GRANT'S
INTEREST RATE OBSERVER®
Vol. 30, No. 2d Two Wall Street, New York, New York 10005 • www.grantspub.com JANUARY 27, 2012

Above its weight

Singing the song of Graham and Dodd, the portfolio managers of the Africa Opportunity Fund, Francis Daniels and Robert Knapp, had this message to their shareholders at the end of a more-than-respectable year: "We remain focused on investing, at historically low valuations, in companies with minimal debt that sell goods and services in short supply."

Now begins an admiring review of a tiny enterprise. Listed in London, the Africa Opportunity Fund (AOF) had, at year-end, 42.6 million shares outstanding, net assets of $39.7 million and a market capitalization of $31.3 million. In a not-great year for investing anywhere, NAV increased by 1.6%, including dividends. The share price fell by 10.4%. At Tuesday's closing price, the discount to year-end NAV stood at 19%.

Attendees at the fall 2010 *Grant's* Conference will remember Daniels mentioning Shoprite Holdings Ltd., the "largest, fastest-moving consumer goods retailer in Africa," as he put it (*Grant's*, Oct. 29, 2010). In 2011, Lusaka (Zambia)-listed Shoprite, his biggest position, was up by a cool 79%.

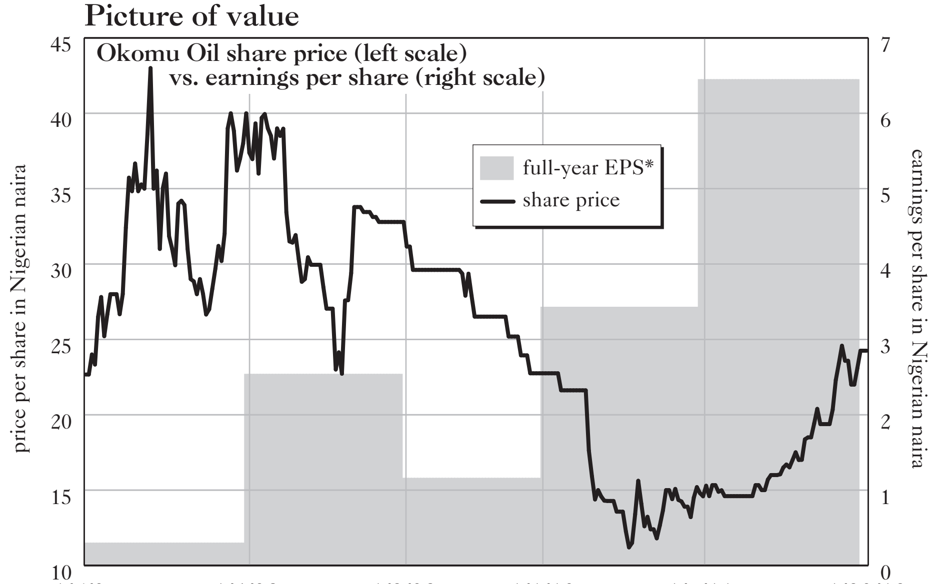
As for 2012, Daniels says he's bullish on Africa and bearish—he's a fully paid-up subscriber—on central banks and the People's Republic of China. "A big difference between value investing in a continental market like the United States and value investing among 53 countries is [that] I have to think a lot about currency," Daniels said, speaking on the phone from Johannesburg. "It's not just that there are 53 countries, it's that in a lot of countries the economies are very dependent on a few commodities. Or they're countries which have very little manufacturing and import a lot, and therefore a sharp devaluation of the currency has a dramatic impact on the cost of living."

Working both top-down and bottom-up, Daniels picks companies, countries, currencies and industries. He can go long or short, invest in debt or equity, buy listed and unlisted securities and enter into arbitrage operations.

As hard as it is to navigate the monetary and macroeconomic rocks and shoals, there are benefits to investing where others mainly choose not to commit, he went on: "If one asks, 'Is there a place on earth where the writ of the central bankers does not run or runs with faint ink?' the answer has to be 'yes, in many an African country.' If a country like Zimbabwe does not have its own currency and lacks a currency board like Hong Kong, there is no writ to ponder. If a country like Cote d'Ivoire, recovering from civil war, closes its banks for a few months, there is too little money for the monetary transmission mechanism to function in a classical manner. Furthermore, unlike east Asian economies, African countries tend to have modest foreign-exchange reserve levels, limiting the capacity of central banks to intervene against market forces."

In the absence of money printing, capital tends to be scarce, Daniels

Picture of value



*analyst estimate for 2011
source: The Bloomberg

pointed out; so much the better for people with capital. Asked for a favorite name, he mentioned Okomu Oil (OKOMUOIL on the Lagos Stock Exchange), a developer of palm-oil plantations and processor of palm oil, a commodity about which *Grant's* can't seem to stop writing (see the prior issue). On the one hand, Okomu is tiny and illiquid (a $71.9 million market cap with a 50.4% majority stake held by Indufina SA of Belgium). On the other hand, the stock is valued at 3.8 times earnings. "If you happen to look at its report," said Daniels, "you'll find that its net margins are close to 40%. In fact, I commented to some friends of mine that it has the kind of metrics that you'd associate more with an Apple."

"In sum," wrote Daniels in a follow-up e-mail message, "there are quite a few profitable companies valued as if they had reached U.S. levels of maturity, that [in fact] have several years of growth ahead of them. They have large market shares, high returns on assets and equity, little to no debt and trade at P/Es of 12 or less. I have to worry about currency collapses, the euro, elections, droughts and floods, but there is more than adequate compensation."

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