PRESCIENT

# AFRICA LOOKING FOR GOOD NEWS

The *Africa Rising* narrative from a few years ago has increasingly become an *Africa is dead* storyline. The negative image currently portrayed in the media is probably not completely without merit. The continent faces some tough challenges, from macro-economic headwinds resulting from lower commodity prices and a generally weaker external environment to a shortage of hard currency and weaker currencies. Furthermore, the drought in southern Africa regions is causing higher inflation and putting pressure on consumer discretionary incomes. Despite the persistent flow of negative news and the short-term deterioration of economic fundamentals, we believe there are a number of reasons to be optimistic about the longer term investment potential of Africa.

Much of the negative news flow has been concentrated on Nigeria. Many of Nigeria's current economic problems stem from the shortage of hard currency in the country. The demand for dollars has outstripped the supply ever since the oil price started falling in September 2014. It probably doesn't help that oil is by far the major forex earner making up more than 75% of exports. The rebound in the oil price this year hasn't really brought relief as oil production has been impacted by militant attacks in the Niger delta. However, the passing of the budget in May, the flexible exchange rate and signs that dialogue with the militants in the Delta could yield positive results, would all be supportive of growth. For the supply of dollars in the economy to increase, there needs to be a sustained increase in the oil price as well a speedy resumption of production at full capacity. Investment in the upstream oil sector, to increase total oil production, would certainly help. In this regard, there has been a flurry of announcements regarding interest from China to invest in the upstream oil and gas sector.

However, it is on the demand side where the potential to relieve the imbalance of supply and demand of hard currency lies. Although Nigeria is a country that imports a variety of products ranging from cars and manufacturing equipment to chemicals and food related items, the most recent imports are led by refined petroleum which represents about 15% of the total imports of Nigeria. For a country that is the largest oil producer on the continent, it seems strange that products derived from oil would make up such a big component of imports. This situation was brought on by years of neglect of refineries and lack of investment in new capacity. This is something that Africa's richest man, Aliko Dangote, is aiming to address with a massive $14 billion refinery project. The refinery is expected to be completed by mid-2018 and is projected to refine 650,000 barrels of crude oil per day. It will produce petrol-chemicals, fertiliser, and fuel, which would significantly reduce import demand for these

products. Nigeria could potentially save $5 billion annually in import substitution on these products. Moreover, the local fertilizer and gas production could be a boon to the agriculture and power sectors.
Number five on the list of highest imports is raw sugar cane. In this regard Dangote also has ambitions to decrease dependence on imports. Dangote Sugar Refinery Plc has launched its backward integration project with a 10-year sugar development plan, to produce 1.5 million metric tonnes per annum of sugar from locally grown sugarcane. Although there is currently some pressure on the Naira due to imbalances in supply and demand for hard currency, it is expected to ease somewhat in the medium term.
Cement, however, is the industry where Dangote has built his empire. Not only has he increased cement production to take Nigeria from a cement importing country to producing enough cement locally to export cement to neighbouring countries. The potential of the cement industry in Nigeria lies in the fact that it has approximately 187 million inhabitants driving demand for housing and infrastructure. Nigeria's current cement consumption is 119kg per capita compared to a global average of 513kg per capita. In addition to the three manufacturing plants Dangote Cement operates in Nigeria it has existing or planned operations in 15 other African countries. From an investor perspective, Dangote Cement is an attractive investment due to its higher quality characteristics. It is trading at decent valuations given its growth potential and whilst delivering a return on equity of 25%. Furthermore, it is a lower cost producer and as the market leader by capacity and volumes, can determine market prices of cement in line with its own profitability considerations and expectations.

Staying with cement and housing demand, there has been an increasing willingness of cement producers to team up with financial institutions like Lafarge Africa and microfinance bank, LAPO, in Nigeria; and Bamburi cement and Commercial Bank of Africa in Kenya, to help reduce the housing shortage. The aim of the corporate partnerships is to provide low-cost, quality housing solutions at affordable financing rates for low- income segment of the population. The annual housing deficit in Kenya is estimated at about 200,000 units, whereas the World Bank estimates suggest Nigeria is facing a total 17 million unit housing deficit. This represents a huge opportunity in the construction and building material sectors in these regions.

In Kenya, and in the broader East Africa region, banks have increasingly pursued alternative banking channels to capture more of the unbanked population. Equity Bank, for instance, is set to introduce its mobile banking platform Equitel in five new markets within the East Africa region where it has a presence. Equitel, which already has 2 million active subscribers, acts as a platform for the bank to gather low-cost deposits and extend short-term retail loans. The mobile banking strategy, along with its agency banking channel, is a way to access customers in a low-cost manner, especially relative to more traditional bricks and mortar bank branches.

Safaricom in Kenya has already proven the willingness of Kenyan consumers to utilise their mobile phones for peer-to-peer financial transactions with their hugely successful money transfer platform, MPesa. Leveraging off this success the company has extended the service to person-to-business and business-to-business transactions with Lipa na M-Pesa. By March 2016 over Sh20 billion had been made in payments on the Lipa na M-Pesa platform, with more than 44,000 merchants accepting the service, an increase of 74 percent from the previous year. Eight out of ten payments in Kenya are still cash-based, therefore the opportunity for alternative payment solutions is big. In an effort to capture a share of Kenya's card payment market, Safaricom has also launched a debit card product linked to M-Pesa.

In Egypt, our preferred holdings are in companies that are able to pass on price increases to customers in an inflationary environment. Companies like Eastern Tobacco are relatively resilient with inelastic demand for their product. This allows them to pass on price increases to customers without experiencing large declines in volumes. Integrated Diagnostics Holdings, an Egyptian company listed in London, also has defensive qualities which make it attractive in the current environment. The real estate developers listed in Egypt tend to perform well during times of higher inflation. Following on the recent currency devaluation, the resultant inflationary pressure has continued to drive the demand for real estate property in Egypt. This has translated into increased contracted sales for real estate developers, which has reflected positively on their cash inflows and consequently on their reported financial results.

Maroc Telecom is our largest holding in Morocco as well as in the Telco space. As the main telecommunication company in Morocco, it has a market share of more than 60%. It has the best quality of service thanks to a decent 2G/3G/4G network and a large coverage, as well as a large commercial network and a decent loyalty programme called Fidélio. After a new guideline adopted by the National Telecommunication Regulatory Agency this year, we should see mobile prices reach an inflection point which should spur revenue growth. Operating margins should see a recovery on the back of higher average revenue per user amounts and continued growth in mobile data revenue. The group is also rapidly expanding in sub-Saharan Africa with operations in more than 10 African countries outside Morocco. With a dividend yield higher than 5% and a return on equity of 28%, Maroc Telecom currently has a compelling investment case.

As bottom-up equity investors in Africa, we can’t help but feel that there are still a number of exciting investment opportunities on the continent. The long-term growth outlook for Africa continues to remain positive with the Prescient Africa Equity Fund providing investors with diversification benefits, through lower correlation relative to other markets and access to non-traditional global exposure. The Prescient Africa Equity Fund currently has a historical PE ratio of 9 and ROE of 21%.

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***For media interviews:***
Monique Martheze
PR/ Media
Email: monique.martheze@prescient.co.za
+ 27 (0) 21 700 3663

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- Prescient's subsidiaries include: Prescient Investment Management (SA), Prescient Securities, Prescient Management Company, Prescient Life, Prescient Fund Services, Prescient Fund Services (Ireland) Prescient Wealth Management, Prescient Profile, and EMHPrescient Investment Management.
- Prescient Investment Management is a signatory to the United Nations Principles of Responsible Investing (UN PRI) and pledged to the Codes for Responsible Investing in South Africa (CRISA).
- The Prescient Global Income Fund, now known as the Prescient Global Income Provider Fund, was ranked by Morningstar as the 7th top performing fund for 2015.
- **More recently, the Prescient Income Provider Fund won the Raging Bull Award for the Best South African Multi-Asset Income Fund, Best South African Interest-Bearing Fund as well as a certificate for the Best South African Multi-Asset Income Fund on a risk – adjusted basis over five years to December 31, 2016.**
- Morningstar data also confirmed that The Prescient China Balanced Feeder Fund has been the top performing South African domiciled fund for the second year in a row.

- Prescient Investment Management was the first institution in Africa to be granted a Qualified Foreign Institutional Investor (QFII) licence by the China Securities Regulatory Commission (CSRC).
- Prescient Investment Management was named Overall Investments/Asset Manager of the Year at the Imbasa Yegolide Awards 2011, Absolute Return Manager of the Year in 2013 and Bond Manager of the Year and Responsible Service Provider of the Year in 2015.
- The full details and basis of the award can be obtained from the fund manager.
- For any additional information such as fund prices, brochures and application forms, email info@prescient.co.za or visit www.prescient.co.za
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