



Sea Meadow House, PO Box 116  
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Oysterbay  
Dar es Salaam

19 August 2023

Dear Investor,

There is a lot to cover this time. I apologize for the delay with this letter. Having returned last week from a 1-month road trip in Europe with my family for our summer holidays, there was much to catch up on at home.

The Fund gained 3.65% in the three months to June 30. It was flat in July. Year to date, through July 31, we are up 6.19%.

You have already received your July valuation statements from Bolder.

The companies we own shares in, for the most part, continue doing very well. Recent earnings announcements from **NMB Bank** (1H2023 net profits up 26.1% year on year), **Twiga Cement** (+6.3), **Tanzania Breweries** (+12.7%) and **Tanzania Cigarette Company** (+29.2%), among others, show the clear upward trajectory.

Nonetheless the Fund has faced significant headwinds this year due to continuing weakness in all the frontier African market currencies. Were it not for significant foreign exchange rate losses, we would be up by well into double digits for the year, mirroring the earnings growth of our portfolio of companies (in local currency terms).

With exchange rate weaknesses top of mind, in this letter I want to present some data on:

1. Long-term profit growth for the universe of large-cap African frontier companies (in USD terms).
2. Long-term depreciation rates of African currencies.

Before getting to that, some more background on the currency situation is warranted...

### **Where are the dollars?**

The overriding theme for the past few months in frontier markets, as well as many emerging markets, has been tightness in the foreign exchange markets, and a notable lack of US dollar liquidity. This has to do partly with the most aggressive rate-hiking cycle since 1973 from the US Federal Reserve, which has taken benchmark rates on US dollars from 0.25% to 5.5% in just 16 months.



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As I remarked to more than one person recently, if you can get 5.5% on US T-Bills, I guess many people don't see the point of investing in emerging or frontier markets taking on all the extra risk in the hope of 10% to 15% returns.

But I think the lack of dollar supply in our markets also has to do with an unwillingness by central banks here to just let exchange rates adjust. Supply of dollars would come out at levels where the sellers felt they were getting enough local currency for their dollars, instead of an artificially low number dictated in part by central banks.

In the markets we cover, we first experienced this in Kenya. I wrote before that we were reluctant to add to our investments at the Nairobi Stock Exchange until we saw FX spreads come in and we received closer to market value for any dollars we remit to Kenya.

That has now happened. The Kenyan Central Bank first got a new Deputy Governor, and then, shortly after my visit there in May, let the official KES rate begin to steadily depreciate toward the parallel rate that had already evolved, as an informal market with true pricing sprung up to supplant the official one, which attempted price controls. As such, for the quarter the KES lost 5.8% going from 131.40 to 139.55. Since then, it has dropped another 3.2% to 144.20. Year to date, the KES is down 15.1%.

The Tanzanian shilling (TZS) is now undergoing a similar adjustment. Having kept a tight rein on it for years, the central bank has had to let it adjust as pressure built up for a devaluation. Banks now quote as much as TZS 2,600 / \$1 to sell US dollars in larger volumes. The official rate is still 2,499, from around 2,330 at the start of the year. That is a 6.7% drop, year to date.

#### **East Africa should be able to avoid the trap Nigeria was in for many years**

Hopefully, these adjustments, now sanctioned by the central banks in Kenya and Tanzania, can avoid a repeat of what happened in Nigeria, where the central bank stubbornly held the line for years, refusing to let the official exchange rate adjust, and a parallel market, with the naira some 60% lower than the official rate operated for years. As a result, foreign exchange became almost impossible for portfolio investors to obtain, and money got trapped in naira for years ... until Bola Tinubu, the new Nigerian president, upended the apple cart in June.

Say what you will about Tinubu, and the way in which he "won" the election (the two other leading candidates challenged the result in court, but nothing more came of it), but he has certainly not been shy about implementing much-needed sweeping reforms in Nigeria.

First, during his acceptance speech at his inauguration he abolished the insanely costly fuel subsidy that previously saw the Nigerian government shoulder about 80% of the cost of each litre of petrol sold in the country and resulted in rampant smuggling of fuel to neighbouring countries.



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Following that bold step, which many had doubted he would follow through on, Tinubu had the central bank governor stew in jail over the weekend and, come Monday, the naira was floated and allowed to find a level nearer to that which had prevailed in the parallel market for months.

As a result of this 30%+ devaluation of the naira, the S&P African Frontier BMI (USD) Total Return Index which we use as the hurdle index for our performance fee computations, which has the majority of its exposure in Nigeria, lost 16.3% in ONE DAY. It wasn't pretty, but it is exactly what I had been expecting for a number of years.

I could not know the timing. But I knew it had to happen one day, and that is why I had deliberately maintained only a small allocation of our capital to Nigeria – even then, having moved most of the money in via the dual-listed stocks so as to obtain an effective exchange rate of well over 1,000 naira per USD, versus the "official" rate of about 460.

Our hurdle index is now down 4.7% for the year. We are up 6.2%. We have been hit hard by FX weakness. Our hurdle index has been hit much harder.

As we make abundantly clear in our Private Placement Memorandum (PPM), and I have discussed in nearly every Podcast, interview, conference call or presentation I have given since I started this Fund, the steady (or sometimes rapid) depreciation of most African frontier market currencies is a fact of life, and something we build into our expectations and targets.

As you may recall, we are aiming to at least double your money in African Lions Fund every 5 years, in USD terms, after all fees and expenses. We do this by investing in companies we believe have the potential to double their sales and profits on a similar time-horizon. We also aim to build in a solid margin of safety by paying multiples of earnings or book value for these investments that we think are so low, they also have the potential to double over 5 to 10 years.

The complication is that most of the currencies our investments make their sales and profits in depreciate by between 3% and 5% per annum. So, for a double in USD terms, we need compound growth rates of sales and profits of closer to 18% to 20% in local currency terms.

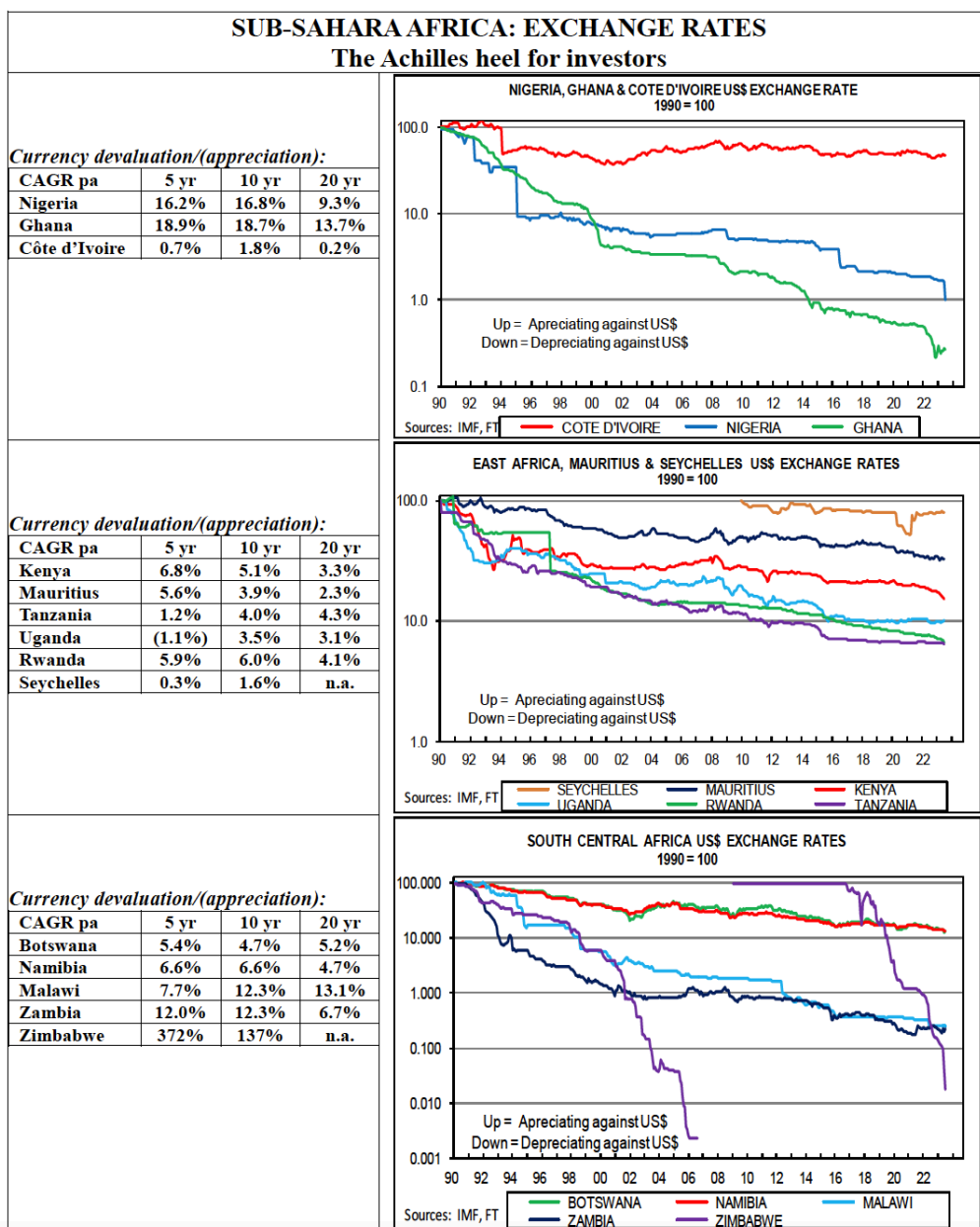
But, do the best African businesses really generate enough earnings growth in US terms over the long-haul, that our aim to double your money every 5 years is realistic? To answer that question we first need to look at the historical rate of currency depreciation, then at earnings growth.

My professional colleague, Christopher Hartland Peel, an old Africa Hand, has put Africa's currency depreciation into stark relief in his latest "Africa Top 30 Companies" update. He has called it "The Achilles Heel for investors." I reproduce some of his excellent work on the rates of exchange rate depreciation across Africa below, for your reference.



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He splits his analysis into different regions: West Africa, South and Central Africa, and East Africa plus Mauritius and Seychelles. You can see that “Cote d’Ivoire,” or, in actual fact, the union of eight countries in West Africa that use the West African Franc (XOF) as their medium of exchange are the best performers over 20 years, with an annual currency depreciation vs. the US dollar of only 0.2%. That is because the XOF is effectively pegged to the Euro. Ghana and Nigeria do MUCH worse.





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Contrast that with basket cases in South and Central Africa, such as Zimbabwe, Malawi, and Zambia, where the annual depreciation over 10 years ranges from 12.3% to 137% (!) and you can see it matters a GREAT DEAL how the currencies of the countries in which we invest fare over time.

East Africa in general has done better. Tanzania, you will note, has done particularly well over the last 5 years, with an annual exchange rate depreciation of only 1.2% per annum. But the 10 and 20-year records aren't as good, with depreciation rates of 4.0% and 4.3% respectively. While you could argue there is thus an improving trend, I think the past five years have likely been an anomaly, and that the Tanzanian shilling is likely to see a reversion closer to the long-term mean. That means some "catch-up" depreciation is likely in the near term, as indeed we are already seeing.

Only in Uganda has there been currency APPRECIATION over the past 5 years, at the rate of 1.1% per annum. Given the 20-year cumulative depreciation in Uganda of 4.3% per annum, we are probably in for some Ugandan shilling weakness in the near term as well if mean reversion holds. With oil exports set to commence in the coming years, and large gold and uranium discoveries recently announced, however, who knows? Uganda might be the exception that proves the rule when it comes to across the board African currency depreciation.

Taking the analysis one step further, I also had Christopher go through his database and look at **how the net profits of Africa's Top 30 Companies have grown in US dollar terms over the medium and long run**. You can see in the table that there are only a handful of businesses that have grown earnings at sustained rates above 10% in USD terms for 10 years.

For shorter periods of 3 years and 5 years, the track record is better. That said some of these businesses are newly listed and we don't have the data. Others are cyclical. And, for smaller companies, outside The Top 30 by market capitalization, you would expect to see many faster growers.

		5-year	10-year
MTN Group		26.10%	-7.40%
Dangote Cement		8.10%	-1.70%
MTN Nigeria		28.40%	-4.60%
Safaricom		5.20%	14.70%
BUA Cement	3 yrs >>	9.50%	39.90%
Endeavour Mining		losses	losses
Airtel Africa	3 yrs >>	11.40%	na
BUA Foods		56.40%	na
SONATEL		4.00%	2.20%



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IHS Towers		losses	losses
ORANGE-CI		na	na
Zimplats		45.30%	na
Nestlé Nigeria		2.60%	-2.40%
AVZ Minerals		losses	losses
Zenith Bank		7.50%	7.10%
GTB		-0.30%	-3.00%
MCB		1.60%	4.80%
Seplat Energy		-25.10%	-5.40%
Geregu Power		-10.00%	na
Helios Towers		losses	losses
Tanzania Breweries		6.30%	-2.20%
Equity Bank		16.50%	11.10%
Stanbic IBTC		10.90%	12.70%
EABL		6.30%	-6.90%
MTN Uganda		na	na
KCB Bank		9.40%	8.80%
Africa Oil		losses	losses
Lafarge Africa		-11.50%	8.90%
First Bank Nigeria		51.80%	2.50%
MTN Ghana		20.60%	9.90%
Ireland Blyth		-59.10%	na
NMB Bank		12.20%	11.60%

My job as a stock picker is to select those businesses that I think can grow EPS in US dollar terms at 10% to 15% rates, or better, for the *next* 10 years. It's a small club. That's why our holdings are relatively concentrated.

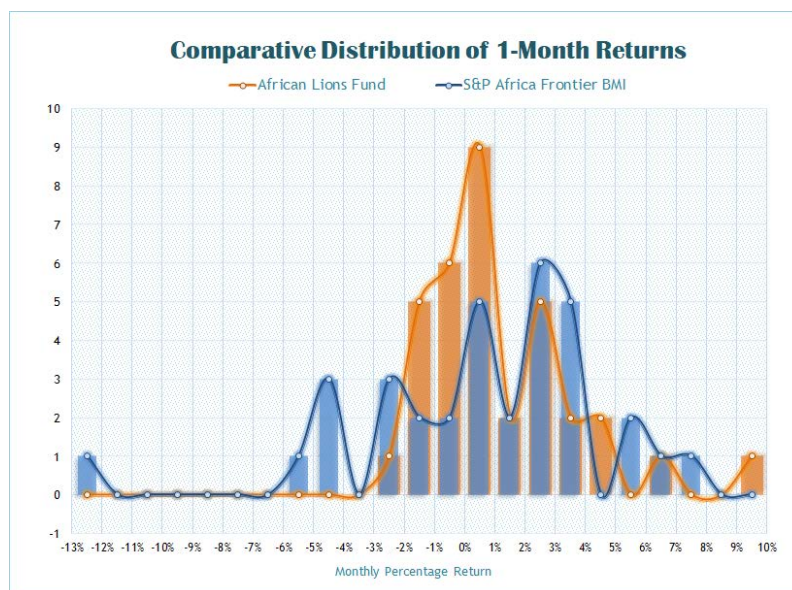
The good news is that my process, so far at least, is working. It has **produced returns for the Fund that are well ahead of a broad-based index of African frontier equities**. The Fund has seen a compound annual rate of return of 14.01% per annum in the 34 months of its existence. That's only slightly behind the rate required to double in 5 years.



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And we are also doing this with low levels of volatility in our returns, should that matter to you. It does not matter too much to me if I am honest. But it does to some people.

One investor suggested last month that I look at how the distribution of the Fund's monthly returns compare to those of our hurdle index. While I don't usually put too much stock in such statistics, I was curious. So, I had my assistant Eunice do the analysis. Here is the result.



While the Fund has had just as many down months as the hurdle index (12) during the 34 months we have been in operation, what you will notice from the frequency distribution of our 1-month returns is that **losses for the Fund in our down months are small**, clustered around 0% to -1% and -1% to -2%.

The hurdle index on the other hand has had many much worse months, including one horror month with a near 13% loss after the aforementioned naira devaluation in June. Our best single month of +9.5% was also better than the best month for the hurdle index of +7.1%.

In short, **our returns are relatively less volatile and skewed more positive than the hurdle**. Hence our 28-percentage-point outperformance against the hurdle index (+45% vs +17%) since the Fund's inception.

Over time, we hope this outperformance will become even more pronounced. It should do, as the quality of the businesses we own stakes in shines through, in the form of faster increases in earnings, which should eventually also be rewarded by the market in the form of higher valuation multiples.

That said, we cannot control what the market does. All we can do is aim to select the right investments and then wait patiently.



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### **Housekeeping, and upcoming travel schedule**

The Fund has continued to enjoy net inflows year to date. We have one quarterly redemption to pay in October, after the September 30 valuation cut-off. I am hopeful that further inflows will materialize between now and the end of the year.

Depending on our performance between now and then, I estimate we should close the year with somewhere between US\$22 million and US\$24 million under management. That would be great place to be, after 3 and a bit years since starting the fund.

I will be in London very briefly September 17, but could meet for brunch between changing airports from Gatwick to Heathrow, and in Denmark (Billund) on September 18. I will be in Cyprus September 19 to 23 for an investment conference.

I should be in London again October 8 to 12. I am in Dubai October 13 to 22. And in November I will finally make a return trip to Nigeria. In December, I should be in Johannesburg December 16 to 18, and in Sydney from December 19 to 23.

If anyone wants to arrange a meet-up in any of those places, let me know. I am also keen to meet potential new investors. So, if there is anyone you think I should meet, please sing out.

As always, questions and feedback are welcome at [tim@africanlionsfund.com](mailto:tim@africanlionsfund.com)

### **Quarterly investor call**

The quarterly Zoom call for investors, will be at 2.30pm Dar es Salaam this coming Thursday, August 24. That's 7.30am EST in the USA, and perhaps some of our investors there and in Latin America will be able to join this time. Apologies to those on Australian Eastern time where it will be a bit late, at 9.30pm. For those in Europe, The Middle East, Africa and Asia, the timing hopefully works fine.

We will send dial-in instructions early next week and a reminder email ahead of the call. If you have questions, but cannot join the call, please send them to me ahead of time.

Until next time...

Good investing!

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