



**FRONTIER MARKET**  
ASSET MANAGEMENT

## *Rough Seas in the Gulf of Guinea - West Africa*

By Larry Speidell  
June 2015



*Steering for the beach in Cape Coast, Ghana*

Life is hard in the boats at Cape Coast in Ghana, a three hour drive from the main city of Accra. In the shadow of the slave castle, the fishermen depart at 6 pm and return in the morning, with barely time to eat and sleep before setting out again. Hand hewn from logs up to 40 feet long, the boats power out with Yamaha outboards and sail home if the wind is right. Cell phones make it easier to locate the fish and know where to sell them, but it is still hard and hazardous work.

The cities in West Africa are filled with hard working people too: brokers who put in 10-12 hour days, hotel workers who have 15 hour shifts, while raising a family and attending school. Because of the long hours, rush hour traffic in frontier cities starts before dawn and the journey home can be slow well into the evening. Leaving after a meeting in Lagos at 6:30 pm, it took two hours to travel two miles. Their long hours and hard work show in the competence of company managers, whom I would rank the equal of most in the developed world.

The table on the next page gives some basic economic statistics of the companies we visited on this trip, as well as Pakistan, which we visited in February and, although on a different continent, has some interesting comparative features relative to Nigeria.

At 177 million people, Nigeria is similar to Pakistan in population size as well as in land mass. Nigeria's urbanization is higher, 47% vs. 36%, as is its population under age 15, 43% vs 33%. GDP per capita in Nigeria is nearly double at \$6,100 versus \$3,100, but this is distorted by oil revenues, much of which finds its way into the hands of a select few. Oil has provided 70% of government revenues, making the recent oil price drop particularly painful, especially since taxation is easily

avoided. Taxes represent only 3.8% of GDP versus 12.6% in Pakistan. The paucity of effective government services in Nigeria is reflected in three statistics:

- 1) Life expectancy is only 53 years because of poor health care, compared with 67 years in Pakistan.
- 2) Nigeria has only 29,000 kilometers of paved roads compared to 189,200 in Pakistan.
- 3) Annual electricity consumption in Nigeria is only 145.1 kWh per capita, less than half of Pakistan's 357.3 kWh per capita. Nigeria's power shortage is an embarrassment for an energy rich country, and it has hobbled economic growth for not only itself, but also its neighbors who receive unreliable imported energy from Nigeria.

Economic Freedom ranks from The Heritage Foundation are near the bottom of the table below, and Ghana, 63, is the winner, ranking higher than France, at 62.5. Cote d'Ivoire has a 58.5 rank, while Nigeria at 55.6 ranks even with Pakistan and higher than India, 54.6, China, 52.7, and Russia, 52.1.

Ghana is also the winner in women's literacy at 65% compared with 42% in Nigeria and only 31% in Cote d'Ivoire. Part of this is due to the Muslim practices in the north of each country, since Muslims total 18% of the population in Ghana, 50% in Nigeria and 39% in Cote d'Ivoire. Another reason Cote d'Ivoire lags in this measure as well as in GDP / capita is the civil war that began in 1999 and continued to ferment unrest until the arrest of former president Gbagbo in 2011.

	Nigeria	Ghana	Cote d'Ivoire	Pakistan
GDP Growth (2015 est)	5.0%	4.5%	7.5%	4.5%
Inflation	8.5%	15.0%	3.0%	5.0%
Population (mil)	177.2	25.8	22.8	196.2
People / km sq	192	108	71	246
% Literate	51%	72%	41%	55%
% Literate Female	42%	65%	31%	40%
% under age 15	43%	39%	38%	33%
Life expectancy	52.6	65.75	58.0	67.1
% Urban	47%	53%	54%	36%
GDP / cap (PPP)	\$6,100	\$4,200	\$2,800	\$3,100
Electricity/cap kWh	145.1	319.8	170.3	357.3
% Unemployed	24%	11%		7%
Land (km sq)	923,768	238,533	322,463	796,095
Market Cap (\$ bil)	\$56.4	\$3.5	\$7.8	\$43.7
Market Cap/GDP	9%	10%	23%	18%
GDP (Official Exch Rate)	\$594.3	\$35.5	\$34.0	\$236.5
GDP % Agriculture	21%	21%	26%	25%
GDP % Industry	26%	29%	22%	22%
GDP % Services	54%	49%	52%	53%
Taxes % GDP	3.8%	23.2%	21.3%	12.6%
Military exp % GDP	0.9%	0.6%	1.7%	3.0%
Economic Freedom	55.6	63.0	58.5	55.6
Electricity Cons Bil kWh	25.7	8.2	3.9	70.1
Muslim	50%	18%	39%	96%
Christian	40%	71%	32%	1%
Other	10%	11%	29%	3%

Source: The World Factbook, CIA, <https://www.cia.gov/library/publications/the-world-factbook/> 2015



Source: <http://www.freelargeimages.com/map-of-west-africa-695/>



## Ghana

*"Ghanaians are conservative. There's always a Grandma in the village who'll catch you..."*  
 – Kwabena Okai-Ntoni, SIC Brokerage



*Cape Coast from the parapets of the slave castle*

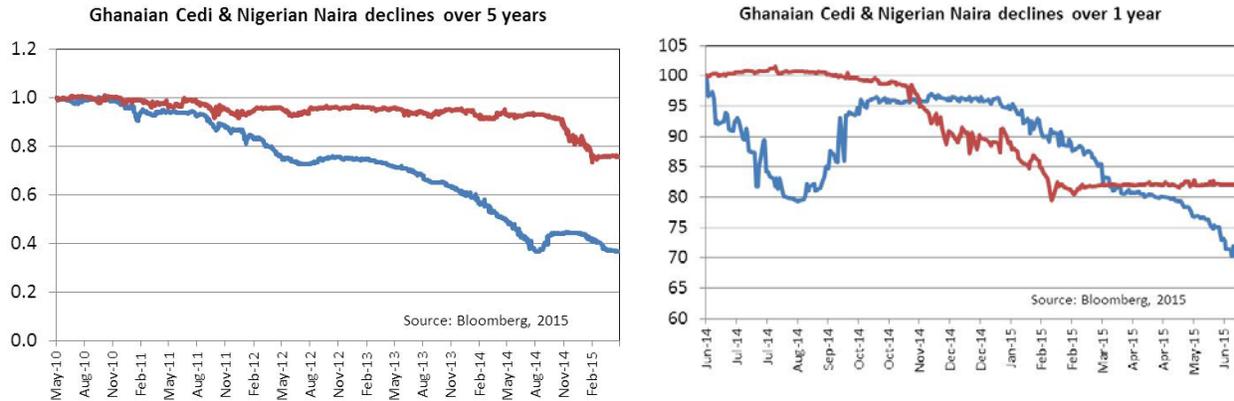
On my last visit in 2012, offshore oil and gas were starting to come into production five years after the deep water discovery of the Jubilee Field. GDP growth was 13%, and optimism was everywhere.

I wrote in my trip report that spring:

*"...in general the macro outlook is good. To avert corruption from the "black gold", Ghana has sought advice from Norway and The Netherlands in order to set up two sovereign funds: a Stabilization Fund, for smoothing economic cycles, and a Heritage Fund, for future generations. Against the advice of the World Bank, Ghana also has*

*taken on a \$3 billion loan from China, \$800 million of which will source gas from Jubilee through a pipeline to supply Ghana's power plants beginning in 2013."*

In hindsight, temptation was irresistible, and the World Bank was right. Ghana went on a spending spree, the current account went deep in the red and huge pay raises were granted to government employees. Now, the currency has dropped from 1.4 to the dollar in 2010 to 4.4 with a 26% drop in 2014 and another 26% drop in January-June 2015.



I hope that calmer seas are ahead, and there are three changes that may help:

- 1) The IMF has come forward with a \$950 million loan that has teeth in it, including demands for government reforms and austerity. It is reported that Ghana's government payroll of 500,000 includes 150,000 "ghost workers" whose salaries are paid to someone for no work at all.
- 2) The Cedi may find relief from both the IMF and the seasonal strengthening that occurs as the cocoa crop comes in between May and June.
- 3) The longstanding electric power shortages may be ending with the arrival of two barge-mounted power plants from Turkey that will be anchored offshore in May.

With the Cedi depreciation, companies in the consumer sector have been penalized.

Unilever Ghana has seen rising costs of imported finished products (OMO and Sunlight powders from Nigeria) and raw materials (palm oil for soap is priced in dollars). As market leader, Unilever put through price increases of close to 60% in 2014 and has recovered its profitability. Long term, Unilever Ghana is moving upscale with the rising middle class. Foot-long bars of Key laundry soap are a commodity; so Unilever is selling more Lux and Lifeboy bath soaps. In 2014, they introduced Vaseline creams and Rexona deodorants to capture a thriving market of Ghanaians who customarily take two baths a day.



Cape Coast, Ghana

## Nigeria



*The Sacred and the Profane –  
Above the towers of the Cathedral Church of Christ -  
a row of yellow Danfo jitney buses, the scourge of the streets -  
and a jack-up oil rig parked in the Lagoon, symbolic of the curse of Black Gold*

After a few days in Ghana, Lagos is like jumping from calm, courteous Minneapolis to raucous, rushed New York... only ten times more so. Nigeria is in a hurry, but it isn't sure where it's going.

Is it now a nation, welded together after the disastrous Biafra civil war (1967-1970), when the oil-rich southeast Niger River delta failed in its bloody bid for independence? Or is Nigeria a fragmented place where tribal and religious differences make every man and woman fight for him or her-self? Or is it a country making progress toward leadership in Africa, now that its restated GDP shows the economy to be bigger than South Africa?

Lagos is emblematic of this conflicted state. With 21 million people struggling to coexist, opulent homes and office towers loom over crumbling, clogged roadways and slums everywhere on any open scrap of land.

At the top of the pecking order are the rich businessmen and even richer politicians. It is said that the wily former governor of Lagos now runs a tax consultancy for the city that rakes in a 10% fee on all levies, earning him \$22 million a month. In keeping with a political tradition of "cross-carpeting" (switching party alliances) he recently backed former military ruler Buhari in the presidential election. He probably now expects even more

### Vaulting ahead

Biggest sub-Saharan economies  
GDP, 2013 estimates, \$bn



Source: *The Economist*, "Step Change", April 12, 2014

generous patronage... Then there is tycoon, Alioto Dangote, who from humble beginnings has amassed an \$18 billion fortune as the richest man in Africa, controlling Dangote Cement, Dangote Sugar and Dangote Flour.

In the shadow of fortunes such as these, it is hard for the upper middle class to get its bearings. To keep up, a milestone birthday party can run \$4,500, private schools cost \$18,000 a year and a wedding celebration with 800 family and friends can cost more than \$70,000.

Still the number of middle class in Nigeria who can afford more than the bare essentials is rising and presents an opportunity almost as alluring as that in China in the 1980s.

The oil price decline hit Nigeria hard, as oil exports equaled 19% of GDP and accounted for 70% of government revenues. Since November, the Nigerian Naira is down 17%, and the expectation is for 10% devaluation later this year. Meanwhile, oil marketers are not being paid, causing a gasoline shortage, long gas lines and rush hour traffic jams. Some state employees are not being paid either, and the new government may find no money left in the coffers when it takes charge.

However, the March election gives reason for optimism. It was hotly contested, but was won by Muhammadu Buhari leading the newly unified opposition. It was a relief that Goodluck Jonathan conceded gracefully. One critic last fall told me there would be civil war no matter what the outcome. Then in February, when the election was postponed six weeks, cynics said it was for Goodluck Jonathan to have more time to manipulate the polls. When the army, aided by coalition forces from Cameroon, Niger and Chad beat back the bloodthirsty Boko Haram Jihadists in the north, it was said that this would cement Jonathan's image of success.

Now during the lull before the inauguration, "carpet crossers" are proclaiming their new-found allegiance to the All Progressives Party (APC), and with these defections, the Peoples' Democratic Party (PDP) is struggling to survive intact.

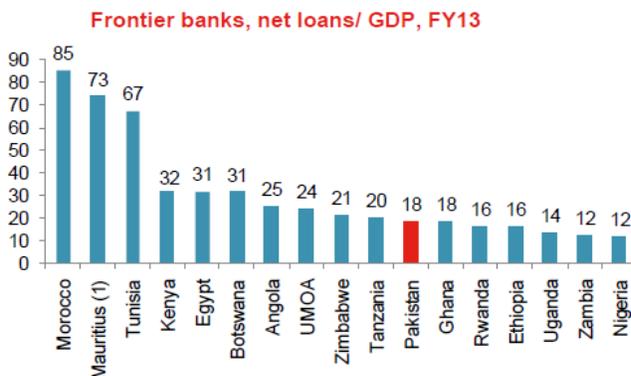
Additionally, it is said that corrupt government officials are hastily trying to "tidy things up". Perhaps files are being shredded and emails erased? The old government just released a forensic report by PwC stating that missing money at the NNPC (Nigerian National Petroleum Company) is only \$1.5 billion covering the 18 months from January 2012 to July 2013 - not the \$10-20 billion suggested by former Central Bank Chief Lamido Sanusi (for which he was immediately dismissed). Most people say the report is a whitewash, too limited and wholly inadequate.

The new government will have to clean up a mess and also deal with the currency. Still Buhari could be just the man for the job. At age 72 now, he was the military ruler for 20 months in 1984-1985 before being deposed. He is seen as incorruptible. And he is a disciplinarian, who made late employees do frog jumps to atone for tardiness.

Even with economic growth reduced to 5%, there is significant long-term opportunity in Nigeria. Because of strong loan growth, banks are frequently forced to raise their capital adequacy through rights offerings and borrowings. Some banks have recently reported loan growth as high as 30% or more, although this is somewhat overstated by the translation effect of devaluation on U.S. dollar loans which can be 40% of the loan book. Amazingly, Access Bank recently completed a rights offering that was nearly 100% subscribed ABOVE the market price. Although borrowers are dealing with the challenges of low oil prices and the weak currency, the banks seem confident that their

cost of risk is well in hand. While some banks may help borrowers by restructuring loans to longer terms, most are re-pricing loans to higher interest rates to reflect the market level.

The long term banking opportunity is illustrated in the chart to the right that we also used in our recent trip report on Pakistan. Similar to Pakistan, the loan/GDP ratio is 18% in Ghana, while it is even lower in Nigeria at 12%. The unbanked population is huge in these countries, and the rewards should be attractive.



*Source: South Asian Banks, Exotix, Feb 2015*

In addition to meeting with five banks in Lagos, I saw UAC, a diversified consumer company.



*UAC's diversified product basket*

Most of the consumer stocks in Nigeria sell at high PE ratios, including Nestle Nigeria at an estimated 2015 PE of 49x and Nigerian Breweries at 27x. Meanwhile UAC is around 12x. It has divisions in cereal, foods, paints, restaurants, real estate and livestock feed.

While Boko Haram was terrorizing the north, UAC had curtailed exports to Chad and Niger and parts of Cameroon, but things are improving now. And because of election uncertainty, street vendor sales of Gala snacks dropped from 11,000 packages per day to 8,000. Now they are recovering.

Management expects that real estate sales will bounce back as well.

One persistent problem for UAC is power or lack thereof - with six or more blackouts per day, ranging from 30 seconds to 3 minutes. The reason they aren't longer is that most businesses have their own power generators that kick on when public power cuts out. UAC has been petitioning for two years to have the power station in the Marina district send its excess power to the grid for the neighborhood, but the power law restricts it to streetlights and government needs. Despite the station's excess power, the ministers have done nothing to make power available to private customers.

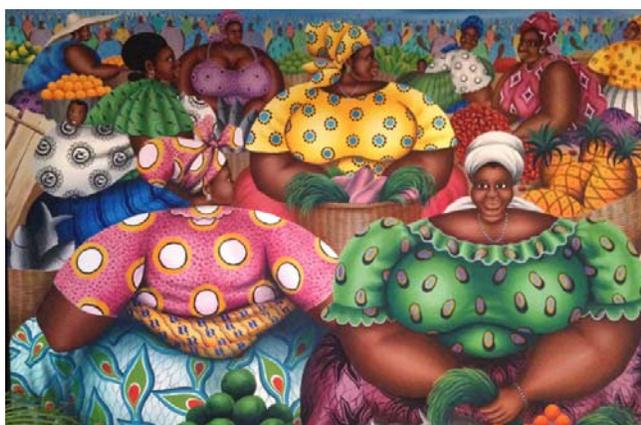
The positives in Nigeria may offset the uncertainties: The country managed its election well. And last year Nigeria managed to contain its cases of Ebola swiftly and effectively. Screening is prominent at the airport and dispensers of Purell hand cleaner are ubiquitous in Lagos. It is possible that Nigeria may provide more positive surprises, including a peaceful transition of power, post-election reforms, needed infrastructure spending and a rewarding stock market.



## Cote d'Ivoire

Colorful fabric prints are popular among fashionable Ivoirian women although not generally in the sizes shown at the right. 8,000 CFA francs (\$35) buys six yards from a vast range of colors and patterns, and tailors everywhere in Cote d'Ivoire will make a dress in any style you like for \$9.

Most of these cotton fabrics in Cote d'Ivoire as well as the neighboring francophone countries of Benin, Niger, Mali and Guinea are printed by Uniwax, 85% owned by Vlisco, a Dutch conglomerate that is controlled by the private equity firm Actis.

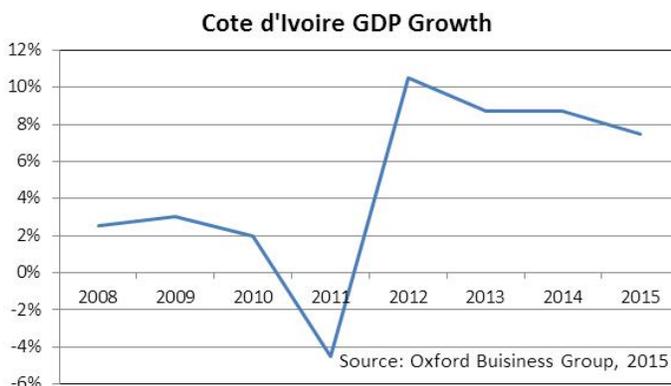


*Pullman Hotel, Abidjan*

Security is tight and secrecy seems overdone until one considers how porous the moats around its business model are. Bootleg products from China are being stopped by tariffs and tight border controls, but the whims of fashion and the rise of eventual competition make the outlook unclear.

Overall, however, the Ivoirian economy seems sound. After years of peace and prosperity since independence in 1960, there was a coup in 1999, followed by disputed election, civil war and the arrival of 6,000 UN troops, who are still there. An election in 2010 led to a flare-up of civil war until former president Gbagbo, who refused to leave office, was captured and sent to The Hague for his war crimes trial.

President Alassane Ouattara (pronounced "watara"), whose background includes work as an economist at the IMF, has been reforming the government, attracting FDI and completing infrastructure projects that include highway flyovers and a third bridge over the Abidjan lagoon. He has also reformed archaic citizenship laws to embrace the many refugee workers in Cote d'Ivoire from neighboring countries. The economy has recovered and growth is high.



A presidential election is set for October 2015, and it is expected that Ouattara will be reelected. Unfortunately, meaningful opposition will be absent because Gbagbo's party is in disarray.

Among challenges facing Cote d'Ivoire and its francophone neighbors is the burden of the French civil code system that lacks the flexibility and capacity for evolution of the Anglo-Saxon common law system used by much of the world. There is a heavy bias toward state imposed standards. Thus, simple changes, such as allowing stock splits, need to be approved by all countries in the region, which can take years. Also, company reporting is far from timely, as the law says that companies

have until June 30 for annual meetings with annual reports due only two weeks prior. Quarterly reports are unheard of... It will take years to change these rules.

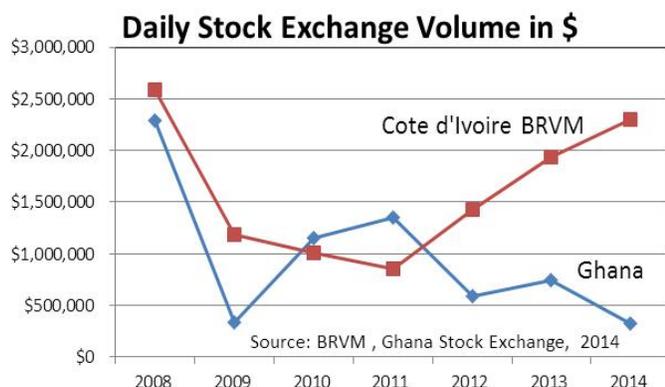
The fall in oil prices has benefitted Cote d'Ivoire, and its energy balance will be further improved by the completion of a dam being built by the Chinese in 2019. This will shift the power balance from 75% gas to 50% hydro. Also, Cote d'Ivoire hopes for a negotiated agreement on the ocean boundary with Ghana, which should give it claim to some of the Jubilee oil field.

Cote d'Ivoire is coming out of hard times, and it will prosper despite its regulatory obstacles. The challenge is finding attractive stocks among the many good companies in the market. It is easy to buy the biggest company Sonatel, but it may be too popular to be a bargain. In addition to Uniwax, there are interesting industrial distributors and producers although their liquidity will require patience. Given reporting rules, the banks are unwilling to provide data on 2014 results before mid-June, and they are unwilling to provide the guidance for 2015 on the basic metrics like loan growth, cost of risk and net interest margin that are routine in every other country. Still, they could be attractive for the optimistic investor, since banking penetration is just as low as elsewhere in Africa.

## Markets – Availability and Opportunity

While Africa has grown its GDP at an annual rate of 5.5% over ten years, per the IMF data, the stock markets have not followed along. In market capitalization, Nigeria is the giant at \$60 billion, while others, such as Ghana (\$5 bil), Cote d'Ivoire (\$10.8 bil), Rwanda (\$780 mil), Uganda (\$1.2 bil) and Malawi (\$1.3 bil) are so small as to be easily ignored by most large foreign investors.

The chart above shows annual U.S. dollar trading volume in Ghana and Cote D'Ivoire.



Ghana's stock market has lagged far behind its economy which grew at a 7.6% rate from 2006 to 2014. After a rush of reforms and privatizations from 2000 to 2006, local interest was high. But then came 2008. Many retail investors got burned, and most have never returned. From a high of \$2.3 million per day in 2008, trading volume sank to \$340,000 in 2009. It recovered to \$1.35 million in 2011, but then the Euro crisis hit, and volume sank again, reaching a mere \$324,000 per day last year. Adding to market's woes is that local Treasury Bill rates are approximately 25%, providing stiff competition to potential investment in stocks. Of course, with good news on Ghana's government, the IMF package, inflation and the Cedi, things could change fast.

Meanwhile, the Bourse Regionale des Valeurs Mobilieres (BRVM), the regional stock market in Cote d'Ivoire, has made a better recovery from its lows, although it is still not keeping up with

economic growth. A third of the BRVM volume, however, is in Sonatel, the Senegalese telecom that is an institutional favorite.

In the past few years there has been a lull in foreign investor interest in both the frontier and emerging markets, while the U.S. has made a strong recovery and the dollar has risen. We believe this is a good time to look closely at West Africa because of the progress that is being made in each of the countries we visited on this trip.

Hopefully there will be calm seas ahead in the Gulf of Guinea. Perhaps stable oil will calm the waters. But let's keep our life jackets handy just in case.



*"Psalm 12" at the left- boat names reflect the Evangelical Christianity of Cape Coast*

	Market Cap (\$ Mil)	% Total
Nigeria	\$60,880	26.3%
Morocco	\$53,648	23.2%
Egypt	\$43,765	18.9%
Kenya	\$24,553	10.6%
Cote d'Ivoire	\$10,868	4.7%
Tunisia	\$7,942	3.4%
Mauritius	\$7,210	3.1%
Tanzania	\$5,649	2.4%
Ghana	\$5,069	2.2%
Zambia	\$4,487	1.9%
Zimbabwe	\$4,253	1.8%
Malawi	\$1,325	0.6%
Uganda	\$1,250	0.5%
Rwanda	\$781	0.3%
	\$231,680	100%

Source: BRVM 2014

### **P.S. From a Fellow Traveler**

We are delighted when clients can join us on a trip. On this trip, one of our clients, Eric Pirkl of Okabena, joined me in Ghana and Cote d'Ivoire. He generously offered the following comments:

*"Despite all the hubbub around Ghana's new found wealth of black gold and Cote D'Ivoire's dominance in world cocoa markets, after this trip, it is clear that West Africa's greatest resource is its people. After an endless of string of meetings in Ghana and Cote D'Ivoire, the fog of my initial skepticism lifted away, and I firmly believe that management teams in these countries are on par, if not better given what they are able to achieve in the environment within which they ply their trade, with those of any western management teams that are in the fortunate position to operate in docile established markets.*

*As a first time visitor to Ghana and Cote D'Ivoire, I was naturally nervous given the unfortunate picture the international media paints of poor, violent, unwelcoming Africa. Fortunately, from the moment I stepped off the plane in Accra the warm smiles and welcoming nature of the Ghanaians set my mind at ease. Then in Cote d'Ivoire, the amazingly delicious food and eternal patience with our awful French language skills sealed away any negative inclinations."*

## P.S. Travel Tips

Before our trip, Eric had asked for some travel advice. I suggested several tips, but after the trip a few more come to mind:

- 1) Ask your hotel to send a car to pick you up at the airport. The airport taxis may be reliable, but then sometimes they may not. I've been ripped off by taxis in Rome and Budapest, so it's a good idea to be careful in Lagos. In Dar es Salaam though, the taxis are great.
- 2) Always bring around twenty \$5 bills. People love dollars everywhere, and tipping with \$5 wins you a friend. A nice tip at the start of your hotel stay can be worth more down the road. And if it's for a driver who has battled a one hour traffic jam, tip \$20.
- 3) It is always a good idea to change \$20 into local currency in each country. It comes in handy if you're bargaining for a souvenir, but occasionally, local currency can solve bumps in the road. After being pulled over at a police check point in Ghana, our driver, Patrick, had a long discussion with two officers who said his driving license had expired. I gave Patrick 10 Cedi (\$2.50) to pass on to the officers, and suddenly their literacy improved. They could now read that his license said "Exp Nov 12, 2017". On an earlier occasion, when leaving Nigeria, I was asked by a uniformed officer if I had a "gift" for him. I looked confused and muttered in French that I didn't understand English. This time, however, I had already greeted the customs officer when he asked if I could help him get a cup of coffee. Magically, a 500 Naira note (\$2.50) made him my friend, and he was a cheerful guide through the maze of laser temperature checks (for Ebola), photograph snapshots and visa scrutiny needed to clear customs. While it is easy to be outraged by these requests, junior officers in poor countries struggle to feed their families. It is hard to know what we would do in their place.
- 4) Leave time for connections, because transfer desks are rare. If you're changing airlines or even just changing planes during your journey, you may need to actually enter the country you're transiting along the way. When Arik cancelled my one-stop flight from Lagos to Abidjan, I had to fly to Accra, enter Ghana and then rush to the EgyptAir check-in counter. I had 20 minutes to spare – but they had closed the flight. At times like that, it's good to have a friend to call who is in a nearby time zone, rather than an 800 number from your travel agent back in the U.S. In this case, Neil Barnard, at our broker, Securities Africa, in Johannesburg, was ready to help and got me on the Emirates Airline flight to Abidjan - with a five hour delay providing plenty of time to drink coffee.
- 5) Bring snacks... Just because food may be available on the plane or in the terminal doesn't mean it'll be safe. Be sure to bring granola bars, nuts or whatever you like. And grab the packaged cookies and chips if you pass through business class lounges.
- 6) Arriving at the airport two hours early may seem like a waste of time, but you never know what might come up. Gridlock in Africa can achieve colossal proportions, freezing you for hours in a mélange of cars, buses, motorcycles, dump trucks, tuk-tuks, matatus, dellis, danfos and whatever. In Abidjan, heading to the airport at 7:30 pm, Africa took the one last chance to keep me in her embrace. Traffic was at a standstill. We wove through every one of the six official lanes on the highway, including the on-coming ones, plus trying additional lanes on the side that the roadbuilders never thought of. After a mere 1,000 yards of

progress in an hour, suddenly there was a single traffic lane to scoot through, surrounded by a dozen baffled police milling about. At times like this, it helps to have a good book in your briefcase and a headlamp to read it by – I recommend *Whatever You Do, Don't Run: True Tales of a Botswana Safari Guide*, by Peter Allison, Lyons Press, 2008.



“You can get anything you want...” – in Lagos

### *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.*

*This is not an offering. An offering will be made only by means of a final offering memorandum and only in those jurisdictions where permitted by law. The fund is subject to a variety of risks, including but not limited to: investments may be volatile depending on the type of hedging techniques employed and subject to stock market risk; investments may be illiquid; an investor could lose all or a substantial amount of any investment in the fund; there is no secondary market for interests in the fund nor is one expected to develop, and there are substantial restrictions on transferring an investment in the fund; fees and expenses of the fund may be higher than those of other investments and will reduce the portfolio return. Consult the fund's offering memorandum for complete risk disclosures and other important information. Past performance is no guarantee of future return.*

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