

Finding opportunities in currency devaluation

By [Heleen Goussard, Nicholas Olds](#) 17 Aug 2016

While some African countries that are considered great investment opportunities have seen recent currency devaluation, this could create an opportunity for African manufacturers.

Import substitution has been a significant part of Africa's economic growth during the preceding decade, as seen, for example, by Nigerian-based Dangote Group, currently manufacturing cement, sugar, and flour. A lot of these items were previously imported by Nigeria even though most of the raw materials are readily available locally. So where could other opportunities lie?

As can be expected, there are numerous products that can be examined, but our process for identifying these sectors was first to look at African countries experiencing currency devaluation of more than 20% in the last 18 months, and secondly by drawing on RisCura's Bright Africa research, which highlights the products being imported and exported by the continent.

The first quite marked observation is the prevalence of the by-products of refining and the downstream products that are manufactured from these by-products. These include items like bitumen, PET, fertilizer, petroleum coke and synthetic rubber.

Petroleum



skeeze via [pixabay](#)

Refining of petroleum, for example, within a country instead of importing it, should result in many benefits, such as reducing margins paid on fuel and significant industrialisation that comes from processing some of the by-products into finished products. This not only negates the need for imports but also contributes towards employment.

The reality is, as always, not as easily said than done. In order to build new refineries, even with the increased costs of imports created by currency devaluation, there would be short-term structural disadvantages that need to be overcome. Refinery projects are highly capital intensive for a start, and there has already been strong growth in the global refining capacity. The aging and inefficient infrastructure that

exists in some parts of Africa, often taking strain from repeated power outages, for example, has made it more of a challenge to compete with global 'super refineries' in trading hubs and areas such as the Gulf.

Primary agriculture



©Rafael Ben-Ari via [123RF](#)

Another category of heavily imported products is primary agriculture. This sector includes products such as meat, milk, palm oil, sugar, and rubber. We have seen successful private equity investments in the downstream processing of these products, illustrating the growth potential in these industries, but it does have unique risks and rewards.

High cost of capital, low production yields and a long-term investment time horizon makes this an industry that cannot react instantaneously to short- or even medium-term trends. It is also not an industry that has traditionally produced returns for foreign investors in line with their expectations given the perceived risks.

Data provider, BMI, predicts that growth in demand will outstrip growth in supply in dairy and meat for the foreseeable future in key markets. The devaluation of currencies should, therefore, allow for the establishment of more primary dairy farmers, and ultimately present further downstream opportunities for investors.

The margin created by currency devaluation does, however, need to be substantial enough to overcome disadvantages including investing into land as well as attaining equipment both for farmers and processing plants, which would require importing capital goods.

The international milk markets have also been oversupplied recently with imports from China and Russia remaining subdued, and the structural subsidisation of production in Europe further contributing to a depressed price. The lack of needed infrastructure in Africa makes the route to market that much more difficult and expensive, while the commodity-like nature of milk and the concentration of processors makes farmers a price taker, threatening margins.

Packaging



©Zhang Yongxin via [123RF](#)

A more accessible opportunity, possibly more suitable for private equity, is the packaging industry. The local industries have traditionally provided a low-cost solution, though suffering from a reputation for poor quality and a lack of variety. This has resulted in a number of international firms opting to import their final product

If the local industry could offer the likes of Unilever and Procter, gambling a local packaging solution of a sufficient quality, along with the gains made by the devaluation of the currency, a significant opportunity could exist. As always, however, the structural issues that result in packaging not being done locally still prevail. There is a lack of skilled staff to operate machinery, capital goods need to be imported at current currency level, electricity costs are high and unpredictable supply chains can make inventory management difficult.

Although structural issues are not entirely widespread and where needed, they are currently being addressed on the continent. They are still among the biggest complications facing African manufacturing. There are opportunities in small pockets for investors, but mostly for those who truly understand African risks and the potential longer-term rewards.

ABOUT THE AUTHOR

Heleen Goussard and Nicholas Olds, RisQura

For more, visit: <https://www.bizcommunity.com>