaders have longingly admired the 10 percent plus per annum growth rates that China achieved over the decades at the end of the 20th century and the beginning of the 21st, wondering whether those same rates could be achieved in their African markets by using the "Chinese model." Idealists both in Africa and the West frequently idealize China's modernization, using romantic terminology such as "China model" and "Beijing consensus," without appreciating how radically different Africa is from China.[6] While one might debate the degree to which Chinese economic and socio-political lessons translate well into an African context, what is indisputable is that Chinese investment, trade and engagement will be key to unlocking the promise of the African continent, as articulated in the African Union's Vision 2063.

Figure 7: Infrastructure financing in Africa (2015)
(US$ billion)

Source: Infrastructure Consortium for Africa.

Figure 8: Extrapolating the growth rates in FDI stocks from 2010 to 2015 forward suggests that China may overtake the United States in this area by 2019
(Stock US$)



Source: UNCTAD and CSG analysis

1 The Bandung Conference was the first large-scale Afro-Asian conference and was a meeting between mostly newly independent states in the two regions, to promote Afro-Asian economic and cultural cooperation and to oppose colonialism or neo-colonialism in any form. It was an important step in the formation of the Non-Aligned Movement.

2 Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road, 28 March 2015, issued by the National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic of China, with State Council authorization.

3 The Egypt Round II Solar PV Feed-in Tariffs Program (the Project) consists of 11 photovoltaic solar power plants (the Sub-projects), 9 x 50MWac and 2 x 20MWac, all to be located in the Benban Solar Park near Aswan, with an aggregate power generation capacity of 490MWac. (Source: Mr Joachim von Amsberg, Vice President Policy and Strategy, Asian Infrastructure Investment Bank)

4 Agenda 2063 is a framework for African socio-economic transformation over the next 50 years. It builds on and seeks to accelerate initiatives such as the Lagos Plan of Action, The Abuja Treaty, The Minimum Integration Programme, the Programme for Infrastructural Development in Africa (PIDA), the Comprehensive Africa Agricultural Development Programme (CAADP), The New Partnership for Africa's Development (NEPAD), Regional Plans and Programmes and National Plans, as well as national, regional and continental best practices.

5 Source: Ministry of Commerce, National Bureau of Statistics and State Administration of Foreign Exchange, "Statistical Communique on China's Outward FDI in 2015"

6 Shinn and Eisenmann, 2012

Exiting African PE investments

While IPOs remain scarce, other promising exit strategies are gaining traction

By Kenneth Barry and Linford Coates

Historically, one of the key concerns of LPs regarding African private equity has been the number and quality of available exit routes. Illiquid domestic exchanges as well as political and foreign exchange risk have all weighed on the exit multiples that investors have hoped to achieve. However, as the African private equity market matures, the chances of achieving a successful exit have notably improved. The African Private Equity and Venture Capital Association (AVCA) and African Securities Exchanges Association (ASEA)[1] have reported a record number of PE firms in Africa exiting in 2015 and 2016 (44 and 48, respectively), which is double the numbers that were achieved a decade ago. Nor was this record exit activity confined to a small group of private equity funds. It involved 48 deals spread across 31 firms.

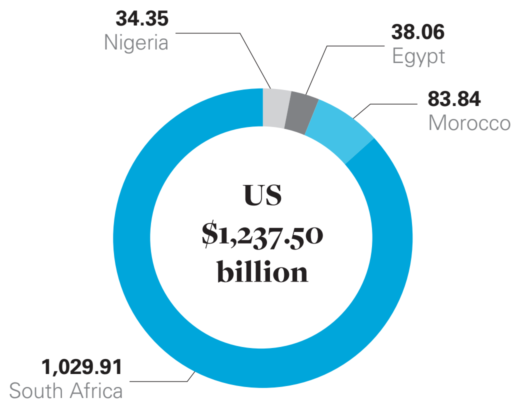
Furthermore, the majority of respondents in a 2016 Deloitte report[2] expected the volume of exits in the 12 months that followed to increase or remain the same, despite increasing challenges in the debt funding environment.

GEOGRAPHICAL EXIT PERFORMANCE AND FORECASTS

Performance among African private equity exits is not uniform across the continent. Political and macro-economic drivers differ significantly from region to region. It is no secret that South Africa has historically been home to by far the most private equity investment, due to its more advanced and diversified economy as well as its relatively stable political platform. By both market capitalization and number of listed companies, the Johannesburg Stock Exchange (JSE) is considerably larger than all the other African bourses combined (Figures 1 and 2). This investment matured into 42 percent of the continent's exits over the past ten years, which is 13 percent more than the next four countries combined.[3] While South Africa's reign as the most advanced African economy looks set to continue for at least the next few years, the general consensus is that the country's economy will continue to deteriorate in the short term, which is likely to increase exit activity and reduce multiples in the coming years.

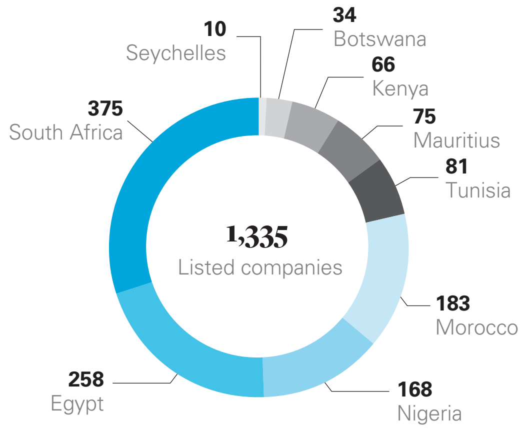
The next region that has experienced the most private exits is West Africa. Between 2011 and 2016, West African transactions accounted for 27 percent of Africa's total deal volume compared to only 18 percent in East Africa.[4] These transactions were not only focused in the resources sectors but also retail sectors, as profits flowed down to employees and generated a more affluent consumer base. As a result of the depressed oil prices, coupled with last year's dramatic devaluation of the Nigerian naira and its subsequent volatility, investor attention has turned elsewhere. These factors have led private equity investors to focus more on exits in West Africa than in previous years, with 11 percent of respondents to the Deloitte report stating that they are more likely to exit than invest in the short term, up from zero percent in 2015. However, the sudden and pronounced impact of the naira devaluation coupled with the oil price decline has reportedly caused a wide bid/ask spread on West Africa divestments, as sellers struggle to come to terms with the significant reduction in the dollar value being offered for their businesses. This behavioral economic factor could weigh on exit deal volumes in the short term, although this should lessen as oil prices start to stabilize.

Figure 1: Market capitalization (June 2017)
(US$ billion)



Source: ASEA

Figure 2: Total number of listed companies (2017)



Source: ASEA

Cape Town, South Africa.

East Africa has historically not experienced the same level of private equity investment as its neighbors to the west and south, but its more diversified (and generally oil importing) economies are proving attractive to private equity investors who are keen to rebalance away from the West. Ninety percent of private equity investors intend to invest more in the region than they exit, which is widely expected to improve buyer competition for prize assets and add upward pressure to transaction multiples in the region given the imbalance in demand and supply. Kenya has been the biggest beneficiary of this shift in attention, mostly due to its economy's limited reliance on oil—its GDP is predicted to grow in excess of 5 percent this year and to continue that pace throughout 2018.[5]

Historically, exits have been fairly evenly distributed across business sectors, with the most common sector for exits being financials with only 20 percent of the total, followed by industrials with 15 percent. More recently the industrials sector has become the sector with the most exits, comprising 21 percent of the 2016 exits, more than double the next most common sector (Figure 3).

TRADE SALES

Trade sales to strategic investors continue to be the most preeminent exit route, constituting more than 50 percent of private equity exits in 2015 and 2016. These have also historically generated the highest average returns. This is expected to continue to be the case in the next 12 months, particularly in West Africa, where the expectation is that trade sales will comprise 72 percent of any contemplated exits, possibly due to subdued secondary buyout interest (sales to other private equity firms).

If one were to break down the types of strategic buyers into local, national and multinational, the mix of strategic buyers has remained fairly consistent over the past ten years. Local firms remain the most likely strategic buyer, with involvement in 42 percent of acquisitions in 2016, closely followed by multinational buyers, who were involved in 38 percent of acquisitions.

A notable feature of the evolving private equity market is the increased prevalence of auction sales, such as the sale of Brandcorp in June 2016 by Ethos Private Equity to The Bidvest Group following a competitive process. Given the strong fundraising by Africa-focused funds in recent years and the competition for quality higher-value African assets, it is likely that auction processes will become increasingly common.

SECONDARY TRANSACTIONS

After trade sales, secondary buyouts, such as the sale of Algeria-based manufacturer Cellulose Processing by Mediterranean Capital Partners to Abraaj in 2016, account for the next largest proportion of exits, at 55 percent of deals surveyed in 2016. This is a dramatic increase from 2015, when only 20 percent of deals were secondary buyouts.[6] Another notable trend is that the private equity buyers in these secondary transactions are increasingly international brand names. In 2016, 47 percent of secondary buyers were classed as multinational private equity firms, an increase from less than 30 percent a decade ago. With strong fundraising by international Africa-focused and global funds such as Carlyle and KKR, who made their maiden African investments in 2014, we expect that secondary buyouts will continue to be an increasingly important feature in the African private equity market.

As the quality of assets and deal sizes increase over time, we would also expect to see more sophisticated secondary transaction structures, such as "portfolio" deals, which package up several assets together to be sold to another fund, or deals that involve the breaking up of larger investments into smaller divisions for sale. Given that 75 percent of deals in the first half of 2016 were below US$250 million, it may be some time before the market develops to such a point.

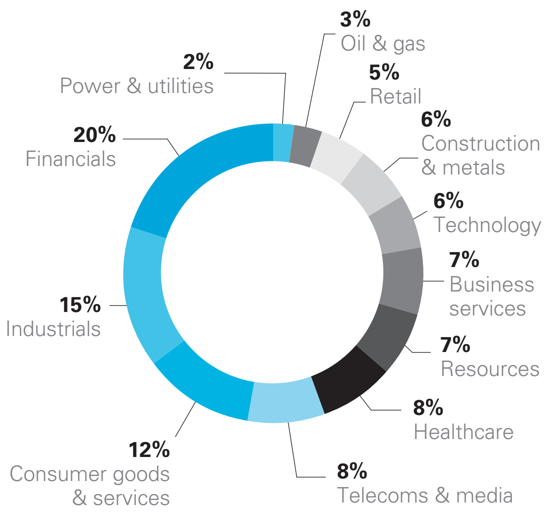
TRANSACTION MULTIPLES

While enterprise value to EBITDA multiples for listed companies in Africa have steadily decreased from nearly 10x in the first quarter of 2014 to less than 8x in the second quarter of 2017, multiples on private equity transactions have followed the opposite path. In 2013, the average private deal multiple was sitting just above 6x, but now these multiples have almost converged on listed company multiples at around 8x. Nevertheless, there still seems to be a fairly heavy risk discount applied to African transactions when these deal multiples are compared with global transactions—since 2012, only 40 percent of private equity transactions achieved a multiple in excess of 7.5x, compared to almost 55 percent globally. This risk discount appears to decrease as transaction values increase, with the average multiple for transactions in the past five years with a deal value exceeding US$250 million being close to 9x.[7] The rationale for this correlation of value and multiples is thought to be caused by the added stability and cash generation that come with larger companies on the continent.

In terms of regional performance, as indicated above, transaction multiples in Southern and West Africa are expected to decrease over the next 12 months[8] as a result of decreased macro-economic forecasts. In East Africa, multiples are anticipated to increase, but only

> **“Ninety percent of private equity investors intend to invest more in the region than they exit.**

Figure 3: PE exits—sector mix



Source: ACVA, EY

slightly due to the uptick in interest from private equity being largely cancelled out by the increased cost of debt.

Certain sectors tend to consistently achieve greater transaction multiples in Africa, despite this not being the case elsewhere. The consumer staples and discretionary sectors have recently seen the highest multiples due to evidence of a growing middle class with increasing disposable income. These sectors have also proved themselves to be more resilient across the economic life cycle and a helpful hedge in a depressed oil price environment. Factors such as these have led to more competitive bidding processes between private equity sponsors for assets in those sectors. This was apparent from the Abraaj Group's US$100 million acquisition from Emerging Capital Group in July of the Java Group, a growing coffee shop chain. It is reported that the sellers received 12 non-binding bids for this middle class demographic-focused business, a degree of interest that would previously have been unheard of. Another sector that has fared well for similar macro reasons is healthcare. As the wealth of the people increases, high-quality healthcare is close to the top of the list of priorities.

IPOS

Although IPOs and stock sales on public markets remain some of the most attractive exit mechanisms in the global PE industry, the converse has historically been true in African PE. Fragmented regulation, political uncertainty, underdeveloped capital markets and low levels of market capitalization compared to the developed world result in low usage of IPOs as a PE exit route: Only 1 percent of all 83 PE exits in Africa during 2014–2015 took place by way of IPOs (Figure 4).

Despite a large increase in IPO proceeds raised in 2016, African exchanges saw the lowest volume in IPO activity since 2013, with only 20 IPOs, compared to 30 in 2015.[9] The suspension of Nigerian fintech company Interswitch's IPO plans to raise as much as US$1 billion, due to fears over the further weakening of the naira and a general shortage of foreign currency, is a good example of the challenges faced by African PE investors attempting to use IPOs as an exit route. While opportunities outside South Africa's Johannesburg Stock Exchange, Egypt's Cairo and Alexandria Stock Exchanges and Nigeria's Lagos Stock Exchange remain limited, the Abraaj Group's exit of Unimed via an IPO on the Tunis Stock Exchange in May 2016 and Actis's exit of Ugandan electricity company Umeme Ltd. via the Ugandan and Kenyan capital markets in December 2016 show that viable options do exist.

When investors decide to IPO African companies, they often opt for dual listings with international exchanges. The London Stock Exchange (and in particular AIM) is the international exchange of choice, due to its liquidity and the credibility of its governance and disclosure criteria. This is evidenced by the fact that the combined market value of African-operated companies listed in London is US$149 billion, which is more than any other African exchange except the Johannesburg Stock Exchange.

A number of initiatives have been introduced to improve the listing of shares in African companies such as: (i) the East Africa Community (EAC) stock markets integration project; (ii) the introduction of the Growth Enterprise Market Segment by the Nairobi Securities Exchange (NSE); and (iii) new mechanisms to trade and settle ordinary shares of London-listed or dual-listed Nigerian companies. As such initiatives come to fruition, we would expect that exit options on a limited number of exchanges will become more viable.

US$149 billion

The combined market value of African-operated companies listed on the London Stock Exchange, which is more than any other African exchange except the Johannesburg Stock Exchange.

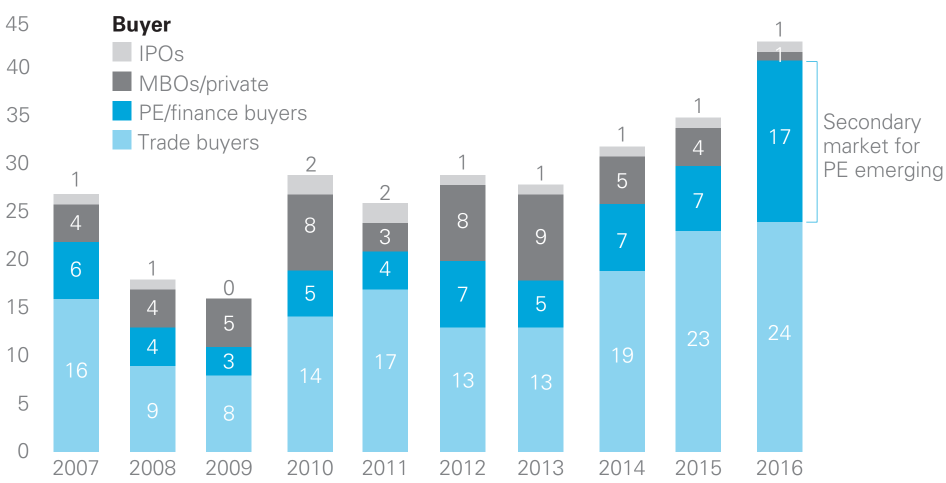
African Development Bank

CONCLUSION

Despite some recent headwinds in certain African regions and sectors, the outlook for private equity investment in the continent is undeniably positive. Almost 90 percent of limited partners interviewed as part of a recent AVCA report confirmed their intention to either increase or maintain their private equity allocation in Africa over the next three years, and only 2 percent believed that over the next decade Africa will be less attractive than other private equity markets. These statistics are a clear indication that investors' concerns with the region, in particular that pivotal concern of how to successfully exit, have substantially improved.

1 Sources: (i) 2016 How private equity investors create value—by EY and AVCA, and (ii) ASEA
2 Deloitte 's 2016 Africa Private Equity Confidence Survey
3 EY report
4 AVCA
5 Trading economics website
6 EY and AVCA—Cambridge Slide 9
7 Riscura
8 2016 Deloitte SAVCA Africa Private Equity Confidence Survey
9 Dealogic; PwC 2016 Africa Capital Markets Watch

Figure 4: Buyers for Africa PE exits
(US$ billion)



Source: ACVA, EY

Cape Town International Airport.

Storm clouds or clearer skies for African airlines?

Competition with international carriers is tight, but opportunities exist for African airlines to grow market share

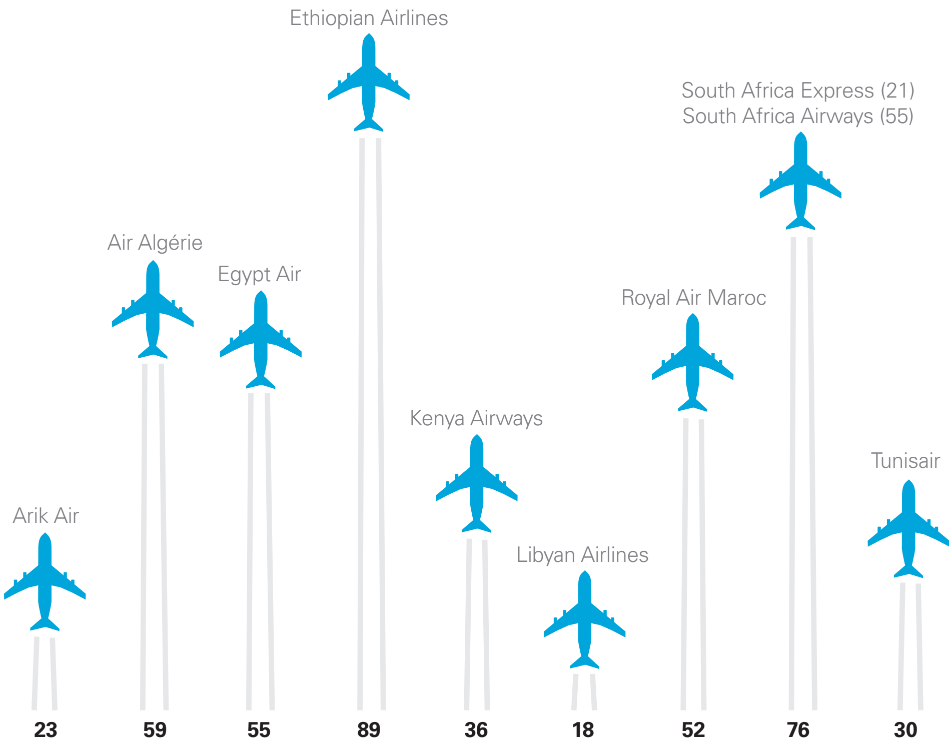
by Justin Benson and Sam Harding

African airlines are in a steep decline. Their market share has fallen by approximately 40 percent over the last three decades. African carriers now represent only 20 percent of the market across the continent. Emirates is now the dominant carrier in many African countries.

This stark warning came from the Ethiopian Airlines (EA) Group CEO Tewolde Gebremariam, speaking in June 2017 at the second International Civil Aviation Organization (ICAO) meeting on Air Cargo Development in Africa at the 29th African Union (AU) summit (the "Summit") in Addis Ababa.

In light of this, the AU announced at the Summit the launch of a single African air transport market (the SAATM) from January 2018. SAATM is an important step forward in the liberalization of the aviation sector in Africa, particularly for African carriers. Other indications also exist that the more ambitious of these are pushing forward with plans for development and growth, bolstering investor confidence. (Figure 1 shows the 10 largest African carriers by fleet size.)

Figure 1: Top 10 African carriers by fleet size



Source: Planespotters (Oct 2017)

At its Middle East and Africa Aviation Day, held in Jordan in October 2017, the International Air Transport Association (IATA) identified four priorities for the region:

- Safety
- Intra-African connectivity (as envisaged by the SAATM)
- Blocked funds (due to the problems encountered by airlines in trying to repatriate their foreign currency earnings from African states—it is estimated in Nigeria alone that more than US$600 million in blocked funds owed to foreign carriers was held in 2016)
- Smarter regulation (promoting growth-supporting policies and favorable tax regimes for the industry)

Optimism should be tempered with caution, though. Efforts to overcome some barriers in this area have been stilted, and entrenched structural issues persist. Real transformation will require sustained commitment from governments and other key players in the aviation sector.

> "SAATM is an important step forward in the liberalization of the aviation sector in Africa, particularly for African carriers.

A SINGLE MARKET

The SAATM has its roots in the 1988 Yamoussoukro Declaration (the "1988 YD"). This sought to achieve concord on the principles of air travel liberalization by promoting cooperation between African carriers and encouraging improvements in their operation and management. The 1988 YD was followed by the 1999 Yamoussoukro Decision (the "1999 YD"), which was endorsed by the Assembly of Heads of State and Government of the AU. However, many African states have failed to properly ratify or implement the 1999 YD. By the end of July 2017, only 20 of the 55 AU member states were committed.

In the absence of a single African air transport market (like the EC's Single European Skies network) African carriers cannot avoid the market restrictions arising from bilateral air service agreements. This means that they are unable to make optimal use of existing infrastructure. For instance, of the nine "flight freedoms" defined under the Chicago Convention, even the crucial fifth freedom (namely, the freedom to fly between two foreign countries on a flight originating or ending in one's own country) is absent in much of Africa (Figure 2).

The International Air Transport Association estimated in 2014 that the implementation of the 1999 YD by just 12 key states would generate 155,000 jobs and US$1.3 billion in annual GDP—an indication of the economic and employment benefits that could arise from intra-African air connectivity. Morocco's open-skies agreement with the EU in 2005 prompted an increase of 25 percent in passenger traffic among the national carriers within just two years.

Even within individual states, some African carriers have struggled to cooperate and share resources efficiently. The former General Secretary of the African Airlines Association (AFRAA) identified the depletion in Nigeria's total fleet to 40 aircraft as symptomatic of the lack of collaboration between the Nigerian carriers, for example, with regard to training and maintenance, or in pooling spare parts.

THE BIGGER PICTURE

There are also more tangible issues to consider. Key infrastructure lags behind its European and Asian counterparts, particularly in the sector-specific areas such as airports, air traffic control and compliance with safety and technical standards. Speaking on the side lines of the ICAO's third International World Aviation Forum (IWAF) in Abuja, Nigeria in November 2017, the president of the African Development Bank (ADB), Dr. Akinwumi Adesina, acknowledged that the African aviation sector accounts for about 9 percent of aircraft accidents and 37 percent of aviation fatalities globally per annum. This poor record is reflected in the number of African carriers listed on the EU's Air Safety List as banned or restricted, meaning these airlines cannot compete intercontinentally.

25%

Morocco's open-skies agreement with the EU in 2005 prompted an increase of 25 percent in passenger traffic among the national carriers within just two years.

IATA

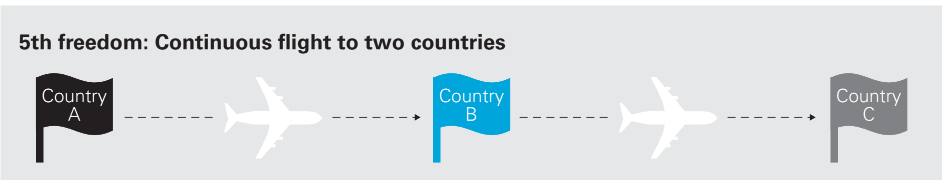
Lack of sophistication of African financial systems is a further issue. Some international banks and financial institutions see many sub-Saharan states as insufficiently capitalized to be a viable market for aircraft finance. Local banks are frequently unable to provide the debt needed, either. Financing, insurance and lease rentals that African carriers are able to obtain come at a significantly higher cost than those for their rivals in Europe, the Middle East and Asia-Pacific. Attempts to employ unusual sources of financing may have further exacerbated the problem. For instance, the use of special notarial bonds in South Africa proved unattractive to investors because they are only enforceable within that country's borders. However, the use of ECA financing has become more common, with development banks often funding the difference between the ECA-supported loan and the aircraft purchase price.

To achieve the level of growth sought by the industry, Dr. Akinwumi Adesina suggested that the continent's carriers need to procure a substantial number of additional aircraft. Together with the necessary infrastructural improvements, he estimated this to require an overall financing amount of approximately US$150 billion. Given the statistics from IATA released at AFRAA's 49th Annual General Assembly held in Kigali, Rwanda in November 2017, though, indicating that African airlines collectively suffered losses of almost US$700 million in 2015 and more than US$130 million in 2016, it would appear that those airlines will struggle to obtain such finance and leasing packages from conventional sources, or without significant premiums being applied.

OPPORTUNITIES AND PROGRESS

The picture is not as wholly bleak as the decline of the last 30 years might suggest, though. In 2016-17, for example, Kenya Airways reported 4 percent year-on-year growth in load factor, complemented by a 5.4 percent increase in passenger numbers. The then CEO Mbuvi Ngunze also

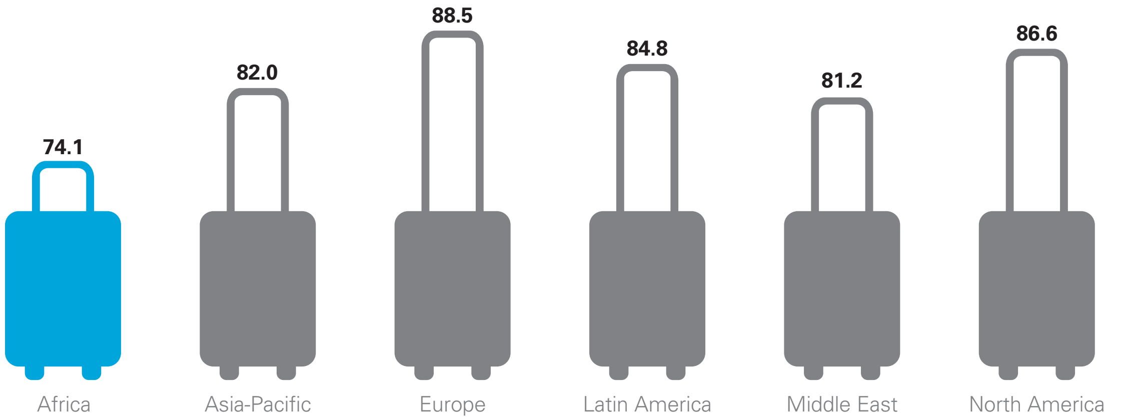
Figure 2: Flight freedom—the crucial 5th freedom is absent in much of Africa



5th freedom traffic rights by sub-region	West Africa	East Africa	Central Africa	North Africa	Southern Africa	Total
African carriers with 5th freedom	4	4	2	0	1	11
Non-African carriers with 5th freedom	6	7	3	1	0	17
Number of 5th freedom city-pairs	29	27	11	2	2	71
Total 5th freedom city-pairs (%)	41	38	15	3	3	100
Number of countries	16	13	7	2	2	40

Source: Manual on the Regulation of International Air Transport (Doc 9626, Part 4), AFRAA, Innovata

Figure 3: Passenger load factor (utilization) in flights by continents
(Percent)



Source: IATA (July 2016-July 2017)

highlighted reduced operating costs as a driving factor. In South Africa, Q2 2017 turned around a lackluster Q1 to indicate increased aviation activity in its key airports, and Q3 2017 was reported by the Commercial Aviation Association of Southern Africa to have consolidated its modest recovery.

Other carriers are pushing ahead with ambitious growth and expansion projects. EA has ordered 10 Airbus A350-900s (having been the first African carrier to operate these models in 2016), in tandem with an estimated US$345 million expansion project to increase passenger capacity at Addis Ababa's Bole International Airport. This progress has not gone unobserved—EA is one of the few African airlines allowed by the US Federal Aviation Administration to fly into the US. Following the success of Congo and Djibouti in resurrecting their flag carriers in 2015, Ghana—among others—has also recently announced its intention to re-establish its own. The signing of the Ezulwini Declaration of Regional Safety Oversight Organizations in Africa, in conjunction with the Global Forum on Regional Safety Oversight Organizations for Global Aviation Safety (jointly hosted by ICAO and the European Aviation Safety Agency), is another encouraging sign that ICAO is aware of the precedent for regional oversight of state safety regimes. Similarly, the ADB and IATA have signed a memorandum of understanding under which they will work in partnership to promote Africa's economic and social development by improving the safety, security and efficiency of its aviation sector. Should this partnership prove productive and see measurable improvements in these areas, African carriers could improve their chances of securing the investment necessary to develop and grow into airlines that can compete internationally. In addition, relatively low passenger load factors (utilization) on African flights, relative to global norms, also suggest scope for growing revenues even without further investment in infrastructure or fleet expansion (Figure 3).

Industry figures outside the continent are confident that the African aviation sector can make significant progress. The African Business Aviation Association (AfBAA) (founded in May 2012) was recently admitted to the membership of the International Business Aviation Council (IBAC). This was established in 1981 and holds permanent observer status at ICAO. IBAC Director-General Kurt Edwards has pointed to the growth in the number of African companies that demonstrate their commitment to safety and professionalism by achieving International Standard for Business Aircraft Handling and International Standard for Business Aircraft Operations registrations. "We look forward to working with AfBAA to further advance safety excellence across Africa," he said.

CONCLUSION

Africa's aviation sector has yet to become the catalyst for economic growth that the industry might have hoped for. Paradoxically, the slow uptake of the 1999 YD, which might reflect an underlying protectionist attitude to the industry, has allowed foreign airlines to extend their reach into the African market and pry revenue away from the African carriers.

While there is much to be optimistic about, and meaningful strides are being taken in the right direction to improve infrastructure to entice investment and support growth in the African aviation sector, the states need to fully commit to the SAATM at a political level in order to set in full motion the liberalization of the market and allow African carriers to operate successfully and competitively.

Green finance in Africa

Achieving sustainability objectives through innovative funding of climate-change projects

By Mindy Hauman and Tallat Hussain

The first green bond was issued only ten years ago, but since then the market's depth and volume has increased exponentially. Green issuances are now considered mainstream. While sovereign issuers were initially slow to issue them, they now realize that green bonds offer easy access to a large and diverse funding pool, providing a source of low-cost and much-needed capital to finance infrastructure projects and set up green funding programs.

The various forms of green finance are open to almost any sovereign. While France might have been a predictable early mover, very few would have bet on Poland and Fiji being among the first sovereign green bond issuers. This demonstrates that green bonds are a viable alternative to traditional financing mechanisms. There is no set issuer profile: Most sovereigns that can issue international bonds could also issue green bonds if they meet the criteria. Many African states have indicated their intention to facilitate and undertake green issuance at the sovereign level, some of which are in the pipeline for the not too distant future.

THE CASE FOR GOING GREEN

Almost every African sovereign is party to and has ratified the Paris Agreement[1] on climate change and has committed to reducing carbon dioxide emissions through national programs.[2] In developing the Paris Agreement, green bonds were identified as one of the most readily accessible and economical options available to nations to facilitate raising large amounts of capital to meet environmental targets and the funding of infrastructure projects that underpin them. Quite significantly, African nations are among the most vulnerable to impacts of climate change and therefore, many have a need for climate change adaptation and "sustainable infrastructure" such as public transport, water services or clean energy. According to the African Development Bank (AfDB),[3] the African region's vulnerability to climate change, translated as damage relative to GDP and population, is proportionally most acute. Financial requirements to adapt to climate change are projected to be between US$20 and US$30 billion annually until 2030. These can only be met through diversification of finance mechanisms and sources of funding. The particular climate-related challenges depend on the circumstances and geography of each nation. A summary of the key issues is shown in Figure 1.

These factors may drive decision makers to the green bond markets. Ambitious targets and limited public resources support the need for a large portion of projects that could be funded through green financing initiatives, tapping into a broad base of investors looking for exposure to green assets. Green financing mechanisms are a perfect fit for nations that must now balance the need for infrastructure projects with raising large amounts of capital to meet national targets and international commitments.

There is no shortage of potential green projects. In power generation alone, Africa's potential for renewable energy dwarfs levels achieved so far on the continent. Further investment in sustainable energy infrastructure could unlock this vast potential (Figure 2).

INTERNATIONAL DEVELOPMENTS

Financial institutions in Africa are becoming more active in facilitating green finance. The AfDB has played a major role in sustainable investment in Africa and is promoting green projects in national development planning. Between 2011 and 2015, AfDB mobilized approximately US$12 billion to support climate-resilient projects as part of its Climate Change Action Plan (CCAP).[4] The bank's African Climate Change Fund (ACCF)[5] is aimed at providing access to large amounts of funding for African countries to scale up green finance. Nations across Africa are also set to benefit from the International Finance Corporation (IFC) and Amundi's joint US$2 billion "Cornerstone" fund designed to buy green bonds issued by emerging market banks that would not otherwise attract institutional investors owing to their risk-return profiles.

> **There is no set issuer profile, so most sovereigns that can issue international bonds could also issue green bonds if they meet the criteria.**

Irrigated agricultural crop circles in Johannesburg, South Africa.

Figure 1: Potential climate change risks

Farmers' yields will fall
Climate change is likely to reduce yields of major cereal crops across Africa. In **Namibia**, for example, climate impacts on agriculture could reduce annual GDP by between 1% and 6%. **Nigeria** and **Kenya** could be similarly impacted.

Extreme weather will increase
Global warming changes the frequency, intensity, extent and duration of weather and climate extremes. These include more pronounced droughts, floods, heat stress and tropical cyclones. **Morocco**, **Ethiopia** and **Nigeria** are particularly vulnerable to such weather.

Disease and malnutrition
Extreme events such as flooding can combine with longer-term changes such as warmer temperatures to spread infectious diseases, shift malaria regions and exacerbate malnutrition. Among others, **Mozambique**, **DRC** and **Ghana** will be affected.

Water resources may dwindle
Changes in rainfall could reduce water availability in some regions. As many as 90 million people would be at risk if rainfall drops to the point at which groundwater resources become non-renewable. This will be a problem particularly for **Zambia** and **Namibia**.

Impacts on energy generation
Energy production that depends on hydropower will be most affected. Rainfall changes may increase capacity to generate in East Africa but decrease it in West and Southern Africa. **Angola** and **Côte d'Ivoire** will be negatively affected.

Rising sea levels threaten cities
Most of Africa's biggest cities are on the coast, including Accra, Dar es Salaam, Lagos and Maputo. Millions of people could be at risk from flooding in **Mozambique**, **Ghana** and **Gabon**.

Fisheries under threat
Rising ocean temperatures and ocean acidification are radically altering aquatic ecosystems. This jeopardizes the sustainability of fisheries and aquaculture, and the livelihoods of the communities that depend on fisheries, such as those in **Gabon**, **Namibia** and **South Africa**.

Source: AfDB

THE OIL ECONOMIES

Nigeria

Despite its economy being heavily reliant on fossil fuels, Nigeria is at the forefront of preparing to transition to a sustainable future. One of the keys to unlock green bond success for Nigeria will be to cultivate and preserve investors' confidence by complying with the Nigerian green bond framework together with SEC Nigeria's new listing rules, which codify the criteria and approval process of green bonds in Nigeria. To qualify as a green project, the investment must fall into one of eight listed categories that largely mirror the categories of the Green Bond Principles[6] (GBP). Other requirements aligned with the GBP include a green use of proceeds commitment; the process for evaluation and selection of projects; and reporting.[7] This framework is consistent with the Nigerian green policy drive and is timely, given that Nigeria's much anticipated debut sovereign green bond came to market in December 2017. This was the first sovereign green bond to gain the coveted certification of the Climate Bonds Initiative and sets a strong precedent for other African sovereigns to follow.

Angola

Like Nigeria, Angola's economy is heavily oil-reliant. Fluctuating oil prices have amplified the importance of investment in other sectors, not only to reduce its exposure to oil and create a stronger buffer against market volatility as fossil fuel becomes a less viable long-term investment. The abundance of rivers in Angola also creates considerable opportunity for hydropower projects. Many projects have been completed, and there are many more in the pipeline geared to help meet the country's ambitious hydroelectric energy generation target of 9,000 MW by 2025.

Gabon, Ghana, Côte d'Ivoire and Democratic Republic of Congo

These nations have all benefited from their booming fossil fuel industries over the past decade, however, falling oil prices in 2016 hit their local economies hard and for some, oil reserves may be in decline. Therefore, each government has a strategy to diversify its economic interests going forward. Forestry, agricultural and mining industries are set to benefit from this diversification, and instilling sustainability as a core principle at the heart of developments will be vital to achieving success through green finance.

Figure 2: Renewable electricity generation by region (2015)
(TWh)

Generation	Hydro	Wind	Bio-energy	Solar	Geo-thermal	Marine	Total
Africa	119	8	3	4	4	<1	137
Asia	1 577	229	122	94	24	<1	2 044
Central America & Caribbean	24	4	4	1	4		37
Eurasia	248	12	1	0	4	<1	265
Europe	562	306	179	110	12	<1	1 168
Middle East	20	0	0	2	0		22
North America	633	226	82	38	25	<1	1 033
Oceania	40	14	4	6	8	<1	72
South America	642	27	61	2	<1	<1	732
World total	**3 893**	**826**	**456**	**256**	**81**	**1**	**5 512**

Source: IRENA

THE RENEWABLE ENERGY FRONTRUNNERS

Morocco

Morocco is among those spearheading the development of a green bond market in Africa and the regulatory infrastructure to support it, as part of its commitment to a lower-carbon economy. In the wake of Morocco's hosting of the 22nd Conference of the Parties to the United Nations Framework Convention on Climate Change, the Moroccan Capital Market Association (AMMC) published a green bond framework and practical guidelines for green bond issuance.[8] Among the first to benefit from this was the Moroccan Agency for Solar Energy (Masen), which issued Morocco's first green bond to finance the country's development of solar power projects. Morocco aims to obtain 52 percent of its electricity from renewable energy sources by 2030,[9] and eventually seeks to export its solar energy to Europe.

Ethiopia

Ethiopia is well recognized for its commitment to building a climate-resilient (and middle-income) economy by 2025. The Ethiopian government has published a comprehensive strategy paper[10] on how to achieve this. Ethiopia is now the largest producer of hydropower in Africa and is aiming to increase its current output five-fold by 2030.[11] The country has declared its ambition to become the energy hub of East Africa and already exports energy to Sudan and Djibouti, and will soon export to Kenya as well.[12] It is also developing power stations and grids based on other renewable energies to reduce reliance on hydropower, which requires rainfall to function. These developments are prime candidates for funding through sovereign green bonds.

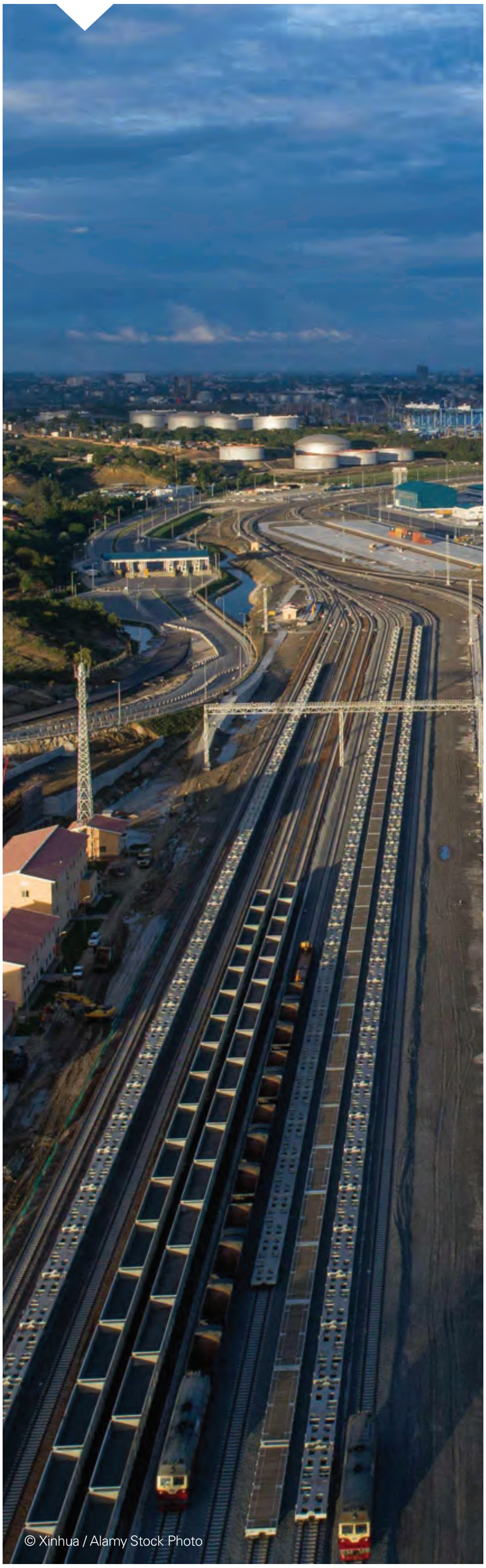
THE MUNICIPAL BOND INNOVATORS

South Africa

South Africa has the most developed bond market in Africa and, like many jurisdictions across the world, it issued green bonds at the municipal level first. The City of Cape Town and the City of Johannesburg have each issued green bonds, the proceeds of which were used for local climate change mitigation and adaptation projects providing examples for other municipalities to follow.[13] A positive market signal recently came from the Johannesburg Stock Exchange, which launched its Green Bond Segment and Green Listing Rules in October 2017,[14] promoting further green bond issuance in the jurisdiction. Through this pioneering move, South Africa is seen as positioning itself as a gateway to green investment in sub-Saharan Africa.

Ouarzazate Solar Power Station in Morocco.

Mombasa passenger depot of the Mombasa-Nairobi standard gauge railway in Kenya.



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THE CLIMATE-VULNERABLE STATES

Kenya

Sustainable finance is particularly important for Kenya owing to its vulnerability to the effects of climate change—in particular drought and flooding. Government coffers alone cannot bridge the financing gap of what is needed to transition to a sustainable economy. As part of its Vision 2030 campaign, Kenya's ambition is to reduce greenhouse gas emissions by 30 percent by 2030 with the goal of becoming a middle-income country based on sustainable development. To date, the Kenyan government has focused on developing a green bond framework and incentivizing the development of renewable energy, prioritizing geothermal, wind and biomass. Sustainable transport is also on Kenya's agenda after the success of the recently completed Mombasa-Nairobi railway, which is planned to connect to Uganda, the Democratic Republic of Congo, Rwanda, South Sudan and Ethiopia.

Mozambique

Mozambique's vulnerability to climate change impacts can be seen through recent extreme events of drought and flooding, which have repeatedly set back the already struggling economy. Against this background, the Mozambique government has produced an ambitious "Roadmap for a Green Economy," making it a national objective for Mozambique to become a middle-income country based on inclusive, efficient and sustainable development by 2030.[15] Commitment to this objective has, to an extent, been solidified by the government's Green Economy Action Plan, which sets out a strategy for the development of a sustainable green economy. Key entry points were identified as sustainable infrastructure, efficient and sustainable use of natural resources, and strengthening resilience and adaptability to climate change. Government funding is limited in its ability to address each of these broad targets, therefore coordination with supranational and private capital will be essential, and attracting international capital through green bonds will be invaluable. Investor confidence may have to be rebuilt initially from a municipal level following the sovereign default in January 2017, although foreign debts have become easier to service after a 19 percent rise in value of the Mozambique metical against the dollar last year.

Namibia and Zambia

Other countries that are particularly vulnerable to climate change include Namibia and Zambia, whose vibrant wildlife reserves are susceptible to drought and desertification. Conservation, sustainable tourism infrastructure and the protection of wildlife and the ecosystems they interact with need capital injection, as do projects that alleviate the impact on subsistence communities that are completely dependent on the natural environment in which they live. Furthermore, the impact on climate change on the cost of staple foodstuffs could be devastating (Figure 3).

Figure 3: Impacts of climate change

	Maize	Rice	Wheat	Other crops
Growth rate decrease	12%	23%	13%	8%
Price increase	90%	89%	75%	83%

Source: Farming First

CHALLENGES FOR SOVEREIGN ISSUERS

One of the key challenges for a first-time sovereign green bond issuer is its commitment to developing green framework legislation. Green frameworks play a key role in encouraging green finance within a jurisdiction through transparency and commitment and send an important signal to markets globally. With regional and global examples in place, African nations should continue to develop green bond frameworks and identify a pipeline of eligible green projects that could be financed under each framework. In some cases, it may be easier to begin on a small scale with a municipal issuance, rather than lead at the sovereign level. Sub- and quasi-sovereign issuers have been comparatively prolific and diverse in terms of geography, economic development and project type, further demonstrating the versatility of green bonds and their ability to be tailored to local circumstances.

In order to meet global commitments under the Paris Agreement, 33 percent of oil reserves, 50 percent of gas reserves and 80 percent of coal reserves globally may have to be left in the ground. Several African countries will need to look at scaling down their exposure to the fossil fuel industry if they are to meet their commitments. At the same time, growth will need to be achieved in other sectors to replace the revenues no longer being earned from fossil fuels. Real sustainable alternatives to fossil fuel-based power production will need to be developed, financed and implemented to meet low-carbon energy demands. Governments will need to make public policy shifts in favor of a greener and more climate-resilient economy. Government involvement is also vital for encouraging the green finance market through the creation of fiscal policy that makes holding green assets more attractive.

The extreme lack of electrical infrastructure in many parts of Africa presents an opportunity for African countries to be at the cutting edge of sustainable development, not only in the power sector. Lack of legacy infrastructure based on fossil fuels allows countries to adopt international best practices, tailored to unique African conditions. This should allow African countries to develop without the same level of environmental harm as developed Western economies experienced at the height of their use of fossil fuels.

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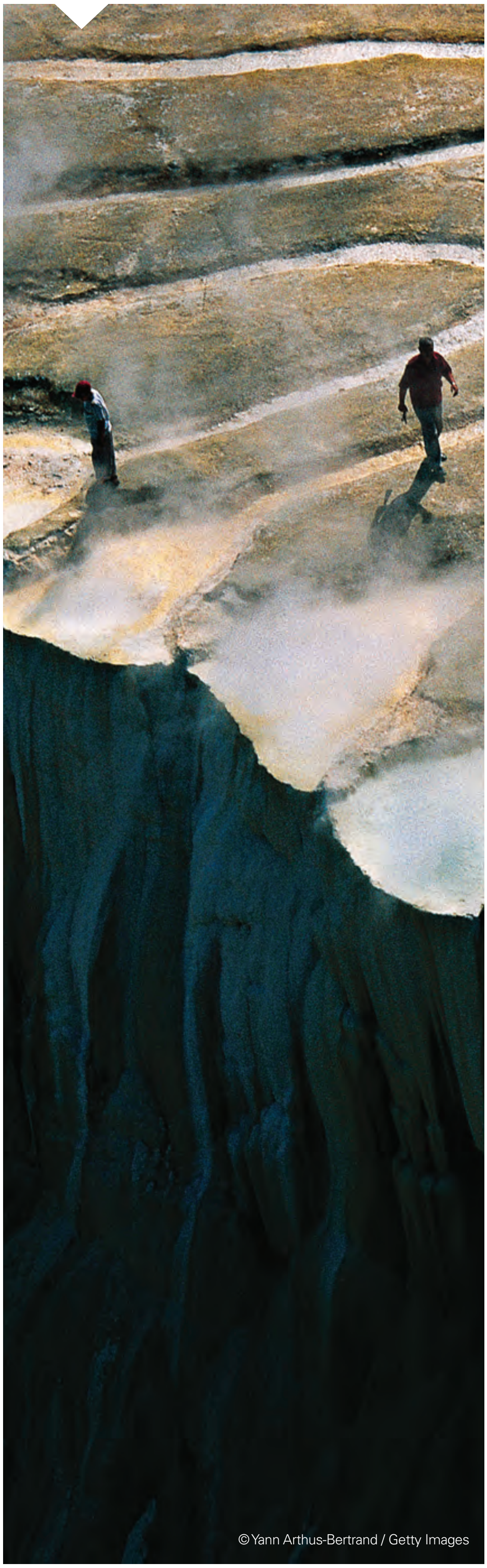
1 https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf
2 The Paris Agreement requires each party country to propose strategies for achieving the goal through 'nationally determined contributions' ("NDCs") that must be submitted to the UNFCCC in order to track progress on meeting their targets.
3 https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Cost%20of%20Adaptation%20in%20Africa.pdf
4 https://www.afdb.org/fileadmin/uploads/afdb/Documents/PolicyDocuments/Climate%20Change%20Action%20Plan%20%28CCAP%29%202011-2015.pdf
5 https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/africa-climate-change-fund/
6 https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/GreenBondsBrochure-JUNE2017.pdf
7 SEC Nigeria proposes new rule for green bonds [Federal government] to Launch First African Sovereign Green Bond in December https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Cost%20of%20Adaptation%20in%20Africa.pdf
8 www.ammc.ma/sites/default/files/AMMC%20BROCHURE%20VGB.pdf
9 http://www.masen.ma/en/actualites-masen/masen-issues-moroccos-first-green-bond-91/
10 http://www.greengrowthknowledge.org/sites/default/files/downloads/resource/Ethiopia_Climate_Resilient_Green_Economy_Water_Energy.pdf
11 https://www.hydropower.org/sites/default/files/publications-docs/2017%20Hydropower%20Status%20Report.pdf
12 https://www.hydropower.org/country-profiles/ethiopia
13 In July 2017, the City of Cape Town issued a 10-year, R1 billion green bond, which will fund adaptation and mitigation initiatives including procurement of electric buses, energy efficiency and water management.
14 https://www.jse.co.za/articles/Pages/JSE-launches-Green-Bond-segment-to-fund-low-carbon-projects.aspx https://www.afdb.org/fileadmin/uploads/fdb/Documents/Generic-Documents/
15 https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/Transition_Towards_Green_Growth_in_Mozambique_-_Policy_Review_and_Recommendations_for_Action.pdf

Hammam Meskoutine hot springs, a potentially major geothermal resource for Algeria.



Oil & gas exploration.

Angola and Mozambique: Oil & gas and mining

Planning for the up-cycle and managing risks in Lusophone Africa

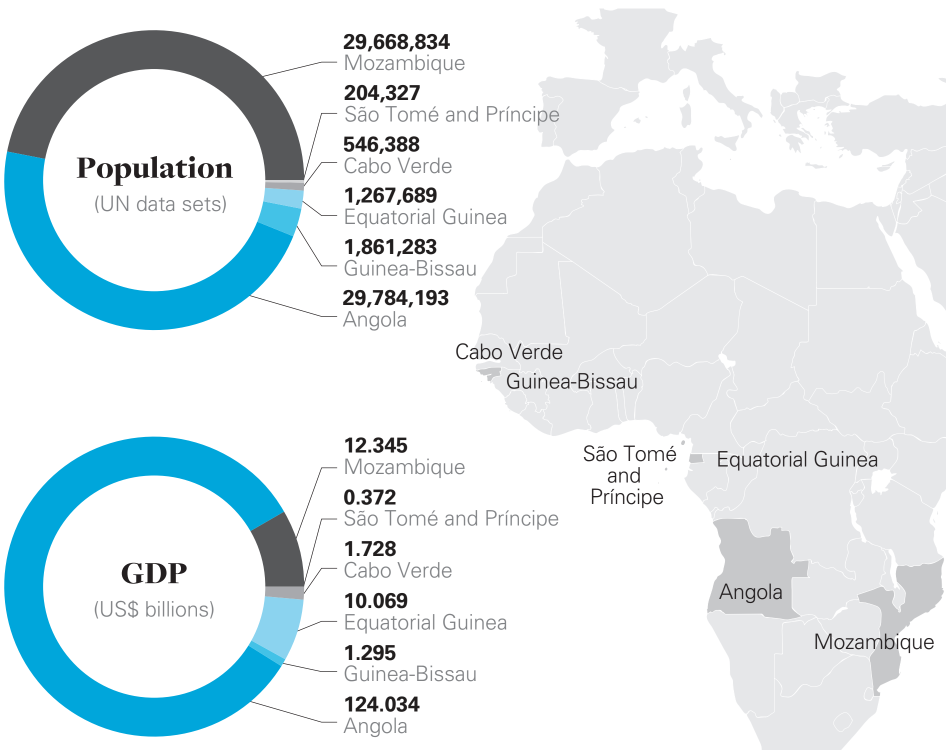
By Luiz Aboim and Natalie Lucas

Between them, Angola and Mozambique represent 94 percent of the population and 91 percent of the 2017 collective GDP of Lusophone Africa (Figure 1). In the early part of this decade, investors were very optimistic about oil-rich Angola's prospects and those of Mozambique, with its vast gas and mineral reserves. A market consensus existed, though, that the heavy reliance on natural resources and the general lack of diversification left these two countries' economies dangerously exposed to global commodity price fluctuations—especially in oil and coal.

Contracting oil and coal prices since 2014 have severely impacted the economies of Angola and Mozambique. Reduced revenues and increased debt have undermined their ability to finance the infrastructure needed to unlock the wealth from their vast natural resources, to develop their human capital and to grow and diversify their economies. Since 2013 Mozambique has attracted investment into a number of industries besides coal, oil and natural gas (Figure 2). In Angola, though, the investment into its coal, oil & gas sector has continued to dwarf all other industry sectors (Figure 3).

In this article, we examine some of the challenges that Angola and Mozambique will face in coming years if they are to consolidate their positions in the African oil & gas and mining sectors. We also explore how investors can use the existing legal frameworks in those countries to mitigate legal risk.

Figure 1: GDP and population of African Lusophone countries (2017)



Source: IMF for GDP, United Nations for population

ANGOLA—DECREASING OIL OUTPUT AMID ONGOING FINANCIAL CRISIS

The oil boom turned Luanda into one of the most expensive cities in the world in which to live. But Angola's reliance on oil—which, according to OPEC, represents more than 95 percent of its exports[1]—has taken its toll as commodity prices declined. Government payments on foreign debt reached 44 percent of Angola's revenues in 2016, the heaviest debt burden on the African continent.[2] It remains unclear whether the 2017 election of João Lourenço as President, after 38 years of Eduardo dos Santos as President, will result in the changes needed to address the impact of low oil prices, and soaring debt. Mr. Lourenço's swift replacement of key government individuals and executives, including the chair of Angola's state-owned oil company Sonangol, has been viewed with cautious optimism by the market. It is yet to be seen if these are signs of meaningful structural reforms.

As this article went to print, the governor of the Angolan central bank appointed by Mr. Lourenço announced that it will end the kwanza's peg to the dollar before the end of the first quarter of 2018, allowing the Angolan currency to fluctuate within an undisclosed band, and that it intends to renegotiate Angola's debt. This announcement sharply depressed the value of Angola's US dollar-denominated debt, putting further pressure on

Figure 2: Mozambique—capital expenditure by industry sector
(US$ million)

4,457 Coal, oil and natural gas	10,471 Real estate	4,396 Transportation	2,364 Wood products
1,920 Food & tobacco	1,198 Warehousing & storage	769 Metals	370 Communications
499 Building & construction materials	417 Alternative/ renewable energy	342 Financial services	9 Industrial machinery, equipment & tools

Source: fDi Intelligence

Figure 3: Angola—capital expenditure by industry sector
(US$ million)

18,428 Coal, oil and natural gas	0 Real estate	46 Transportation	0 Wood products
75 Food & tobacco	197 Warehousing & storage	179 Metals	310 Communications
109 Building & construction materials	0 Alternative/ renewable energy	66 Financial services	233 Industrial machinery, equipment & tools

Source: fDi Intelligence

the kwanza—which has already devalued by 41 percent since 2014. Furthermore, parallel market trading at approximately twice the official rate suggests that a far more significant devaluation might be possible. Bondholders, other sovereign creditors and foreign investors with credit in kwanzas should follow these developments closely, especially given Angola's tightening of its foreign exchange policies since 2014.

Angola may not be able to rely on oil revenues in sovereign debt renegotiations or to alleviate the impact of the kwanza's devaluation. Despite the forecast of a boost in oil production in 2018 due to Total's Kaombo Field, production is set to decline from 2019 onwards due to the lack of investment in the sector during the downturn. The improvement in oil prices in December 2017 alone is unlikely to offset the decline in oil production. Sonangol will have a difficult time ahead, partly related to disputes arising out of (at least in part) the depreciation of oil prices and the consequent slowdown in investment in exploration projects by investors. The mid-December 2017 announcement of the settlement of a protracted dispute with Cobalt is a sign that Sonangol (now under new leadership) may take a more pragmatic approach in handling those disputes so that it can focus on its business.

Angolan mining and agricultural sectors are not sufficiently developed to fill the oil revenue gap, and the government is unlikely to be able to invest quickly and efficiently enough to deliver the infrastructure required to diversify Angola's economy. Other sectors, such as consumer products and telecoms, have been adversely affected by the economic downturn. This has given rise to several billionaire corporate disputes in the telecoms space, as businesses aggressively compete for alternative sources of cash.

Chinese and other foreign support have helped Angola thus far through the crisis, but long-term solutions will be deeply dependent on diversification of Angola's economy. Here lies the greatest challenge for the Angolan government and simultaneously the greatest opportunity for its investors in sectors other than oil & gas.

MOZAMBIQUE—MAJOR GAS AND MINING OPPORTUNITIES REMAIN DESPITE ONGOING FINANCIAL CHALLENGES

Until very recently, Mozambique was largely seen as a success story. This perception, despite its ongoing dependency on donations and considerable delays in major mining and gas projects, was needed to boost the country's economy. However, large planned projects had not yet come online before the commodities crisis hit in 2014, and the deterioration of Mozambique's financial position, among other factors, prompted intervention by the IMF.

The government of Mozambique and investors alike have been working to improve the country's financial and economic landscape. For example, Brazilian mining giant Vale and Japanese Mitsui & Co. signed the US$2.73 billion financing of the Nacala Corridor Railway and Port Project with project finance lenders in early December 2017. Widely reported as Africa's largest-ever infrastructure deal, the cross-jurisdictional project—the construction and refurbishment of a 912-km railway line to transport coal from the Moatize mine across Malawi to a new coal deep seaport in Nacala-à-Velha on the eastern coast of Mozambique—will be a major step toward unlocking the country's coal reserves for export and helping Mozambique to become a major player in the global mining market. In addition, when Anadarko's Area 1 LNG project and Eni/Exxon Mobil's Area 4 FLNG Project both come on stream, these projects will be instrumental in placing the country among the largest LNG exporters in the world. In addition, the government of Mozambique continues to address the fallout from the non-disclosure to the IMF of certain state-guaranteed loans incurred in 2013 and 2014. The consequent suspension of IMF lending and donor budgetary support to Mozambique has created significant fiscal pressures, and a restructuring of the government's external debt to improve medium-term debt sustainability remains pending.

As with Angola, Mozambique's main challenge is to build the infrastructure to diversify its economy and deliver wealth through different sectors. The government remains under considerable fiscal pressure. Although spending may be sustained until local and general rounds of elections take place in 2018 and 2019, respectively, foreign investment will continue to play a key role in Mozambique's ability to position itself as a major player, be it in the natural gas or mining sectors. In addition, the country will also need to manage the political conflict between its FRELIMO party and the RENAMO opposition.

PLANNING FOR THE UP-CYCLE AND MANAGING RISK

It will take a number of years for Angola and Mozambique to fully realize their potential to become part of the premier league for oil & gas and mining within Africa and globally. However, the sheer size of the opportunities in these Lusophone countries justifies the appetite of both public and private global investors in the oil & gas and mining sectors.

Despite their similar official language and colonial past, Angola and Mozambique have a number of country-specific political, economic and institutional challenges to address as they pursue investors' attention and seek to unlock wealth from the exploration and development of their natural resources.

Investors targeting the up-cycle in the oil & gas and mining spaces, in addition to the usual operational risks, will need to manage and seek to mitigate the associated legal risks. Sponsors may seek to mitigate these risks through the structuring of investments, typically alongside tax planning, to attract protection under Angola's and Mozambique's bilateral investment treaties. These treaties allow investors of signatory states to bring arbitration proceedings directly against these states, for instance, in cases of discriminatory expropriation.

At the project level, some investors in Angola and Mozambique are seeking to mitigate legal risks by including arbitration clauses in key contracts. Angola and Mozambique provide reasonably good and modern dispute resolution frameworks for investors, and courts are slowly becoming familiar with and supportive to arbitration. Both countries have enacted modern arbitration laws, and ratified the New York Convention of 1968 on the enforcement of arbitral awards. The latter binds the slowly improving local courts to respect arbitration clauses as a matter of international law, and entitles the winning party to reasonably and readily enforce arbitral awards against the losing party's assets in more than 100 signatory countries.

Despite Angola's and Mozambique's reasonably good legal frameworks for dispute resolution, mitigation of risks at the early development stages of projects and in support of exit strategies typically require not only Portuguese language capabilities and understanding of the local culture, but also experience in working with local co-counsel in what are heavily fragmented and tight legal markets.

“The sheer size of the opportunities in these Lusophone countries justifies the appetite of both public and private global investors in the oil & gas and mining sectors.

1 http://www.opec.org/opec_web/en/about_us/147.htm

2 http://jubileedebt.org.uk/countries/angola

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