Value Investor INSIGHT
The Leading Authority on Value Investing
April 30, 2017

Investor Insight: Lawrence Speidell

Frontier Market Asset Management's Larry Speidell and Andrea Clark describe why their target markets are a "paradise" for stock pickers, why their research priorities may differ from other investors, some unusual site visits they've made, and why they see opportunity in companies such as Jordan's Al-Eqbal, Bangladesh's BRAC Bank and Kenya's Centum.

You've built a successful business investing where many fear to tread. Describe your going-in rationale.

Lawrence Speidell: Opportunities for investors generally occur when there is an arbitrage opportunity between perception and reality. If you consider the conventional wisdom about frontier markets, it's generally that they are dreary and uninteresting. But if you go to these countries you find wonderful people, dynamic economies and exciting companies with good management. These markets are a relative paradise for stock pickers because there aren't financial analysts everywhere. You can actually practice active management and expect to earn rewards for doing so.

Start off by defining your opportunity set.

LS: Over the past 10 to 15 years a number of indexes have been created for frontier markets, initially by the World Bank's International Finance Corporation and then by Standard & Poor's, MSCI and Russell. They basically include most of the countries that have stock markets that aren't otherwise in either developed-market or emerging-market indexes. Of those we'll invest in around 30 different markets.

We focus primarily on businesses offering quality products and services that benefit from rising consumer incomes. Globalization really took off with the fall of the Iron Curtain and the Bamboo Curtain and people – 1.2 billion of them in frontier markets – are increasingly aware of what we in the U.S. and elsewhere take for granted, and they want it. We've seen companies in emerging markets flourish in catering to those consumer demands, and we're looking for businesses that can do the same in frontier markets.

What sectors provide the most fertile ground for ideas?

LS: Our primary focus is on consumer staples, consumer durables and financial services. Providing a representative example of each, we own a glass-container company in Nigeria called Beta Glass, an assembler and distributor of cars in Pakistan, Pak Suzuki, and a retail bank in Georgia, TBC Bank.

ON THE OPPORTUNITY:

We focus primarily on businesses offering products and services that benefit from rising consumer incomes.

Our interest in consumer staples and durables is directly tied to rising incomes and standards of living. With respect to banks, most frontier markets have been systematically underbanked. In these countries banks historically just took deposits, paid nothing for them, and offered practically no services to consumers. Driven in large part by smartphone technology, the situation is changing rapidly as more services are now accessible to more people. That's creating a dynamism that we think makes the banking sector – which makes up about 40% of the universe of stocks traded in the frontier – an extremely attractive area for selective analysis and investment.

Why did something like TBC Bank meet your standards?

Andrea Clark: We visited Georgia in mid-2014 soon after TBC had gone public and we wanted to meet with management. The bank has a strong presence in retail and small-business banking, areas we find especially interesting. The stock is listed in London, so it's fairly liquid, and we found the financial reporting to a high standard. At the country level, we saw the underbanking Larry talked about on the consumer side, and a relatively stable political environment. Finally, the stock traded at an attractive valuation – we first bought in at around 7x earnings. As we have gotten to know the company, we appreciate how well it has navigated a difficult economic environment, including a currency devaluation, without a material increase in its non-performing loans. They also have made a couple of well-timed acquisitions that look to have been integrated quite well.

LS: In all of our work, the non-financial data are equally or more important than the financial data. If we don't believe the business and management are of sufficient quality, we're not going to invest no matter how cheap the stock. That's why we think there's no substitute for direct contact with management, field research and hands-on confirmation of the key elements of our thesis. There's really no standard form of analysis in these markets.

We see a selection of locally traded subsidiaries of global multinationals – like Pak Suzuki or British American Tobacco Bangladesh – in your portfolio. Does that tend to help on the qualitative assessment?

LS: Governance is one of the prime areas we must gain comfort with, and while there's no guarantee, we can generally presume good oversight when the parent is a global multinational.

AC: There's also a level of business expertise and brand and marketing support in these companies that can be very beneficial. I had dinner not long ago in Nigeria with a senior manufacturing executive for Unilever who had been brought in to improve the manufacturing efficiency of the company's local subsidiary. That's not to say there aren't extremely well-run businesses to invest in that don't have big parent companies, but the ability to tap global expertise can be a valuable resource.

How do you source ideas?

LS: Today there are more brokers and analysts following stocks in frontier markets than when we started. While that's somewhat helpful in sourcing ideas, our inclination is more toward smaller companies that have little or no analyst coverage and that aren't being touted by brokers who often tend to sing the same song.

One of the best resources for us is simply to prepare with a few keystrokes on Bloomberg what we call comp sheets on individual markets, basically listing companies by market cap, profitability and P/E ratio. When we're on the ground in the country we'll start asking questions about the stocks with the attractive relative valuations and potential for profit expansion. If we're asking enough good questions of the right people, we'll generally be able to surface ideas worth looking into further.

Is financial information readily available?

LS: I think people misunderstand the contrast between frontier markets and the rest of the world on this front. When we started out it was indeed hard at times to even get annual reports – companies often didn't think prospective investors deserved them. We'd have to enlist local brokers to drum up hard copies and scan them into PDFs for us. But that's completely changed, as data is far more robust and available across the frontier world. Approximately 90% of the firms we research are audited by Big 4 accounting firms.

ON RESEARCH:

The challenge is putting financial data in the right context – being on the ground is really indispensable.

The real challenge isn't finding decent financial data – it's putting it in the right context and understanding what's behind it. That's why being on the ground and visiting companies is really indispensable.

Picking out one colorful holding, how did crocodile-farmer Padenga Holdings get on your radar screen?

LS: We had invested in Zimbabwe in the period after the dollarization of its economy, expecting that to lead to a revival of economic activity in the country. During that time we got to know Innscor Group, a holding company that had acquired Padenga during the hyperinflation in Zimbabwe. It was particularly valuable because it was a hard-currency earner, selling crocodile meat in a variety of international markets and, more importantly, selling crocodile skins to big clients like Hermes, which sells crocodile bags for as much as $20,000 each. When Innscor spun off Padenga in 2010 it wasn't a popular item to many Innscor shareholders, so we ended up buying on the spinoff and ultimately added to our position to make it a significant holding.

Any good site-visit stories to share here?

LS: We've met with top management in Harare and we consider them the equal of the best managers of the best companies from around the world. We also last year visited one of the crocodile farms in the bush and were particularly struck by the commitment of the staff there to the animals, which can mature at 15 feet long and weighing 1,000 pounds. The crocodiles are coddled like you wouldn't believe and eat only the best food designed scientifically to produce the highest-quality skins and meat. As was the case here, these types of visits can add considerably to our knowledge and conviction on a company.

How about another research tale or two from what are certainly more exotic locales than what most value investors typically encounter?

LS: One that stands out for me was my first meeting with the chief executive of Al-Eqbal [Jordan: EICO], which is based in Jordan and is a leading global supplier of flavored shisha tobacco, which is very popular in the Middle East and becoming more so elsewhere as hookah bars and other similar venues proliferate around the world.

The meeting felt right out of *The Arabian Nights*, with the CEO seated at an elevated desk, chain smoking long thin cigarettes and engulfed in a circle of smoke. I was sitting in front of him on a low hassock and there was a large, muscular gentlemen standing to his left who gave the impression that if I asked the wrong question I might never have left the room. It certainly stirred the imagination.

AC: One visit that made a real impression on me was a meeting I had with the largest, self-contained vintner in Montenegro, which is a beautiful place by the way. The company was partly state-owned, which is usually a red flag, and I had been warned that it maybe wasn't so focused on profits, let alone shareholders. I'm speaking with a top manager and asked her about why profit margins are so low and she says through a translator something to the effect that they didn't really pay attention to or care about margins, adding, "We're state-owned and have to employ a lot of people, most of whom are lazy." I had to applaud how upfront she was, but let's just say that's not the type of response we're looking for. While we thought there was a lot of low-hanging fruit, so to speak, we didn't think it was going to get picked anytime soon.

How do you think about valuation?

AC: We're primarily focused on P/Es, particularly in combination with earnings growth rates. We don't have strict rules because markets and companies are so unique, but something like Padenga trading at a forward P/E multiple of maybe 9x, with a prospective earnings growth rate of 15-20%, is a combination we would consider quite attractive.

We don't think the relative valuation levels in frontier markets are widely known. On trailing earnings, the P/E for the MSCI Frontier Markets Index is around 13.5x, while for the comparable emerging-markets index the P/E is around 15x and in the U.S. it's 22-24x. The weighted-average P/E on our portfolio is generally lower than the FM index.

We don't know when or the full extent to which the valuation gap narrows, but we very much believe such a wide discrepancy isn't warranted. If growth in these markets comes through, we have to believe that will ultimately be recognized in at least somewhat higher valuation levels.

You mentioned investing across 30 or so countries. How many positions do you typically hold at a time?

LS: While we pride ourselves on our company-specific research, we need to be sufficiently humble about the depth of our knowledge on each company we own. That's especially true when there are also so many externalities involved in frontier markets. Even if we have the specifics of a company addressed thoroughly, we're still exposed to a number of risks at the country level such as those around politics and regulation. As a result, we diversify the portfolio across 70 or so stocks, limit individual-country exposure to 15% and usually consider positions above 4% as a source of funds.

How do you handle currency risks?

AC: We don't hedge, which is often prohibitively expensive in many of the countries in which we invest. We do, however, on a company-by-company basis assess exposure to currency risks or opportunities and that gets built into our assessment of individual stocks.

LS: Over time, currency has been a drag of 2-3% per year on the portfolio. It's been a period, of course, in which the U.S. dollar has been generally strong. There's no guarantee the future will look exactly like the past.

Describe your investment case for Kenya's Centum Investment [Nairobi: ICDC].

LS: This started out as a partly government owned development entity that is now a prototypical holding company that acquires and develops businesses that it believes have excellent long-term potential and holds them in a diversified portfolio. You could consider it kind of the Berkshire Hathaway of Kenya, with a very smart entrepreneur, Chris Kirubi, controlling about 25% of the company.

Centum has a number of areas of em-

INVESTMENT SNAPSHOT

Centum Investment
(Kenya: ICDC)

Business: Kenya-based holding company with investments across a variety of sectors, including real estate, power production, asset management and beverage distribution.

Share Information
(@4/27/17, Exchange Rate: $1 = KSH 102.95):

Price	**KSH 35.75**
52-Week Range	KSH 30.50 - KSH 51.00
Dividend Yield	2.8%
Market Cap	KSH 23.79 billion

Financials (TTM):

Revenue	KSH 24.16 billion
EBIT Margin	n/a
Net Profit Margin	44.7%

Valuation Metrics
(@4/27/17):

	ICDC	S&P 500
P/E (TTM)	3.0	24.2
Forward P/E (Est.)	n/a	18.4

ICDC PRICE HISTORY

THE BOTTOM LINE
With exceedingly capable management and a positive macroeconomic backdrop, Larry Speidell expects the diversified investment holding company to compound shareholder value for years to come. But its shares today trade for only 70% of a reported book value that he believes significantly understates the current value of the company's assets.

Sources: FactSet, company reports, other publicly available information phasis, but the business mix is fairly broad. It's developing an upscale shopping mall in Nairobi and a large residential, commercial and marina property in Uganda. (As an aside, the Nairobi mall will include a water park that will have dolphins, a first for Kenya.) It distributes Carlsberg beer in Kenya and runs the largest Coca-Cola bottler. It owns asset-management firms, banks and microfinance companies and also wants to become East Africa's leading independent power producer. The management team is very smart, has a great eye for value and knows how to do deals. They are a favored partner and always have an attractive pipeline of future projects in the works.

Are you bullish on Kenya in general?

LS: Kenya is very appealing to us, with a strong entrepreneurial culture and more economic diversity than many countries in West Africa, or example, that rely heavily on oil. By and large, the political situation in the country has been improving and we're hoping the upcoming election – which will likely keep the ruling party in power – is as uneventful as we expect.

At a recent 35.75 Kenyan shillings, how inexpensive do you consider the shares?

AC: The stock currently trades at only 70% of book value. When we value the assets on a sum-of-the-parts basis, we arrive at a net asset value that is well in excess of even the current stated book value. So we believe we're buying assets at a significant discount to what we think they're currently worth, and we think that asset value through smart stewardship can compound at a very healthy rate well into the future. We expect this to be something we can own for a long time.

Getting past your *Arabian Nights* meeting with Al-Eqbal, why are you bullish on its prospects?

AC: The company is the second-largest global supplier of shisha, which is a syrupy tobacco mix containing molasses and

INVESTMENT SNAPSHOT

Al-Eqbal
(Jordan: EICO)

Business: Production, sale and distribution of flavored shisha tobacco, primarily in Middle Eastern markets but expanding as well in Europe, Asia and the United States.

Share Information
(@4/27/17, Exchange Rate: $1 = JD 0.709):

Price	**JD 23.20**
52-Week Range	JD 20.00 - JD 26.25
Dividend Yield	5.7%
Market Cap	JD 696.0 million

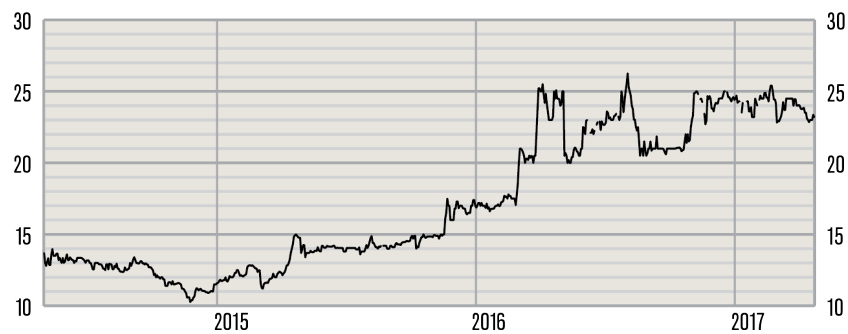
Financials (TTM):

Revenue	JD 142.7 million
EBIT Margin	28.8%
Net Profit Margin	26.2%

Valuation Metrics
(@4/27/17):

	EICO	S&P 500
P/E (TTM)	18.6	24.2
Forward P/E (Est.)	n/a	18.4

EICO PRICE HISTORY



THE BOTTOM LINE

Fueled by positive demographic trends, efficient manufacturing and well-developed distribution, Andrea Clark believes the company can generate annual earnings growth for some time of 15-20%. Adding in a healthy dividend yield, she says, "even if the multiple stays where it is, we'd be happy with keeping the earnings growth and the dividend."

Sources: FactSet, company reports, other publicly available information

other flavoring and is typically smoked in a hookah. The product is very popular throughout the Middle East and in many parts of Africa, but the company is also penetrating new markets, especially those with large Arab populations. They've even started selling into the West Coast of the United States.

LS: This is a case where we were looking at comp sheets for the market in Jordan and we see this stock trading at an attractive P/E with what seemed to be appealing financial characteristics. We then went through a local broker to set up that first meeting I told you about. Despite all the atmosphere at the meeting, it was clear early on that management had a clear vision for the company and that its shisha held a dominant position at the premier end of the market. Since then we've only gotten more comfortable that this company can provide us with a compounding long-term return.

AC: This is also a case where on-the-ground research was critical. We were already positive on the long-term opportunity in shisha, driven by good demographic trends in the Middle East. We saw how profitable the company was – its ROE is typically in the 40% range – and liked that it paid 90% of net income in dividends. But then we spent a day at the company's new factory in the Emirates tax-free zone and were extremely impressed by the state-of-the-art equipment, the efficiency of the operation and the quality of the people in charge. Seeing all that clearly gave us a higher comfort level that the business really was on as solid a footing as we thought.

What upside do you see from today's 23.20 Jordanian dinar share price?

AC: This is one where we find the P/E multiple relative to growth potential very attractive. Last year sales increased 16% and earnings increased 20%, but the stock currently trades at around 18x trailing-twelve-month earnings. We think annual earnings growth of 15-20% is a reasonable expectation and the dividend yield today is about 6%. Even if the multiple stays where it is, we'd be happy with keeping the earnings growth and the dividend.

Explain your thesis for Bangladeshi bank BRAC Bank [BRAC:BD].

AC: The bank is 47% owned by BRAC, which is based in Bangladesh and is one of the largest non-governmental development organizations in the world. BRAC Bank's traditional focus has been on financing small and medium-sized businesses in Bangladesh, but it has also developed the biggest retail-banking network in the country and has had a huge success in launching bKash, a mobile-payment platform that is bringing banking services to a large segment of the population – up to 70% of the total – that has never used banks before. When we spoke earlier about banks that are well positioned to grow as their countries develop and their services reach more people, this is a perfect example.

The company's financial metrics are very good. It has the best asset quality among competing banks. In 2016 total assets grew 17%, net earnings grew 74% and the return on equity was just over 19%. I mentioned the bKash division – it's operating earnings grew 63% and now account for just under 10% of the total. We think that's just getting started as the services offered through the platform expand. This year, for example, they're launching a new micro-loan program, offering $150 loans, say, with 18% annual interest rates.

How attractive do you consider Bangladesh as a market?

AC: It is one of the fastest-growing economies in our universe, with a large population (165 million), low labor costs and some political stability, finally, over the past two years. That stability has a clear positive effect on the economy, which we believe can generate fairly steady 6.5% to 7% GDP growth.

How are you valuing the shares, recently trading at 73.20 Bangladeshi taka?

AC: Bangladesh isn't a country like Nigeria, where you find banks trading at 4x earnings. But it also doesn't present the challenges you see in Nigeria, and in fact the country's economic prospects are quite bright.

BRAC Bank stock currently trades at 2.7x year-end 2016 book value and at a P/E of about 15x. Not putting too fine a point on it, we basically think that's a very reasonable valuation for a Bangladeshi company with the potential for strong earnings growth well into the future. Net profit from 2012 to 2016 grew at an annualized rate of 55%. Even if that moderates substantially, we believe there's plenty of upside in the stock.

As a frontier-markets pioneer, what would you say has surprised you the most about investing where you do?

INVESTMENT SNAPSHOT

BRAC Bank
(Bangladesh: BRAC)

Business: Leading commercial bank in Bangladesh focused on small and medium-sized companies; also owns and operates fast-growing bKash retail mobile-payments system.

Share Information
(@4/27/17, Exchange Rate: $1 = BDT 82.09):

Price	**BDT 73.20**
52-Week Range	BDT 41.10 - BDT 97.50
Dividend Yield	1.1%
Market Cap	BDT 62.15 billion

Financials (2016):

Total Assets	BDT 268.32 billion
Return on Assets	1.6%
Total Capital/Assets	12.1%

Valuation Metrics
(@4/27/17):

	BRAC	S&P 500
P/E (TTM)	16.1	24.2
Forward P/E (Est.)	16.0	18.4

BRAC PRICE HISTORY

THE BOTTOM LINE
Already strong in serving small and medium-sized businesses in Bangladesh, the company is also significantly expanding its retail products and services through its bKash mobile-payments platform, says Andrea Clark. She believes the 16x P/E at which the shares currently trade is "very reasonable" given the company's earnings-growth potential.

Sources: FactSet, company reports, other publicly available information

LS: I would say broadly that we've been overoptimistic over the past 10 years, about how quickly good government would span the world, how quickly frontier equity markets would develop, and how quickly investors would embrace the opportunity available. I think we were ten years too early and I hope we're not 100 years too early. I honestly don't believe that's the case, and I believe now is the perfect time to be looking at these markets.

AC: You're looking at countries that for the most part will benefit from small incremental change. When I was in Nigeria it felt like the lights went out at least hourly. Think about that and the impact on productivity and income levels if basic services, infrastructure and educational levels continue to improve at even modest rates. Unlike in more-developed markets, small incremental changes can have big impacts. That may be lost on many investors in today's world, but we hope and believe that will not always be the case. VII

Additional Disclaimer:

"This reprint is furnished for general information purposes in order to provide some insight into the investment management process and techniques that Frontier Market Asset Management, LLC ("Frontier Market") uses to make investment decisions. It is provided for illustrative purposes only. Opinions and information provided are as of the date indicated. This material is not intended to be a formal research report, and as such, it should not be construed as an offer or recommendation to buy or sell any security, nor should information contained herein be relied upon as investment advice. Opinions and information provided are as of the date indicated. The statistics in the article were obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed.

The MSCI Frontier Markets Index captures large and mid-cap representation across 30 Frontier Markets countries. The index is representative of the types of equity assets in which Frontier Market invests its clients' assets. Market indexes are unmanaged and do not reflect the deduction of fees and expenses. Investors cannot invest in an index and the performance of the index does not represent the performance of any specific investment.

This article contains commentary regarding securities that have been purchased by Frontier Market on behalf of our clients. Individual account holdings may vary, and the views expressed herein may change at any time subsequent to the date of this article. <u>It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities referenced in this article.</u> The price and value of any securities in this article will fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed and a loss of all of the original capital invested in any security discussed in this article may occur."