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## **African Equities Re-emerging?**

### **Atria Africa's View**

Readers of the financial pages would be forgiven for thinking that the African growth story had fizzled out.

The news flow in 2015 was unrelentingly negative. Plunging commodity prices, in particular oil, has hit some of the continent's biggest exports. Lower Chinese growth forecasts are having a knock-on impact on resource dominant economies. Finally, local currencies have weakened, in some cases dramatically, as a result of the strong US Dollar and expectations of rising US interest rates.

There have also been country specific issues that have affected sentiment. As examples, South Africa has suffered from political uncertainty, chronic power shortages and labour unrest, whilst Zambia has seen poor rainfall exacerbate power shortages and a 25% fall in the spot price of copper in 2015 alone, which accounts for 66% of total export revenue and 11% of the country's Gross Domestic Product.

So has anything changed today compared to, say, 2000, when the Economist ran a cover story entitled "Hopeless Africa" or since 2005 when the team began investing in Africa?

Unlike its emerging market peers which have experienced a 1% gain since September 2008, African frontier markets have experienced a prolonged period of capital outflows and sharply falling equity markets, down 40% according to the MSCI FM Africa index, reminiscent of past emerging market "crisis" when foreign investors abandoned frontier equity markets.

From a valuation perspective, it is a familiar story. The sharp decline in many African stock markets in 2015, among them the more liquid markets in Kenya and Nigeria, which were both down over 20% in US Dollar terms, has meant that the price of many equities are now far below levels seen three years ago. The sell-off has been indiscriminate with the price of listed subsidiaries of international multinationals also falling. Diageo and Unilever, sensing an opportunity with the decline in local share price and depreciating local currency in the preceding 24 months, made offers at a premium to existing shareholders in 2015 to increase their equity stakes in Guinness Nigeria and Unilever Nigeria respectively. In Atria's investment universe, valuations on many stocks have fallen to the point where P/E ratios are approaching dividend yields – a strong signal that equities are out of favour.

The multiple that equities trade at have clearly fallen very significantly, but is this merely a re-run of previous downturns? Atria's view is that it is not.

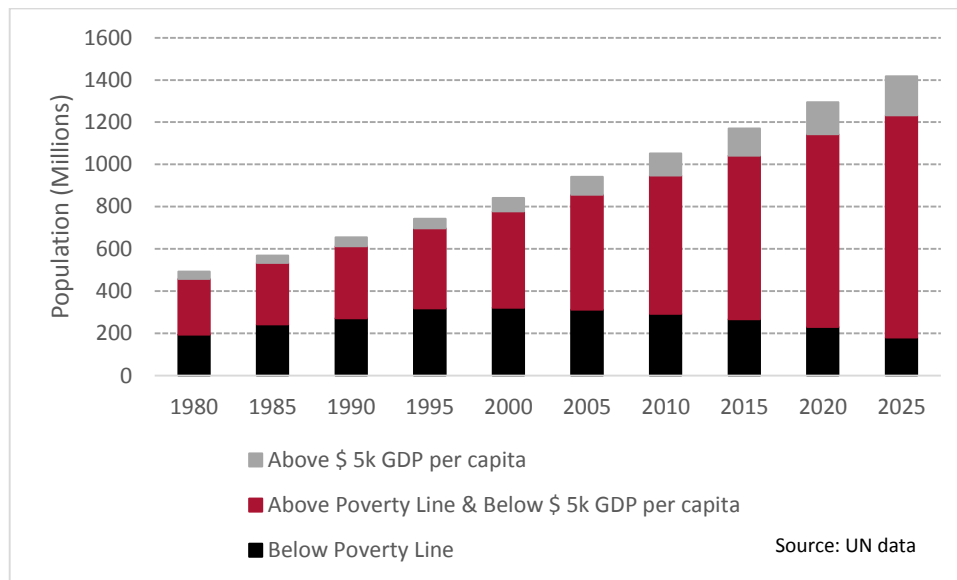
One big difference today is that capital markets in Sub-Saharan Africa are deeper and considerably larger than in previous downturns. The total market capitalisation of companies listed on the Nairobi Securities Exchange, for instance, has increased fourfold in the last ten years in Dollar terms and the market capitalisation in Mauritius has tripled in the same period. Annual value traded has also grown. Value traded in the BRVM regional market is up 100% in Dollar terms since 2009 and the loosening of foreign ownership restrictions in Tanzania at the latter part of 2014 enabled value traded to double in the space of two years whilst at the same time introducing a new market to the opportunity set.

There have also been a number of new listings. Demand has been strong in most cases and Initial Public Offerings have been oversubscribed by retail and institutional investors alike. Egyptian food maker, EDITA's public offering in March 2015 was 4.5 times oversubscribed.

These factors in combination mean that liquidity is significantly higher now than it was even ten years ago. It is, therefore, easier – most of the time – for foreign investors to buy and sell, equities listed on the region's larger markets. Discussions have also been initiated between the smaller local stock exchanges to form regional stock markets with the aim of further improving liquidity in the future.

If the evidence suggests that this is potentially a good time to buy African equities from a valuation or trading perspective, what about the investment case for corporates? There is a perception that the story is mixed, with some corporates reporting disappointing earnings over the second half of 2015. For example, in the 9 month period to September 2015, Nigerian Breweries reported an 11% fall in pre-tax profit as operating expenses and finance charges increased.

The reality, from Atria's viewpoint, is rather different. Investing across three core themes of the growing middle class, increasing urbanisation and rising incomes, the evidence Atria sees on the ground is that the African growth story is as strong as ever. Despite the negative headlines encompassing politics, falling commodity prices, weakening currencies and electricity shortages, the African consumer is continuing to become wealthier, better educated and more likely to live in an urban conurbation. The resultant decrease in the poverty count and proportion of population is seen in the graph below.



At the beginning of 2016, Africa is at a stage where valuations have fallen, the consumer sector is continuing to grow and capital markets are becoming deeper and more sophisticated. Corporates are generally in stronger positions than they were ten years ago, having strengthened balance sheets, built up IT systems and invested in more sophisticated distribution networks. For those patient investors who are willing to look beyond the noise, African equities justify closer scrutiny.

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