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REVIEW

Africa fund sees value and opportunity throughout continent

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Jenni Chamberlain, portfolio manager of Finch Africa Fund, spent 12 years working in African markets in a variety of investment banking and corporate advisory roles. This experience convinced her that Africa was ripe for investment.

In June 2006 she launched the fund with only \$2m. Backed by Finch Asset Management, part of the Finch Group, a global provider of alternative asset services to institutional investors which offers access to a suite of investment funds with \$1.8bn assets under management, she was able to build up the fund to a total of \$50m. She believes her experience gives her the skills needed to find value in Africa.

Before starting the fund she was employed by HSBC and worked on a number of transactions in the private and public sectors in Africa where she brokered many deals on the majority of the African stock exchanges. With an intimate knowledge of trading in these markets and an understanding of the regulatory environment, she believes she is well placed to find value in African companies.

She notes there is certainly appetite for investment into hedge funds focused on Africa. Nevertheless, Chamberlain is content to keep the fund size relatively small in order to deliver alpha enhancement and boost returns. She expects the fund to increase in size to \$100m by the end of 2008 and grow it up to \$250m by the end of 2009.

While in London Chamberlain worked for HSBC Investment Bank as part of the Africa-focused team for three years. This involved broking and trading African and Middle East equities. She was also part of an advisory team serving a number of African-based companies looking to list on international stock exchanges and requiring additional fundraising.

All of this, says Chamberlain, has given her the insight and knowledge needed to be able to hunt out the best companies on the continent and find value propositions. Her long association with the continent means local companies and officials trust her and are comfortable talking with her.

Chamberlain is passionate about the prospects for the continent and believes there is much value to be tapped. Foreign direct investment into sub-Saharan Africa remains relatively low but has steadily increased in recent years. Most of the flow has been directed towards commodities and commodity-related investments, particularly in areas such as power, telecommunications, consumer goods, construction and financials.

The banking and financial sector is developing. Disclosure and transparency rather than corruption and graft are the watchwords for the majority of companies. Valuations, she says, look very compelling. She points to urbanisation, rising consumer spending and consumption and significant infrastructure development.

Large domestic pension funds have become dominant players in the sub-Saharan African equity markets. These funds have long-term liabilities and this means they are taking a long-term perspective when investing in African equities.

Recent legislative initiatives have helped to expand the investment market for these funds and increased their ability to invest in domestic equities. While liquidity still remains relatively low compared with other emerging countries, overall it is increasing throughout the continent.

Investor demand and interest in Africa is also increasing. Hedge funds that focus on Africa and the Middle East have more than doubled in asset size over the past three years. Despite this, these two regions account for under 2% of the total emerging market universe. Chamberlain believes there is room for growth. While there is limited market access, she says there is tremendous scope for structural arbitrage opportunities.

"We're seeing a huge change on the continent," says Chamberlain, and believes perceptions of Africa are out of date.

While there are some spectacular exceptions (like Zimbabwe), overall, democracy throughout the continent is becoming the norm. In 1985 45 out of 53 African countries were considered undemocratic. Today over half of African countries hold regular democratic elections that are seen as free and fair.

Political risks have considerably reduced, says Chamberlain, and the incidence of

corruption has also lessened. She believes overall the continent is both politically and economically stable.

"It is unlikely we'll see all 53 countries blow up at the same time," she says. Chamberlain believes the trend is towards stability both economically and politically. She is also confident that the rule of law, and particularly of ownership, will be respected with only a few exceptions.

She says the widescale nationalisations in the 1960s and 1970s have given way to property rights. Local Africans are now empowered and own companies. She thinks it is unlikely that the continent will see the same type of nationalisation throughout the market again.

Chamberlain cites statistics to back her claims that the area is ripe for investment and offers many compelling and profitable trade opportunities. She points out that Africa has considerably improved its fiscal and monetary position at country level. This is due to a combination of international debt relief and restructuring as well as a general improvement in economic fundamentals in many countries. Current account balances have improved, foreign exchange reserves are expanding and outstanding debt in most African countries is falling.

Untapped potential

As the second-largest continent in terms of both population and land mass, its potential remains untapped. Africa accounts for only 2% of world aggregate GDP.

Africa has a yearly urban growth rate of 3.2% compared with a world average of 2%. This strong growth has important implications for domestic spending patterns. As a middle class develops and spending power increases, Chamberlain expects to see rising protein consumption, more spending on housing and building materials, and a changing pattern of consumer spending, including more interest in areas such as telecommunications (mobile phones in particular) and expenditure patterns beginning to mirror more developed economies.

Already mobile phones have transformed the continent. Increased access to information, too, has dramatically improved the quality of life for the average African. Phones per thousand have increased a whopping 328.6% over the past 10 years and mobile telecommunication has directly contributed to the rapid growth in mobile banking and internet use.

To illustrate how mobile access has transformed the continent Chamberlain points to farmers who no longer need to take a full day to go to a bank to check on money transfers. This information is relayed to them by SMS text message.

Others are using SMS text messages to receive the latest commodity prices. For example, cocoa farmers now access latest price information via mobile phone before beginning negotiations. One farmer in Nigeria uses a sophisticated satellite system linked to mobile phones to control the irrigation of his farmland.

Improved access to information has positively impacted small business creation, increased competition in the domestic markets and helped to increase productivity. New business models geared towards the needs of the less wealthy segments of the population have proliferated.

Africa has long been seen as a continent rich in natural resources. Rising commodity prices have led to a dramatic growth in resource-rich nations. High on this list are the oil-producing countries of Nigeria, Sudan, Angola, Mauritania and Gabon where GDP growth has averaged close to 6% since 2000.

Structural alpha

Chamberlain follows a clear investment philosophy. She looks to capitalise on a number of structural alpha opportunities she sees in Africa, pointing to a fundamental growth story. She says mispriced macro-economic factors have created political and economic risk premiums.

By leveraging and capitalising on her long-standing relationships in the private and public sector, she believes she has both preferential access to individual markets and exchanges as well as knowledge of companies and specific sectors of the economy.

Her investment objectives are to achieve significant absolute returns by investing in undervalued African equities as well as sovereign and corporate debt. At any one time she has around 25-35 positions open. She also runs a proprietary small and medium enterprise platform designed to capture real-time position and cash levels.

While some positions may be relatively illiquid, she wants to keep to uncorrelated asset classes with a wide diversity and spread.

Chamberlain says the fund has clearly defined and highly disciplined exit strategies. Her priorities are capital preservation with a focus on downside risk protection.

The investment process is a combination of country and company analysis. At the country level she reviews political and economic fundamentals. Industry and banking reform is important.

For countries and companies, Chamberlain considers on-site visits essential. She has a depth of knowledge of the main players in local markets and has their trust from years of working in the region. She targets companies with good growth prospects and low debt.

Frequent personal meetings lie at the heart of this strategy. "We do a lot of travelling. This is the best way to find ideas. We meet managers and visit companies. You can get far more out of a personal meeting than a telephone conversation," Chamberlain says.

Companies she invests in are the first to phone her when anything happens or to discuss the finer points of any deals. "I know most of the managers and have strong relationships with them," Chamberlain confirms. On average she or one of her team is travelling somewhere in Africa on a fortnightly basis.

Africa overview

Countries: 53

National stock exchanges: 23

Total market cap: \$1.2trn

GDP: \$1.75trn (2006); 2.5% of world total

GDP growth: 5.6% (2006)

Total population: 900m

Total area: 11,668 miles sq; second-largest continent by land mass

Telecommunication (phones per 1,000): +328.6% increase over 10-year period

Improved sanitation (% households): +19.3% increase over 10-year period

Improved water (% households): 18/1% increase over 10-year period

Improved electricity (% of households): +43.8% increase over 10-year period

Sources: World Bank, African Development indicators 2007; International Monetary Fund, world development indicators; UN Economic Commission for Africa; Bloomberg

Fundamentals of Finch Africa Fund

Name of manager: Jenni Chamberlain

Full name of fund: Finch Africa Fund

Address of manager: Finch International Advisors, 85 Front Street, Hamilton HM 12, Bermuda

Contact: + 1 441 278 7625; research@finch.ltd.com

Launch date: June 2006

Portfolio size: \$41.1m (April 2008)

Average annualised return: +42.80% (April 2008)

Administrator: Apex Fund Services

Auditor: Deloitte & Touche

Management/performance fee: 2%/20%

Minimum investment: \$1m (subsequent investment \$250,000)

Hurdle rate/high water mark: 0%/yes

Lock-in: none

Redemption period: monthly

Legal entity: Cayman Islands open-ended fund segregated portfolio investment company organised as an exempted company; Class F Segregated Portfolio of the Finch Opportunities Fund SPC

Custodian: Barclays Mauritius.