#38

AFRICA AM
ASSET MANAGEMENT

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EDITOR'S VIEW

In the week that *Africa AM* went to press, Nigeria's Islamists kidnapped some 20 girls just miles from a small town where the group abducted several hundred schoolgirls in April. It seems that the terrorist group Boko Haram, which began life as a separatist movement led by a northern Nigerian Muslim preacher, Mohammed Yusuf, will stop at nothing to get on the radar of the international community. But what does it mean for financial markets? Alkan Shenyuz, CEO and head of global solutions, Veventis, says that the Islamist group's "deeply troubling activities, unprecedented by modern standards, have barely registered in domestic economic terms" (*pp. 20-21*).

Meanwhile, in South Africa, we learn from Eugene Visagie of Novare Investments that the regulatory changes in the hedge fund industry are likely to increase the demand for this asset class by enabling retail investors to invest directly into these funds, which were previously only available to institutional investors and high-net-worth individuals (*pp. 18-19*).

On the private equity side, the subject of our profile feature, Duncan Owen of Phatisa, discusses the role of development equity and the firm's African agriculture fund. The firm strives to build sustainable assets on the ground, ensuring the best possible returns for investors and stakeholders, including the community in which it operates (*pp. 12-13*).

Finally, this issue's strategy feature focuses on SME financing. Nish Kotecha of Fusion Group says that this can offer a real opportunity for both commercial return and long-term sustainable development. "As this investment methodology yields results, other PE firms will be attracted by the opportunity, delivering the much needed capital and expertise to the burgeoning SME sector in East Africa" (*pp.14-15*).

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LAUNCHES

Rudiarius launches Africa equity fund

Rudiarius Capital Management, an owner managed investment firm, has launched its first Africa equity fund a month after opening doors to the public.

The fund is a rand-denominated unit trust, domiciled in South Africa, with roughly $50m in third party assets under management. The fund is open to individuals and institutional clients globally.

The fund's universe is primarily Africa-listed stocks, subject to liquidity filters, and offshore listed companies deriving more than 70% of their revenues from Africa.

Sandisile Dlamini, investment analyst at Rudiarius Capital Management, said: "We travel extensively across the continent in search of these investment opportunities. The fund's largest exposure is Nigeria at the moment."

The team, comprised of Fungai Tarirah, Sandisile Dlamini and Annie Yates, developed and ran Momentum Asset Management's Africa strategy prior to setting up Rudiarius.

With almost 50 years of combined investment experience, they believe that Africa's growing middle class and consumer demand, rising banking penetration and infrastructure development, all continue to present good investment opportunities on the continent.

"Infrastructure development and increasing banking penetration are two major themes unfolding across the continent and we feel that various sectors will continue to offer a good opportunity for any patient investor on the back of these developments," Dlamini told *Africa AM*.

"Rudiarius' focus is on valuation and we look to carefully choose our stocks in the different countries that we invest in," she added.

Dlamini was excited about the long-term prospects that Africa had to offer, highlighting that Rudiarius would soon launch a dollar-denominated SICAV to allow a wider array of investors to participate in these opportunities. ■

PRIVATE EQUITY

Phatisa partners with Africa Reit

The Pan African Housing Fund (PAHF), managed by Phatisa, has invested an undisclosed amount in a special purpose vehicle with Africa Reit to develop an apartment complex in Kikuyu Town, west of Nairobi, Kenya.

Eton Price, PAHF fund partner and deal team leader, said that the deal "marked a significant milestone" for Phatisa, as it was the first transaction for the fund.

"This is the fund's first investment in Kenya and we are extremely positive that another will follow this initial investment in the very near future," he said.

"The conclusion of this deal is the result of many months of groundwork and will enable us to use this platform to increase deployment of funds into our target geographies and sector," he added.

Kenya, and in particular Nairobi, is experiencing a shortage of good-quality middle income housing units (200,000 units per year, according to the Ministry of Land Housing and Urban Development, Kenya Government).

This investment adds good-quality middle income residential apartments to the Nairobi market.

According to Phatisa, Kikuyu Town housing demand is strong and there is a limited supply of quality middle-income housing units.

This project involves the development of 66 residential apartment units in a single phase in two eight-story towers, with a lift in each tower, within a gated, access-controlled security estate.

Africa Reit is experienced and well versed in residential development, with a proven track record. The company has significant business interests in East African real estate and has completed six similar residential apartment developments in Nairobi over the last six years.

The Westpoint Heights development will be managed on a day-to-day basis by a strong local management team that has extensive experience with real estate developments in Kenya.

The joint venture will enable Africa Reit to deliver the project rapidly with decreased risk by unlocking bank funding, and providing value-enhancing project management mechanisms.

"We are looking forward to building on the very good working relationship we enjoy with Africa Reit and look forward to finally getting our boots dirty," said Price.

It is envisaged that PAHF will exit this investment through the sale of units to end-users.

PAHF is a private equity fund that provides risk capital to the fast-growing and lucrative middle and affordable housing sector in Eastern and Southern Africa.

Phatisa, as the manager of PAHF, is committed to providing development-enabling equity finance to experienced and reputable property developers to enable the increase in the supply of affordable middle class housing in East Africa, Zambia and Mozambique (*Read more on Phatisa on pp.12-13*). ■

66 Number of residential apartment units being developed by Africa Reit

INVESTMENT

Investec secures 18.5% stake in Umeme

Investec Asset Management has invested $40m in Uganda's electricity distributor Umeme, securing 18.5% stake in the company.

Investec successfully bid on the stake in Umeme, following the decision by emerging markets private equity firm Actis to reduce its holding from 60% to 21%.

Investec is the single largest shareholder in the company after Actis.

Roelof Horne, portfolio manager at Investec Asset Management, said: "We are always searching across the capital spectrum for investment opportunities that offer our clients access to Africa's exciting growth potential and infrastructure development is a key investment theme for us."

Horne said that Umeme has greatly improved and extended access to power across Uganda over the past decade.

"Umeme is a critical component of the Ugandan energy sector, with the laudable ambition of providing access to safe, reliable and cost effective power," he said.

Umeme is a public company cross listed on both the Uganda Securities Exchange and Nairobi Securities Exchange with over 6483 shareholders.

Umeme operates under a concession with a structural monopoly on the distribution of electricity across Uganda, distributing 99% of electricity in Uganda through a single buyer model.

Since Actis invested in Umeme in 2005, the company has invested over $134m in modernising its distribution system.

"We are confident that our investment will facilitate their continued growth. This investment also reiterates our commitment to identifying high-quality investments that play such a critical role in fostering Uganda's economic growth," said Horne.

Alastair Herbertson, infrastructure investment specialist at Investec Asset Management, added: "Investing in Umeme is an indication of Investec Asset Management's developing ability to invest in infrastructure. This type of investment is a means of supporting African economies by reducing the cost of doing business and generating future opportunities for further investment." ■

ACQUISITION

RECM acquires WellsFaber

RECM Holdings, the holding company of privately owned, global value manager, Regarding Capital Management (RECM), has acquired a 70% stake in WellsFaber, an independent financial services company.

RECM will purchase the remaining 30% of the business in two equal tranches in four and five year's time.

Current directors Ray Faber, Niel Krige and Ian Morris will remain shareholders until such time.

Chairman of RECM, Piet Viljoen and RECM CEO, Jan van Niekerk, will join Faber and Morris on the Board of WellsFaber as non-executive directors, with Niel Krige as chairman.

According to Jan van Niekerk, WellsFaber will operate completely independently from RECM, but will share the same principles and code of ethics that RECM has always adhered to.

"We have made it clear from our first discussions that WellsFaber is not seen as a potential referral source of assets under management for RECM, but rather a method of always providing objective advice to its clients," he said.

Founder of WellsFaber, Ray Faber, said that through joining the RECM group, the longevity of WellsFaber has been secured and the business will continue to provide sound advice to clients for many years to come. ■

NEWS IN BRIEF

PE in SA expands by 17% in 2013

The 2014 KPMG and SAVCA (Southern African Venture Capital and Private Equity Association) Venture Capital and Private Equity Industry Performance Survey indicates increasing investor appetite for private equity, with the asset class expanding by 17% last year to reach R162.2bn ($15.15bn) in funds under management in 2013. The major portion of the funds raised in 2013 is from South African sources, mainly pension funds.

NSIA to address Nigeria's infrastructure deficit financing

The Nigeria Sovereign Investment Authority (NSIA) and GuarantCo, a development finance fund, have entered into an arrangement to explore the potential creation of a Nigerian Credit Enhancement Facility (NCEF) to attract capital from pension funds, insurance companies and sovereign wealth funds. NSIA and GuarantCo see this partnership as a potential catalyst for unlocking long-term patient capital, typically required by infrastructure projects to be commercially successful. .

SEM takes stake in Soras Group for $24.3m

Sanlam Emerging Markets (SEM) will acquire a 63% interest in Rwanda's largest life and non-life insurance company, Soras Group, for $24.3m. The transaction will see Sanlam doing business directly for the first time in Rwanda. As at December 31, 2013, the Sanlam Group had unallocated discretionary capital of R4bn ($372m).

Cauris invests $4.2m in Cipharm

Cauris Management's Fonds Cauris Croissance II (FCC II) has invested $4.2m in a Cote d'Ivoire-based pharmaceuticals manufacturer Cipharm to fund a new production line for injectable pharmaceutical products. The €60m ($82.29m) FCC II is a generalist fund that aims to take minority or strong minority stakes in growing SMEs in West Africa.

DERIVATIVES

MX launches the FTSE Emerging Markets Index Futures

Montréal Exchange (MX), Canada's derivatives exchange, has introduced the FTSE Emerging Markets Index Futures (MX-EMF), a new futures product based on the performance of the FTSE Emerging Markets Index.

The product, which began trading on 13 June 2014, is targeted at a wide range of market participants seeking exposure to emerging markets (EM) for hedging, asset allocation, speculative and arbitrage purposes.

Alain Miquelon, President and CEO, Montréal Exchange and Group Head of Derivatives Markets, TMX Group, said this is the first EM product for the Exchange, whereas the current products are tied to the Canadian underlying asset classes.

"It is a product that will interest investors, who are active in the emerging markets and specifically who need tools and products that can help them risk-manage their positions in EM," he told *Africa AM*.

The futures business of the Exchange is a global business with more than 50% of the business done outside of Canada. "Our market is used globally by fund managers, liquidity providers, and hedge funds."

The MX-EMF allows customers to synthetically replicate the performance of the FTSE Emerging Markets Index and better manage tracking risks versus the underlying index.

The constituents of the FTSE Emerging Markets Index include large and mid-cap securities from advanced and secondary emerging markets, classified in accordance with FTSE's transparent Country Classification Review Process.

The Index is denominated in US dollars, thereby reducing foreign exchange risk for international users, particularly those engaging in global asset allocation.

Participants can trade the MX-EMF through an approved participant (AP) or a foreign approved participant (FAP) of the Montréal Exchange, a distribution network including major brokers and futures commission merchants in the world.

Miquelon believes that there is a need for the MX-EMF as EMs are getting larger and more accessible to the mainstream investors.

"Emerging markets represent 50% of global GDP and the market capitalization of those countries and the companies that they represent are solid investments. I think any investor should be allocating a portion of their investments into emerging markets," he said. ■

SOVEREIGN WEALTH

Mozambique plans SWF

Mozambique is considering the establishment of a sovereign wealth fund (SWF), the country's finance minister Manuel Chang has said.

"We think it is a good idea, but we won't do what others have done," he said, suggesting Mozambique would not rush into creating the fund given other pressing demands that will require huge injections to fix, such as infrastructure.

An estimated $10bn in foreign investment are expected to flow into Mozambique once a natural gas processing plant is built on its northern coast.

Chang said the country should avoid "opening so many (bank) accounts and having all these billions but continue to have a lack of roads and infrastructure to help develop the country".

Despite recording economic growth of over 7% for over a decade, Mozambique remains one of the poorest countries in the world and highly dependent on international donor support (mainly from the EU and World Bank). ■

PEOPLE MOVES

The **Public Investment Corporation** (PIC), a South African fund manager, has announced the resignation of its CEO, **Elias Masilela**, with effect from 30 June 2014. Masilela will take his outstanding leave with immediate effect. Matshepo More, CFO, is appointed as acting CEO of the PIC. Masilela has been at the helm of the PIC since February 2011 and has since overseen the growth of AUM from just under R1trn ($94bn) in 2010 to above R1.6trn ($151bn) in 2014.

Barclays Africa's chief executive of regional management and head of strategy, **Kennedy Bungane**, has resigned. Bungane will leave the group on June 18 to pursue other business interests. In the interim, Maria Ramos, group CEO of Barclays Africa, will assume accountability for Bungane's portfolio in addition to current responsibilities.

Franklin Templeton has named **Kelsey Biggers** as head of performance analysis and investment risk (PAIR), overseeing the company's global PAIR team comprising more than 100 professionals across 19 locations around the world. Biggers was head of risk at Franklin Templeton subsidiary K2 Advisors, where he pioneered full transparency risk analytics for hedge funds.

Standard Chartered has hired **Andrew Halford** to the Board as group finance director and group executive director. In line with the Board's announcement on 9 January 2014, Richard Meddings will step down from the Board with effect from 30 June 2014. Halford joins Standard Chartered from Vodafone Group PLC where he spent 15 years, 9 years as CIO.

PRIVATE EQUITY

Helios invests in ARM Pensions

Helios Investment Partners will acquire a minority stake in ARM Pension Managers PFA, a subsidiary of Asset & Resource Management Company (ARM).

Tope Lawani, managing partner of Helios Investment Partners, said: "ARM Pensions is an attractive business with a best-in-class management team and an established track record within the Nigerian pension industry."

"Helios has a long-standing relationship with ARM and we look forward to working with the management team to grow the business in what is a massively underpenetrated market," he added.

ARM Pensions is Nigeria's largest independent pension fund manager with over $2.2bn of pension assets under management.

Since the country's adoption of pension reforms in 2006, the pension industry in Nigeria has grown by over 30% annually, constituting an important part of the economic landscape today.

The industry is expected to continue to grow strongly and benefit from the favourable secular trends.

Currently, less than 10% of Nigeria's estimated 70 million strong workforce is enrolled in the country's newly established and mandatory contributory pension scheme.

The company has grown impressively in recent years with revenues growing roughly 45% per year between 2008 and 2012.

In 2013, ARM Pensions' funds under management grew by 37% while revenue appreciated by 43% and profit before tax went up by 86%.

It is well positioned to increase its market share, and Helios and the ARM Pensions management team have identified multiple value creation opportunities.

Sadiq Mohammed, MD of ARM Pensions, said: "Helios brings deep experience in African financial services, a proven track record of partnering with growth companies like ours, as well as a global perspective. We are excited by the opportunity in our industry and believe that Helios is the perfect partner for us as we consolidate our market leading position." ■

PRIVATE SECTOR

OPIC provides PPA guidelines

Bankable power purchase agreements (PPA) are key to unlocking private and public sector capital needed to build generation capacity across the African continent, according to Elizabeth Littlefield, President and CEO of the Overseas Private Investment Corporation (OPIC).

Littlefield presented a set of guidelines aimed at increasing private sector investment in the power sector in developing countries while speaking at the US-Africa Energy Ministerial, an event co-hosted by the Governments of Ethiopia and the US.

The document offers a ten-point framework of essential elements to making a PPA bankable.

This list of key PPA elements was developed collaboratively – and represents the consensus viewpoint of – OPIC, the US Agency for International Development, the US Department of Commerce, the US Trade and Development Agency and numerous international development finance institutions.

Littlefield said that an agreed-upon list like this benefits government, producer, and consumer.

"Developers, lenders, and local governments can devote time and resources towards projects with shared expectations and clear paths for progress," she said.

"This framework helps connects the people who benefit from increased energy access with the investors, financiers, and innovative project developers who have the resources to build power projects throughout the continent," she added. ■

MONTH IN NUMBERS

$50m
Third party AUM in Rudiarius's Africa equity fund
(page 4)

30%
Annual growth of the Nigerian pension industry
(page 7)

7.3%
Inflation rate in Kenya
(page 10)

$246m
Phatisa received in capital commitments for the AAF
(page 12)

78.3%
Proportion of investments financed internally in SSA
(page 15)

$509bn
Nigeria's GDP after re-basing
(page 20)

PERFORMANCE INSIGHT MAY

In May, the African markets continued to show mixed performance.

Once again, Nigeria topped the performance tables with the country index appreciating by 8.81% in USD terms. The majority of funds reporting to the *Africa AM* database showed positive performance, returning between 1% and 4%. Meanwhile Nigeria country funds were the best performing funds for the month: the Sustainable Capital Nigeria Fund returned 10.75%, whereas the Nigerian fund, managed by Imara, gained 6.3%.

The best performing market YTD is Kenya (+10.06%). Nevertheless, the decline in Kenyan stocks in May was due to security concerns as the country prompted foreign investors to pull their money from East Africa's biggest economy. Aly-Khan Satchu, CEO of Rich Management in Nairobi, said: "The recent spike in frequency and intensity of attacks has given the bulls a pause."

REGIONAL PERFORMANCE (%)

SOURCE: MSCI

	MAY	YTD
BOTSWANA	▼ -1.96	▼ -11.18
GHANA	▼ -3.91	▼ -11.04
KENYA	▼ -0.82	▲ 10.06
MAURITIUS	▲ 0.31	▲ 2.82
NIGERIA	▲ 8.81	▼ -3.89
SOUTH AFRICA	▼ -1.84	▲ 5.07
ZIMBABWE	▲ 3.26	▼ -9.97

MAY

BEST
NIGERIA
+8.81%

WORST
GHANA
-3.91%

YTD

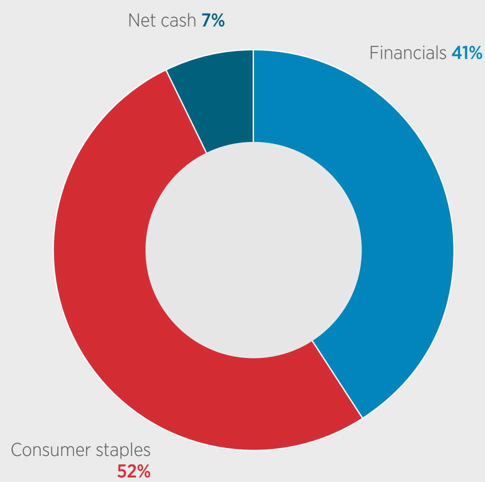
BEST
KENYA
+10.06%

WORST
BOTSWANA
-11.18%

NIGERIAN GAINS

The rise in the Imara Nigeria fund (+6.3%) reflects a recovery following the sharp fall caused by the departure of Lamido Sanusi from the Central Bank in Q1. The April abduction of schoolgirls by Boko Haram and its subsequent bombing campaign has not impacted equities, although the inept response to the insurgency could easily affect the 2015 presidential election. While the market will probably now pause for breath, fundamentals are positive – regulatory reform of the banking sector is no longer a headwind to earnings and consumer demand is finally showing signs of life following the petrol price rise in January 2012.

Imara Nigeria Fund (sector breakdown)
Source: Imara



Fund performance (USD returns)

MAY

BEST
Sustainable Capital Nigeria Fund
+10.75%

WORST
Imara African Resources Fund
-5.49%

LAST 12 MONTHS

BEST
Steyn Capital Africa Fund
+24.56%

WORST
Imara Zimbabwe Fund
-13.10%

3-YEAR CAR

BEST
Steyn Capital Africa Fund
+27.73%

WORST
Imara African Resources Fund
-23.83%

AFRICA FUND LISTINGS

DATA ENDING 30 MAY 2014

Fund Name	May 2014 Return	Last 12 Months Return	CAR Last 3 Years Return	May AUM ($m)	Objective	Start date
Africa Opportunities SAC Ltd	0.72	2.53	18.40	45.00	Equities	6/06
African Alliance Africa Pioneer Fund I	2.60	7.70	6.70	27.00	Equities (ex-SA)	6/07
Allan Gray Africa Equity Fund	-0.47	15.37	9.34	322.00	Equities	7/98
Allan Gray Africa ex-SA Equity Fund	0.45	12.62	N/A	195.00	Equities (ex-SA)	1/12
Amigo Partners African Franchise Fund	-0.79	*	N/A	1.00	Equities	3/13
Amigo Partners Shamwari Fund	-1.41	*	N/A	1.00	Equities	3/13
Amigo Partners Zimbabwe Income Fund	0.58	*	N/A	3.40	Fixed Income	3/13
Ashburton Africa Equity Opportunities Fund	1.95	14.49	N/A	26.26	Equities	5/13
Coronation Presidio Partnership (ZAR)	4.12	20.30	25.10	273.75	Equities	9/05
Duet Africa Opportunities Fund	2.49	3.88	9.33	324.11	Equities	3/09
Duet Victoire Africa Index Fund	2.44	5.48	12.67	161.30	Index (ex-SA)	11/07
FCOM Africa Part J	4.26	N/A	N/A	26.90	Equities	8/13
Fleming Africa Fund Ltd	0.97	-0.39	5.09	28.39	Equities	10/10
Granite Fixed Income Fund (ZAR)	0.60	7.20	7.70	11.56	Fixed Income	9/02
Imara African Opportunities Fund	-0.06	-0.36	3.91	86.73	Equities	6/05
Imara African Resources Fund	-5.49	-4.22	-23.83	1.31	Commodities	12/08
Imara East Africa Fund	0.46	3.79	10.05	4.75	Equities	1/08
Imara Nigeria Fund	6.33	11.79	8.92	8.29	Equities	2/07
Imara Zimbabwe Fund	-0.35	-13.10	-2.93	16.36	Equities	2/07
Insparo Africa & Middle East Fund	0.64	1.77	4.33	91.23	Equities	5/08
Insparo Africa Equity Master Fund LP	1.50	2.43	7.85	38.51	Equities	1/11
Investec Africa Fund	2.16	2.49	4.33	1034.43	Equities (ex-SA)	11/05
Investec Africa Opportunities Fund	1.33	8.34	-0.25	58.03	Equities	9/10
Investec Institutional Pan Africa Fund	2.43	3.02	4.61	272.16	Balanced	5/08
IPRO African Market Leaders (i2) class	1.91	-3.45	7.88	10.07	Equities	6/08
Matrix Multi Strategy Fund [former Brait] (ZAR)	0.56	7.37	9.74	51.83	Multi-Strategy	6/14
Matterhorn Breithorn Fund	2.32	2.50	-2.20	*	Equities	8/07
Matterhorn Palmyra Fund	3.15	6.20	1.30	*	Equities	1/03
MCB Africa Bond Fund Class B	0.34	N/A	N/A	9.31	Fixed income	2/14
Momentum IF Africa ex-SA Equity Fund	1.97	5.50	11.70	11.00	Equities (ex-SA)	9/07
Momentum IF Africa Fixed Income Fund	0.09	N/A	N/A	10.00	Fixed Income	8/13
Nile Pan Africa Fund Class A	-0.61	4.92	*	*	Equities	4/10
Nile Pan Africa Fund Class C	-0.68	4.18	*	*	Equities	4/10
Nile Pan Africa Fund Inst Class	-0.54	5.19	*	*	Equities	11/10
Nubuke Africa Multi Strategy Fund	-0.63	-2.76	5.02	101.00	Multi-Strategy	5/08
Old Mutual African Frontiers Fund	1.09	15.14	7.93	78.73	Equities	5/10
Old Mutual Pan Africa Fund	1.82	10.18	3.77	11.77	Equities	4/10
Old Mutual S&P Africa Custom Index Fund	1.87	1.88	N/A	95.60	Index	9/11
Optis African Frontier Fund	3.00	2.48	6.67	67.55	Equities (ex-SA)	8/09
PineBridge Sub-Saharan Africa Equity Fund	3.00	2.98	8.69	58.14	Equities	7/08
Prescient Africa Equity Fund (ZAR)	3.69	12.53	26.54	6.05	Equities	4/11
Renaissance Pan African Fund	2.80	-0.80	9.70	55.05	Equities	10/10
Renaissance Sub-Saharan Fund	5.80	5.40	9.60	121.27	Equities	10/10
Robeco Afrika Fonds	-1.59	7.74	4.81	83.00	Equities	6/08
Scipion Commodity Trade Finance Fund	0.41	*	*	*	Fixed income	8/07
Silk Africa Bond Fund	0.77	N/A	N/A	4.16	Sovereign bonds	2/14
Silk African Lions Fund USD	0.52	4.60	0.15	89.65	Equities	6/09
Steyn Capital Africa Fund	1.84	24.56	27.73	153.00	Equities (ex-SA)	9/11
Sustainable Capital Africa Alpha Fund	3.37	24.56	N/A	37.27	Equities (ex-SA)	2/12
Sustainable Capital Africa Consumer Fund	1.65	7.07	N/A	15.30	Equities (ex-SA)	3/13
Sustainable Capital Africa Sustainability Fund	0.54	16.68	2.05	26.96	Equities (ex-SA)	10/09
Sustainable Capital Nigeria Fund	10.75	1.99	N/A	21.51	Equities	5/12
Tower Fund Ltd USD Class A	4.30	*	N/A	*	Equities	7/12
Tower Fund Ltd (ZAR)	4.10	*	*	*	Equities	8/09

FUND OF FUNDS

Alpha Cautious Hedge A (ZAR)	0.93	7.90	7.69	15.15	Multi-Asset	1/09
Alpha Equity Hedge A (ZAR)	2.25	18.55	14.10	40.77	Equities	1/09
Alpha Fixed Income A (ZAR)	0.81	1.60	4.31	5.06	Fixed income	1/09
SYm|mETRY Africa Fund of Funds	2.49	7.28	N/A	10.30	Equities	5/12

Based on funds reporting data as of 9 June 2014

*May fund data not available at time of going to press

MANAGER'S VIEW

DEAN D'SA, co-managing director, MCB Investment Management

The MCB Africa Bond Fund has performed positively since its launch in February, delivering a three-month return of 1.78% in USD terms gross of fees against a benchmark performance of -0.27% for the same period. It has been a difficult time for local currency African bond markets as the currencies of many countries have faced considerable headwinds internally, as well as knock-on effects as a result of Fed tapering. Our cautious approach to building the holdings in the fund has paid off well and resulted in our investment team adding value to investors.

We continue to maintain a market neutral position in ZAR related currencies as we believe that the ZAR/USD exchange rate is close to the top end of its range, but are wary that the yields available in domestic markets do not provide enough compensation for the currency risk being taken.

In Nigeria, we bought some short dated bonds when yields were higher and look to remain overweight the short end of the yield curve where yields are approximately 11.5% and currency volatility, though higher than observed in previous months, is expected to remain muted as the new Governor continues to implement the strong Naira policy.

Our East African exposure (currently Kenya) is expected to perform strongly due to currency stability and attractive yields. We expect to build a position in Uganda where the shilling has come under pressure and where short maturity government bonds are able to yield 14.5% – a level we think compensates us for the currency risk.

The fiscal pressure in Ghana and Zambia and the ongoing discussion on IMF involvement has pushed yields up to 25% and 20% respectively and we expect some currency weakness in the short term, though are looking at these yields as an attractive opportunity from a hold to maturity perspective.

AFRICA ECONOMIC INDICATORS
(AS OF 6 JUNE 2014)

COUNTRY	INTEREST RATE (%)	INFLATION RATE (%)	CPI	UNEMPL. RATE (%)	GDP GROWTH RATE (%)	DEBT TO GDP (%)
Botswana	**7.50**	**4.50 [4.43]**	**174.50 [173.90]**	**17.80**	**4.70**	**23.50**
Cameroon	3.25	1.60	-	3.80	6.10	6.50
Cape Verde	**8.25**	**-0.30 [0.60]**	**-**	**16.40 [16.80]**	**0.50 [1.20]**	**95.00 [66.20]**
Côte d'Ivoire	3.50	-0.20 [0.00]	-	15.70	9.80	54.10
Egypt	**8.25**	**8.87**	**145.70**	**13.40**	**1.00**	**83.30**
Ghana	18.00	14.70 [14.50]	123.70	12.90	4.90	44.90
Kenya	**8.50**	**7.30 [6.41]**	**149.70 [148.20]**	**40.00**	**4.70 [4.40]**	**51.70**
Malawi	25.00	23.90 [24.00]	157.70 [161.20]	3.00	6.10	16.30
Mauritius	**4.65**	**3.40 [4.20]**	**107.69 [107.70]**	**8.20**	**3.20**	**58.10**
Mozambique	8.25	2.91 [2.87]	114.82 [114.68]	17.00	7.13	42.80
Namibia	**5.50**	**5.87 [5.30]**	**108.30 [107.30]**	**27.40**	**5.10**	**23.90 [23.80]**
Nigeria	12.00	7.90 [7.80]	156.20 [155.20]	23.90	7.72	11.00
Rwanda	**7.00**	**2.72 [3.43]**	**-**	**30.00**	**3.90**	**29.42**
South Africa	5.50	6.10 [6.00]	109.20 [108.70]	25.20	1.60 [2.00]	46.10
Swaziland	**5.00**	**4.40**	**-**	**28.20**	**2.78**	**9.68**
Tanzania	12.00	6.30 [6.10]	150.70 [149.70]	10.70	6.50	39.90
Uganda	**11.00 [11.50]**	**5.40 [6.70]**	**218.50 [216.20]**	**4.20**	**6.90**	**33.30**
Zambia	12.00	7.80	-	15.00	6.50	31.20
Zimbabwe	**14.24 [14.08]**	**0.30 [-0.90]**	**-**	**10.70**	**10.60**	**150.90**

▲/▼ up / down from previous month's value

Source: Trading economics, African Central Banks

AFRICA INSIGHT

UGANDA

The Bank of Uganda (BoU) cut the country's benchmark interest rate following subdued price inflation figures for May. Consumer price inflation continued to decline in May, falling from 6.7% y-o-y in April to 5.4% y-o-y in May. In June's monetary policy statement, the BoU noted that the balance of risks to the country's economic outlook remains tilted towards lower inflation and sluggish economic growth. Consequently, the central bank decided to cut the country's benchmark interest rate by 50 basis points to 11% (the first cut since December 2013). The BoU concluded that the accommodative monetary policy stance should provide support to domestic demand, and help economic growth to strengthen over time. Jacques Nel, analyst at NKC Independent Economists, said: "We maintain our view that upside inflation risks remain dominant, and while the cut in the policy rate should support GDP growth, the expansionary monetary policy runs the risk of undermining monetary stability in the short term."

KICKING THE TYRES

LONG RAINS

Grant Flanagan, managing director, Amigo Partners

Our trip to Kenya took place a few days prior to the Madaraka Day celebrations, which market 51 years of self-rule. It can be argued that the country has now firmly positioned itself as the economic hub of the East African community. The enthusiastic, aspiring and industrious mood of Kenya seems to have embedded itself throughout the country, which according to the IMF will grow at approximately 6.5% in 2014.

At the time of visiting there had been a significant amount of bad press surrounding the Somalian Al-Shabaab terrorist group. Local mini-buses, more commonly known as Matatus, had been a popular target for the group and the recent evacuation of British tourists and a spate of travel warnings throughout the EU are just some of the repercussions that have impacted Kenya's tourism sector in particular.

While the resilience of their economy is laudable, Kenyans often speak of their 'Achilles Heel' – the weather. Our trip coincided with the "long rains" season, which begins in March and continues through June and plays a pivotal role in the performance of the economy. Good rains often result in a successful agricultural season, which increases the proportion of locally produced food and reduces the need to import. In addition, these rains are critical in to Kenya's hydroelectric generating capacity, which is by far the cheapest source of electricity.

When combined, these two factors serve to alleviate some of the pressure as well as the balance of payments deficit. Since food is also a major constituent in the consumer price index, the "long rains" can be likened to an economic barometer for people in Kenya, and while the current rains have not met expectations, many Kenyans continue to hope for a better end to the season.

DEVELOPMENT EQUITY

Africa AM speaks with **Duncan Owen**, senior managing partner of **Phatisa**, about the company's agriculture fund and how to deliver on development equity

BY ANNA LYUDVIG

In September 2013, African private equity fund manager Phatisa closed the African Agriculture Fund (AAF) with $246m in capital commitments. It was backed by an impressive pool of multinational investors, including development finance institutions (DFIs) like AfDB, OPIC (Overseas Private Investment Corporation), government agencies, commercial banks, development banks, funds-of-funds and private investors.

Phatisa, which also manages the Pan Africa Housing Fund, launched the AAF in 2009 in response to the food shortages being experienced across many African countries. The fund targets three subsectors of food and agriculture: primary, secondary and tertiary (services and infrastructure), with projects touching on primary farming, protein production, processing, inputs, fertiliser, mechanisation and FMCG beverages. The fund has committed investments in excess of $100m in twelve businesses across the African continent.

First deal

The AAF's first deal – the Goldtree palm oil plantation and mill – was a very early-stage investment in post conflict Sierra Leone. Complementing its own plantation output, the Goldtree palm oil business supports an extensive agricultural community, buying in fruit from over 5,000 outgrowers.

It is working on significantly improving the fruit yields and technical skills of these smallholder farmers while mitigating against environmental risk and dangerous agricultural practices. What was a long-abandoned plantation in Daru, a small town in Kailahun District in the Eastern Province of Sierra Leone, is expected to produce over 5,000 tonnes of palm oil in 2014, and permanently employ more than 400 people.

For Duncan Owen, senior managing partner of Phatisa, Goldtree is an ideal example of the sustainable and far-reaching impact of development equity. This form of investment takes conventional private equity to a new and more meaningful level, according to Owen. Development equity takes traditional private equity, which is strongly focused on investor returns, and combines this with development finance from governments and institutions. "The outcome is multifaceted and positively impacts on all stakeholders," he explains.

At the time of AAF's initial investment in Goldtree, the mill had been destroyed and surrounding plantations dilapidated during the 1991-2002 civil war. Palm oil processing had reverted to the traditional method, which is basic and involves "cooking the fruits, trampling them in an open pit, adding water so the palm oil product would float, and then flushing the pollut-

> **"The Goldtree approach builds sustainable assets in emerging countries, has a meaningful influence on communities and positively impacts on the African growth story"**
>
> DUNCAN OWEN

Pre-investment mill

Operational Goldtree mill

ant waste into rivers". "This was a dangerous, environmentally destructive and low yielding method," says Owen.

With an investment injection of $20m plus and ongoing support from Phatisa agri specialists, Goldtree has been completely transformed. It now has a mechanised, safe and hygienic processing mill supported by office facilities, a canteen, workshops, stores, a quality control laboratory, holding tanks and a fleet of vehicles. While presently managed mainly by expat staff, the aim is to transfer skills so local employees can ultimately run the business.

"Goldtree operations are located in a classic palm oil climate, close to water, and a reasonable six hour drive from the capital city Freetown. Its potential rewards for investors are closely aligned to the AAF investment philosophy of development equity. This approach builds sustainable assets in emerging countries, has a meaningful influence on communities through employment and training, and positively impacts on the African growth story," says Owen.

The expected investment horizon for AAF's investment in Goldtree is until 2020 when, at time of exit, the business should be "solid, sustainable and pleasingly profitable". Over that period annual crude palm oil output should rise to 18,000 tonnes, supplying domestic and regional markets. For Owen, development equity is more than simply maximising value on exit: "Investments need to give the best possible return for our investors, but also the community in which these funds operate."

Supporting the need for food security

Phatisa's investment moment has continued. Other investments by the AAF to date include an investment in Zambian poultry producer Goldenlay and two follow-on investments – the purchase of Kanyenda, a soya farm on Zambia's Copperbelt, and the purchase of Kafubu, a former dairy/arable and soya farm on Zambia's Copperbelt. Phatisa also invested in Côte d'Ivoire-based fruit juice and water bottling and distribution company, Continental Beverage Company; agricultural engineering and equipment distribution company FES in Malawi and palm oil business Feronia in the Democratic Republic of the Congo.

To enhance its impact on development, the fund has deployed two instruments: the AAF SME Fund (an AAF subsidiary fund, focused on small to medium sized enterprises to boost development returns) and a €10m Technical Assistance Facility (TAF) to finance studies and capacity-building for small firms and larger outgrower/smallholder schemes across portfolio companies.

Phatisa has also made investments in Madagascar, Cameroon and Zimbabwe through its AAF SME fund, which received $30m from the main AAF fund in 2012. Overall, the AAF portfolio produces 62,000 tonnes of food and beverages and hopes to "triple-fold" this output amount within five years, according to Owen.

A balanced blend of private equity and development finance aligns investor returns with food security, job creation, skills improvement and community upliftment. For Owen, a development equity opportunity is the perfect place for DFIs who want to invest in a way that "generates traditional private equity financial returns and sustainably uplifts communities - rather than simply donate". "Besides generating an annual return which could be over 20% in the medium term, development equity is transformative," he adds.

Owen stresses that development equity is "exceptionally hard work". "Businesses are based in remote geographies and very young markets where skills and infrastructure are lacking. The challenges can be huge. But you commit to a long term vision and stick to that goal. The rewards for everyone are worth it," he concludes. ■

AAF AT A GLANCE
(SOURCE: PHATISA)

FUND YEAR 4
PORTFOLIO PARTNERS 6 (excluding follow-on investments)
INVESTMENT COMMITMENTS > $100m
COUNTRIES Sierra Leone, Zambia, DRC, Madagascar, Côte d'Ivoire, Malawi, Nigeria and Cameroon
INDUSTRIES Primary production, palm oil, protein production, processing, inputs, mechanisation, fertiliser and FMCG beverages.
PORTFOLIO COMPANIES EMPLOY > 4,700 people
PORTFOLIO PRODUCES > 62,000 tonnes of food and beverages

FACT BOX

Phatisa is an African private equity fund manager, operating across sub-Saharan Africa, with offices in Mauritius, South Africa, Zambia, Kenya, Ghana, as well as London.

The firm has two sector-specific funds under management, totalling more than $285m focused on food and affordable housing. Phatisa comprises a team with a significant track record of managing private equity funds and businesses throughout the continent.

The Phatisa team is located in Africa and spends a considerable amount of time developing relationships with strategic partners in all countries where funds under management are active. This ensures that funds have reliable networks and information in the countries in which they invest.

At the heart of Phatisa is development equity, which is defined as a blend of private equity and development finance. It is embodied in the formula: DevEq = PAT * x + i 2 ™; where PAT is profit after tax, x is a given investment return/multiple and i is impact. Phatisa aims to deliver a healthy return to its investors plus positively impact the investment and the community they affect, leaving sustainable value at the exit.

SME INVESTING

SME investing can offer a real opportunity for both commercial return and long-term sustainable development, says **Nish Kotecha**, managing director, **Fusion Group**

This is Africa's decade, but what to invest in and how is a completely different matter. The stock markets are small, and the good stocks trade with liquidity premiums; infrastructure opportunities are attractive but are for the long haul and require a large amount of capital outlay, which limits the number of projects that can be undertaken by a single group. Private investments in well-established businesses are a way forward, but the pool of attractive and available companies looking for private equity is shallow and these smart promoters know how achieve top dollar. Enter small and medium enterprises (SME) investing – another common hypothesis in the 'invest in Africa' thesis. SME investing can offer a real opportunity for both commercial return and long-term sustainable development.

At Fusion Group we have been implementing this for over seven years in East Africa. However, before we look at how, let's remind ourselves of the continent's profile: 57 nations, seven time zones, 2,000 languages and over one billion inhabitants with a demographic dividend which is the envy of the developed world. It has a consumer base of 900 million with a growing disposable income, and consumer demand is now outpacing supply. With a GDP growth rate averaging 5% a year since 2000, Africa now counts for six of the top 10 fastest growing countries globally.

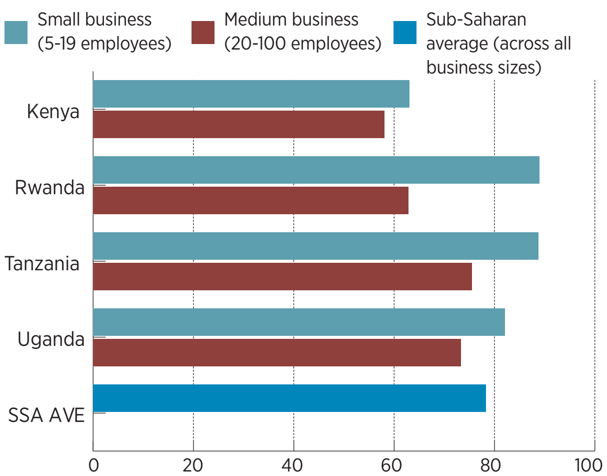
By 2030, the combined GDP of the largest 11 African economies will overtake Italy and Canada and potentially be as large as France. By 2050, these 11 could collectively become as big as any G7 economy outside of the US. By the same decade, Africa's middle class is predicted to exceed China's, although it is worth noting there are 300 million adults who as yet do not have access to banking. The challenge of financial inclusion is an area where countries like Kenya are leading the world with offerings such as M-Pesa and M-Shwari (powered by CBA).

Cynics will say that Africa has a history of disappointing but there is only so much you can hold back aspirations driven by those who demand inclusion. "We need compassion to get started and enlightened self-interest to get ourselves serious," says Paul Collier, author of "The bottom billion" and member of Fusion Group's Advisory Board.

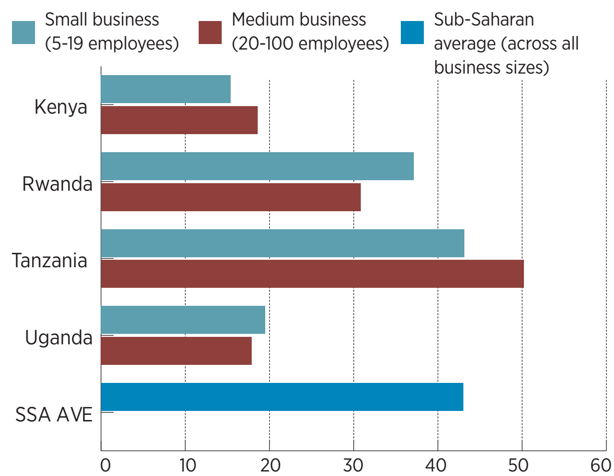
> **"Cynics will say that Africa has a history of disappointing but there is only so much you can hold back aspirations driven by those who demand inclusion"**
>
> NISH KOTECHA

So how can private equity (PE) be a catalyst for such momentum? My inspiration, the late C.K. Prahalad in his ground-breaking book "The fortune at the bottom of the pyramid: eradicating poverty through Profits", turned traditional corporate strategy up-

PROPORTION OF INVESTMENTS FINANCED INTERNALLY (%) Source: IFC Enterprise survey (2013); Rwandan data refers to 2011



% OF FIRMS IDENTIFYING ACCESS TO FINANCE AS A MAJOR CONSTRAINT Source: IFC Enterprise survey (2013); Rwandan data refers to 2011



side down. Why focus on the top of the pyramid where competition is intense when you can seed the entrepreneurial aspirations of those at the base? The emerging middle class are consumers, employees and most importantly entrepreneurs – driven by their desire to build a better life for their children. Business creators from this segment have special needs but they bring drive, flair and a creativity that does not always exist in their professionally managed larger peers.

Most will agree that growth in the small and medium sized enterprises is vital to building the foundation for long-term growth and tackling the region's poverty, through home-grown job creation. SME growth is usually a core part of the government's strategy for sustainable growth because of the indirect value effect. Each new job creates another 20 along the chain. To achieve this, SMEs need financing and support. The latter is increasingly difficult to justify when you look at the typical fund economics.

SME financing

SME financing requires the right people on the ground. This is expensive and requires mentoring skills, but does provide a significant advantage in a market which tends to be occupied by PE firms who adopt a fly-in fly-out approach to opportunity creation and investment. However, without such on-the-ground support, SMEs cannot become the bigger employers of tomorrow. The term 'forgotten middle' is commonly used to describe this segment. Nevertheless, I would suggest that it is within this segment that the greatest investment multiplier opportunities exist, but they will make private equity teams really sweat for their equity.

Limited cash flows from these early stage businesses implies that equity is required early on to provide the right foundation. However, it is not unusual for base of the pyramid entrepreneurs to regard this as donation capital, particularly when it is invested at a very early stage of the lifecycle. It is not uncommon for such entrepreneurs to minimise their risks by engaging in varied business activities with the hope that one of them will strike the right chord. Focusing the attention on the one you have invested in can be a challenge, putting your investment at risk.

On the other hand, debt investments can be difficult to structure and risk putting pressure on vital cash flow in the early stages; but debt can bring an important discipline. The principle of respecting external capital and managing your cash flows to repay your investment on a regular basis is a fundamental requirement for any long term successful entrepreneur. This requires the creation of business plans and cash flows, which need to be followed through active management of that scarce resource – cash.

Using debt can also avoid the need for that difficult conversation; valuation at a stage in the business when it is too early to tell. In mature markets, PE firms may regard this as the best time to strike a deal. In emerging markets, sustainable value creation can only happen if it is fair to both over the long haul. The Fusion experience has shown that it is better to prove that you are the preferred partner for a long-term equity investment by investing a smaller amount and working together, rather than compete on price and promises of future collaboration. Good partnerships then are spoken about in the business community, spurning new opportunities. "There is no better referral than from a fellow entrepreneur with whom you have previously invested capital," says Phil Goodwin, co-founder and chairman of Fusion Group.

Fusion experience

Fusion Africa was founded in 2006 with headquarters in Nairobi, and regional offices in Kampala, Kigali and Dar es Salaam. Fusion has some 35 professionals across the East African region. The group has approached the SME segment in an interesting way. Understanding that the real value creation among SMEs requires a long term view, Fusion began seeding interesting SMEs and backing entrepreneurs at the base of the pyramid in 2006. Some 270 investments later, Fusion has created a valuable proprietary pipeline for tomorrow. “You may speak to entrepreneurs but it is only once you put your money in that a relationship is sealed,” according to Luke Kinoti, co-founder and CEO of Fusion Group.

In 2006, Fusion set out to bridge the funding gap for SMEs that exists between banks, for whom the SMEs are too small, and friends and family groups, with whom they can only get so far. Fusion’s model of investing small amounts of capital, typically as debt to support local entrepreneurs with their business ventures, has resulted in an attractive opportunity for private equity investing today.

Those businesses that have paid back previously invested capital, with an appropriate return through growth, represent an attractive investment today. Those that failed can be written off, to avoid a potentially larger loss down the line. Interestingly, Fusion’s average NPA (non-performing assets) from this early stage SME portfolio was around 5%. Most importantly, Fusion investees are given a chance to demonstrate how they respond to their responsibility towards external investors. The way they respond becomes a key consideration in future investment plans.

So, let’s examine this model in more detail. By deploying small amounts of capital (typically, $5,000 to $100,000), the team at Fusion were able to get under the hood of the business, assess it in real time, work closely with its management team and implement the foundations for future sustainable growth. Considering a significant future investment with the experience and understanding of the existing management’s ability to execute provides a strategic advantage for the investment committee. Further, the Fusion team who are already working with the investee can lead the fundraising discussions rather than being invited to compete at a later date. “When you are being asked to present your term sheet for an investment, you know it is too late,” says Kinoti.

The level of the investment (people, money, time) over the last eight years has been significant. Today, this pipeline and Fusion’s advocates in local business communities offer a unique investment opportunity to back known entrepreneurs. As this investment methodology yields results, other PE firms will be attracted by the opportunity, delivering the much needed capital and expertise to the burgeoning SME sector in East Africa. ■

CASE STUDY: GAL BAKING

Location: Nairobi, Kenya
Sector: Consumer

GAL Baking is one of Nairobi’s premier bakeries. They produce a range of biscuits and cakes, some of which are distributed via a small retail chain.

- GAL has become the leading niche supplier of cakes and biscuits to a growing middle class customer base
- Fusion has continuously invested in GAL from an individual start-up loan of $3,500 in 2008 until today.

Fusion’s ESG Impact

- Environmental:

- Waste management;
- Environment monitoring

- Social:

- Since Fusion began investing in GAL, the job numbers haves increased from c.30 to 130 employees today receiving regular training;
- Responsible sourcing of inputs

- Governance:

- Improving internal governance structures;
- Board involvement;
- Strategic support and mentorship.

CASE STUDY: RUSORORO AGGREGATES

Location: Kigali, Rwanda
Sector: Mining

Rusororo Aggregate Ltd is a stone extraction and crushing company that currently owns three quarry sites within 20km of Kigali’s CBD.

- Fusion’s investment funded the mechanisation of the quarry site.
- Annual production is expected to increase from 14,800m^3 to 131,400m^3 in a region with high demand for construction materials.

Fusion’s ESG Impact

- Environmental:

- A full NEMA environmental assessment has been conducted

- Social:

- From the two founders, the business has grown to over 140 employees since Fusion invested;
- Regular health and safety checks in place;
- A well has been dug to supply water to the local community;
- Road access and electricity installed

- Governance:

- Establishing management & accounting procedures;
- Board involvement;
- Strategic support and mentorship.

RISING DEMAND

South African hedge fund industry regulatory changes are likely to increase the demand for this asset class, says **Eugene Visagie**, portfolio manager, **Novare Investments**

Over recent years, the South African hedge fund industry has been relatively stable with regards to assets under management, which reached an all-time high of R46bn ($4.32bn) at the end of 2013. Even at this level, the SA hedge fund industry remains a fraction of the size in comparison to both South African collective investment schemes and global hedge fund assets. According to the Association for Savings and Investments South Africa (ASISA), collective investment schemes' AUM totalled R1.33trn ($0.12trn) as at the end of December 2013 and Hedge Fund Research reported that the global hedge fund industry amounted to R23.78trn ($2.23trn) by the second quarter of 2013.

Expected regulatory changes during 2014 are likely to increase the demand for South African hedge funds by enabling retail investors to invest directly into these funds, which were previously only available to institutional investors and high-net-worth individuals.

In line with G20 commitments, National Treasury determined that hedge funds should now be regulated at fund level. As most South African hedge funds operate as pooled investments, it was decided that product regulation should be in accordance with existing collective investment scheme regulations. The regulation of hedge fund managers has, however, been in effect for several years now under the Financial Advisory and Intermediary Services Act of 2002.

According to the ASISA, South Africa is one of the first countries to implement hedge fund regulations. The proposed framework for hedge fund regulation distinguished between two classes of funds: retail hedge funds, which will be available to the general public, and qualified hedge funds, which will only be available to investors who meet specified criteria, or those making use of a financial adviser.

Retail hedge funds will be subject to more strict investment guidelines, as well as more frequent reporting to the Registrar and investors to ensure increased investor protection. Qualified hedge funds will be subject to less cumbersome regulation, with a focus on reporting and monitoring of potential systemic risk, as well as adequate disclosure to investors.

Long/short strategies

In South Africa, the equity long/short strategy dominates the hedge fund market with 52.5% of hedge fund assets allocated to this strategy. One of the unique differences between the proposed regulations of SA retail hedge funds and the more popular Ucits it that managers will be able to engage in physical short selling. When looking at gross exposure (long exposure plus absolute short exposure divided by the fund's Net Asset Value), retail hedge funds will be limited to a gross exposure of 200%, or alternatively a Value at Risk (VaR) approach can be applied. Qualified investor funds will not be subject to such prescribed limits but the founding documents of the fund can however specify such a limit. Gross exposure limits will be reported to the Registrar and investors on a regular basis.

The bulk of South African equity long/short hedge funds will easily comply with the gross exposure limits for retail hedge funds and can therefore be expected that the majority of managers will register their funds under the retail hedge fund class (*see corresponding graph*).

The proposed regulations also distinguish between levels of liquidity offered to investors. Retail hedge funds will require a 30 days' notice for redemption, and qualified investor funds will require a maximum of 90 days. It appears that three quarters of the industry will be able to meet the 30 days' notice period to facilitate investor redemptions. The majority of the balance will be able to accommodate redemptions within 90 days.

On the valuation of hedge funds, the regulations propose that valuations should be undertaken by an external third party administrator. Fund managers will be expected to appoint independent administrators and custodians, but these requirements have already been met by the majority of South African based hedge funds.

Risks

South African equity long/short strategies are not without risks, including those common to most hedge funds which include higher fees, the use of leverage and reduced liquidity compared to unit trusts.

Where liquidity is concerned, the graph however indicates that most of these strategies invest in instruments that can easily be liquidated within 30 days, which is consistent with the liquidity requirements for funds in the retail market.

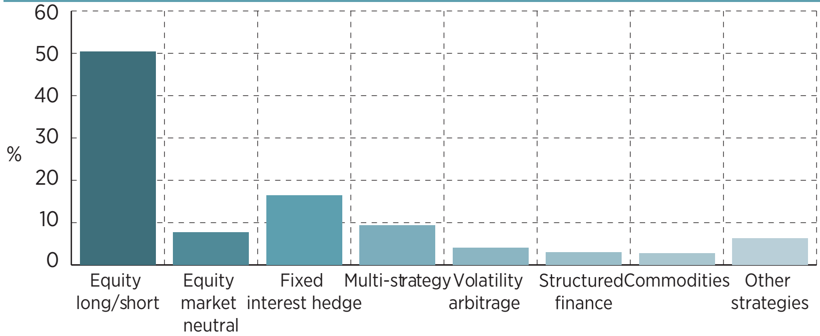
On fees, South African hedge funds charges are considerably lower than their international counterparts. The average management fee charged by South African hedge fund manager's amounts to 1% p.a. Most funds charge a performance fee, subject to their meeting minimum return hurdles.

In addition to generic hedge fund risks, the equity long/short strategy has some unique risks, including the portfolio manager's capability of correctly forecasting the relative performance of two stocks – which can be difficult. Another type of risk results from a so-called beta mismatch where the stock market declines sharply resulting in long positions losing more than short positions.

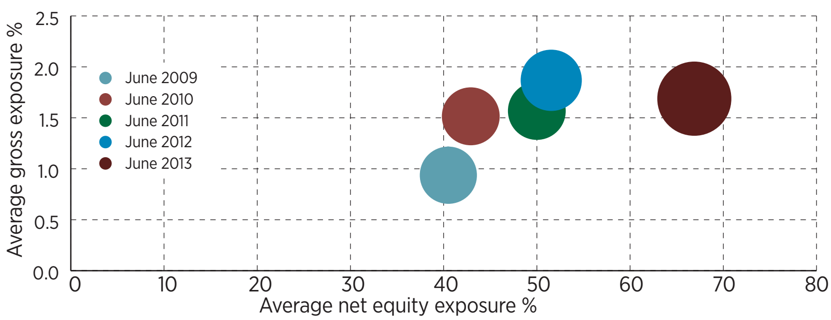
The proposed regulation requires funds to have a risk management programme addressing risks relating to investments in unlisted instruments, the use of derivatives and the trading process employed. Increased emphasis is also placed on the monitoring of systemic risk.

In summary, equity long/short hedge fund strategies can potentially increase returns in a balanced portfolio. Regulatory progress will assist to ensure that these benefits become available to a wider range of investors as hedge funds enter the investment mainstream.

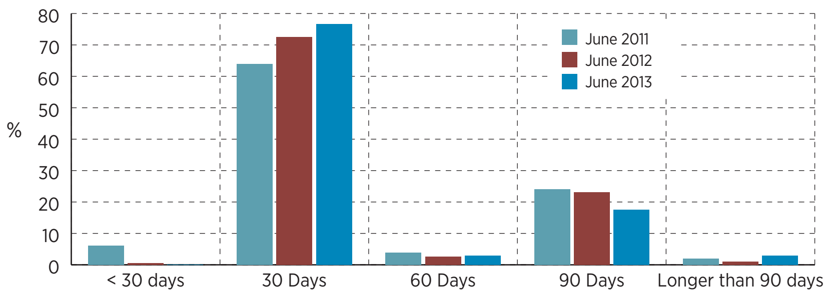
ASSETS BY STRATEGY JUNE 2013 (%) Source: Novare



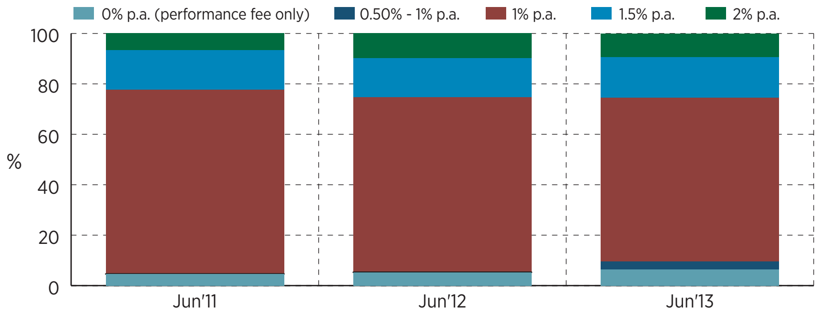
AVERAGE NET EQUITY AND GROSS EXPOSURE Source: Novare



REDEMPTION NOTICE PERIOD Source: Novare



MANAGEMENT FEES Source: Novare



MARKETFOCUS

NIGERIA

Boko Haram's activities pose a serious security threat for the largest African economy

BY ALKAN SHENYUZ, CEO AND HEAD OF GLOBAL SOLUTIONS, VENTIS

SECURITY THREAT

In the first week of June, Nigerian stocks surged to a four-month high after equity index provider MSCI increased the weight of Africa's biggest economy in its frontier market index. Vast natural resources, a youthful population, a high economic growth rate and an ever-expanding middle class have continued to draw investors to Nigeria. Average traded volumes hit $72m at the end of May, compared with an overall average of between $20m and $30m this year.

Re-basing the economy recently pushed Nigeria's GDP (to $509bn) well above South Africa's ($370bn) in 2013. Certainly, these are impressive numbers, laudable by any standards. Surely then, only a major political event or national security problem could have the power to disrupt such a bullish performance. In April, when news broke of Boko Haram's mass kidnapping, it took some time for the whole country, longer still for the international community, to take notice.

The financial markets, on the other hand, hardly noticed at all. In fact, throughout the period to May, the Islamist group's deeply troubling activities, unprecedented by modern standards, have barely registered in domestic economic terms. The market wobble was barely detectable. So far, no investor has pulled out of the country nor even threatened it. Prospective investors, too, have not flinched. It would seem then that it is business as usual, but are the markets right to ignore the risk? Equally important, is the government right to be complacent about Boko Haram's potential threat to the economy?

Boko Haram's activities

In May, when the World Economic Forum met in Abuja, the mounting apprehension of the international community was enough to force the African growth story, which has rarely left the headlines in recent years, to take a back seat. Before presenting a new education initiative at the forum, former UK Prime Minister Gordon Brown spoke about the incident, voicing the forum's hope for a resolution. Many tweets from conference delegates included the hashtag 'bring back our girls' bookending economic statistics and business goals. Meanwhile, hundreds of miles away to the north, Boko Haram also claimed responsibility for a rash of bombings that killed more than 100 people, and an attack that week on a small border town that killed many more after its activists set fire to homes and fired shots into a busy market. The ugliness could hardly be ignored. By the end of the week, it was clear that the crisis sparked by the insurgency group which had operated in the northern hills of Nigeria largely unchecked for four years and was once regarded as a provincial nuisance was now a serious regional security threat, which required an immediate international response.

Alkan Shenyuz, Veventis

As it stands, Boko Haram threatens to be a particularly alarming security problem for Nigeria and its economy in the foreseeable future. Calling for, among other things, a Sharia government, a war on Christians, and the death of Muslims it sees as traitors, the group has been connected with upwards of 4,700 deaths in Nigeria since 2009. It is, without a doubt, a particularly virulent strain of a wider terrorist problem facing West Africa at the moment. With 170 million inhabitants, Nigeria is the continent's most populous country (one in six Africans is Nigerian) and now has Africa's largest economy, even by its immense standards the threat posed by Boko Haram is substantial.

Disturbingly, the security threat is no longer confined to the northern parts of the country. In April, a twin bomb attack claimed by Boko Haram killed more than 70 at a bus station in the heart of Abuja. Further afield, experts point out that a strengthening Boko Haram could threaten the security of neighbouring countries like Cameroon, leaving Nigeria with a vulnerable eastern border. In recent months, attacks by Boko Haram have indeed spilled over into Cameroon, where foreigners including Chinese and French citizens have been abducted by suspected militants. Mali, too, has been marred by similar problems in the last two years. The situation as the international community has come to recognise is one which requires a collaborative effort. Either way, the government's hitherto effete response means that it will be playing catch up for a while longer before the situation is brought under control. Some argue that Nigeria's importance to foreign investors in terms of oil and gas is not going to be derailed by what has largely been viewed as a geographically-limited, poorly organised insurgency. Indeed, the resilience of the markets may have done much to colour that view. But, in a rapidly evolving like Nigeria's, it would be rash to assume that the repercussions would not be felt in other parts of the economy.

Action required

As Nigeria's economy makes the transition from one dependent on oil to one which services an emerging middle class with a growing disposable income, it is not difficult to imagine longer term investors who draw their profits from the rather more precarious margins of FMCG than oil revenues preferring to be in more stable markets. The brace of restaurant chains drawn from all of the world not least of all from the US is a key marker of where international commerce see risk in Nigeria today. KFC, owned by Louisville, Kentucky-based Yum Brands Inc., has seen a rapid expansion across Nigeria, with 17 restaurants opening across southwest Nigeria. Domino's Pizza Inc. of Michigan, recently opened in two locations in Lagos and, going forward, the test will be whether these brand names can continue to build on their success in a region where security poses an increasing threat to symbols of western interests.

An even more immediate challenge to the economy, however, and one which must be overcome if Nigeria is to continue to draw investors in the same volumes as it has done in recent years, is the need to improve electricity generation across the country. Without doubt, this is a problem which is likely to be hampered further if Boko Haram is left unchecked. For Nigeria already beset by a nationwide paucity of supply, an increase in electricity supply will depend on a massive investment programme, estimated at around $70bn to reach the equivalent level of supply in countries like Brazil and South Africa. This is far beyond what the government can finance by itself. Foreign investors on which the government relies will, no doubt, want comfort that security risks are in hand.

There is also the human aspect of the security problem posed by Boko Haram, which is perhaps potentially more damaging to the economy than anything else. The group's ideological position on the subjugation of women and the rejection of what it believes is Western-style education are the antithesis of arguably two of the most significant drivers in the Nigeria's modern economy – women and an educated middle class. According to the findings of a study published in the Management Research Review in 2010, there is a strong indication that Africa has sizeable hidden growth potential in its women. From the results, it was evident that for the most part female entrepreneurship in Nigeria is driven by microfinancing as well as family dynamics that work to shape and influence the creation of a business.

The rise of women in the work place does not stop there. According to *New Faces, New Voices*, an initiative founded by Graça Machel in 2009 to give African women a platform to influence change across different sectors, women comprise 31% of the Nigerian government's cabinet, and are forecast to constitute 30% of the boards of Nigerian banks, and 40% of top management positions within two years. Unless the threat from Boko Haram can be thwarted, the security risks to Nigeria's maturing economy can only get worse. ■

CHINA GOES TO AFRICA

Chinese companies' involvement in Sub-Saharan Africa is a result of pressures back home, says **Chris Becker, chief Africa strategist and head of Africa research, ETM Analytics**

The Chinese economy has hit the upper limit of its investment-led economic growth model, and the sectors that boomed during the last five years – a period when the Chinese banking system more than doubled in size and replicated the entire US commercial banking system's assets in five years – now face mass liquidation and bankruptcy risks. The companies that constructed the numerous ghost towns and elaborate transport infrastructure facilities have seen huge excess capacity develop during this period. As bankruptcy and liquidation risks of these companies grow, so does the risk to commercial, state-owned banks, and the shadow banking sectors in China. In our view, the Chinese are being highly strategic in reorienting the focus of domestic companies facing liquidation risks, to the least developed region in the world: sub-Saharan Africa.

The Chinese investment and credit boom of the past decade (and more specifically the past five years) spilt over into Africa as it allowed Chinese state and private banks to extend financing to African sovereigns and companies on much easier terms than would otherwise have been the case. As this credit boom now turns to bust, money capital that flowed from China to SSA during the boom, will now tend to flow back to China, or at the least new flows will not come nearly as fast. Already Chinese state-owned banks have frozen credit lines to some African sovereigns.

That said, we watched with interest the flurry of deals signed between the Chinese Premier, Li Keiqiang, and his African counterparts during his recent trip to Africa. The Chinese signed deals with at least seven SSA governments. Among the deals were agreements for the Chinese to provide technical assistance to African governments on infrastructure programmes, a Chinese pledge to build high-speed railway lines in East Africa and Nigeria, while Chinese companies will be actively involved in the supply of refined industrial metals and other construction materials.

The inquisitive mind will wonder how the Chinese are able to commit themselves to this much construction and financing to SSA, under conditions of a potentially acute credit crunch and growth slowdown back home.

First, it should be noted that China has, since 2009, been recycling its trade and current account surpluses into emerging and frontier markets such as Africa by slowing the rate at which it accumulates US Treasuries to a stall-speed. Instead, it has been rolling its surpluses into acquiring the debts of other strategic partners (i.e. Europe) and into securing raw energy and commodity supplies in Africa – a diversification away from accumulating even more promises to be repaid in newly created US dollars (US T-bills).

Second, in continuing its aggressive push into developing SSA infrastructure, Chinese companies facing liquidation and bankruptcy back home, could earn profits in the African construction boom and repatriate those profits back home to cushion losses to profitability and offset rising excess capacity.

Third, the Chinese are not funding these projects, but are rather mostly plugging into a SSA external financing play. The surge of global private capital inflows into SSA in recent years is in large part being fuelled by ultra-loose monetary policies in the developed world, which drives down African sovereign borrowing costs. This has helped to trigger an African sovereign credit binge, in turn fuelling an unsustainable growth boom in credit sensitive sectors of the economy with long-term investment horizons.

These three factors explain the China-bust, Africa-boom, QE-trilogy: the Chinese are sending their companies facing liquidation and bankruptcy to partake in the Africa construction boom where profits are to be made and repatriated. In so doing the shift of the Chinese economy from an investment-led to a consumer-led growth model can be cushioned (to an extent). However, these projects are being financed in large part by the wall of money flowing from western printing presses and into high-yielding frontier market asset classes, where Africa is presently a major recipient of these flows. This has numerous real implications to the cost of doing business, and the productivity of commercial Africa, and is why we believe it is an important longer-term theme to monitor for any investment or asset manager. ■