

Botswana Pension Society Conference

**Investment ethics in a
concentrated and illiquid market:
the case of Botswana listed
equities**

February 2019



Key messages

- Sound and robust organisational ethics are key to protecting shareholder value
- This is particularly important in Botswana where the local equity market is concentrated (i.e., having limited investment options) requiring asset managers to actively engage with the management of investee companies
- It is fundamentally important that you have a competent and independent board.

Agenda

1. Ethics, Environmental / Social / Governance (ESG)
 - what does it mean, how is it applied, and why it matters
2. Botswana equity market
 - unique characteristics
3. Our investment strategy in Botswana
 - responsible investing of long term capital
4. Conclusion
 - where to from here?

Ethics



Ethics

... some definitions

- Ethics is a philosophical term originating from the Greek word “ethos” meaning **custom or character**
- Ethical behaviour is defined as behavior which is viewed **as “good” and “right” as opposed to “bad” or “wrong” in a given situation**
- CFA Institute Code of Ethics emphasizes **‘promoting the integrity and viability of global capital markets for the ultimate benefit of society’**

Ethics

... a system of rules that inform decision making

- Boards must have regard to **long-term stakeholder issues** when making decisions. And, they have a responsibility to **shape and oversee their company's culture**
- We believe companies with **a strong ethical culture** should be less vulnerable to shock and more likely to thrive in the long term

Boards historically focused uniquely on financial results

Ethical bombs in 2018...



Source: <https://learn.censible.co/risky-business-top-ten-corporate-crackdowns/>

Corporate Malfeasance

Estimated at USD 100 billion in 2017



J.P.Morgan



Source: <https://learn.censible.co/risky-business-top-ten-corporate-crackdowns/>

Worlds biggest banks

... have paid USD400 billion in fines since 2008



Environmental, social and governance (ESG)



The importance of ESG



- **ESG is an integral part of the investment analysis and decision making process** and not an addendum to our process
- This is the **responsibility of the investment teams** with the support by the ESG team
- We think a **positive and constructive dialogue between shareholders and the companies** is a good way to preserve value, create stability and inform our analysis over the long term

Environmental, social and governance (ESG)

... recent engagements focus on governance

- Seek to understand **corporate strategy, capital allocation and framework for achieving long-term growth**
- Companies approach to board **diversity**
- As long-term investors, **we aim to thoroughly understand the companies in which we invest**

Engagements in 2018

... focused mostly on financial services companies

- We are active investors and **we meet with companies and their leadership on a regular basis** to discuss a range of material ESG related matters
- **We take a materiality approach to engagement** and hence engage on issues which we believe may impact the bottom line in the long term
- **Governance is critical to all businesses** and hence forms a core part of this dialogue. Key issues include: lack of disclosure and rationales behind voting resolutions and board composition issues

Governance



Governance is a critical element of our ESG assessment

An effective system of governance reduces forecast risk



The Board of Governors



External Auditors



Investors

- A **diverse, independent and skilled board** is the material element of the system of governance
- Deep **interaction with board and management** leads to a detailed understanding of the company and culture
- Assessment of **culture and system of remuneration helps to identify dominance of a CEO**

Governance analysis

Critical to investment decision making and active ownership

- **Good governance secures confidence** in earnings and free cash flow projections
- **Poor governance requires a governance discount** to be applied to the valuation or an adjustment to future earnings
- Sound **governance principles are therefore very important** and align with competence and capacity

King III

Introduced September 1, 2009

From January 1, 2019 the BSE adopted the King III code of corporate governance. Thus, listed companies are required to comply with this framework.

Ethical values of responsibility, accountability, fairness and transparency

King III – focuses on governance

- **Good governance** – essentially about effective leadership
- **Sustainability** – the primary moral and economic imperative of the 21st century
- **Corporate citizenship** – companies should operate in a sustainable manner

Promote good governance and creation of value

The Objective of King IV

Introduced November 1, 2016

“The overarching objective of King IV is to make corporate governance more accessible and relevant to a wider range of organisations, and to be the catalyst for a shift from a compliance-based mindset to one that sees **corporate governance as a lever for value creation**”

A system for the creation of sustainable value

Governance: local challenges



Corporate Governance

Key considerations

- Related party transactions
- Key man risks
- Internal controls
- Minority interests
- Board composition
- Local vs foreign companies
- Relationship between the Group and local subsidiary
- Patterns of cross shareholding



Sound governance reduces value destruction risk

Creation of sustainable value requires sound governance



Better governance enables greater confidence in future earnings

Governance dynamics...

From Multinationals to owner-managers to key man risks

Board composition

Example: Retail

- Majority of board members are not independent
- Dominance of the Executive
- Quality and experience of board members suspect

Minority shareholders

Example: Banking

- Group recharges are contentious
- Majority shareholders paid first
- Minority shareholders in a weak position to reverse this approach

Executive team

Example: Property

- Key man risk evident with Executive Chairman
- Sizeable business done with related parties
- No clear succession planning

Engagement required to ensure alignment with minority investors

The Botswana equity market



Stock Market Indicators: December 2018

The local market is small (in many respects) and very illiquid

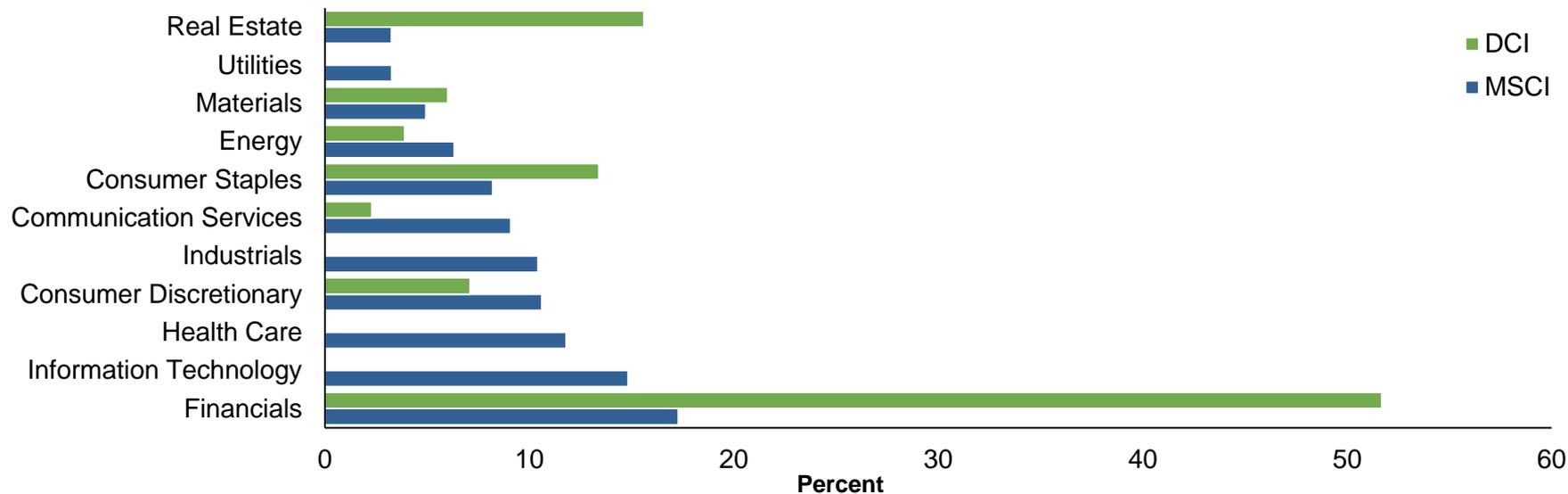
	Number of listed companies	Market capitalisation (USD, billions)	Market capitalisation (% of GDP)	Turnover ratio (%)
Botswana	26	4.2	27.1	1.5
Egypt	203	54.3	24.8	30.7
Kenya	65	23.1	30.3	14.9
Nigeria	163	36.4	10.9	5.9
South Africa	372	182.6	52.2	25.8
United Kingdom	2600	4600	175.4	116.1
United States	3671	32000	164.9	108.6

The local market is thus unique relative to peers

Sources: International Monetary Fund, World Bank and Investec Asset Management

The DCI vs MSCI

The local market is very distinct from global benchmarks



The composition of the DCI is very concentrated

Sources: Morgan Stanley Capital International, Botswana Stock Exchange and Investec Asset Management

DCI driven by 'a handful' of trades

The tyranny of numbers...

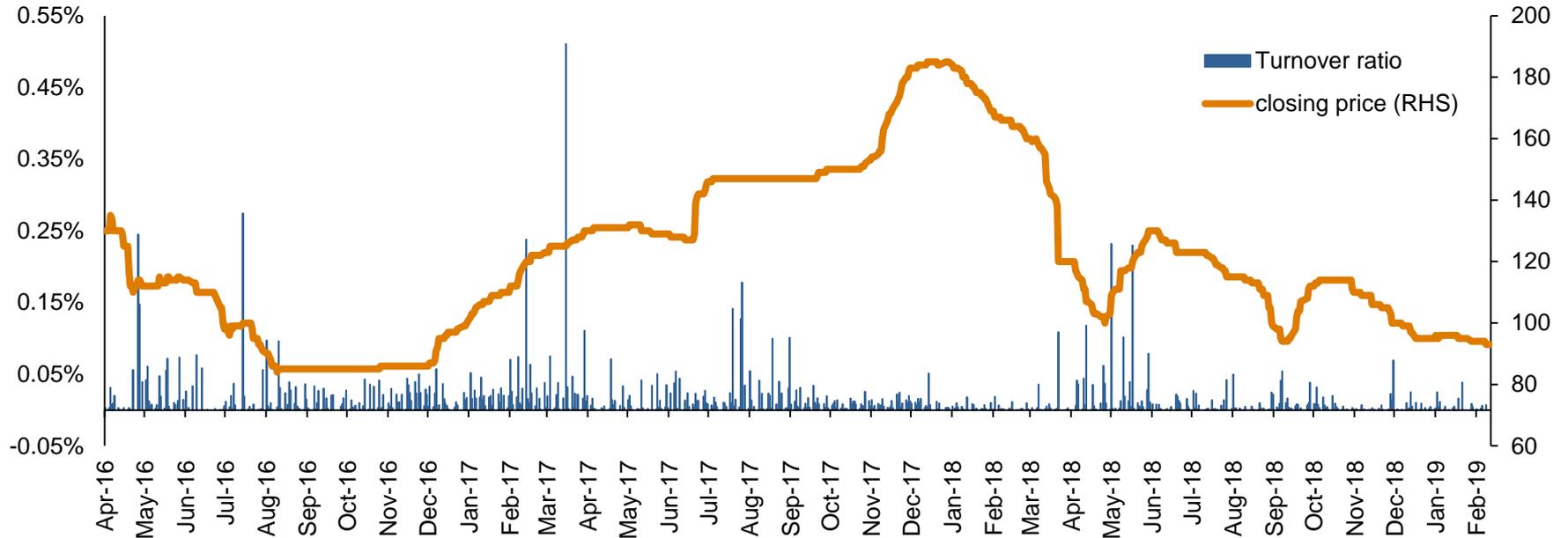


Thin volumes drive market pricing

Sources: Botswana Stock Exchange and Investec Asset Management

Botswana Telecommunications Company Limited

The most widely traded stock by retail investors

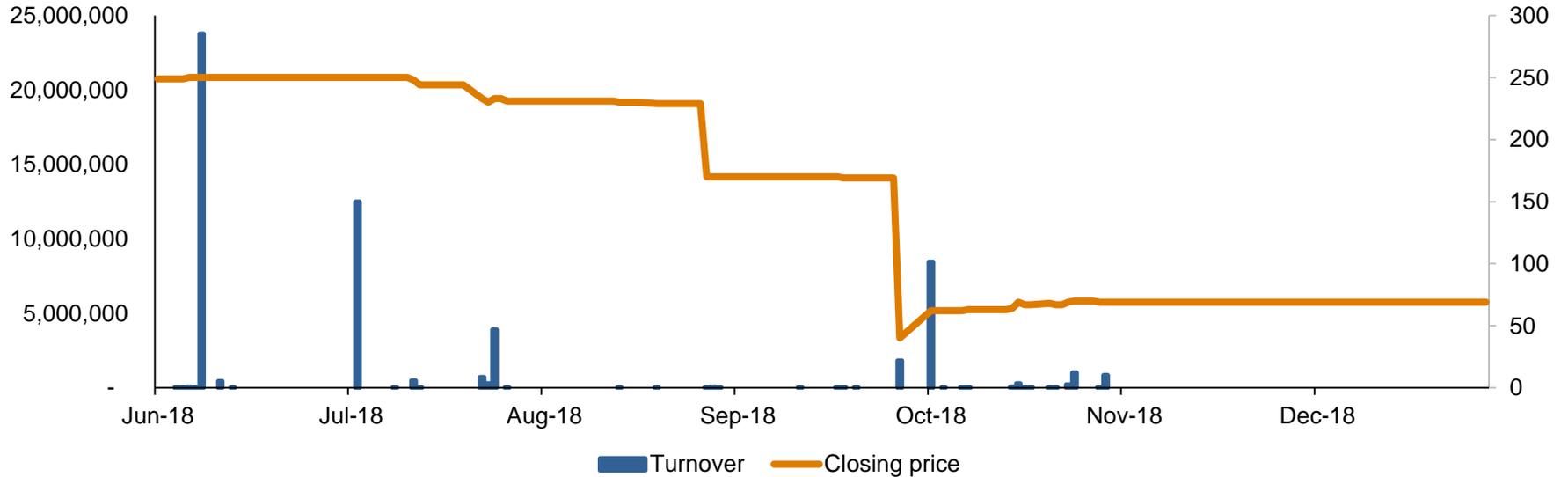


Price volatility not reflective of underlying fundamentals

Sources: Botswana Stock Exchange and Investec Asset Management

Choppies

When the tough gets going...



Price action reflects investor sentiment

Sources: Botswana Stock Exchange and Investec Asset Management

FAR Property Company

Buy and hold...

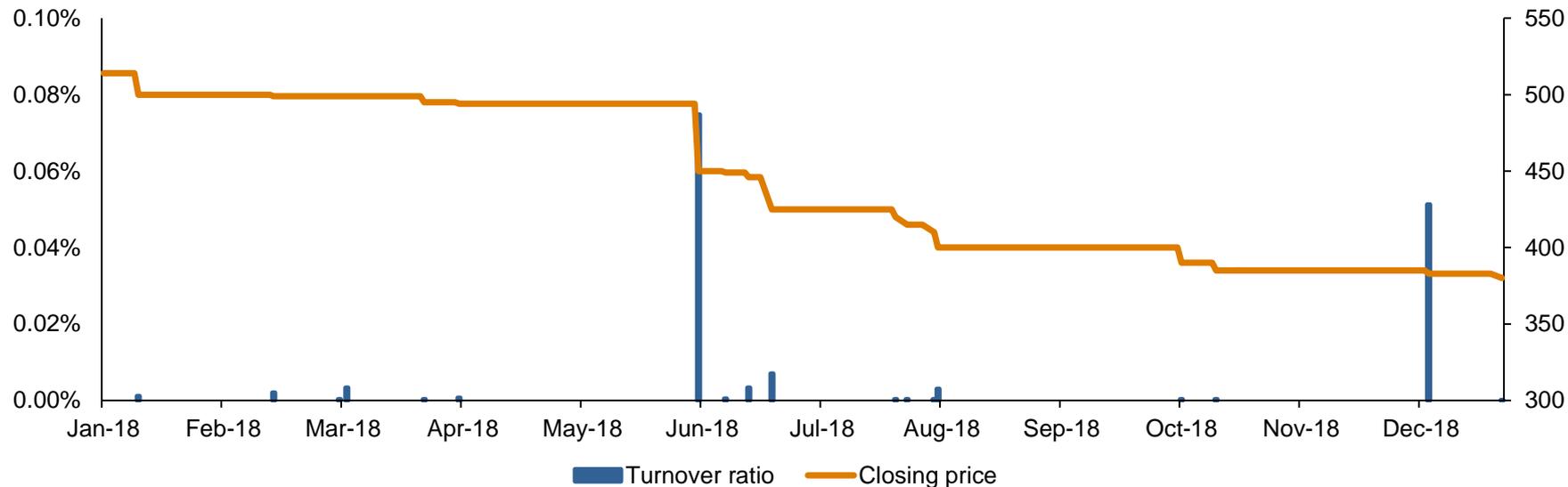


A classic trading strategy in an illiquid stock...

Sources: Botswana Stock Exchange and Investec Asset Management

Standard Chartered Bank

No walking out ...



Virtually no trading activity despite ongoing investor concerns

Sources: Botswana Stock Exchange and Investec Asset Management

Risks of 'thin' markets

... few buying or selling offers

Tiny size and low turnover

- Poor research coverage
- Incomplete information
- Frequent gaps between current prices and underlying company valuations

Relatively easy to manipulate share prices

- Transacting shares (with yourself) to create a false impression of trading activity
- Placing fake orders that artificially inflate the price
- Trading own account to set the closing price

Market Behaviour

- Insider trading
- Unlawful disclosure of non-public information
- High volatility and/or high bid-ask spreads

Botswana investment strategy



Our investment philosophy

We invest with a quasi-private equity mindset with a focus on quality and valuation

1. We are fastidious in applying rigorous **valuation and risk assessments**
2. We take a long-term view and look to build **productive relationships with management** in the execution of our investment strategy

Experienced, on-the-ground research is the only way to build a portfolio of attractively valued, quality businesses in Botswana

Domestic equity investment process

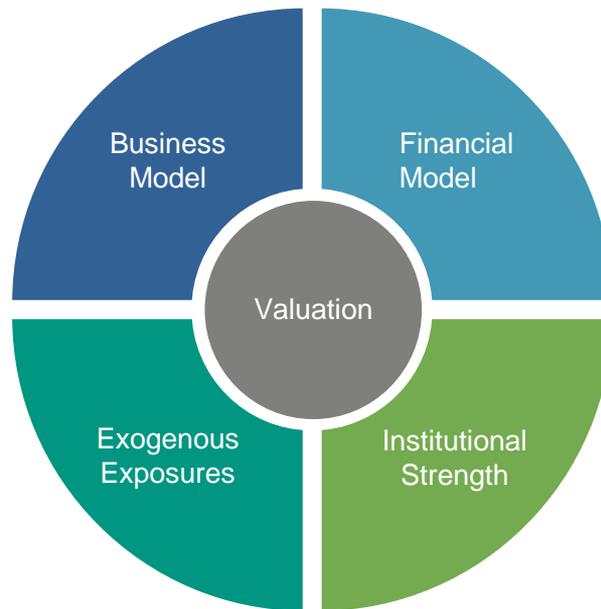
Fundamental research and analysis

Strategy and Product

- Distribution channel
- Brand equity
- Product differentiation
- Supply chain
- Operational complexity

External risk

- Rate of industry innovation
- Competitive landscape
- Regulatory environment
- Reliance on foreign markets



Financial Model

- Normalised return on invested capital > cost of capital
- Balance sheet strength
- Operational leverage
- Cashflow conversion

Management and Governance

- Shareholder alignment
- Effective Board of Directors
- Succession planning
- Management track record

Institutional strength a key pillar of our investment process

Compliance



Compliance

- Good governance is achieved by proper **risk and compliance management**
- Compliance shows **adherence to specific requirements in laws, regulations, contracts, strategies and policies**
- The risks that **governance and compliance** are designed to protect against are often **interdependent**



Conclusion

- Governance risks can materially impact value
- The Board's structure and composition should be carefully considered if it is to fulfil its role and live up to shareholders' expectations
- It is imperative to actively engage with companies to drive shareholder value

Thank you

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