# SUSTAINABILITY MATTERS

Sustainable Capital's founder and managing director Kevin Macdonald tells *Africa AM* how fundamental investment research and a sustainability overlay make the firm stand out, and why themed funds are gaining momentum

BY ANNA LYUDVIG

With around $60m under management, Mauritius-based asset manager Sustainable Capital specialises in the research and management of listed African (ex-South Africa) equities, with assets split between four funds: the Africa Alpha Fund, the Africa Sustainability Fund, the Nigeria Fund and the recently launched Africa Consumer Fund.

Founded in 2008, the firm has dedicated all of its resources to "detailed, in-situ, bottom up fundamental and sustainability research in Africa". Company analysis includes an in-depth assessment of the long-term sustainability risks and opportunities that are material to financial performance and shareholder value.

Sustainable Capital's investment process is designed on the basis that sustainability and long-term investment performance are "intrinsically linked and mutually inclusive", says Kevin Macdonald, Sustainable Capital's founder and managing director.

"Our research experience in Africa affirms the empirical evidence that points to a significant positive relationship between corporate sustainability, financial performance and shareholder returns," he says.

The main difference between frontier markets like Africa and more sophisticated markets is that to gain enough conviction to make an investment decision, the research team needs to spend a huge amount of time on the ground in the African countries checking the assets and verifying the information.

"We conduct more than 130 on the ground, in-country, company due diligences and site visits per year. Sustainable Capital has patiently built a team of investment professionals that have a combination of significant training and experience in both investment analysis and sustainability research," he says.

▲ Kevin Macdonald, managing director at Sustainable Capital

"We consider this to be a major competitive advantage and do not see much evidence of this type of detailed due diligence being conducted by the larger investment managers whose Africa portion is perhaps 1% of their total assets under management," he adds.

### Sustainable investing

As its name suggests, the firm believes that its key differentiator is that it applies sustainable investment research into its investment decision-making, enhancing long-term portfolio returns in the process.

"Unlike mainstream asset managers, who focus solely on financial information in the determination of fair value, at Sustainable Capital we believe that by combining rigorous fundamental investment research with detailed in-situ diligence on material sustainability factors, we can determine a more accurate estimate of a company's fair value," says MacDonald.

The firm assesses and prices these risks and opportunities, and then uses an overlay approach to incorporate this research into the rules-based funds and an integration approach within the valuation-led investment process. "In our view, the investment case for generating alpha through proprietary research by taking advantage of mispriced, material sustainability factors is stronger in Africa than in more developed countries," explains Macdonald.

"Our investment process has been designed on the underlying premise that international best practice in the sustainability field needs to be applied within an African context. This context brings its own unique challenges and opportunities that are difficult to address using a developed world framework," he adds.

### Specialised products

The asset manager only invests in Africa ex-South Africa listed equities, and believes that this region demands a dedicated approach. The rules-based investment process of the Africa Sustainability Fund (launched in 2009) allows for the investment team to leverage off the existing research process and create portfolio carve-outs to suit its investor needs. "Should investors require country, regional or themed funds, we are able to create investment opportunities for these clients without impacting on the research team capabilities," he says.

Themed funds offer sophisticated investors, who already have a knowledge and history of investing in Africa markets, access to specific investment drivers in an attempt to enhance their return profile. And the recently launched Africa Consumer Fund has proved there is a demand in the market. Macdonald says investor sentiment is "very much regionally driven with good sentiment from Scandinavia, UK, Switzerland and the US".

The fund is almost unique (its only direct competitor being the Arisaig Africa Consumer Fund) and Macdonald believes its research and application of country and company sustainability information in the portfolio construction process also sets it apart.

"This process has the effect of increasing the fund exposure to best managed consumer related companies within the best governed countries within Africa. The Sustainable Capital Africa Consumer Fund also gives investors exposure to only Africa ex-South Africa dominant stocks, avoiding any duplication in underlying investments to global funds," he says.

With 15 stocks in the portfolio, the fund currently has the largest overweight in Nigeria and Kenya. Macdonald believes that the consumer story is appealing at the moment because of the unique demographic profile of Africa in the context of global investment.

"The population distributions that we observe in the major investment markets of Nigeria, Kenya, Mauritius, Egypt and Morocco bear a striking resemblance to the US demographic profile of the 1960s. The young populations of these key listed equity markets in Africa leave them well positioned to benefit from demographic tailwinds in the form of real per capita GDP growth and longer-term from excess stock returns.

"Both Egypt and Morocco have already experienced an influx of potential new workers that are currently in the consumption phase and would likely begin their savings in stocks within the next five to 10 years. Nigeria and Kenya both have steep demographic share curves and will see the entry of a new generation of workers within the next five to 10 years. Naturally, the challenge for these countries is to create sufficient employment to ensure that their boomers become productive workers that contribute to economic growth," he says.

Overall, the company's objectives remain to identify, price and take advantage of the chronic mispricing evident in African investment markets. Macdonald says: "We have chosen the strongest partners and strive for the greatest level of transparency in all of our business and investment activities. We understand the cost implications of investing in Africa's frontier and emerging markets and are dedicated to be industry leaders in lowering fund costs for investors."

"The team is incentivised through long-term equity participation in Sustainable Capital and is aligned with investors through co-investment in the funds. Through this alignment, Sustainable Capital has had no investment team turnover since inception which has a direct, and positive, impact on the quality of long-term investment decisions," he adds. ■

### LONG-ONLY AFRICAN EQUITY FUNDS

Source: Sustainable Capital

| | Africa Sustainability Fund | Africa Alpha Fund | Nigeria Fund | Africa Consumer Fund |
|---|---|---|---|---|
| Portfolio | 40 stocks | 15-30 stocks | 15 stocks | 15 stocks |
| Fund size ($m) | 19.6 | 17.8 | 11.2 | 8.0 |
| Target turnover | 20% | 20-50% | 20% | 20% |
| Strategy | Rules-based | Valuation-led | Rules-based | Rules-based |
| Return since inception | 2.2% | 42.3% | 58.3% | 18.3% |
| Inception date | November 2009 | February 2012 | May 2012 | March 2013 |