CONVERGENCE PARTNERS

Idan Segal, Founding Partner and Chief Investment Officer

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Convergence Partners is a pan-African tech–focused private equity player, delivering enhanced investment returns while underpinning Continental development. Convergence Partners has a proven track record of developing new investment opportunities as well as actively adding value to investments across the lifecycle of ICT assets. As impact investors, Convergence Partners brings its skills, experience and capital to accelerate ICT infrastructure development on the Continent.

AVCA speaks with Idan Segal & Yolande Tabo about breaking barriers in the ICT industry and their goals for the future.

NAME OF GENERAL PARTNER
Convergence Partners

ASSETS UNDER MANAGEMENT
Over US$260mn

REGIONAL FOCUS
Pan-African

Q: What is the history of Convergence Partners (Convergence) and how did you start the firm?

The vision behind Convergence derives from the Pan-African Telecommunications Network's plan (Panaftel) to create direct intra-African communications links (which were seen as critical to economic and social development in the region). Thus, from the get-go, we looked at the broadband and telecommunications landscape across sub-Saharan Africa and what we found were networks with insufficient reach, poor quality and high prices, generally held by State-owned incumbents. This old-style market structure created an opportunity for strategic financial investors.

Since its birth, Convergence has been dedicated to accelerating communication access and ICT infrastructure development on the Continent. As impact investors, we develop investments that deliver enhanced returns while bridging the gap between the social needs of Africa whether it is in education, banking, healthcare and government services.

The formal launch of Convergence in 2006 was backed by our balance sheet and the support of two leading South African institutions. We wanted to bring a sector-focused value adding investor into the market, which was pretty unusual at the time. Ten years on, firms and funds now use this model to differentiate themselves within the market.

Since then, Convergence has built a strong reputation whilst retaining its passion for the ICT sector. Our focus on impact and returns has been within the team's DNA, subconsciously from the outset, at a time when nobody was talking about impact investing as an asset class. As founders, we weren't really aware of the broader impact community, which was emerging, so we weren't looking at it from a theoretical perspective but simply as the right way to grow our business. In recent years, however, the impact sector has become more structured.

Q: Can you tell us about the first few investments you made under Fund I and how this experience shaped your strategy for Fund II?

One of the first things we did when we put this business together was to look at what technologies were available and what business models and networks had been used to change the dynamics of broadband delivery on the Continent.

We initially looked at the satellite space, which was the principal delivery tool for international connectivity and backhaul at the time. In our research, we discovered that the geostationary telecommunications satellites, orbiting over the African equator were primarily designed to service Europe, and then Africa.

To change this paradigm, we conceptualised a purely

African-focused satellite designed to service the needs of African operators and broadcasters. We also partnered with a leading global player within the satellite industry to launch the first African owned commercial satellite. The project had an innovative funding structure, with more than 90% of its funds coming from African sources, the first of such projects to use non-recourse lending.

Next, we looked for ways to introduce this wholesale open access model into the undersea fibre optics space. At around the same time, we were introduced to the promoters of SEACOM and got involved as early stage pre-launch investors. Soon, we started looking at what we could do, to move our work towards the end-consumers of bandwidth, terrestrial fibre and wireless.

Before the official launch of Convergence in 2006, we had invested in more traditional ICT companies such as Dimension Data and Telkom to establish our brand and credibility in the broader ICT market. From Convergence's inception, the need for quality broadband infrastructure in Africa was obvious and we wanted to close this gap. We discovered that these major infrastructure projects could be de-risked, and structured in a way that was both financially attractive and generates development impact.

In terms of structure, Fund I is a ZAR based permanent capital vehicle with bespoke funding instruments, so it is limited in its ability to scale. This led us to create a USD denominated Fund II and structure it more like a traditional GP/LP vehicle to invest in ICT infrastructure, on a bigger scale. This structure has allowed us to invest bigger ticket sizes and take bigger stakes, where we have a strong conviction.

Convergence manages both Funds I and II and has invested in three types of assets:

a) Infrastructure such as fibre networks, wireless networks and data centres - the 'plumbing' of the ICT sector;

b) Tech-enabled platforms to drive the growth of adjacent sectors such as financial services, content distribution and education; and

c) Over the top services including some earlier life ventures that are delivered on top of the tech-enable platforms such as applications and software in the security and content space

To put it simply we seek out assets that we like, writing bigger cheques and taking bigger stakes where we have a strong conviction.

Q: The Communications Infrastructure Fund (CPCIF), which is your second fund, is the only infrastructure fund dedicated solely to ICT in Africa. What are the key drivers of demand in this space?

Our infrastructure play was dismissed by the Mobile Network Operator (MNO) community, who at a network level, wanted to maintain their strategic advantage through the continuous building of their infrastructure.

At the time, our approach seemed maverick. We favoured creating independent owners of infrastructure and connecting wholesale carrier services to all operators on an open access basis, achieving the efficiencies of scale and capital derived through a shared spending model. Though this model and market structure have become commonplace, when we pioneered this approach, MNOs were massive institutions, highly cash generative, and growing rapidly to connect Africa. So convincing operators to use external infrastructure was extremely challenging.

We had to educate the market, showing the inefficiencies of managing infrastructure in-house for a single operator. Over time, market pressures, greater competition, shrinking margins, and regulatory pressures (e.g. regulators asking MNOs to reduce their environmental footprint by sharing infrastructure) made our case much more compelling. The cost of growing data-rich networks was going up with each generation and MNOs realised they couldn't continue to build and operate their own infrastructure. They quickly understood that truly independent third parties could help them remain efficient.

Towers were the first wave in outsourcing infrastructure in Africa. They allowed MNOs to free up their balance sheets and focus on their core business - the provision of services. Selling the towers helped MNOs change their mind-set about the management of infrastructure more broadly.

We think the demand for broadband infrastructure will continue to grow in the coming years, due to the growth in video consumption and the need for more sophisticated ICT solutions to deliver financial services at scale. As Africa continues to generate an increasing demand for content every year, networks will need to be more complex and that means they get expensive. We believe that private capital, therefore, has a key role to play. Added to that, the current connectivity across Africa is still low, at c.25% broadband penetration. You also have to bear in mind that the rest of the world isn't staying still, they are moving rapidly towards 5G. The density, cost and complexity of those networks dwarf what we see today in 4G.

Q: How do you see competition for deals in the communications infrastructure space evolving between international and indigenous PE firms? As entrepreneurs become savvier in attracting PE investment, is there greater competition for deals?

We've seen an increase in international investors, competing for deals across all 3 of our chosen segments of the ICT sector. They've participated in the development of the ICT sector in other emerging and developed markets and are now looking to deploy their expertise in Africa. The ICT sector is definitely an interesting place to deploy capital.

Asset prices are therefore increasing although it's still not a fully efficient market as yet. We are seeing certain trophy assets draw international attention from top global investors. Others don't attract the same attention and so our positioning as a sector-focused player enables us to identify and pursue those less hotly contested assets and often aggregate them into platforms that will ultimately draw more international attention through scale.

When looking at the market as a whole, the multiples paid for larger assets are higher than for smaller assets. This is true globally, not just in Africa, and also beyond ICT in other sectors too. Many PE opportunities across the continent are in owner-managed businesses. When investing in founder-owned businesses, there's often much more work to do to convert these businesses into 3rd party investable assets than say when doing a secondary from a PE firm, and so it's often not worth the additional heavy-lifting.

Most of the deals we look at are exciting opportunities with founders, where the challenge is to build individual assets into cohesive groups that will be attractive to larger PE firms in a future trade sale. This requires a process of proper integration to develop high-quality institutions as opposed to simple bundling just to drive up EBITDA.

Q: To take full advantage of Africa's technology infrastructure potential, a more refined and progressive approach to policy, procurement practices, and project design will be required. What is the magnitude of the challenge and the associated opportunities?

In some places, it's a capacity issue in terms of the regulatory framework or legacy issues (e.g. the spectrum for 4G is not allocated in many markets), which means there's wastage or missed growth opportunities in multiple sectors. The battle is to reduce end-user pricing to enable more people to get connected. Regulators are experimenting with different approaches for this, but effectively a collaborative approach is needed between industry and government to put a sustainable business model coupled with good regulation in place.

Above all else, investors want predictability. An imperfect, but understandable business environment means you can price and mitigate risk effectively and generate returns, whereas regulatory changes and unpredictable swings at short notice are not helpful, nor are an inability to enforce or uphold existing regulations.

Industry and the investment community, therefore, have an obligation to proactively contribute to the dialogue with Government. These issues are global. We're evangelists for shared infrastructure, creating efficiencies and strengthening the business climate but also for the industry to contribute meaningfully and positively to capacity building in regulators.

Q: Certain cities such as Lagos, Nairobi, and Accra are positioning themselves as leaders in smart infrastructure investment to drive innovation across multiple sectors. How can the rest of the continent develop technology hubs to cater for the growing demand for better connectivity in under-served markets?

Creating ICT hubs in any market requires a functioning ecosystem. A combination of entrepreneurial talent, investors, capital and strong Research & Development is required, particularly through tertiary institutions. You also need to be close to an addressable market and be able to access solid infrastructure. Businesses emerge from this combination and investors take notice. Successful hubs, in turn, provide support to entrepreneurs, but it's often challenging to scale, as many places don't have that combination of qualities to make it viable. The key initial enabler is that people need decent devices, usually a smartphone, and access to affordable internet. For a boom, we need to bring connectivity at affordable prices: shared infrastructure is crucial to this.

Expanding tech hubs beyond these major cities is a challenge and is often at times, commercially unviable. To reach the underserved areas requires innovative models: for example, the public-private partnerships such as CSquared's collaboration with USAID and the Government of Liberia, bringing reliable and affordable broadband infrastructure to Monrovia.

Q: Convergence prides itself on its positive impact on local communities and wider society. How do you create value in portfolio companies, and how do you balance financial returns and generating social impact?

The ICT industry by its nature creates both financial and social impact. At a granular level, each investment we make is assessed on its own merit against both these goals. We chose to be sector focused so that we could stay on top of industry developments in order to maximise financial value – this takes many forms.

It's about working with portfolio companies on strategy, taking advantage of new global opportunities, M&A, balance sheet optimisation, bringing in new shareholders, optimising management teams, improving regulatory relations and setting the agenda more broadly and positioning the portfolio company in that space. We also encourage synergies between our portfolio companies and we take a holistic approach to building relationships with management and shareholders to maximise value and sustainability. In terms of optimising developmental benefits, we map the achievements of our portfolio companies to the UN's sustainable development goals. However, we are looking to deepen our approach in this regard, and are in the process of developing a set of measurement tools that will ultimately enable us to articulate impact achievements in the same manner as we track and report financial goals and achievements.

Of course, we still map to traditional ESG measures from a compliance perspective, but we view this as but one component of impact. We urge our investments to actively seek out ways to maximise their value, for the communities they operate in.

Education is one area we feel particularly passionate about and where we believe the networks and businesses we invest in can play a key role. For example, SEACOM was a key driver of East African digital economy development: support was provided to local educational institutions by reducing the cost of bandwidth to dedicated educational backbone networks by around 99% and support was offered in terms of free or heavily discounted connectivity into numerous tech hubs in the region.

Q: Can you share your perspectives on the value of ESG standards in your investment strategy? How effectively have you been able to deploy ESG training across your portfolio companies?

We needed to upskill at Convergence on ESG first. The governance piece is understandable and commonplace – it's a way to reduce risk and enhance value and it's an integral part of pre-investment due diligence in order to be able to invest. The environmental and social sides have evolved over the past few years and the sophistication of measurement and impact is being enhanced. Alignment in philosophy is the first step and our relationship with portfolio companies is characterised by alignment in the way we view ESG. It has to be discussed from the onset, as it can't be seen as a distraction to generating financial returns.

We subscribe to key ESG delivery mechanisms. As active investors, we have standardised tools and methodologies to help portfolio companies optimise ESG performance and we also offer training – either our own in-house resources or we bring in specialist consultants. Our portfolio companies have generally been receptive to formalising and expanding on existing ESG measures and adopting proposed recommendations and action plans. We have also introduced a comprehensive reporting framework at multiple levels: portfolio companies to Convergence and Convergence to LPs. This creates good discipline so that environmental and social impact can now be quantified effectively. It's a journey. It's new and like any strategic intervention, we have the discussion upfront and embed the necessary conditions into the legal agreement framework to reduce push back down the line.

Q: 40% of the jobs Convergence has created through impact investing are for women. Do you see ICT in Africa as a sector which is actively changing perceptions about women in work?

The data is still difficult to source, but we believe the participation of women in the ICT industry is still limited. It is a global issue, but it is more pronounced in Africa, where female consumers' access to ICT still lags behind that of men.

There have been some high-profile success stories of women tech leaders, but this needs to be scaled. There's much work to be done.

Q: What do you want Convergence to achieve over the next 12 months, and which countries present exciting opportunities for you?

We see the next 12 months characterised by a focus on our pipeline of opportunities, bringing some to fruition to complete deployment under the current fund. We have a substantial number of assets to bed down. We're driving early interventions so we can create platforms for future growth, rather than management of individual assets, and we're managing our existing portfolio and identifying new opportunities. In the longer term, when looking at the continent as a whole, it's missing certain waves of tech so we're thinking about how we can ensure Africa is an early adopter of 5G and can shape it for its needs – both from a tech and regulatory point of view - to maximise value and potential for growth. It's going to be a busy year no doubt!

Convergence continues to be as excited and optimistic about the sector and the continent as we were at inception. Our scale and sophistication have grown a great deal over the past 12 years but our fundamental principles and excitement about our impact haven't changed.

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