Zimbabwe: 2nd Floor Unit K, Block 1, Celestial Park, Borrowdale Road, Harare, Zimbabwe • **Tel**: +263 4 883701/2
Mauritius: Suite 302, 3rd Floor, NG Tower, Cybercity, Ebene • **Company No:** 113484 • **FSC Licence No:** C112011404

atria africa | investment advisors and fund managers

www.atria-africa.com

Monthly Investment Commentary

April 2017

Information/Queries:

Email: enquiries@atria-africa.com

Website: www.atria-africa.com

Macro Commentary

Global equities advanced (in US dollars) in April, supported by positive economic data. The bell weather S&P500 index rose 1.0% over the month, with other indices also rising. This was despite the economic news being disappointing, with the publication of the Q1 US growth figure at 0.7%. This was some way less than forecasts and significantly lower than the Q4 2016 figure of 2.1%. The energy sector was also weaker as crude oil prices fell with US output increasing and the country's rig count continuing to rise.

The most significant political development of the month was Emmanuel Macron's victory in the first round of the French Presidential election, lining up a run-off vote against Marine Le Pen in early May. Markets around the world rebounded at the prospect of lower political risk but particularly European equities, with the FTSE Europe Ex UK index finishing the month up 2.6%.

In emerging markets, those most sensitive to tighter global liquidity were beneficiaries of dollar weakness, specifically Turkey and South Africa, but also Indonesia and Malaysia.

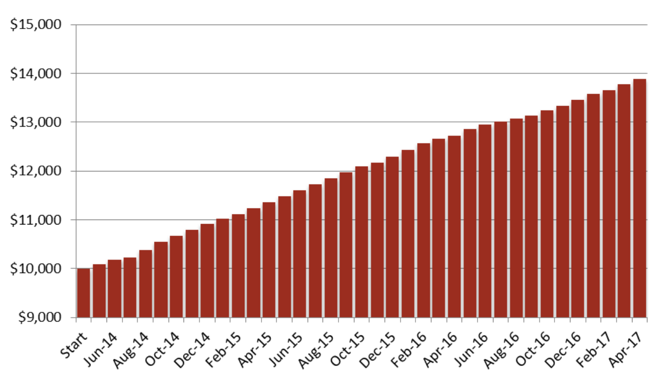
By contrast, Russia underperformed with weaker oil prices a headwind. Latin American equities also fell, attributable in part to commodity price weakness with other South American markets also registering negative returns.

In Africa, attention has turned again to the epidemic of fall armyworm, which has been decimating crops across the continent, particularly maize, and is threatening to cause billions of dollars of damage over the next few years. The pest is thought to have arrived in a consignment of maize and difficult to eradicate being resistant to many pesticides.

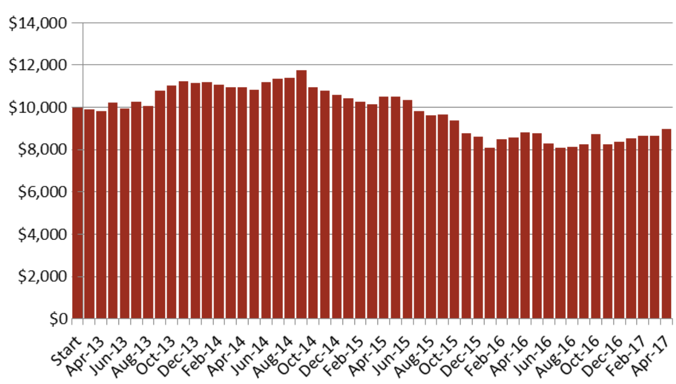
In South Africa, Fitch and S&P cut their ratings on the country's sovereign debt to junk status, following the dismissal of treasury minister Pravin Gordhan by Jacob Zuma. Moody's also put its rating under review, with a negative outlook. Also under the spotlight were South Africa's plans to build new nuclear power plants after a court ruled that President Jacob Zuma should have sought parliamentary approval for a deal with Russia, signed in 2014.

The cut to South Africa's sovereign rating might normally have expected to have resulted in government issued bonds plunging. However, accordingly to investment bank Citi, in an article published on the Financial Times' website (subscription required), foreign investors have purchased more than ZAR20bn (USD1.4bn) worth of South African government bonds since Mr Gordhan was fired.

Trade Finance Fund: Value of US$ 10,000 invested since launch



Franchise Fund: Value of US$ 10,000 invested since launch



Trade Finance Fund
Monthly Report

The Fund achieved a return of 0.77% for the month of April, bringing its rolling twelve-month return to 9.12% and a return since inception of 38.88%.

The AfDB Africa Economic Outlook 2017 has a special theme on entrepreneurship and industrialisation in Africa. According to the report, ‘the continent has the highest share in the world of adults starting or running new businesses, but often in sectors where productivity remains low.’ For the continent to be able to compete globally there is need for a paradigm shift. Africa should first diversify its exports to reduce exposure to commodity price shocks and this can only be achieved through industrialisation.

Whilst various theories have been proffered, there hasn’t been an industrialisation model developed that has been accepted at continental or regional level. The diversity of African economies makes it difficult to have a common policy on industrialisation but a common purpose is possible. An article titled “Germany’s Hidden Champions” in the Harvard Business Review caught our attention and if adapted to African conditions could provide a realistic model that addresses Africa’s challenges as it seeks to industrialise.

In the article, the author highlights Germany’s small and mid-size companies, known as the Mittelstand, as having a talent for export and a command of their markets that belie their small size and low profile. The companies are in the top three in the world in their industry, first on their continent, have revenues below €5 billion (which in the African context is considered a major industry) and are little known to the general public. Many of their products are invisible to consumers. For example, labelling machines for beverages, metal filters, bookbinding textiles and sunroofs for cars, are used in the manufacturing process or subsumed by the end product. Forty eight percent of the mid-sized world market leaders come from Germany, the article says.

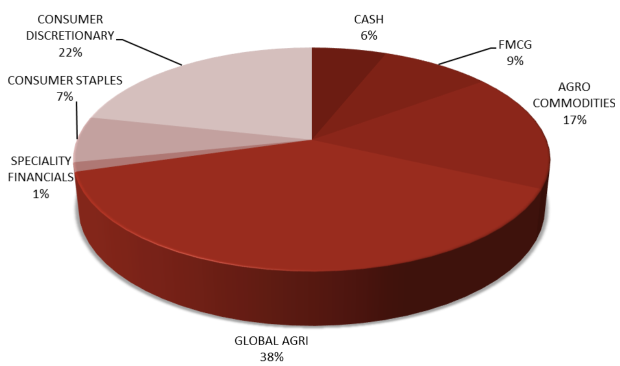
Companies like Krones, Körber/Hauni, Weinig, Webasto, and TetraWerke are examples of Mittelstands or Hidden champions. ‘They focus narrowly on a particular market niche, usually one that requires technical expertise, and direct all of their resources toward maintaining the top position in that niche. The idea of diversification is alien to them. They see any deviation from their focus as simply a distraction. They achieve world-class quality by keeping their focus narrow, the most important element of a Hidden Champion’s strategy.’ Whilst focus makes a market small, by globalising the market is bigger and controls 70-90% of world market shares. About one quarter of German exports comes from the Hidden Champions.

Where Africa can develop its industrialisation model, is in the competitive strength of these companies anchored on the German dual system of apprenticeship, which combines practical and theoretical training in non-academic trades. Hidden Champions invest significantly in vocational training, language competencies, and international experience to attain global leadership through their employees. This would help address the skills shortage which is significant on the African continent.

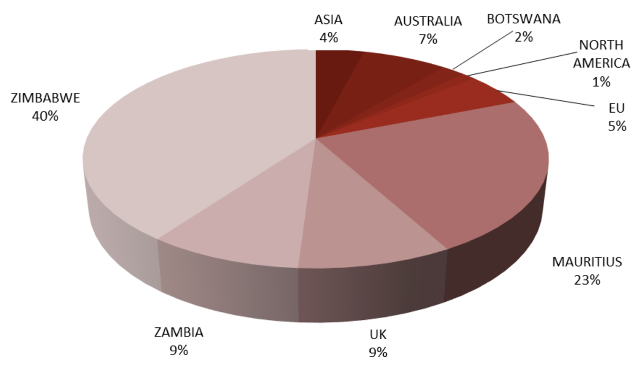
The other factor which will play well in the African model is that typically the hidden champions are in small towns rather than big cities. The rural locations create interdependence and foster close relationships between employer and employee. For better or worse, the company needs the workers who live in the town or village, and the workers need the jobs the company provides. Employees of the Mittelstand are, in turn, loyal to their employers. Workers identify with the company and are highly motivated to help the company succeed. Workers are actively involved in the business and strikes and labour conflicts are extremely rare.

Hidden Champions provide a model of inclusive growth that’s worth emulating for African economies. Whilst the continent is endowed with resources, there are very few notable businesses that can compete on a global scale. A strategy that encourages industrial development and manufacturing in rural locations would redefine industrialisation and urbanisation on the continent. As a Fund, we study the model and with the new insight, help our small and medium sized businesses develop to world champions. We thrive in staying ahead, anticipating that future business needs to create sustainable returns for our investors.

Sector Allocation



Country Allocation



Franchise Fund Monthly Report

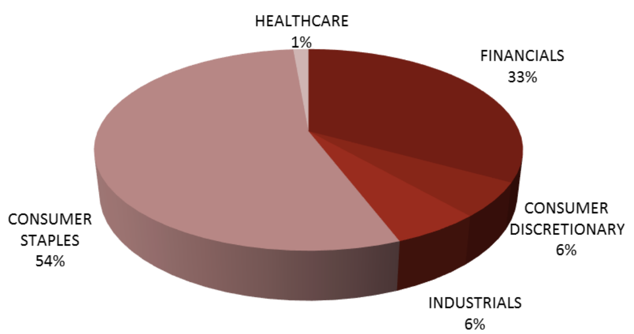
With the momentum begun in the first quarter of the year, the fund inched up a further 3.90% in April whilst the MSCI FM Africa index was up 2.47% in the month.

For the first time in over nine months, the Nigerian Naira was seemingly devalued by the fiscal authorities through a window open only to Investors and Exporters who could purchase Naira at a more “liberal” exchange rate. This is opposed to attempting to purchase the currency at the official rate, which is significantly lower than that quoted in the market. This Investors and Exporters FX window is seen as the Central Bank’s solution to attracting and encouraging FDI and exports. The thinking behind this exchange rate window is relatively simple in that the price of local goods and services would be closer to purchasing parity. For example, an investor sells each of his US Dollars for N377, which is effectively 20% more than what he would receive through his bank. An article published by Bloomberg confirmed that “eligible transactions include those for loan repayments, interest payments, capital repatriation and remittances. Those allowed to sell hard currency are banks, portfolio investors, exporters and the central bank.”

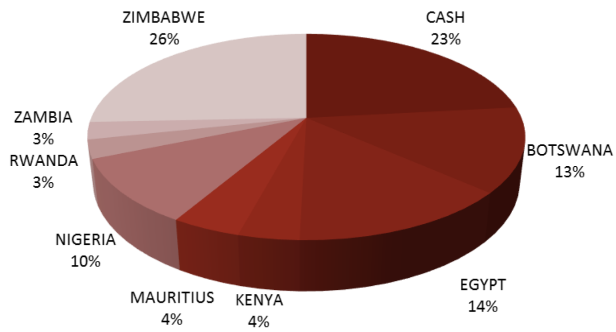
Well this is the theory at least. Unfortunately, the reality as a foreign investor is diametrically the opposite of the information disseminated by the central bank. When requesting use of this window on behalf of our clients, our custody bank was only made aware of the official rate. Digging deeper, we found that the foreign exchange rate in Nigeria has multiple identities; in addition to this FX window, there is the Nigerian Autonomous Foreign Exchange rate (NAFEX), the Nigerian Interbank Foreign Exchange Rate (NIFEX) and the parallel/unofficial rate. Whilst the FX window is said to have traded volumes in the region of USD25 million, the confusion, uncertainty and opaqueness of the exchange rate will work against the Naira here. We remain convinced that to positively adjust the economy’s trajectory, authorities need to devalue the Naira, provide clarity and fill local industry with the confidence and transparency it desperately requires.

To provide further substance to this devaluation, the stock market (in the last twelve months) is up 2.8% in Naira terms, whilst it is down 34% in US Dollar terms. This could suggest that stocks are cheap in US Dollars, or it could mean that the underlying businesses have lost value on their balance sheets through their inability to operate efficiently without access to foreign currency. Nigeria is not alone in this currency predicament as Egypt, Zambia, Rwanda and even Zimbabwe are examples of economies which are experiencing their own currency squeeze. In Rwanda, Bralirwa (Brewery) released its results where profitability decreased by 80%! The primary culprit was the currency devaluation which impacted their costs of raw materials and increased interest on foreign loans. Next month we take a wider look at global economic shifts being contributors to African currency woes and what may change this.

Sector Allocation



Country Allocation



The Background

Who We Are

Atria Africa is an investment manager specialising in Sub-Saharan Africa. We are regulated and licensed by the Mauritian Financial Services Commission and the South African Financial Services Board.

Investment Philosophy

We seek to achieve meaningful and sustainable investment returns on both a real and relative basis, through investing in advantaged businesses, run by exceptional management teams, which meet our strict investment criteria.

Investment Process

We follow precisely defined investment themes in order to benefit from the continuing economic development of Africa. Within these themes we identify durable scalable businesses run by exceptional management teams. We invest in businesses whose shares are trading at a discount to our assessment of intrinsic value as determined by our internally developed rigorous bottom up methodology. This is complemented by a top down overview, regular management contacts and qualitative analysis. This allows us to continually interrogate our assumptions on value, guarding against the potential for permanent capital loss. These factors encourage a strict sell side discipline, critical in volatile African markets. Fixed income and cash form an important part of our investment process. Where markets are expensive relative to our assessment of intrinsic value, we will hold cash or income bearing securities as a hedge pending investment.

Our Values

We do not profess to be nor aspire to be all things to all people. By concentrating on specific themes, we commit our resources to knowing more about our chosen themes than the average fund manager. This focus allows us to better understand the complexities of a particular business and its competitive advantages in a market, lowering the overall risk of an investment decision. We believe in running high conviction portfolios comprising investments in only the best performing entities (12-25 holdings at most). Given the limited opportunity set and liquidity constraints in our target markets, we have predetermined optimum product sizes.

This ensures we place greater emphasis on monitoring existing investment performance as opposed to simply gathering new assets. Constant market price monitoring of potential holdings versus our valuation metrics enables us to rapidly respond to opportunities that present themselves. It also means our best ideas are not diluted thereby prejudicing performance. We put our own money at the same risk as our investors. Our officers and staff are only able to invest in our own products, ensuring our interests are perfectly aligned with our clients. Our investment team is also responsible for our clients, allowing our clients to interact with and get first hand knowledge from the investment decision makers.

We will make mistakes. When we err in our investment judgment, we will own up to it, we will learn from it and we will endeavour to ensure it will not happen again. As part of this process we will engage frequently with our clients in a transparent, informative and honest manner.