CORONATION

# AFRICA FRONTIERS STRATEGY

INSTITUTIONAL STRATEGY FACT SHEET AS AT 31 DECEMBER 2022

CORONATION TRUST IS EARNED™

## LONG TERM OBJECTIVE

The Coronation Africa Frontiers Strategy aims to maximise the long-term risk-adjusted returns available from investments on the continent through capital growth of the underlying stocks selected. It is a flexible portfolio primarily invested in listed African equities or stocks listed on developed and emerging market exchanges where a substantial part of their earnings are derived from the African continent. The Strategy may hold cash and interest bearing assets where appropriate.

## INVESTMENT APPROACH

Coronation is a long-term, valuation-driven investment house, focused on bottom-up stock picking. Our aim is to identify mispriced assets trading at discounts to their long-term business value (fair value) through extensive proprietary research. In calculating fair values, through our fundamental research, we focus on through-the-cycle normalised earnings and/or free cash flows using a long-term time horizon. The Portfolio is constructed on a clean-slate basis based on the relative risk-adjusted upside to fair value of each underlying security. The Portfolio is constructed with no reference to a benchmark. We do not equate risk with tracking error, or divergence from a benchmark, but rather with a permanent loss of capital.

## STRATEGY RETURNS GROSS OF FEES

| Period | Strategy | Benchmark | Active Return |
|---|---|---|---|
| Since Inception (cumulative) | 116.4% | 13.4% | 103.0% |
| Since Inception p.a. | 5.6% | 0.9% | 4.7% |
| Latest 10 years p.a. | 1.5% | 1.0% | 0.5% |
| Latest 5 years p.a. | (2.4)% | 1.4% | (3.8)% |
| Latest 1 year | (23.4)% | 1.7% | (25.1)% |
| Year to date | (23.4)% | 1.7% | (25.1)% |
| Month | 4.4% | 0.3% | 4.1% |

*For a side-by-side comparison of gross and net performance, please refer to http://www.coronation.com/us/strategy-performance*

## SECTOR EXPOSURE

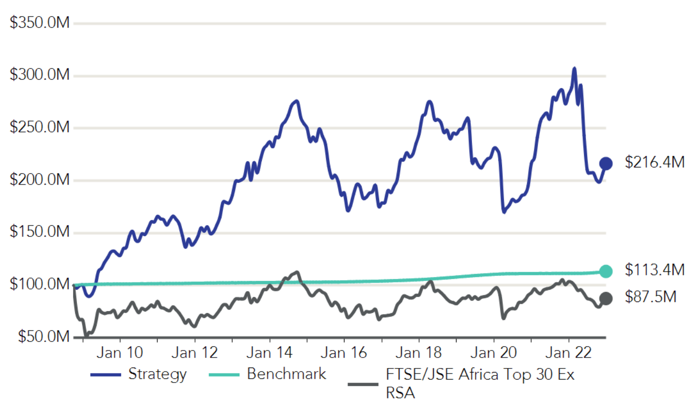
| Sector | % Strategy |
|---|---|
| Consumer Goods | 28.0% |
| Financials | 21.5% |
| Basic Materials | 18.1% |
| Telecommunications | 9.3% |
| Oil & Gas | 6.0% |
| Health Care | 5.0% |
| Industrials | 4.8% |
| Utilities | 3.5% |
| Consumer Services | 1.9% |
| Interest Bearing | 1.9% |

## GENERAL INFORMATION

| | |
|---|---|
| Inception Date | 01 October 2008 |
| Strategy Size * | $269.6 million |
| Strategy Status | Open |
| Target | Secured Overnight Financing Rate (SOFRINDX Index) + 3% per annum |
| Redemption Terms | An anti-dilution levy will be charged |
| Base Currency | USD |

*Strategy assets under management as at the most recent quarter end.

## GROWTH OF US$100M INVESTMENT




Benchmark: Secured Overnight Financing Rate (SOFRINDX Index) from 01 December 2021. Previously ICE LIBOR USD 3 Month (US0003M Index).

The performance shown is gross of fees.

## GEOGRAPHIC EXPOSURE

| Country | % Strategy |
|---|---|
| Egypt | 31.6% |
| Zimbabwe | 19.1% |
| Kenya | 13.9% |
| Nigeria | 12.3% |
| Canada | 4.9% |
| Uganda | 3.5% |
| Tanzania | 2.8% |
| Botswana | 2.3% |
| South Africa | 2.0% |
| Ghana | 1.9% |
| Morocco | 1.6% |
| Senegal | 1.1% |
| United Kingdom | 0.2% |
| Zambia | 0.2% |
| Namibia | 0.1% |
| Other | 0.6% |
| Interest Bearing | 1.9% |

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## PORTFOLIO MANAGERS

Peter Leger - BScEng, BCom (Hons), CFA

Peter is head of Global Frontier Markets and manager across all strategies within the investment unit. He joined Coronation in 2005 and has more than 24 years' experience in African financial markets as both a portfolio manager and research analyst.

Gregory Longe - BBusSc, CA (SA), CFA

Greg co-manages the Africa Frontiers Strategy and has over 9 years' investment experience across Frontier markets. He joined the Global Frontiers investment unit in 2013 as an investment analyst.

## FUND MANAGERS

Please contact Coronation for further information

Gus Robertson

International Client Service Fund Manager
tel: +27 21 680 2443
email: grobertson@coronation.com

Liesl Abrahams

International Client Service Fund Manager
tel: +27 21 680 2849
email: labrahams@coronation.com

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The volatility of the Benchmark represented in the growth chart above may be materially different from that of the Strategy. In addition, the holdings in the accounts comprising the Strategy may differ significantly from the securities that comprise the Benchmark. The Benchmark has not been selected to represent an appropriate benchmark to compare the Strategy's performance, but rather is disclosed to allow for comparison of the Strategy's performance to that of a well-known and widely recognized Benchmark.

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## REVIEW FOR THE QUARTER

### Strategy Performance

2022 was a tough year for financial markets globally. African markets were no different and the FTSE/JSE All Africa (ex-South Africa) 30 Index (JA30) was down -15.6% in US dollars during the year. This index return would be even worse had a more realisable exchange rate been used for Nigeria. The Strategy's return was -23.4% over the same period. The negative index returns for 2022 were driven by Kenya (-29.8%), Morocco (-29.0%), and Egypt (-22.5%). Ghana was one of the worst performing markets (-46.5%) after the currency lost 39% of its value. In contrast, Nigeria was positive, returning +10.4% at the official unrealisable exchange rate.

During the final quarter of the year (Q4-22) the Egyptian market was strong (+17.3%), while Nigeria (-0.8%), Kenya (-2.9%), and Morocco (-3.1%) declined. Against this backdrop the Strategy's return was +7.8% over the past three months, while the JA30 index returned +9.1%. Since inception more than a decade ago, the Strategy returned +5.6% p.a., while the index return over this period was negative: -0.9% p.a.

A key factor to consider when looking at the Strategy's performance relative to the index, is the fact that the index simply uses official exchange rates. This overstates the index return because investors cannot transact at the official rate in a market like Nigeria. When striking the NAV of the Strategy, we mark assets down to a value that would be realisable.

Nigeria: During the year the official exchange rate weakened by 8%. In contrast, we use the exchange rate implied by dual-listed shares to value the Nigerian assets in the portfolio. This exchange rate weakened by 34% over the past year. Phrased differently, we estimate that the index would have to take a performance hit of approximately -17% if the index were to value the Nigerian assets the same way we do in the Strategy. Simplistically, this means that the index would have been down more than 30% in 2022 if the index valued the Nigerian stocks the same as we do in the portfolio. We view this as a better like-for-like comparison.

Zimbabwe: During the year we increased the discount we apply to the in-country Zimbabwean stocks in the Strategy. If we valued the Zimbabwean assets in the portfolio using the official exchange rate, the value of the Strategy would have been approximately 12% higher.

Kenya: The official exchange rate weakened by 8% in 2022, but an investor looking to repatriate US dollars cannot get dollars at the official rate and would have to pay a premium. For this reason, we currently use an exchange rate that is approximately 5% weaker than the official rate when valuing the Kenyan assets in the Strategy.

The currencies of several African markets were under pressure in 2022. The Egyptian pound lost 37% of its value in 2022. The country did two devaluations during the year: The first devaluation of 14% was in Q1-22, while the second devaluation (of 21%) took place in Q4-22. While a big step in the right direction, the country did not embrace a fully floating currency and pressure on the currency persisted. In the last week of December, there was another coordinated effort to normalise forex markets with a 3% interest rate hike (bringing the total rate hikes for the year to 8%) and lifting of import controls. In the first week of January, we saw banks offering certificates of deposits yielding 25% and a further currency devaluation. The move in the currency impacted the performance of the Strategy during the year, but these actions resulted in a stabilisation in the parallel market and shares in Egypt now look very attractive, particularly for a US dollar investor.

### Contributors and detractors

Zimplats (a Zimbabwean platinum mine listed in Australia), was one of the largest contributors to performance for the third year in a row and added +1.3% to performance over the past year. In 2022, the stocks listed within Zimbabwe were the large detractors to the Strategy's performance. The Reserve Bank allowed the currency to move to a level that is closer to the economic reality, but this meant that the currency lost more than 80% of its value – moving from ZWL109/USD to ZWL671/USD over the course of the year. The discount we applied to the official exchange rate was also increased, which further weighed on performance. As and when the situation in Zimbabwe improves, we would expect to reduce the discount we apply to spot rates, which would positively impact returns. The Zimbabwean in-country assets detracted -16.0% from performance over the past year.

While the currency in Zimbabwe has been under pressure, the economy is in a much better position to where it was three years ago. Exports are at record levels, supported by record gold production and high commodity prices. Economic activity increased dramatically, with large infrastructure projects in progress. This includes significant additions to power generation capacity, multibillion dollar platinum and steel projects and upgrades to highways and the airport. There are ample US dollars in Zimbabwe and the economy has now largely dollarised. This allowed companies to start paying US dollar dividends to shareholders. The country allowed the official exchange rate to devalue considerably over the past few months and is now a closer reflection of the level where transactions take place in the economy. Therefore, a smaller liquidity discount is warranted on the Zimbabwean assets in the portfolio and a slightly smaller discount will be applied from January 2023.

The largest contributor to performance over the past quarter was Eastern Tobacco, which added 2.4% to performance after releasing very strong results in October and declaring a dividend equal to 15% of the market cap. Eastern Tobacco returned 22% in US dollar terms during the quarter as the share price move and dividend more than offset the currency weakness. However, a few Egyptian companies were the main detractors during the quarter, mainly because of the weakness in the currency over the past three months. These include Qatar National Bank Alahli (-0.9%), Macro Pharmaceuticals (-0.6%), and CIRA Education (-0.4%).

During the quarter, we bought El Sewedy (a major beneficiary of a weaker Egyptian currency), while we trimmed our Zimplats position slightly following the strong performance over the past year.

During 2022 we increased the Strategy's exposure to resource companies.

### Resource exposure in the Strategy

Over the past year, we have increased our exposure to commodity stocks from 17% to almost 25%. These resource businesses include base and precious metal miners and several energy companies.

*Poor economics*

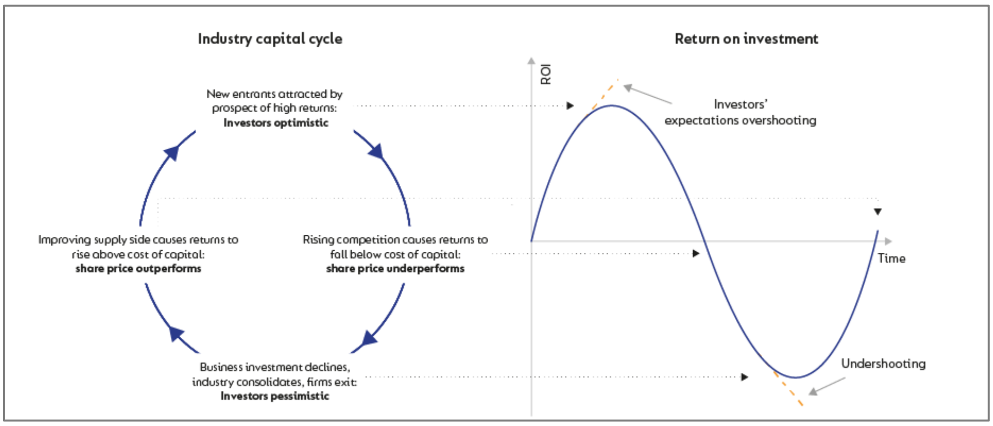
Commodity companies or resource businesses suffer from notoriously poor economics. We typically value commodity companies at a discount to the fair market multiple we would apply to the average business in an economy. These businesses are price takers, seldom controlling enough of global supply to influence end markets. Construction of a mine typically involves massive amounts of capital investment spread across several years, making them very capital intensive. Payback periods are often long. While it is true that some resources are easy to reach, oftentimes companies are attempting to extract minerals or oil from deep underground or under water. The engineering feats required to operate in these harshest of conditions are remarkable. Yet the risk of a disaster (oil spill, landslide, mine collapse) is ever present. In more recent years, community engagement and environmental considerations have rightly increased in importance for companies and governments. Speaking of governments, these cyclical businesses are often subject to more contractual risk than others as fiscal terms are regularly adjusted over time. Finally, as there is only a finite number of resources on earth, companies are continually looking to replenish their reserves. This is becoming harder and harder to do as many of the easier (geology or geography) deposits have already been discovered. Given the challenges, it makes sense to ask why bother investing in such businesses? The answer, as always, lies in valuation but, also in where we find ourselves in the cycle or, more specifically, the capital cycle.

*The capital cycle*

The capital cycle is not a new term, having been around for decades. However, in recent years it has been popularised by Marathon Asset Management and Edward Chancellor in the book Capital Returns: Investing through the Capital Cycle: A Money Manager's Reports 2002-2015. The book is a collection of investor letters from Marathon Asset Management, the London-based asset manager with more than 30 years investment experience in utilising a capital cycle investment approach. The capital cycle can be understood as analysing the flow of capital into and out of industries and how this impacts returns on investments. Instead of trying to predict demand, the capital cycle approach looks at changes in supply.

The diagram from the book shown below describes the various stages of the capital cycle and depicts how returns on investment change through the cycle. In essence, high returns attract capital to an industry which results (in the absence of meaningful barriers to entry) in an increase in capacity and supply. Over time, the increase in supply puts pressure on prices and thus returns. When returns fall below the cost of capital, capital exits, capacity is reduced and supply falls. The decline in supply increases prices and returns recover, starting the cycle off once again. It is this cycle that sparked the old commodity adage that the best cure for high prices is high prices. Understanding where an industry finds itself in the capital cycle is a useful tool in assessing that industry's investment prospects.

Figure 1: The Capital Cycle

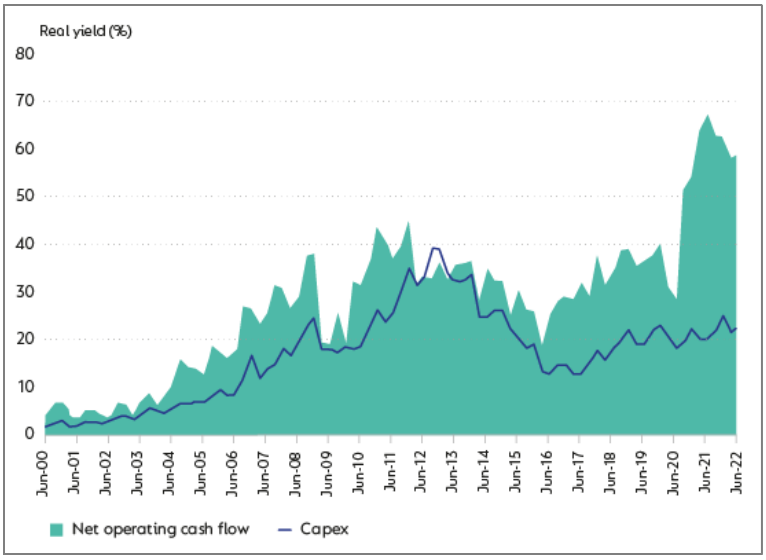



*Source: Edward Chancellor, Capital Returns: Investing through the Capital Cycle: A Money Manager's Reports 2002-2015*

*Where we are today*

The commodity industry is an extensive one, covering a multitude of hard and soft products. A deep dive into each of them is far beyond the scope of this commentary. However, there is a broad trend impacting the general space. Simplistically, it's getting harder, costing more, and taking longer to bring new mines online. Companies are moving into more challenging geology and geographies as they look for new resources to extract. Obtaining environmental and regulatory approval to build new mines is taking longer to receive, if approval is received at all. Financing for certain carbon intensive commodities is becoming more difficult to source and more expensive once sourced. These factors have increased the capital cost of bringing new supply into the market which has resulted in less projects being approved, and less capacity being added. Shareholder demands, coupled with painful lessons learnt in the past cycle, have also contributed to management teams changing their capital allocation priorities. Buybacks rather than capex spending have become far more common. The Bernstein chart below shows how capex for the mining industry (and by implication capacity) has not increased meaningfully over the past five years, despite the industry having enjoyed significantly higher levels of cash flow.

Figure 2: Net Cash Flow in Excess of Capex – A 2016 lesson learned




*Source: Bloomberg, Company reports, Bernstein analysis and estimates*

Copper is a great example of this dynamic. According to Bernstein, from 1986 to 2016 mined supply increased from almost 9mt to just over 20mt. This is a +134% increase, or 2.9% p.a. CAGR over 30 years. From 2016 to 2021, copper-mined supply increased a mere 1mt, or +7%. This is a 1.4% p.a. CAGR, i.e. the annual growth rate in supply halved. The next decade is expected to be even worse for supply with Bernstein forecasting a decline in mined supply of -2.9% p.a. from 2021 to 2031. A reduction in supply should prove supportive for longer-term prices, assuming demand remains steady.

The bulk of the Strategy exposure is to platinum group metals (PGMs) and energy. These markets bear more attractive characteristics than the average commodity company and are worth touching on briefly.

*PGMs*

The medium-term outlook for PGMs prices is favourable. Demand should be robust as vehicle manufacturers will have to increase PGM loadings in vehicles to achieve emission targets. Supply is unlikely to grow much as companies are reluctant to make big capital investments in deep mines and, with Russia being a major producer of PGMs, there is the potential for supply disruptions given the geopolitical situation.

Zimplats is the largest position in the Coronation Africa Frontiers Strategy and the second largest position in the Coronation Global Frontiers Strategy. This is a world-class PGM mine, low on the cost curve with a 40-year life of mine. The mine is becoming a global leader in producing green ounces: the mine is shallow and mechanised, which means Zimplats has a very good safety record, and the company is investing in solar power and a SO2 abatement plant that will make Zimplats world class in terms of emission standards. In addition, the company is involved in numerous social projects.

The valuation really excites us. The company trades on a forward PE of just 4 times, has a double-digit dividend yield and has 20% of its market cap in cash. Within a few years, the earnings should be substantially higher as the company is in the process of expanding capacity by 30%.

*Oil*

Despite all the positive developments to move the world away from oil, the energy transition will be a gradual process and for the foreseeable future the world will still be heavily reliant on fossil fuels. It is very possible that we could see oil supply struggling to keep up with demand for oil over the coming years, which would be very supportive for oil prices. Since 2016, the total global capital expenditure on oil production and exploration has been only about half of what it was in the period between 2011 – 2014. One reason was the drop in the oil price in 2015, secondly the focus on the energy transition has meant that oil companies are allocating less to oil and more to the development of other forms of energy. The number of major oil discoveries have reduced sharply over the past 50 years and with the underinvestment in exploration, it is unlikely that this trend will reverse.

We believe Africa Oil is a unique company that provides exposure to oil and oil exploration at an extremely attractive valuation. Africa Oil owns a 6% stake in the Venus oil discovery offshore Namibia. With estimates ranging from 3bn to 10bn barrels, this is a globally significant discovery. Their partner (TotalEnergies) will drill appraisal wells in 2023 to fully assess the size of this discovery. This asset alone has the potential to be worth more than Africa Oil's whole market cap. What makes this even more attractive, is that investors essentially get this for free. At the current share price, you are only paying for the company's producing assets in Nigeria which should generate the company's whole market cap in cash over the next four years. In addition, the company has assets in Kenya and South Africa, offering further upside.

## Conclusion

After a tough year, valuations across Frontier Markets are compelling. The Strategy is filled with businesses where valuations are very attractive, with many positions in the portfolio trading on mid-single digit price earnings multiples and double-digit dividend yields. We believe our long-term valuation-driven approach is as relevant as ever and by owning these businesses, we believe investors will be rewarded. We wish you a prosperous 2023.