



FRONTIER MARKET
ASSET MANAGEMENT

Fast-growing Ghana and Cote d'Ivoire: Similarities and Differences

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Fruit Stand in Accra, Ghana

"One can state, without exaggeration, that the observation of and the search for similarities and differences are the basis of all human knowledge." - Alfred Nobel

When we last visited these West African countries in March 2012, the Harmattan trade winds were casting a gloomy pall and UN machine gun trucks were parked in Le Plateau, the downtown business district of Abidjan, Cote d'Ivoire. Now the gun trucks and the dark clouds are gone, and economic green shoots are evident. Both Cote d'Ivoire and Ghana are booming. During our visit to these fast-growing economies, we had the opportunity to investigate a diverse collection of investment opportunities. Underpinning our favorable impression was the quality of the men and women running the firms. We also were well supported by our hospitable and knowledgeable local brokers. At the same time, we were struck by the array of contrasts between the two countries, not the least of which was the influence of the French culture in Cote d'Ivoire compared to the Anglo heritage of Ghana.

The table below shows that, while these frontier markets continue to face important development challenges, overall economic activity is robust, and the outlook is favorable. The relatively low per capita incomes represent a vast opportunity for growth going forward. Ghana has achieved full primary school enrollment for its children, an important institutional achievement for future economic prosperity, while Cote d'Ivoire has only achieved 88% enrollment, which is below the Sub-Saharan average. The lower literacy rate in Cote d'Ivoire is another example of why this country remains categorized as having achieved only "Low Human Development" vs. Ghana's "Medium Human Development" in the Human Development categorizations, as given by the United Nations Human Development Index¹. We continue to focus on remaining ahead of the expected convergence by investing in fundamentally sound companies in sectors that are benefitting, and will continue to benefit, from the growing middle classes in markets such as Ghana and Cote d'Ivoire.



Photo with Analysts in Abidjan, Cote d'Ivoire

	<u>Ghana</u>	<u>Cote d'Ivoire</u>
GDP growth (2013 IMF est)	7.9%	8.0%
GDP growth (2014 IMF est)	6.1%	8.0%
Inflation (2013 IMF est)	11.0%	2.9%
Population (mn)	25.4	19.8
Literacy rate	67.3%	56.2%
School enrollment	100%	88%
Life expectancy (yrs)	61	50
GDP pc (PPP) nominal	\$ 2,047	\$ 2,039
GDP (PPP) nominal (bn)	\$ 51.9	\$ 40.5



After flying over wave upon wave of wind-swept sand dunes in the Sahara Desert, we arrived in the Ghanaian coastal capital of Accra. Although our arrival time was late in the evening, we were met at the airport by our broker, who warmly greeted us and guided us to our hotel driver, only 100 feet away. This hospitality was above and beyond the call of duty and was but one example of the welcoming, friendly nature of the Ghanaian people. The "Gold Coast" of Ghana is indeed an "Island of Peace" in the sometimes volatile West Coast of Africa. Shortly before our trip, Ghana's Supreme Court finally upheld the December 2012 election victory of President John Mahama and runner-up Nana Akufo-Addo conceded defeat. Ghana's reputation as a stable democracy remains intact.

¹ The United Nations Human Development Reports : <http://hdr.undp.org/en>

Although agriculture still accounts for half of employment in Ghana, its contribution has fallen to less than one quarter of GDP, while the contribution from services has risen significantly, to roughly 50% of total output. The country still produces some of the finest cocoa in the world, and we spirited a jar of hot chocolate mix home to California for our colleagues to enjoy! We are monitoring Ghana's rising fiscal deficit, falling FX reserves and weakening currency, but on balance we are optimistic that the government's acknowledgement of these challenges and explicit targets for improvement will bear fruit.

These are heady days for the Ghanaian banks, with the Ghana Stock Exchange's Financials Index up 71% year-to-date. We took care to identify the investment opportunities in the financial sector that truly offer superior advantages from those that are simply being flattered by the current wave. We found our meetings with the banks to be insightful and we were particularly impressed by the professionalism of the management. Our impressions of the banking sector can be summarized as follows:



Metal Boat from Art Center in Accra, Ghana

1. Risks of retail lending: Although Ghana is experiencing rapid economic growth and many urban infrastructure projects are underway, there are certain details that are conspicuous by their absence. For example, there are no street numbers! People use landmark buildings and the good nature of helpful strangers to find their way. We experienced this first hand en route to Unilever Ghana, when our driver stopped five times to ask pedestrians for directions! Furthermore, the lack of a nation-wide personal identification system compounds the challenges faced by the banks.
2. Fighting for cheap deposits: Obtaining cheap deposits is always a key for banks across the region. Cheap deposits mean lower funding costs and higher margins. This is a particularly important issue in Ghana given the current high interest rate environment.
3. Increases in minimum capital requirements: The current requirement for new entrants is GHS130mn (\$65 mil) compared to GHS100mn (\$50 mil) for the existing banks. This strengthens the banking system, but makes it harder for new and small banks, thus reducing competition in the sector.

Having this background in mind, the three banks we met with covered the spectrum. We were very pleased to find that the management teams were aware of their banks' strengths and weaknesses and had clear business strategies. *CAL Bank*, a mid-tier bank, will remain a corporate bank with 70-85% of its lending to corporations. *UT Bank*, which was hit hard as a result of the high interest rates and its high exposure to term deposits, will continue focusing on small and medium size enterprises (SMEs). UT is also creative in attracting cheap retail deposits. *Ghana Commercial Bank*, the state controlled bank, is aiming to become the leading retail-focused bank. This is not a surprise since they are one of the few banks who have the government's employee codes and therefore are able to offer payroll deductions for loan payments.

While in Ghana, we were invited to participate in a banking conference² with representatives from central banks across the Sub-Saharan Region. The program included an address by Dr. Henry Wampah, Governor of the Bank of Ghana.

The conference gave us a better sense of African banking regulation policy, priorities and progress, as well as the Central Banks' views on key issues facing other frontier markets such as Nigeria and Kenya. One underlying theme was how to encourage long-term investments following the disruptions caused in 2008 by rapid capital outflows of portfolio investment capital. The working group of conference sponsors was interested to learn more about the long-term, bottom-up investment methodology of investors like ourselves, given the concern regarding hot money flows. To the extent that we have an impact at all, we believe that it is more likely to be countercyclical—providing liquidity in down periods—given our penchant for investing in attractively valued companies that have fallen out of favor. Conversely, some portfolio investors can dampen bullish runs when valuations become excessive. The table below offers some examples of our own patience with stocks, where our long term conviction has overcome short term concerns.



Address of Dr. Henry Wampah, Governor of the Bank of Ghana. Accra, Ghana, 11 Sept. 2013.

Company	Description	Country	Date of first purchase	Date of first sale	Maximum Drawdown	Annualized Return*
SGBCI	Bank	Cote d'Ivoire	11 April 2008	None sold to date	-50%	21%**
Kakuzi	Agricultural producer in Kenya	Kenya	7 April 2008	None sold to date	-53%	23%*
Unilever Ghana	Consumer products manufacturer and distributor	Ghana	21 November 2007	29 April 2013	-26%	47%*

** Realized gains through date of first sale;** unrealized gains to date. Actual investments. Total returns in local currency. For illustrative purposes only.*

In addition to the favorable investment environment, good meetings, and attractive investment opportunities, we love Ghana for its people. They are friendly, smart and full of entrepreneurial spirit. Along the main roads many vendors, especially women, walked the sidewalks and even in traffic selling phone cards, snacks, clothing hangers, electronics, socks, flags, posters and maps. We even had an learning experience the in vast local Art Market, when local proprietors greeted Ning in conversational Chinese! All these experiences give us high hopes for the country.

² Conference hosted by: (1) Overseas Development Institute, the UK's leading independent think tank on international development. (2) The Economic and Social Research Council, the UK's leading research and training agency addressing economic and social concerns. (3) The UK Department for International Development. Conference held in Accra, Ghana on 10/11 September, 2013.



Cote d'Ivoire

As we approached *Le Plateau*, the business district in Abidjan, Cote d'Ivoire, it was hard to imagine that for a few terrible weeks in the spring of 2011 heavy fighting raged in this city, including a downtown core peppered with semi-modern but dilapidated office towers. Fortunately, the stability and peace that came subsequently have remained intact. Former President Laurent Gbagbo, who refused to leave office despite being voted out, is now in jail in The Hague awaiting his trial at the International Criminal Court.

Cote d'Ivoire's economic output is 20% less than Ghana's, but so is its population, resulting in roughly equivalent GDP per capita income around \$2,000/yr on a purchasing power parity (PPP) basis. While the structure of output is roughly consistent with Ghana's (approximately half in services), the agricultural sector is more important in Cote d'Ivoire than Ghana, providing two-thirds of employment. Projected real GDP growth of 9% in 2013 is one of the reasons Cote d'Ivoire presents interesting investment opportunities, but the contrast between haves and have-nots remains stark. The two faces of Abidjan are shown in the picture below. The data are sparse, but hopeful because in general, the evidence is that the middle class is indeed rising in these countries.

Contrasts in Abidjan:



Views of the Le Plateau in Abidjan, Cote d'Ivoire



The other side of Abidjan, Cote d'Ivoire

While our company visits in Accra had focused mostly on financial companies; in Abidjan, we had the good fortune to meet with a broad variety of firms operating in different sectors including agriculture, industrial manufacturing, utilities, consumer products, and of course, banking. Several of the companies we met had strong management teams, healthy dividends (mid-to-high single digits; 100% payouts) and moderate valuations. However, each had unique, material downside risks; for example:

The tobacco/cigarette company faces extreme price elasticity of demand due to smuggled cigarettes at prices 80% below the formal market. And there is constant pressure from the government which raises taxes.

The rubber producer has high exposure to volatile rubber prices.

The water utility outlook is at the mercy of government infrastructure investment decisions.

All these concerns give us pause, but dividend yields as high as 10% can offset many risks....

Conclusion

While Ghana and Cote d'Ivoire are different in many ways, from an investment perspective, they share important similarities. They currently have stable political environments and are enjoying booming GDP growth rates. They offer a number of investment opportunities in companies run by competent managers. They offer the attractive long-term prospects associated with a rising middle class cohort and (hopefully) falling inequality. We believe that a combination of patience and skillful stock selection will bear fruit in these markets, as has been the case in these and other frontier markets to date.

About Frontier Market Asset Management

Founded in 2006, Frontier Market Asset Management holds more than 35 years worth of investment experience including work in Emerging and Frontier Markets since 1987. For more information, please contact us at (858) 456-1440.

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