AFRICA ALPHA FUND

January 2015

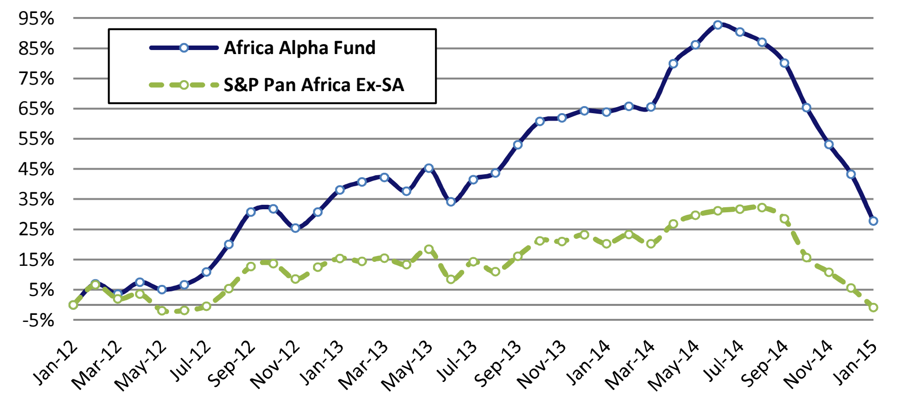
Fund Description

The Africa Alpha Fund invests in African listed equities (ex-South Africa). The fund aims to outperform the African markets using bottom-up research process with an emphasis on detailed, company-specific due diligence. Buy-sell discipline is led by valuation using a long-term investment time horizon. Stock selection is informed by fundamental research conducted in-situ in Africa.

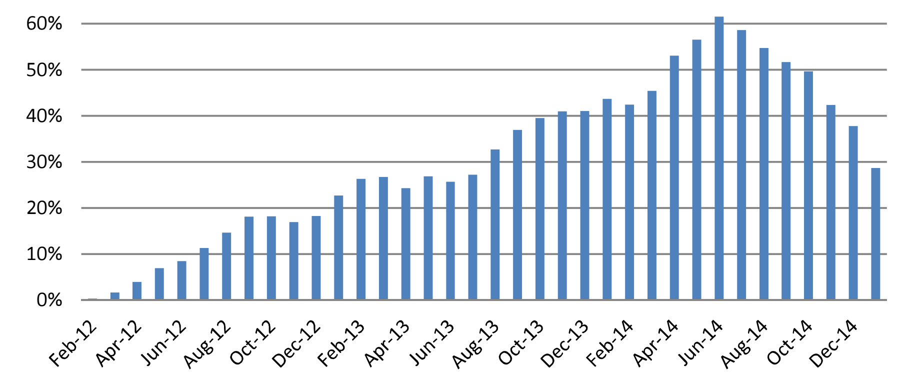
Fund Information

Launch date:	1 Febraury 2012
Fund AUM:	USD 85.1m
Firm AUM:	USD 133.4m
Structure:	Open-ended, Expert Fund
Domicile:	Mauritius
Regulator:	FSC Mauritius
Fund Manager:	Sustainable Capital Ltd
Administrator:	Apex Fund Services MU)
Global Custodian:	HSBC Bank Ltd (MU)
Auditor:	Ernst & Young
Dealing frequency:	Monthly
Bloomberg:	SUCAFAA MP Equity
ISIN:	MU0343S00014
GIIN:	KDIPCD.99999.SL.480
Reporting currency:	USD
Base Fee:	1.5%
Performance Fee:	20% above hurdle
Total Fee cap:	4.0%
Hurdle:	SPPAXSCN Index
High water mark:	Perpetual
Crystallisation:	Annual
Contact:	info@sustainablecapital.mu

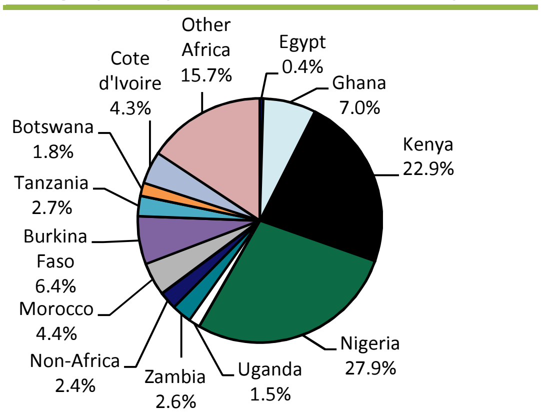
Fund Performance (USD, GIPS*, Since inception)



Cumulative Relative Performance (USD, GIPS*, Since Inception)



Geographic Spread (% Economic Footprint)



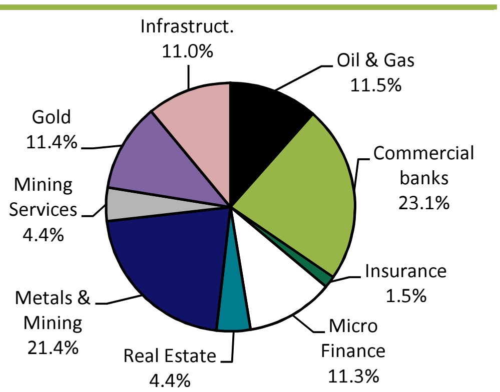
Monthly Performance (%, USD, GIPS*)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Calendar
2012		6.9	-3.1	3.7	-2.3	1.5	4.0	8.2	9.0	0.8	-4.8	4.2	30.7
2013	5.6	1.9	1.1	-3.2	5.5	-7.7	5.5	1.6	6.5	5.0	0.7	1.5	25.7
2014	-0.2	1.1	-0.1	8.6	3.5	3.5	-1.2	-1.8	-3.6	-8.2	-7.4	-6.4	-12.8
2015	-10.9												-10.9

Annualized Performance (%, USD, GIPS*)

	-1 yr	-3 yr	-5 yr	Since Inception
Africa Alpha	-22.1	8.5	n.a.	8.5
S&P Pan Africa Ex-SA	-17.6	-0.3	n.a.	-0.3
Relative Perf.	-4.5	8.8	n.a.	8.8

Sector Spread



Relative Risk and Return (USD, GIPS*, Since Inception)

Benchmark	S&P Pan Africa ex-SA Capped
Portfolio Beta	0.92
Correlation	0.70
Tracking Error	9.4%
Information Ratio	0.94
Relative Downside Std. Deviation	5.4%
Sortino Ratio	1.62
Stock Picking Alpha (% of total alpha)	71%

Fund Manager Comments

The Africa Alpha Fund closed the month down 10.9%, driven mainly by continued weakness in Nigerian listed equities, where we have been steadily building our positions in high-quality companies trading at distressed valuations over the past few months. The Nigerian market ended the month down 17.5% in USD terms, 2.7% of which was due to depreciation of the local currency. From the beginning of the last quarter of 2014 to the time of writing, the Nigerian Naira has lost 19.2% relative to the USD and we expect a measure of further weakness in the short-term. In view of the continued weakness in the Nigerian Naira, we have provided some commentary on our exposure to Nigerian equities, which is concentrated in blue-chip commercial banks.

From a stock selection perspective, our response to the risk of domestic currency devaluation is to place a strong emphasis on companies that are local currency hedges. These companies have revenues and assets denominated in foreign currencies and therefore benefit from earnings tailwinds during periods of exchange rate weakness. Typically, local currency hedges are exporters such as industrial manufacturers or resource companies that sell their products offshore in foreign currencies (Seplat, the leading domestic oil and gas operator in Nigeria, is such an example). However, Nigeria presents a special case: The country's leading commercial banks are partial currency hedges because significant portions of their assets and revenues are denominated in US dollars and other foreign currencies.

Let's consider Access Bank, which is currently the fund's largest holding, as an example. 45% of Access Bank's total loan book is denominated in foreign currency. For each 10% the Nigerian Naira weakens, this portion of Access Bank's assets naturally appreciates proportionately on the balance sheet in local currency terms (through a simple translation effect). Similarly, on the income statement, the predominantly USD-based capital and interest repayments on these loans translate into higher interest income in Naira terms. The obvious risk of providing unmatched foreign currency loans is that when the underlying borrower (earning local currency revenues) becomes unable to meet the scheduled loan repayments. This is why it is critical to assess the underlying asset quality of the loan book.

In the case of Access Bank, 75% of its foreign currency loans are directly matched to the foreign currency revenues of its underlying borrowers, which eliminates the currency risk aspect of the loan. Most of these loans are attributable to the upstream domestic oil and gas sector, which is in the lowest quartile on the global cost curve (for example, Seplat's cash cost of extracting oil is only $12/bbl). As a consequence, these loans are not under immediate stress at current oil prices. The remaining 25% of Access Bank's foreign currency book (the portion that is not matched to foreign currency revenues) is limited to the bank's highest-quality and best-capitalised customers (domestic companies such as Dangote and MTN, that have sufficiently strong balance sheets to withstand substantial currency weakness).

To put this in context, we provide a comparison to a South African blue-chip commercial bank, Standard Bank. Access Bank is currently growing its loan book at 33% and its earnings at 30% (year-on-year), yet it is trading on a price to earnings multiple of only 2.5 (you pay nearly 6 times as much for each dollar of earnings from Standard Bank, despite its inferior growth prospects). Access Bank's current return on equity is 19% and we expect this to normalise at closer to 23% longer-term (in comparison, Standard Bank's return on equity is 12.7%). Based on the company's fundamentals (return on equity, cost of equity and growth prospects), Access Bank should trade on a price to book ratio of 2.5, yet it is currently trading at 0.45, a 55% discount to its book value (in comparison, Standard Bank trades at a 73% premium to its book value, which is exactly what is justified by its fundamentals). On this basis, the expected return on this investment is 445%, which makes a potential 10-20% Naira depreciation seem inconsequential.

Opportunities to buy great companies at distressed valuation levels generally require extremely negative short-term investment sentiment surrounding particular countries, sectors and/or companies. Counter-intuitively, this means that the best investment opportunities in Africa often arise when countries face great uncertainty (post-revolution Egypt being a case in point). When we encounter 'perfect storm' socio-political and economic risk conditions, as is currently the case in Nigeria, it often helps to step away from the short-term noise and ask yourself whether the company you are investing in will be around 5-10 years from now and if so, whether it is likely to survive through a range of possible business cycles. There will certainly be winners and losers that emerge from the current cycle in Nigerian commercial banks and we believe that Access Bank will be amongst the blue-chip companies that will prosper as the operating environment normalises.

In the context of the Africa Alpha Fund, we define risk as the probability of permanent capital losses. For investors who are taking an appropriate time horizon, short-term volatility does not amount to risk. Investors in the Africa Alpha Fund effectively hold a share in 20 high-quality, Africa-dominant companies that - despite compelling fundamentals and great long-term growth prospects - are trading at valuation levels that are close to their all-time lows. History has taught us that investors have made above-normal returns in subsequent years from similar levels in the past.