Investing in Africa: A practical perspective for the South African Institutional Investor

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Zeenat Patel
Nimisha Bhawan
Agenda

1. Introduction
2. Rationale and risks
3. Financial market development
4. Asset manager survey results
5. Implications for trustees
6. Conclusion
Introduction

• The case for investing in Africa is increasingly well documented

• Regulation 28 has allowed retirement funds to invest 5% into Africa since 2008

• South African retirement funds have generally been slow to take up the Africa allowance

• The Government Employees Pension Fund has earmarked 5% of the fund for investment into Africa
Ways of getting exposure

- There are three ways to get exposure:
  1. Direct allocation
  2. Allocation through a balanced portfolio
  3. Indirect exposure

12% of Shoprite earnings are from the rest of Africa
Only 32% of MTN’s income comes from SA

- To date, most allocations have been to listed equity, but growing trend to invest in bonds and private equity

- Those investors that have made allocations have been handsomely rewarded over the recent past
Rationale

- Economic prospects
- Demographic profile
- Urbanisation
- Rise of the African consumer
- Improving political outlook
Rationale: Economic prospects

5.9% Expected growth in GDP in 2014 for sub-Saharan African countries (versus 2.1% for developed economies)

11 Of the 20 fastest growing economies are in Africa

13 Number of African countries expected to grow at a rate faster than 7% in 2013

36.5% Average gross debt-to-GDP for sub-Saharan African countries (versus 109% for developed countries)
### Rationale: Demographic profile

<table>
<thead>
<tr>
<th>10</th>
<th>Countries with the youngest populations are all in Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>41%</td>
<td>Proportion of African population under the age of 15</td>
</tr>
<tr>
<td>30 years</td>
<td>When Africa is expected to have the world’s largest working population</td>
</tr>
</tbody>
</table>
Rationale: Demographic profile

Africa’s workforce will become the world’s largest by 2050

- Africa
- South East Asia
- China
- Japan
- India
- Europe
- Latin America
- Northern America
Rationale: Urbanisation

Expected annual growth rates in urbanisation (2010 to 2050)

Source: United Nations and Credit Suisse
Rationale: African consumer

Share of households in each income bracket measured in US$ terms

(millions of households)

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2008</th>
<th>2020F</th>
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<tbody>
<tr>
<td>Discretionary income</td>
<td>163</td>
<td>196</td>
<td>244</td>
</tr>
<tr>
<td>Basic needs</td>
<td>34</td>
<td>32</td>
<td>29</td>
</tr>
<tr>
<td>Destitute (&lt;2 000)</td>
<td>6</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>Consuming middle class (10 000-20 000)</td>
<td>18</td>
<td>21</td>
<td>23</td>
</tr>
<tr>
<td>Emerging consumers (5 000-10 000)</td>
<td>11</td>
<td>14</td>
<td>17</td>
</tr>
<tr>
<td>Basic consumer needs (2 000-5 000)</td>
<td>11</td>
<td>14</td>
<td>17</td>
</tr>
<tr>
<td>Globals (&gt;20 000)</td>
<td>6</td>
<td>8</td>
<td>12</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Number</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>Number of African countries considered free according to the Freedom in the World survey (2013)</td>
</tr>
<tr>
<td>70%</td>
<td>Proportion of African countries that have improved governance since 2006 (Ibrahim Index of African Governance)</td>
</tr>
<tr>
<td>14</td>
<td>Number of African countries that rank better than India in the Transparency International’s Corruption Perceptions Index</td>
</tr>
</tbody>
</table>
Investment risks

In addition to the risks already highlighted, investors also face the following main risks:

- Volatility
- Low levels of liquidity
- High costs of investing
- Concentrated stock and sector exposure
- Capacity constraints
- Currency risk
- Poor corporate governance and corruption
- Default risk (when investing in government or corporate bonds)

Risk needs to be weighed up against potential returns
Financial Market Development

Zeenat Patel
Equity market development

Source: Supplement to JSE Magazine: African Investment, Wikipedia and various stock exchange websites

* Lusaka Stock Exchange
** Abuja Securities and Commodities Exchange
***Agricultural Commodities Exchange of Zambia
Characteristics: Africa listed equity

- Small in size and number of stocks
  - End 2011: Value of African stocks outside SA was 0.94% of world stocks and 2.14% of emerging market stocks
  - SA, Egypt and Nigeria account for more than 50% of equities

- Dominated by a few large companies

- Small relative to the size of their economies

- Thinly traded affecting liquidity
  - Some markets trade manually
  - Some markets trade over short periods of the day

<table>
<thead>
<tr>
<th>Exchange</th>
<th>Time Zone</th>
<th>Trading Days</th>
<th>Trading Times</th>
<th>Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>GMT + 2</td>
<td>Mon – Fri</td>
<td>07:30 - 08:15</td>
<td>T + 3</td>
</tr>
<tr>
<td>Egypt</td>
<td>GMT + 2</td>
<td>Sun – Thu</td>
<td>10:30 - 14:30</td>
<td>T + 0</td>
</tr>
</tbody>
</table>

Source: Old Mutual Investment Group South Africa and the Johannesburg Stock Exchange
Characteristics: Africa listed equity

- High volatility in equity market returns

12-month rolling returns since 1 July 2007 to 30 June 2013 of various Africa exchanges (in US$)

Source: Bloomberg
### Characteristics: Africa listed equity

- **Low correlation to local and global equity markets**

**Weekly correlations in US$ since 2007 (when Nigerian index was formed) to June 2013**

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>JSE All Share</td>
<td>100%</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Nigeria 30</td>
<td>24%</td>
<td>100%</td>
<td></td>
<td></td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>Morocco</td>
<td>8%</td>
<td>59%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Egypt 30</td>
<td>6%</td>
<td>76%</td>
<td>83%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenya</td>
<td>20%</td>
<td>87%</td>
<td>56%</td>
<td>80%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S&amp;P Africa 40</td>
<td>92%</td>
<td>22%</td>
<td>25%</td>
<td>16%</td>
<td>13%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>77%</td>
<td>61%</td>
<td>4%</td>
<td>21%</td>
<td>55%</td>
<td>60%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hang Seng</td>
<td>78%</td>
<td>56%</td>
<td>43%</td>
<td>55%</td>
<td>54%</td>
<td>74%</td>
<td>67%</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MSCI World</td>
<td>69%</td>
<td>76%</td>
<td>33%</td>
<td>50%</td>
<td>77%</td>
<td>54%</td>
<td>93%</td>
<td>77%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>MSCI EM</td>
<td>91%</td>
<td>49%</td>
<td>42%</td>
<td>44%</td>
<td>47%</td>
<td>88%</td>
<td>73%</td>
<td>94%</td>
<td>79%</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Source:** OMIGSA
**Characteristics: Africa listed equity**

- Low correlation between African markets

**Correlation matrix of various Africa exchanges (Based on data from 1 July 2007 to 30 June 2013 in US$)**

<table>
<thead>
<tr>
<th></th>
<th>Egypt</th>
<th>Kenya</th>
<th>Mauritius</th>
<th>Morocco</th>
<th>Nigeria</th>
<th>Zambia</th>
<th>Tunisia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenya</td>
<td>20%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mauritius</td>
<td>0%</td>
<td>27%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>26%</td>
<td>24%</td>
<td>34%</td>
<td>100%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nigeria</td>
<td>32%</td>
<td>48%</td>
<td>24%</td>
<td>28%</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zambia</td>
<td>-25%</td>
<td>14%</td>
<td>36%</td>
<td>12%</td>
<td>-1%</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Tunisia</td>
<td>8%</td>
<td>13%</td>
<td>48%</td>
<td>25%</td>
<td>-15%</td>
<td>13%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Bloomberg
Listed equity benchmarks

• There is no generally accepted standard benchmark to evaluate manager performance

• FTSE/J SE, MSCI, S&P, Dow Jones, Nedbank, Standard Bank and Merrill Lynch offer indices

• Some key considerations when choosing a benchmark:
  • Representative of the manager’s investment universe – should exclude South Africa
  • Exposure to stocks of African companies listed on exchanges in other markets
### Listed equity benchmarks

<table>
<thead>
<tr>
<th>FTSE/JSE</th>
<th>MSCI</th>
<th>S&amp;P</th>
<th>Dow Jones</th>
<th>Nedbank</th>
<th>Standard Bank</th>
<th>Merrill Lynch</th>
</tr>
</thead>
<tbody>
<tr>
<td>FTSE/JSE</td>
<td>MSCI EFM</td>
<td>S&amp;P Africa 40 Index</td>
<td>Dow Jones Africa Titans 50 Index</td>
<td>Nedbank Africa 100 Index</td>
<td>Standard Bank Africa ex-SA Index</td>
<td>Merrill Lynch Africa Lions</td>
</tr>
<tr>
<td>All Africa 40 Index</td>
<td>Africa Index</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FTSE/JSE</td>
<td>MSCI EFM</td>
<td>S&amp;P Africa Frontier Index</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Africa ex-SA 30 Index</td>
<td>Africa ex-SA Index</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MSCI EFM</td>
<td>S&amp;P Pan Africa Index</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Africa Index</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MSCI FM</td>
<td>S&amp;P Africa Access Index</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Africa Index</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

- **FTSE/JSE and MSCI:** Egypt, Kenya, Mauritius, Morocco, Nigeria, South Africa and Tunisia
- **S&P:** Botswana, Zambia, Tanzania, Congo, Sierra Leone, Gabon, Eritrea and Angola
- **Nedbank:** Malawi
- **Merrill Lynch:** companies listed on an African exchange or that derive a portion of their revenue from Africa
Bond market development

• Bond markets are in a nascent stage of development

• Growth has come from the government sector

• Debt market is dominated by foreign currency issuances

Annual global issuance by sub-Saharan sovereigns since 2007 (US$ billions)
<table>
<thead>
<tr>
<th>Country</th>
<th>Year of issue</th>
<th>Maturity</th>
<th>Yield</th>
<th>Size of issue (US$ billion)</th>
<th>Purpose of issue</th>
<th>Subscription Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ghana</td>
<td>2007</td>
<td>2017</td>
<td>7.50%</td>
<td>0.75</td>
<td>Improving Infrastructure</td>
<td>4X</td>
</tr>
<tr>
<td>Namibia</td>
<td>2011</td>
<td>2021</td>
<td>5.75%</td>
<td>0.5</td>
<td>Financing TIPEEG (Targeted Intervention Programme for Employment and Economic Growth)</td>
<td>5.5X</td>
</tr>
<tr>
<td>Rwanda</td>
<td>2013</td>
<td>2023</td>
<td>6.88%</td>
<td>0.4</td>
<td>Using US$200 million to repay loans in relation to the Kigali Convention Centre and the RwandAir strategic development plan; US$150 million to finance the completion of the Kigali Convention Centre; and US$150 million to be used to pay for building a 28 megawatt hydro-power plant</td>
<td>8.7X</td>
</tr>
<tr>
<td>Zambia</td>
<td>2012</td>
<td>2022</td>
<td>5.63%</td>
<td>0.75</td>
<td>Financing the upgrading of infrastructure in the road and energy sectors and funding the country’s budget and spending in social sectors (education and health)</td>
<td>15X</td>
</tr>
</tbody>
</table>
Characteristics: Bond markets

• No secondary market exists

• Concerns around deployment of proceeds
  • Good corporate governance and debt monitoring structures needed to prevent excessive borrowing by corporates

• Bond issuance is an important source of financing for both government and corporates

• Many countries are planning new or returning issuances
  • Cameroon, Angola, Nigeria, Kenya, Uganda, Senegal, Tanzania and Ghana
Private equity development

- In early stages of development

- Fund raising lags that of emerging economies

Fund raising in Africa and other emerging markets in US$ billions

Source: KPMG Private Equity Roundup 2013
Characteristics: private equity

• Industry is small relative to developed markets

• Growing interest in private equity
  • 2006 to 2012 – 81 funds closed to new fund raising
  • 2012 – 45 new funds opened

• Market is dominated by generalist funds with an increasing trend towards sector-specific funds

• Deal sizes are small and investors can benefit from a first mover advantage

• The biggest challenge for investors is liquidity
African financial markets

• Foreign Direct Investment in Africa is growing
  • US$ 10 billion a year in the 90s to US$ 50 billion in 2012

• Benefits of emerging and expanding financial markets
  • Attract greater private investment
  • Integration into the global financial marketplace
  • Opportunities for local and global investors

• The risks are worth taking and listed equity is a good initial step to enter the market
Asset Manager Survey results
Implications for trustees
Conclusion

Nimisha Bhawan
Survey of Africa Fund Managers

• 15 asset managers contacted and 12 responded

• Assets under management totalled $3.51 billion

• Represents 80% of single-manager universe with Africa offerings

African assets under management
Managers Surveyed

12 Respondents out of 15 Managers Surveyed
Investment teams and process

Dedicated Africa-focused individuals

- Team of 2: 33%
- Team of 3: 25%
- Team of 4: 17%
- Team of 5 or more: 8%

Investment process before investing in an African economy

- Visit all companies before investing: 75%
- Visit most companies before investing: 17%
- Do not visit companies/countries before investing: 8%
Capacity Constraints

- 10 of the 12 managers had fixed targets of assets under management

Target assets under management

- 10%: $100 million or less
- 20%: $101 million to $300 million
- 20%: $301 million to $500 million
- 20%: $501 million to $700 million
- 20%: $701 million or more

Expected cash holdings

- 11%: Not more than 5%
- 11%: Not more than 10%
- 22%: Not more than 15%
- 56%: Not more than 20%
Liquidity issues

- **Gating**: limit total redemptions to a percentage of the net asset value of the fund
- **Side pockets**: accounts created to house illiquid securities that cannot be valued or disposed of easily

**Use of Gating and Side pockets**

- 36% use Gating/Side pocket provision
- 64% do not use Gating/Side pocket provision
Institutional and Retail Investors

- Most managers offer both retail and institutional classes
- Minimum investment amounts ranging from $1000 to $5 million
Benchmarks and Track records

Ex-SA Equity Fund Benchmarks

- MSCI EFM Africa ex-SA Index: 50%
- Standard Bank Africa Total Return Index: 25%
- Nedbank All Africa ex-SA: 8%
- LIBOR + benchmark: 8%
- No benchmark: 9%

Track Records

- Less than 2 years: 25%
- Between 2 and 3 years: 17%
- Between 3 and 4 years: 17%
- Between 4 and 5 years: 17%
- More than 5 years: 17%
Divergent returns

12-month rolling returns in US$
Implications for Trustees

• Pension fund liabilities are long-term in nature which require investment in asset classes where a long-term view is taken.

• Increase in governance burden for the trustees.

• Given the diversity in the funds available it is advisable to consider appointing more than one manager.

• Choice of benchmark is important
  • Implications for performance fees.

• Choice of investment vehicle, need to consider legal structure.

• Rebalancing rules.
Conclusion

• African markets are volatile

• Investments have higher risks than those in developed markets

• A small initial allocation is appropriate as part of a well-diversified portfolio

• Initially listed equities provide the easiest route to investing in Africa

• Areas of further exploration – development of real estate and agriculture investment universe
Thank you

Questions