

ARM-HARITH INFRASTRUCTURE INVESTMENT LIMITED



Opuayo Oforiokuma
Managing Director &
Chief Executive Officer

ARM-Harith Infrastructure Investment Limited (ARMHIL) is the fund manager of the ARM-Harith Infrastructure Fund (ARMHIF), a closed-ended specialist infrastructure fund established by Asset & Resource Management Company Limited of Nigeria (ARM), in partnership with Harith General Partners Proprietary Limited (Harith) of South Africa. ARMHIL is based in Nigeria and Ghana, and has over 70 years of proven infrastructure experience in Africa and globally.

AVCA speaks to Opuayo Oforiokuma, Managing Director and Chief Executive Officer, about investing in African infrastructure, mobilising local capital, and key drivers of demand in the infrastructure sector.



Q: Why did ARM and Harith General Partners come to join forces?

A: ARM was established in Nigeria in 1994 and set up as a traditional asset management firm, offering wealth management solutions for individual investors. The company then evolved into institutional asset management and grew its skills set to serve broader asset classes such as pension funds, life assurance, real estate and hospitality, and generalist PE. As part of this journey, ARM became involved in infrastructure projects, initially through an airport concession in Nigeria, and then the Lekki Toll Road – Nigeria’s first ever public-private partnership (PPP) toll road concession. As ARM consolidated its strengths in the infrastructure sector, it decided to deepen its involvement in the sector by establishing an Infrastructure Fund. During this process, the synergy with Harith, an already established infrastructure-focused private equity (PE) firm based in South Africa, became increasingly apparent.

ARM was well positioned in Nigeria with plans to expand across West Africa, while Harith had a strong track record in infrastructure funds, having already raised its first Pan African Infrastructure Development Fund (PAIDF1), and being in the process of raising its second, PAIDF2. Both ARM and Harith were aligned in seeking opportunities outside the infrastructure sector as well, and they saw exciting potential that could be explored by collaborating in West Africa. They established the ARM-Harith Infrastructure Fund (ARMHIF) as a joint venture, and established ARMHIL to independently manage the Fund.

GENERAL PARTNER

ARM-Harith Infrastructure Investment Limited

FUNDS

ARM-Harith Infrastructure Fund

GEOGRAPHIC FOCUS

West Africa
Cote d’Ivoire
Ghana
Nigeria
Senegal

Q: What differentiates ARMHIF from other African infrastructure-focused fund managers?

A: There is a combination of factors. Firstly, our unique skillset and expertise set us apart. ARMHIF is specifically focused on infrastructure, whereas many funds in Africa tend to be more generalist PE funds. What's more, the specialist infrastructure funds that do exist in Africa tend to be managed by the bigger international players, e.g., Old Mutual, Emerging Capital Partners, The Abraaj Group (Abraaj), and The Carlyle Group. Amongst these international firms, ARMHIF is something of a pioneer, as the first indigenously developed and managed infrastructure fund to have been approved by the Nigerian Securities and Exchange Commission. We are also the first infrastructure fund to have secured commitments from Nigerian pension funds, and to have closed with Nigerian pension fund capital.

Q: For a long time, people have talked about motivating pension funds to invest in African infrastructure. How have you managed to convince local institutional investors to make commitments to the ARM-Harith Infrastructure Fund?

A: It is important to note that the infrastructure asset class is relatively new, and is perceived as being associated with substantial risk. Many governments, bankers, and fund managers have not closed infrastructure deals, and where they have, their experiences have not always been good. There is therefore a degree of wariness towards the sector. But when you think that over 70% of the Nigerian population, for example, is under 20 years old, you should realise the need to think in terms of long-term horizons when considering the future workforce – Nigerian pension funds need to provide for the long-term liabilities that will arise from catering for that market. Infrastructure as an asset class fits well into this dynamic – it can provide steady long term, risk-adjusted, and inflation-linked returns.

For us, it was essential to communicate these messages and to demystify infrastructure as an asset class, in marketing ARMHIF to the pension funds. We also realised that the Nigerian pension funds were ill-equipped to do the due diligence that would be necessary to give them the confidence to make their investment decision about our Fund. So, we connected them with the African Development Bank (AfDB), who was also undertaking due diligence

at the time with a view to becoming an anchor investor in ARMHIF. Through the joint due diligence with the AfDB, the Nigerian pension funds had the opportunity to learn about what infrastructure investments really entailed and how to properly evaluate an Infrastructure Fund. This provided some relief to the pension funds as they felt comfortable with the AfDB, an experienced investor with knowledgeable sector experts and legal experts, leading the due diligence process. AfDB deserves a lot of credit for the role it played in our success with the pension funds, both as an anchor investor and complementing ARMHIF's own efforts of maintaining a regular dialogue with the pension funds, and providing them with information and explanations as required while we marketed the ARMHIF investment opportunity to them.

Q: In your view, are pension funds now more comfortable with the prospect of investing in infrastructure?

A: I believe they are. In Nigeria, we must recognise the contribution of the Pension Commission (PenCom), which has been very forward-thinking and has helped the cause of encouraging pension funds to invest in infrastructure, by amending the investment guidelines and regulations to provide clarity for pension funds to make investing in the asset class easier. Alongside PenCom, you also have the Pension Fund Operators Association of Nigeria (PenOp) to commend, which has acted as a voice for the industry. The strong leadership and the technical committee at PenOp has been effective in advocating for greater investment in infrastructure.

We are now at a stage where pension funds increasingly reach out to us to find out more about the investment opportunities, and we now see a general trend of pension funds becoming more enthusiastic about infrastructure. And this is not only in Nigeria. Look at South Africa, which is home to 78% of African pension funds – the South African Government Employees Pension Fund is a major investor in the Pan-African Infrastructure Development Funds (PAIDF1 and PAIDF2) managed by Harith, and the Eskom Pension and Provident Fund (EPPF) has invested in a variety of infrastructure projects through Abraaj, as well as in telecoms infrastructure through Helios Investment Partners.

“We are now at a stage where pension funds increasingly reach out to us regarding investment opportunities in the infrastructure space...”

In terms of bringing pension funds on board, I think the key is for fund managers to demonstrate solid experience and a good track record, and to structure their products in a way that gives pension funds the confidence to invest with them. We are also seeing encouraging signs of other African pension funds' willingness to invest across borders – in Botswana, for example, the regulations enable pension funds to invest up to 70% of their capital outside the country.

Q: How do you think sources of funding for infrastructure in Africa will evolve?

A: I think the African PE industry has the DFIs to thank for much of its progress. I also believe that DFIs will continue to play an anchor role in terms of funding African infrastructure. Whereas commercial capital is often unaffordable, DFIs enable capital to flow into Africa with more reasonable pricing and a truly developmental focus. While I expect DFIs to continue providing the bulk of African infrastructure funding in the near term, we need more domestic capital to be involved in African deals over the long term. Foreign investors will not remain forever – they need to exit and repatriate capital home. Hence, African investors should be there to take over their stakes when these primary investors want to exit.

We need to see more private and institutional capital working alongside DFIs in Africa - the scope for increasing pension fund participation is huge if you consider the large savings pools that pension funds represent, and the scope for those savings pools to grow as more people are brought into the pension framework. DFIs are constrained in some ways – they do not have an infinite source of finance. So, it is important to develop new pools of capital, such as pension funds and sovereign wealth funds, to continue propelling Africa's growth.

Q: Where has ARMHIL committed capital to date, and what is your strategy for the continent or West Africa specifically?

A: We have closed two deals, both in the energy sector. The first, which we closed in December 2015, was the Azura-Edo Independent Power Project (IPP), a 459 MW Open Cycle Gas Turbine power station under construction near Benin City in Edo State, Nigeria, at a total cost of US\$868mn. This is the first

phase towards a 1,500 MW IPP facility, and is under a twenty-year licence for electricity generation from the Nigerian Electricity Regulatory Commission (NERC). The overall transaction is underpinned by financial guarantees from the Nigerian government through a Put-Call Option Agreement (PCOA) that complements the Power Purchase Agreement (PPA) between the Azura-Edo IPP and the Nigerian Bulk Electricity Trading PLC. The Azura-Edo IPP also benefits from a World Bank Partial Risk Guarantee as well as political risk insurance from the Multilateral Investment Guarantee Agency (MIGA), part of the World Bank group. The project is in construction, now at 90% completion, and is on target to deliver power supply in 2018.

The second is the US\$552mn Amandi IPP, the only large-scale power generation project in sub-Saharan Africa to reach financial close in 2016. The Amandi Project is a 192.4 MW combined cycle power station under construction in Aboadze, Ghana, currently around 12% complete, and expected to come into supply in 2019. Both plants will provide power to nearly 30 million people in Nigeria and Ghana when complete, and both have been recognised with international awards. The Azura-Edo IPP won, amongst others, *EMEA Finance's* PPP prize in 2015, while the Amandi Project was named 2016 African Power Deal of the Year by *Project Finance International*. The Azura project has pioneered a template that we see being followed in Nigeria, as well as in Burundi, Ghana, and Senegal, with the PCOA established as an example of best practice in infrastructure financing. Besides these two major deals, we are also working on a 100 MW solar plant in northern Nigeria as part of the Nigerian government's solar energy programme. This is due to reach financial close in the second quarter of 2018. We have also recently signed equity terms for a port project in Ghana.

Our focus is the West Africa sub-region, with key markets being Nigeria, Ghana, Côte d'Ivoire, and Senegal. Going forward, we will be seeking investments across other ECOWAS member states. In terms of our investment strategy, there are several things we look for: firstly, a well-structured transaction with good risk-adjusted returns and reliable counterparties. We typically look for minority stakes with significant influence, which includes a seat on the board and operational influence. Discipline is important to us, in terms of setting prudential limits, maintaining strict governance, and being thorough in due diligence. Finally, we have a strong focus on environmental, social and governance (ESG) standards, and make a concerted effort to show ourselves to be honest contributors, making a strong and positive environmental impact through our investments.

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Q: In your view, what are the key drivers of demand in the infrastructure space?

A: The first and most obvious is population growth. Nigeria, for example, has an average annual population growth rate of around 2.5 - 3% and will surpass the USA as the third most populous country in the world by 2050, according to a UN report. With that growth comes a realisation that if we do not make attempts to close the infrastructure gaps in education, energy, transport, healthcare, water, etc., millions of people will continue living in poverty. So, there is a need for better infrastructure and increased social services. Another driver is rapid urbanisation, where we foresee even bigger cities and large scale rural-to-urban migration. This provides a fantastic opportunity for the infrastructure sector to keep connecting people in remote and rural areas to those in the cities. Economic development planning is also a driver of demand. Diversification forms a key part of the Nigerian government's agenda. Nigeria is now trying to boost its agriculture and manufacturing sectors, and to export more goods. With farms located in rural areas, it is essential to provide better infrastructure to support the economic diversification strategy. This includes cold chains and storage facilities as well as transport infrastructure to move goods quickly to market and export, whether by road, rail or water.

We see many opportunities across the infrastructure spectrum, which we approach with a three-fold focus: first is transportation – bridges, airports, rail, and sea ports; second is energy – specifically power generation and distribution, and gas processing; third are utilities projects – water and waste water treatment projects, as well as telecoms. In terms of where transactions are taking place, there have been some transportation projects but not a lot of road concessions outside of South Africa. The Lekki Toll Road that I mentioned earlier was almost a unique case in this respect in Nigeria, and the Henri Konan Bédié Toll Bridge Concession is the first of its kind in Cote d'Ivoire. There has also been the Diamniadio Highway in Senegal. Having said that, we are seeing a resurgence of transportation, with a few airport and rail developments emerging in countries like Ethiopia, Kenya, Nigeria, and Senegal. The lack of capacity in energy and power generation, distribution and supply is currently seen as the biggest impediment to Africa's growth, so there are a few transactions taking place in this space. There was the privatization of Nigeria's electricity sector, amongst the largest in the world, and new IPPs like the Azura-Edo IPP in Nigeria, Lake Turkana Wind Farm in Kenya, Cenpower IPP in Ghana, and the Amandi IPP in Ghana. Eventually, we will see more opportunities emerge in utilities, but there are currently not enough. Likewise, in healthcare and education, we anticipate change and an increase in demand.

Q: From a political and regulatory standpoint, do you think the climate for investing is becoming less challenging?

A: There certainly has been some change, and the investment climate is much better. Legislative reforms have made it possible for private investors to get involved in the infrastructure space, whereas previously people thought it was solely the government's responsibility to provide infrastructure. We still need greater clarity in terms of the rules of the game across the board, but overall, governments are becoming more and more educated about infrastructure projects. This is important because PPPs and infrastructure project finance models are often quite complicated. Moreover, because PPPs involve allocating risk around a whole partnership, the government also has a responsibility to shoulder some of the risks with the private partners. Concessionaires also need to be confident of their ability to enforce legal rights.

I think the desire to improve living standards in Africa has galvanised a wide range of stakeholders – not only investors but also politicians at the top level. Democracy is getting stronger in Africa, and politicians are now under more pressure to act in the interest of the populace. Legislation is only the start – it must be applicable in practice, and one should be able to enforce contracts. Operators, providers, and governments are realising that these partnerships are like a marriage – they are intended to last over the long term, and are part of an evolving process that allows all parties to continue learning as they progress. As a result, it is crucial that agreements are flexible so that issues can be dealt with as they arise, without derailing the process.

Overall, I think the investment climate is certainly improving. African governments are more knowledgeable than they were ten years ago, which means that they are more open to engaging the private sector and using specialist consultants to improve their knowledge. The gap between the private sector and governments has narrowed; governments have better technical capacity and more commercial experience; and projects have become more stable.

Q: How do you see competition for deals in the infrastructure space evolving? Do you now compete more with international rather than indigenous PE firms? Is there greater competition amongst firms?

A: There is greater competition for infrastructure projects now. International firms are starting to find developed markets saturated and are looking to investments in Africa to rebalance their portfolios and achieve higher returns. In addition to this, you see a genuine desire to reduce poverty and promote African development as a global security imperative.

Putting all this together, there is now arguably more demand than supply for readily bankable projects. But in Africa, timing is important and one has to shape a project towards bankability. Previously, ARMHIF was more willing to do this than international firms, the latter which often preferred to wait for projects that were already nicely packaged before they would invest. But foreign firms are increasingly adopting a strategy of developing projects now, which presents us with scope for collaboration. At ARMHIF, we are selectively willing to share equity risks with other players. International investors also seek us out for collaboration because we are on the ground and have local insights. We know what works in our local markets, which makes us excellent partners for international firms, rather than being competitors. Collaboration is beneficial for all in the African infrastructure space.

Q: What do you want ARMHIF to achieve in the next 12 months?

A: We are currently focused on making a final close this year. This is a key milestone for us. We also intend to continue deploying capital in a smart and thoughtful way, to make good returns for our investors and create a positive impact in the West African communities that we invest in.

As we close deals, we want to ensure that our portfolio companies are run efficiently and that our investment assets continue to increase in value. This will enable us to continue developing a robust track record and reputation, while playing an important role in shaping and influencing the infrastructure industry across West Africa and Africa as a whole.

ARMHIF is constantly looking for new and innovative ways to provide comfort for pension funds and address their concerns. In the past, pension funds have shied away from equity and construction risks in their portfolios and have shown real concern about political risk as well. We recently signed a US\$80mn political risk insurance facility with Sovereign Risk Insurance and the Overseas Private Investment Corporation (OPIC). The facility gives the pension funds assurance that qualifying projects that ARMHIF invests equity in will be protected against political risks that have typically been known to stress African infrastructure projects during construction and other project phases. These risks include government expropriation, breach of contract, political violence, and currency inconvertibility. This sort of innovative approach will continue to drive our efforts to encourage pension fund investing in African infrastructure with ARMHIF.

ARMHIF Success Story

Project:

Azura-Edo Independent Power Project, Nigeria

Investor:

ARM-Harith Infrastructure Fund

Sector:

Electricity Generation

Financial Close:

28th December 2015

Commercial Operation:

Power into supply in 2018, well ahead of schedule.

ARMHIF's contribution to the project

- Provided development capital, and participated actively in the development process 4^{1/2} years ahead of financial close.
- ARMHIF's local knowledge, experience, and expertise were important factors in achieving financial close.
- Participated actively in the project's execution and delivery through representation on the Board and Board committees, and through advocacy and relationship-management with key stakeholders.

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