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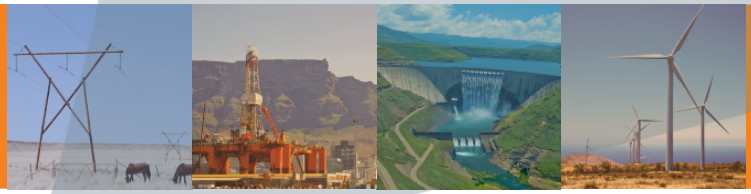

TCX targets doubling of capital by 2021

A new investment in TCX has kickstarted a fundraising drive by international donors to scale up currency hedging options in Africa. Greater awareness of currency products, the rise of off-grid, and concerns about hard currency-indexed contracts is fuelling demand in the power sector

Currency hedging company TCX has begun the process of doubling the capital it manages by 2021-22 with a £31m ($39.4m) investment from the UK's Department for International Development (DfID). As well as increasing the size of the fund, TCX is aiming to raise its single currency exposure limits – the amount of money it can hedge – to $500m per currency.

TCX was founded in 2007 by a group of development finance and microfinance institutions and donors to facilitate local currency financing in frontier markets and prevent currency risk being borne entirely by borrowers and utility customers in vulnerable economies.

"We are covering about 90 exotic currencies with no tenor limitations. So we can go up to 15 years or longer to match the needs of infrastructure investors," TCX senior adviser Harald Hirschhofer told *African Energy*. "There is an increased awareness amongst regulators and local governments, and also within the development community, that we should not burden the weakest part of the population with currency risk. That message has really been falling on fertile ground in the last few years and, because of that, TCX has been experiencing very fast growth. That has put pressure on our capital, because we are a very capital-intensive business."

DfID's investment is a subordinated convertible loan that will mature in 2045 and is expected to significantly improve prospects for fundraising. TCX said in a news release that the loan would allow the hedging of investments worth more than $1.5bn over its term.

"About two years ago we started raising new capital, formulating a capital raising strategy which we are now in the full swing of implementing," Hirschhofer said. "The DfID investment is a vital part of that strategy. As subordinated convertible debt, it enhances the risk return ratio of our equity owners and makes investing in TCX even more attractive. We are expecting significant additional investments from existing and possibly new investors in the coming 24 months."

At end-2018, TCX had a portfolio of $2.7bn, of which around 7% is renewable energy projects and off-grid solar companies. The largest part of the portfolio, around 65%, involves transactions targeting microfinance and small and medium enterprises (SMEs).

The fund hopes to use this experience to extend its off-grid footprint. TCX has already worked with MFX, a specialist provider of currency hedging for microfinance and SME financing, and responsAbility Investments AG to support loans indexed in Ugandan shillings and Kenyan shillings for off-grid solar company M-Kopa.

"Many of these off-grid firms have things in common with microfinance institutions and they are generally SMEs themselves. I think our background is very relevant in the off-grid space and we expect to see quite a lot of growth there," Hirschhofer said. "The off-grid sector has always tried to work with local banks, which is a great use of local savings, but very often the banking sector has not been responsive enough. That, of course, mandates foreign development finance institutions to fill that gap. We will continue to work with them in the future so that they can deliver that needed financing in local currency."

TCX also anticipates increasing demand for local currency in the on-grid sector. Governments, as well as the International Monetary Fund and World Bank, have moving towards power purchase agreements (PPAs) in local currency.

In Egypt, issues around convertibility – as well as arbitration – caused a delay in the first round of solar procurement in 2016, while South Africa saw significant currency spikes when renewable energy independent power producers began hedging their projects in 2013. Kenya and other East African countries had major issues with tariff increases as a result of hard currency-indexed PPAs in 2011.

"We need more PPAs in local currency. I believe personally that once governments send a clear signal that they want local currency PPAs, markets will develop and TCX may have a catalytic role in that process," Hirschhofer said.

Local currency PPAs have proven very difficult to implement, despite a number of attempts. But the falling cost of renewable energy and the potential to deploy it at small scale means there are now some promising schemes. InfraCo Africa, part of the Private Infrastructure Development Group, is backing two 10MW solar photovoltaic plants in Kenya being developed by Gigawatt Global with the intention of at least one of them signing a PPA in local currency (*AE 388/5*). Many development finance institutions are watching the projects with interest.

These initiatives are helped by a growing market for currency management products and an improving awareness among companies of what is available. "Companies are increasingly aware of the need to address currency risk and they are much better informed than they were four or five years ago," Hirschhofer said. "There are definitely much better opportunities to hedge because of this awareness."

However, TCX cannot take the credit risks of projects and off-grid companies and will in most cases require a counterparty guarantee. Instead, the fund mostly provides currency swaps for lenders. TCX has also been working with institutional investors, selling more than 60 bonds in local currency over the past two years. These bonds are attractive for investors who are interested in the risk and return profile of emerging and frontier markets, without being exposed to underlying credit risk, as the bonds are issued by TCX shareholders with AAA ratings.

"We see ourselves as a catalyst of institutional money flow into these currencies and into these countries," Hirschhofer said. "The bigger we get, the more interesting we are for institutional investors."