Africa has the world's lowest access to power and ranks poorly on transportation and sanitation, a situation that results from decades-long underinvestment in infrastructure. This trend raised domestic production and transportation costs, which eroded the competitive advantage of the region on low wages and contributed to the continent's slow industrialization. Aware of these structural issues and their knock-on impact on wealth creation, certain countries initiated bold reforms that opened up new opportunities.

From Morocco, where the renewable share in electricity mix stands above most European countries at 30%, to Kenya, among the world's leading nations in geothermal power, Africa presents numerous cases for which government-led initiatives successfully reduced the infrastructure gap. In most instances, a better infrastructure has emboldened local businesses and strengthened long-term growth prospects. Thus, infrastructure development appears as a guide complementing our reform-led investment approach to gauge which economies or sectors have higher chances of delivering on the huge potential Africa offers to investors.

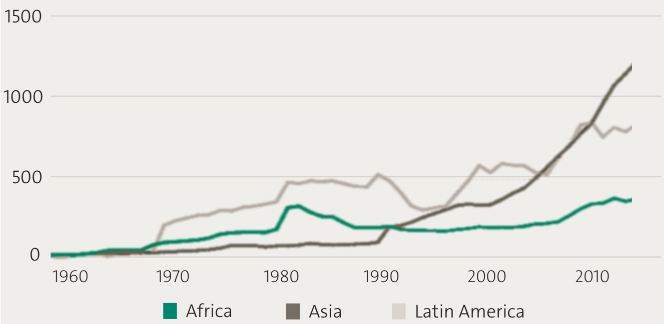
Andy Gboka, Portfolio Manager BB African Opportunities

Infrastructure, the key to unlock the continent's potential

Back in the 50s-60s, the infrastructure deficit in Africa was similar to that of its other developing peers. But, the political instability, reliance on commodities as the main source of governments' revenue and misallocation of resources (e.g. bad economic planning, corruption) created a gap between the continent and the rest of the emerging world. Further, Africa's fast-growing population and urbanization rate raise mechanically the need for infrastructure development that is hardly matched by local governments as they tend to prioritise domestic consumption – via salaries or subventions – over capital spending in their budget decisions.

Aside insufficient public support, the little private sector participation – below 10% of total infrastructure investment in 2012/17 – is another factor explaining the poor state of the capital stock. Indeed, the weak regulatory and institutional framework often blur the visibility on long-term returns necessary to get private money involved, with recurrent issues being regulated prices uncorrelated to the real costs or persistent public subsidies.

Gross fixed capital formation per capita in selected global regions

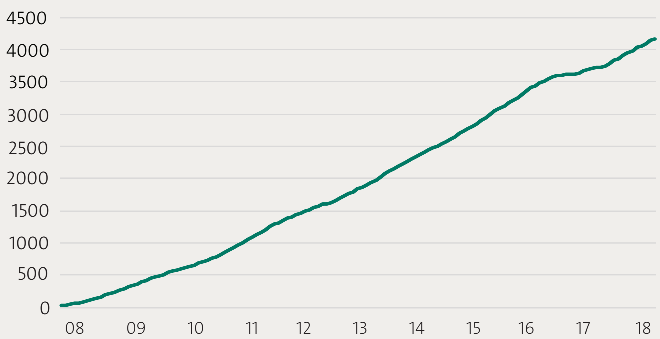


However, it is not all negative. First, another commodity up-cycle and a better fiscal room for investment helped the overall infrastructure set-up improve marginally since 2000 (see chart above). Second, bright spots such as the information and communication technologies (ICT) sector managed to improve their infrastructure access substantially. ICT benefited from the emergence of mobile telecommunications in early 2000s and a general move across the continent to involve the private sector via new legislations (e.g. creation of regulatory body, license issuance). Thus, the high level of private participation and investments brought the mobile network coverage of several African countries in line with that of other emerging nations such as India or China. According to the US-based Brookings Institution, Africa is the world's fastest-growing mobile telecom market, averaging a 30% increase in mobile connections per year since 2000. It overtook Latin America recently to become the second largest mobile market worldwide, behind China.

Infrastructure, a powerful catalyst to boost domestic businesses

The ICT revolution helped existing businesses grow and become more efficient – e.g. acceleration in banking penetration at a lower cost. It also allowed new businesses to emerge, such as Kenya's mobile payment tool MPESA, launched by Vodacom's subsidiary Safaricom. From zero back in 2007, mobile money transactions are now worth USD 40 bn – 1.6x Kenya's GDP – and capture a big part of cash transactions that would have otherwise remained in the informal economy. On energy, investments from state-owned Kenya Power and Kengen lifted the electricity access rate from barely 30% in 2013 to a level above 60% today whilst the contribution of low-cost geothermal sources more than doubled to 29% of the energy mix.

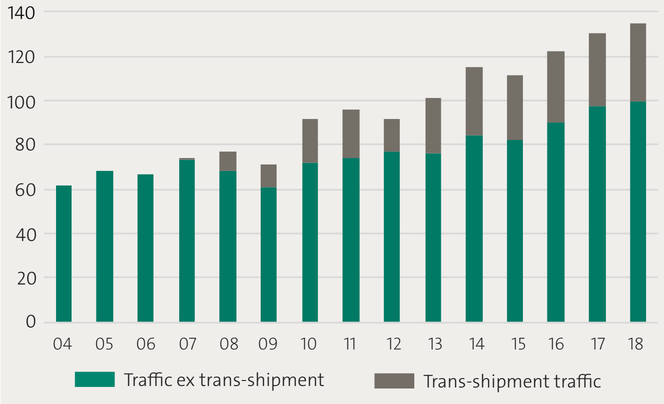
Kenya's mobile money transactions value in KS bn (12m trailing)
(incl. mobile commerce transactions and cash sending/withdrawal transactions)



Despite the Arab Spring and political turbulences that came with it, the current leaders of Egypt and Morocco kept a strong focus on reforms and infrastructure development. Egypt and its collaboration with Siemens to add 14.4 GW of electricity generation capacity in barely two years (a 45% increase) or its Zohr gas field project with Italy's ENI leading the country to become net exporter of LNG this year are testimony of the positive drive a reforming government can initiate.

Moving West, Morocco has one of the highest electricity access rate in Africa and the most ambitious green energy plan with its target of 50% of generation mix coming from renewable sources by 2030. Another strong achievement is the reform of its port operations and the creation of a new regulatory body alongside a sole public port operator in 2006. Marsa Maroc, together with other big international peers, was granted concessions to operate and expand the kingdom's port installations in line with its goal to become a major trading hub on the continent. The flagship trans-shipment port of Tanger (Tanger Med), commissioned in 2007 and expanded in the following years, was instrumental in this reform. Tanger Med now ranks ≠2 in terms of tonnage processed in Africa thanks to its links with 68 countries for container trans-shipment but also the modern railway network connecting the port to the Kingdom's main cities.

Morocco's port traffic (mn tons)



There is also a direct railway connection between Tanger Med and key economic zones such as the Tanger Industrial Park, where Renault set up its first factory. The growing number of Renault car exports going through Tanger Med helped the country become Africa's ≠1 car exporter in 2017/18, overthrowing South Africa in six years with more than 300 000 vehicles exported per year. That number will keep growing as Peugeot inaugurated its first factory in Kenitra last June, with a target production capacity of 200 000 vehicles by 2021.

The role of China in infrastructure investment

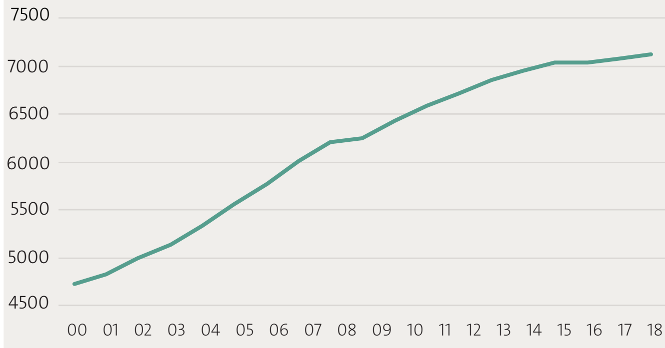
China's growing influence on the continent can no longer be denied: it has funded one in five projects and constructed one in three since early 2000, according to Deloitte Africa. In terms of money deployed, China is the largest single nation investing in African infrastructure with a combined USD 105 bn over 2010-17 (19% of total investments). Although international criticism has mounted against China's resource-backed loans to some African states or the heavy debt burden vs. questionable economic benefits, Chinese infrastructure inroads encourage positive spill-overs, particularly in transportation. Indeed, more than 50% of the projects China has funded to date are in shipping, roads, and railways, which improves logistics, intra-Africa connectivity and the continent's integration into global value chains.

The Addis Ababa-Djibouti railway, one of East Africa's major infrastructure project of late, was funded by China for a total amount of USD 4.5 bn. It eased logistical bottlenecks in the region, provided Ethiopia's manufactured goods with a greater access to export markets while boosting Djibouti's trade activities of which 70% is related to trans-shipment for Ethiopia. Moreover, China uses its bilateral relationship with domestic governments to extend its influence via economic cooperation zones. Between 2014 and 2016, Chinese companies set up 56 special economic zones in more than 20 countries, generating USD 1.1 bn in tax revenues and 180,000 jobs, a clear evidence that these hubs contribute positively to local growth and employment.

Africa has no choice but to industrialise

According to the IMF statistics, per capita GDP in USD terms for the top 10 African economies by size (representing 74% of total GDP) barely grew by 2% a year since 2000 (CAGR). The pace of expansion even fell to 1% over the last 5 years for the same sample of countries, which shows that expectations of an emerging middle class fuelling a booming African consumers market were elusive to say the least.

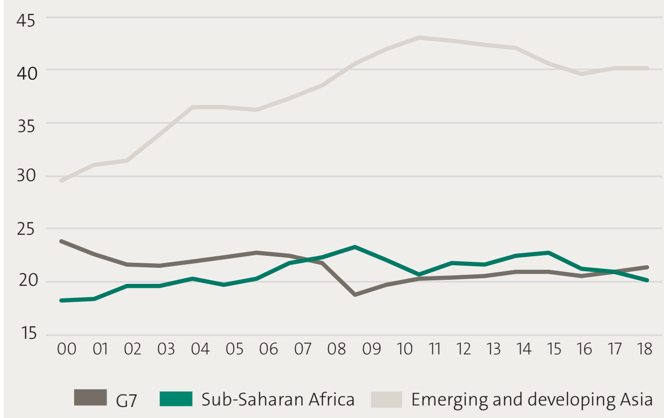
Per capita GDP current price (USD)



The volatility in commodities and agricultural outputs along with the slowness in implementing conducive reforms are among the drivers behind this trend. The latter is exacerbated by other factors such as the high operating costs (e.g. power, transportation) and instable business environment that prevent corporates from thriving and creating enough job opportunities locally.

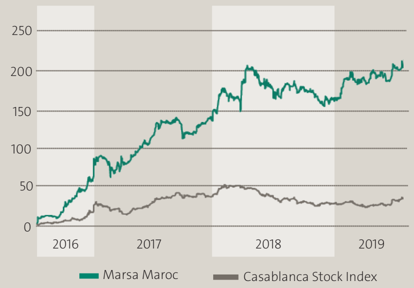
Although the situation varies from one country to another, Africa's main challenge today is to lift the GDP contribution of the more productive and labour-intensive manufacturing industry to benefit from its positive impact on employment and wealth creation. In other words, the continent needs to produce more goods for its internal market and integrate the global value chain via a step-up in the level of complexity of what is manufactured on the ground. This goes through higher investment in infrastructure supporting the domestic production tool as achieved by emerging and developing economies in Asia which invested a total amount representing 38.1% of their annual GDP on average since 2000. This ratio compares to 20.9% for Sub-Saharan Africa, pretty much in line with that of G7 economies at 21.3%, a rather poor achievement for the former region as developed economies already enjoy a solid infrastructure network.

Investment to GDP



Achieving these results takes time and is the fruit of years of continued efforts towards business-oriented reforms. For this reason, we constantly monitor the commitment to reform and capital spending in each African countries we have been covering for more than a decade now. Over that period, Egypt, Morocco and Kenya are those that have been progressing the most in terms of macro policy reforms and infrastructure access rate. They are best positioned to achieve multiple years of high GDP growth and have, despite execution risks and a volatile global environment, the highest chances of delivering on the promises embedded in Africa's potential.

Investment Case Marsa Maroc



WEIGHTING IN BB AFRICAN OPPORTUNITIES

2.1%

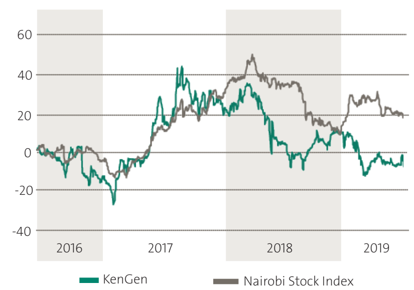
as of 08/30/2019

In July 2016, almost 10 years after it initiated its ports reforms, the Moroccan state decided to sell part of the wholly owned port operator, SODEP-Marsa Maroc, to private investors for a total amount of MAD 1.9 bn (USD 194 mn). This operation was completed via the disposal and listing of 40% of the public company on the Moroccan Stock exchange, allowing the group's employees, general public and institutional investors to take part in one of the best success stories on the local market. We participated in this IPO and remained shareholders of the name ever since.

Marsa Maroc holds the concessions to operate and develop commercial terminals in 9 of Morocco's ports, of which 4 are the county's most important in terms of traffic. It is thus at the heart of the Kingdom's strategy to become a major trading hub in Africa, a platform linking Europe to the whole continent and also competitive enough to capture a share of the cargoes traffic in the Mediterranean basin. As a result, the company is intrinsically related to Morocco's trading patterns and growing ambitions in integrating the global supply chain. This case encompasses most of the characteristics we look for in our reform-driven approach when investing in Africa.

Three years after its IPO, Marsa Maroc managed to grow its revenue, EBITDA and net profit by 27%, 24% and 48% respectively, a performance confirming its strong investment case and reflected in the stock's total return of 217% in USD since its listing (as of August 30, 2019). Earlier this year, Marsa Maroc created a JV with Germany's Eurogate to operate Morocco's biggest trans-shipment terminal. The new installation is expected to be commissioned in 2020, after an investment of MAD 2.0 bn (USD 200 mn), and is likely to compete against other major ports of Southern Europe for the trans-shipment traffic. This move strengthens the group's profile as a major player on the international scene, able, in the future, to challenge other worldwide players for new port concessions across the continent.

Investment Case KenGen



Kenya Electricity Generating Company Ltd was incorporated in 1954 as a private company and converted into a public company under its current name (trademark "KenGen") after the late 90s reform of the power sector. Controlling 70% of Kenya's electricity generation assets, it plays an anchor role in the country's energy strategy with a particular focus on geothermal technology - power production using the internal heat of the earth's crust – as it leverages its experience in this field dating back to the early 80s. Today, KenGen is in the top ten largest geothermal electricity producers worldwide, which, added to its hydro and wind installations means KenGen derives close to 90% of its power outputs from renewable sources.

The backing of the Kenyan government helped the group access funding from Development Finance Institutions such as Germany's Kredistanstalt für Wiederaufbau (KfW) or Japan's Overseas Economic Corporation Fund (JICA) to fund its capacity expansion programme at an attractive cost. It also tapped into capital markets, first in 2006 when Kenya sold 30% of the share capital to private investors via an IPO on the Nairobi Stock Exchange, then through Kenya's first corporate infrastructure bond in 2009.

We participated in KenGen's rights issue in 2016, carried out to beef up the group's balance sheet in order to fund the next phase of investments in geothermal installations along with the addition of wind farms. We exited the position a few years later due to the slowness in implementing the revenue diversification strategy discussed at the time of the right issue and on an unexpected change in dividend/taxation predictability that is key for such long-term investments. However, the instrumental role it has in lowering domestic electricity costs and improving power reliability keep us monitoring the name in case fundamentals justify a re-entry in the name at a better entry point.

BB African Opportunities – building block for optimizing the emerging markets portfolio

BB African Opportunities invests in liquid listed companies in the frontier markets of Africa. The portfolio management team prefers companies in the countries of North Africa and the sub-Saharan region that are benefiting from structural changes, economic reforms and infrastructure investments in particular. The Fund is characterized by its attractive risk/return profile.

Five good reasons

1
Africa – a largely untapped continent with attractive growth potential

2
Structural changes, reforms, natural resources, infrastructure investment – these are the primary growth drivers

3
Low correlation with other stock markets, especially those in other emerging markets

4
Highly familiar with local culture and customs – managed by emerging market experts who stem from the region

5
Experienced and competent with a good track record in Africa – the team boasts a competitive performance track record

Highly experienced portfolio manager with local roots

Our frontier market experts have many years of experience in the management of African equity strategies and are pioneers in this field. Personal familiarity with local culture, strong network with local companies, authorities and chambers of commerce, a long-standing track record as well as a comparatively risk-aware investment approach are characteristics of our new markets investment team.

Malek Bou-Diab
Lead Portfolio Manager

Andy Gboka
Portfolio Manager

Jean-Pierre Gerber
Portfolio Manager

Fund facts

BB AFRICAN OPPORTUNITIES (B-EUR)	
Investment Manager	Bellevue Asset Management
Legal structure	Luxembourg, UCITS V SICAV
Launch	June, 30 2009
Performance since Inc.	60.0% (as at 08/31/2019)
Volume as at 08/31/2019	EUR 70.1 mn
Management Fee	1.60%
ISIN	LU0433847240

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