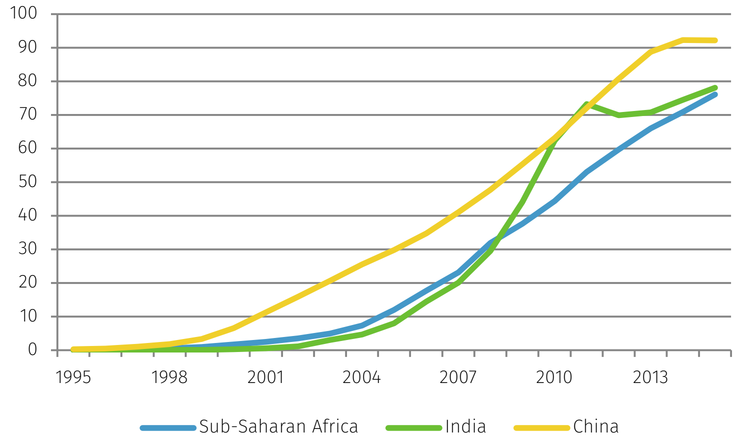
Window of Opportunity

The current market environment in Africa is creating strong investment opportunities, write Harry Wulfsohn, Executive Director Imara Holdings Ltd and Stuart Theobald CFA, Imara Guest Analyst

After 2015's slump in oil prices, African growth is surging back. The World Bank is expecting growth of 2.9% in sub-Saharan Africa this year. That figure is much higher if you strip out South Africa, which is going through its own malaise, at 3.5%, rising to 4.2% in 2018, when world GDP growth is expected to be 2.9%. Growth is returning to a long-term trend that was briefly interrupted by the 2015 commodity price slump.

There are variations between countries, with economies like Nigeria and Angola below the average and small economies like Rwanda and Mozambique, and East Africa's Tanzania, Uganda and Kenya outperform, most exceeding 7% (see figure 1). Africa's strong growth is sure to continue as urbanisation combines with growth in the labour force that will accompany increasing economic diversification. A young urbanising population with these growing employment opportunities will drive consumption and reinforce the positive trend in economic growth.

FIGURE 2: AFRICAN MOBILE PHONE PENETRATION CONTINUES TO GROW STRONGLY (SUBSCRIBTIONS PER 100 PEOPLE)



Source: World Bank Group

The demographic trend in Africa, if managed correctly, could result in a huge consumer class as the continent would have the highest proportion of working age population relative to total population. While Africa has lagged the rapid fall in poverty seen in South and East Asia, it looks set for a dramatic turnaround in poverty levels.

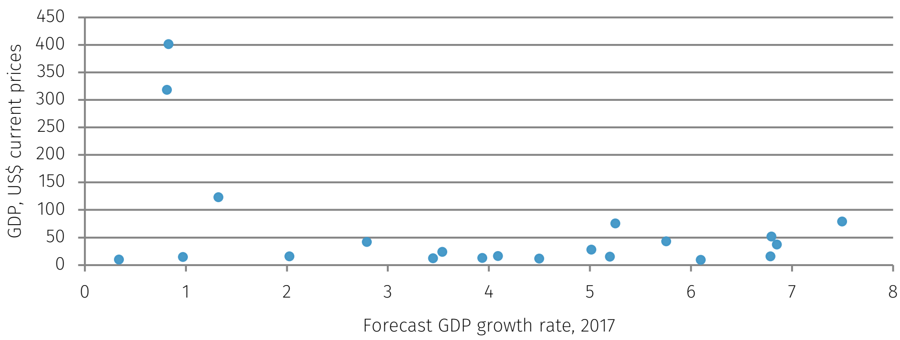
Africa is exposed to the commodity cycle given its abundance of natural resources, but the growth is coming from tertiary sectors of the economy, as well as manufacturing and agriculture. The development achievements of the past two decades, including increasingly entrenched democratic institutions and improved development indicators on health and education, have contributed to an urbanising active citizenry. Infrastructure, from roads to telecommunications links, has been expanding rapidly.

Africa's services sector now accounts for almost half of economic activity on the continent. Africa is by far the fastest growing source of Facebook subscribers, growing 733% between 2010 and 2016, while North America grew just 50% in the same period. Mobile phone usage is growing strongly, now reaching some 78% of the population. Africa has leap-frogged the rest of the world on mobile, which is the main source of internet on the continent. That has led to many innovations, including the use of mobile for payment systems which is far ahead of anywhere else in the world, ensuring that in some markets like Kenya and Tanzania, consumers will never experience a card-based payments phase.

Africa's urbanisation trend continues, with the urban population growing at a steady 4% per year and total urbanisation still far from saturation. China and India's urbanisation rates are far slower while China is heading toward saturation (see Figure 3).

Africa's large, young, work force is increasingly competitive with other global manufacturing hubs. Examples abound. A McKinsey survey of purchasing officers recently found that Ethiopia has become

FIGURE 1: AFRICA'S SMALLER ECONOMIES ARE ALSO THE FASTEST GROWING



Source: Intl. Monetary Fund / Imara

one of the top 10 global sourcing locations for apparel. Huajian Group, one of the world's largest Chinese shoe manufacturers, is moving production to Ethiopia with a plan to have 30 000 employed by 2020 producing up to $1.5bn of exported shoes annually. GlaxoSmithKline is investing £100m to expand manufacturing in Nigeria and Kenya and build up to five new factories in other countries. A study by the Overseas Development Institute found that manufactured exports from Africa doubled between 2005 and 2014 to more than $100m. Manufacturing for the growing domestic market is also growing strongly. The recent acquisition of SABMiller by global brewer AB Inbev was motivated specifically by SABMiller's relatively high exposure to Africa, which has been its fastest growing region for several years. Other consumer goods manufacturers like Unilever, Nestle, Diageo and Heineken have long been present on the continent and have been investing to grow their capacity. Returns in Africa are above the global average for these local subsidiaries.

and US yields are low, as developed world investors go in seek of yield. The post-Trump surge in US equity markets has helped to drain liquidity from African markets but a failure to deliver on deregulation promises and tax cuts could lead to a dramatic swing the other way. As the Trump administration battles to turn those promises into reality, African markets will benefit from a weaker dollar and a loss in optimism for US corporate earnings.

Africa's exchanges provide sufficient liquidity for smaller investors, but some may prefer to access opportunities through private equity, particularly in the smaller high growth markets. There are also many well-valued assets available for private equity investors. Imara's preference is a deal by deal approach rather than via a private equity fund. In our experience this aligns investors better with the objectives of the investee companies to ensure the strongest returns.

Africa's long term growth outlook remains intact and there is currently an opportunity for foreign investors to gain exposure to both

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>
> - Harry Wulfsohn

Global companies have also been buying in to the growth prospects of the services sector. While banks have slowed their acquisition spree on the continent because of changing global regulations, insurance companies have been buying big. In 2015 French giant AXA bought a stake in Nigeria's Mansard Insurance, to gain access to the largest population in Africa. South Africa's Sanlam and Liberty have bought into insurers in several markets across the continent. In March, Sanlam bought the asset management businesses of PineBridge in Kenya and Uganda.

ATTRACTIVE VALUATIONS

In the run up to 2008, many global companies and portfolio investors realised the opportunities in Africa but were put off by high prices. That has now changed. The 2015 commodity slump and subsequent weaknesses in various domestic currencies have created a window of relatively cheap African assets. The MSCI Africa Ex-South Africa index is down by a third since September 2014 against a 28% appreciation in the MSCI World index. Banks in Nigeria and Kenya which used to trade at price:earnings ratios of over 30, are now available at low single figure PEs with dividend yields in double figures. Because of domestic compulsory listing rules, the African subsidiaries of global majors like Unilever, Lafarge, GSK and Nestle can be bought in Nigeria, some at far cheaper prices than their global mother companies. Nigeria has recently suffered from hard currency shortages, but these are now easing making it easier for foreign investors to trade on the market. African exchanges, particularly outside South Africa, suit stock-pickers because of relatively low levels of passive holdings and research. While the overall motivation for African exposure is at the macro level, in our experience a fundamental bottom-up approach allows one to select stocks that have world class management, able to take advantage of even small improvements in inefficiencies as Africa develops, as well as high standards of governance driving these companies' ability to consistently deliver strong cash returns with low debt.

Emerging market equities tend to benefit when the dollar is weak

listed and private assets at deep discounts. This window of opportunity may not stay open for long. Now is the time to act.

FIGURE 3: AFRICA'S URBAN GROWTH RATE IS HIGH AND STEADY