CITY OF LONDON
Investment Management Company Limited

Opportunity Abounds in Frontier Markets

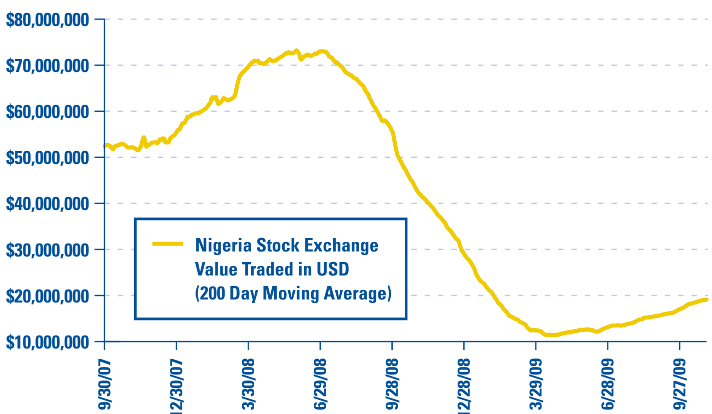
December 2009

The case for the asset class of frontier markets is one of growth, convergence, and timing. For these markets to converge with their more developed counterparts there will need to be considerable development in terms of infrastructure, trade, and modernization; which are the same qualities that attracted investors to the emerging markets a number of years ago. In terms of growth, Frontier markets exhibit some of the fastest rising GDP growth rates in the world. In light of the recent turmoil in world markets, and the subsequent lag in terms of performance of frontier markets relative to emerging and developed markets, present conditions offer an exceptional entry point into this currently overlooked asset class.

One of City of London's favored markets for its Frontier Emerging Markets Fund (Frontier Fund) at the moment, Nigeria, serves as an excellent case in point. The Frontier Fund has been gradually repositioning its country weightings in favor of sub-Saharan Africa over the course of the fourth quarter. These markets comprise just over 7% of the Frontier Fund's benchmark index, the S&P Extended Frontier 150 Index (Frontier 150 Index), while the Frontier Fund has approximately 20% in Africa. There are a number of reasons at present that make this region attractive which include improving political conditions, macroeconomic factors, and fundamental valuations. Nigeria at present exhibits all of these traits and offers very attractive prospects for an investor looking ahead to the next year.

Nigeria, the largest African component in the Frontier 150 Index, lost a third of its market value from the start of 2009 to the end of October. Over the previous two years Nigeria has been tarnished by scandal and mismanagement in its banking sector, disruption to its oil production by militants, and general risk aversion in light of the recent crisis in world markets. This has left both local and foreign investors somewhat shell-shocked. Liquidity fell noticeably due to a number of factors including forced redemptions and a stricter enforcement of margin calls following moves to clean up the banking sector. However, we are now seeing a rather gradual, orderly return of liquidity to the market for the first time in over a year (see figure 1).

Figure 1: Nigeria Stock Exchange Daily Volume*



**Daily volume of the 30 largest stocks traded on the Nigerian Stock Exchange, which comprise 82% of total market capitalization.*

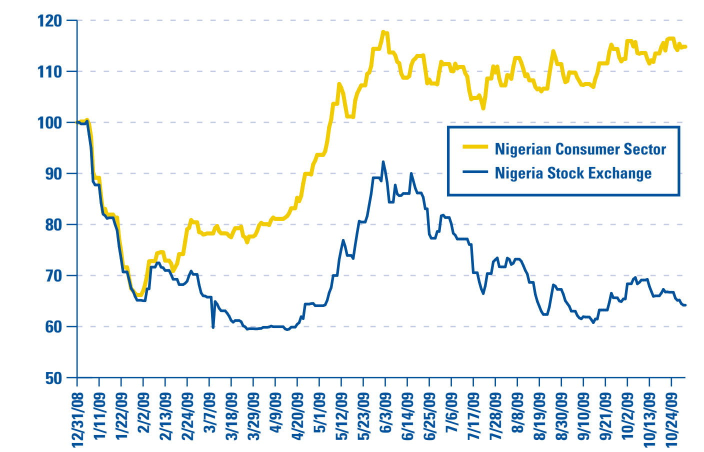
Source: Bloomberg, Nigerian Stock Exchange

The scandal in the Nigerian banking sector revolved around a number of banks participating in excessive margin lending and loans exposing them to speculation on the oil & gas sector. This resulted in unacceptably high non-performing loan ratios and left some of Nigeria's largest banks on the brink of failure. Ultimately, 10 bank CEOs were removed by the Central Bank Governor, Lamido Sanusi, who cited abuse of the credit process, money laundering and insider trading as reasons for their removal. These actions by Governor Sanusi have been viewed as a positive step in cleaning up the banking system, and he had the full backing of Nigerian President Umaru Yar'Adua. The Nigerian Central Bank (CBN) has been active in addressing these issues, and has already injected over US$2.7bn into the banking system. Further, the CBN has announced a proposal to create an asset management company (AMC) to manage the bad loans of the aforementioned banks with plans to boost money supply by buying roughly US$3bn of bonds that will need to be issued by an AMC using money from Nigeria's oil fund. Despite the initial negative impact on investor sentiment, we view these types of scandals as positive in the long term as this is how corruption is exposed and the necessary reforms are developed and implemented.

Also promising is the recent amnesty deal accepted by the various militant groups in Nigeria's oil rich Delta region that have been responsible for significant disruptions to oil production. The amnesty deal was accepted by all the militant groups in the region, unlike previous amnesty offers, due largely to promises of education and training for reintegration into society for those accepting reprieve. The government also announced a plan to allow the Delta region to own 10% of the national oil company as part of a long term solution to the region's problems. Oil production sank as low as 1.75m b/d in August compared to a high of 2.2m b/d two years ago. Even returning to 2m b/d would increase oil earnings by around 8% of GDP.

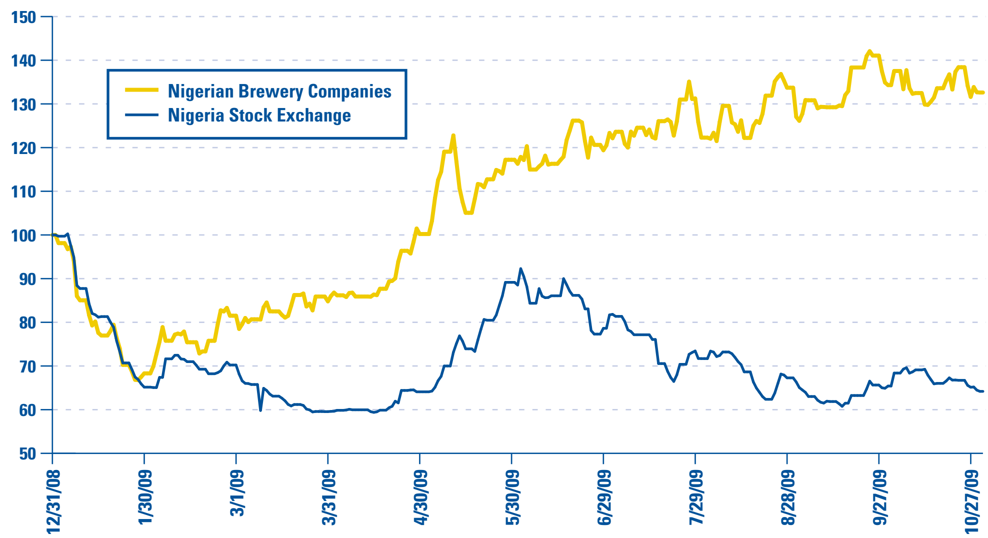
Nigeria, however, is more than just oil and banks. The consumer story is a very strong one, and when looking at the performance of the consumer sector of the Nigerian Stock Exchange versus the overall market, the strength of the consumer sector is evident in its 50% outperformance of the broad market (see figure 2). In particular Nigerian brewers have performed very well this year compared to the Nigerian Stock Exchange. Both Nigerian Breweries and Guinness Nigeria returned over 30% from the start of this year to the end of October versus an equal decline in the Nigerian Stock Exchange (see figure 3). Nigerian beer consumption, per capita, is only 10% of Western Europe's consumption, and yet Nigeria consumes more Guinness every year than the U.K.! Additionally, mobile phone penetration is only around 30% in Nigeria which, compared to roughly 100% in the developed world, allows for very high growth rates in a market with little competition and high barriers for new entrants.

Figure 2: Nigeria Consumer Sector vs. the Nigerian Stock Exchange



Source: Bloomberg, Nigerian Stock Exchange

Figure 3: Nigeria Brewery Companies vs. the Nigerian Stock Exchange



Source: Bloomberg, Nigerian Stock Exchange

When looking at Nigeria on paper, purely at its macroeconomic statistics and fundamental valuations, it furthers the case for investment. With single digit price to earnings valuations and a yield of nearly 6%, it's one of the cheapest markets in any asset class. GDP growth rates are among the highest in any classification of country, and thanks to its extensive oil reserves the country runs quite a sizeable current account surplus. (see figure 4)

Figure 4: Nigeria: Fundamental and Macroeconomic Statistics

	1 YR FWD P/E	12 MO TRAILING P/E	P/BV	DIV YLD
Nigeria (per S&P BMI Index)	7.15	9.95	1.29	5.89

GDP Growth (%), per IMF Actual & Forecast Data

Country	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
G7*	2.48	1.93	2.58	2.27	0.20	-3.97	1.10	2.17	2.30	2.22	2.14
MSCI EM Index*	5.85	5.41	6.29	6.12	4.19	-0.84	3.43	4.56	5.05	5.19	5.17
Frontier 150 Index*	7.21	6.52	6.96	7.36	5.16	-0.79	3.03	4.67	4.92	5.11	5.17
Nigeria	**10.59**	**5.39**	**6.21**	**6.97**	**5.98**	**2.91**	**4.99**	**5.22**	**5.93**	**6.23**	**6.33**

**Average of constituent countries*

Current Account Deficit/Surplus, per IMF Actual & Forecast Data

Country	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
G7*	0.4	0.0	-0.1	0.3	-0.3	-0.9	-0.6	-0.4	-0.4	-0.2	-0.1
MSCI EM Index*	1.2	1.3	1.9	1.5	-0.2	0.8	0.1	0.1	0.2	0.2	0.3
Frontier 150 Index*	0.1	0.5	1.0	-2.1	-2.8	-1.8	-1.0	-0.5	0.1	0.5	0.6
Nigeria	**5.8**	**6.5**	**26.5**	**18.8**	**20.4**	**6.9**	**13.8**	**14.3**	**14.8**	**14.6**	**14.5**

**Average of constituent countries*

Source: S&P BMI Index, International Monetary Fund

To summarize, we feel there is a significant opportunity at present for frontier markets in general, and for Nigeria in particular. Given Nigeria is a country of 150 million people, the profitability for the few multinational market participants across a variety of sub-sectors has been materially higher than almost anywhere else they operate because of the lack of competition. In a country where much of the retail experience takes place in traffic from roadside vendors, there is enormous potential for further development of the more formal, westernized retail experience. ◆

Jeff Gill, December 2009

CITY OF LONDON
Investment Management Company Limited

Contacts

Information/Queries
Megan Hartnett, Client Services, US Office
Phone: 610 380 5065
Fax: 610 380 2117
E-Mail: megan.hartnett@citlon.com

Article
Jeff Gill, US Office
Phone: 610 380 8980
Fax: 610 380 2116
E-Mail: jeff.gill@citlon.com

U.S. Office
The Barn, 1125 Airport Road
Coatesville, PA 19320
United States
Phone: 610 380 2110
Fax: 610 380 2116
E-Mail: info@citlon.com

London Office
77 Gracechurch Street
London EC3V 0AS
United Kingdom
Phone: 011 44 20 7711 0771
Fax: 011 44 20 7711 0772
E-Mail: info@citlon.co.uk

Singapore Office
20 Collyer Quay
10-04 Tung Centre
Singapore 049319
Phone: 011 65 6236 9136
Fax: 011 65 6532 3997

Dubai Office
Unit 2, 2nd Floor
The Gate Village Building 1
Dubai International Financial Centre
P.O. Box 506695, Dubai, United Arab Emirates
Phone: 011 971 4 423 1780
Fax: 011 971 4 437 0510

Website
www.citlon.com