# LGM Frontier Markets Strategy

LGM Investments

BMO Global Asset Management

March 2018

For Professional investors only

## Strategy details

| | |
|---|---|
| **Portfolio managers** | Thomas Vester, CFA<br>Dafydd Lewis, CFA |
| **Composite assets**[1] | US$ 1294.4m |

## About LGM Investments

LGM Investments is a specialist Asian, Global Emerging (GEM) and Frontier Markets equity manager. Our investment professionals are based in London and Hong Kong.

LGM Investments was established in Hong Kong in 1991 and became a wholly owned subsidiary of Bank of Montreal (BMO) in April 2011. It is part of BMO Global Asset Management.

## Investment philosophy

LGM Investments invests with a long-term perspective and applies a bottom-up, fundamental and active approach. Our investment philosophy is based on long-term analysis, quality investing and trust, together with a recognition that indices are historic and do not reflect future opportunities. Quality underpins all our investment thinking and results in non-index driven, high conviction portfolios with outperformance potential.

## Contact details

For more information about vehicles available in specific jurisdictions, please contact us.


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## Top ten holdings[2]

| Company Name | Country | % NAV |
|---|---|---|
| Eastern Tobacco | Egypt | 10.1 |
| Alicorp | Peru | 6.1 |
| Sonatel | Senegal | 5.0 |
| BBVA Banco Frances | Argentina | 4.9 |
| Guaranty Trust Bank | Nigeria | 4.6 |
| Vietnam Dairy Products | Vietnam | 4.4 |
| Famous Brands | South Africa | 4.3 |
| BGEO Group | Georgia | 4.3 |
| Tanzanian Breweries | Tanzania | 4.0 |
| Evertec | Puerto Rico | 4.0 |
| **Total** | | **51.8** |
| **No. of Holdings** | | **37** |

## Strategy characteristics[2*]

| | Strategy | Benchmark |
|---|---|---|
| ROIC (non financials) | 20.1% | 18.3% |
| ROE (financials) | 21.7% | 16.7% |
| Net debt / Equity (non financials) | 5.7% | 28.5% |
| Equity / Assets (financials) | 12.8% | 12.5% |
| Dividend Yield (FY2) | 2.9% | 3.5% |
| DPS growth[5] | 19.5% | 5.4% |
| P/E (trailing 12 months) | 22.5 | 18.7 |
| P/E (12 months forward) | 16.1 | 16.2 |
| Weighted avg daily vol (US$m)[6] | 3.6 | 11.6 |
| Trading under USD 0.25 m / day[7] | 11.2% | 8.7% |
| Turnover rate (12 months)[8] | 20.7% | N/A |

Data historic unless stated otherwise.

## Risk statistics[1]

| | Since Inception |
|---|---|
| Alpha (annual basis) | 9.7 |
| Annualised volatility (Strategy) | 11.0 |
| Annualised volatility (benchmark) | 11.3 |
| Sharpe ratio[4] | 1.5 |
| Tracking error (ex-post) | 7.5 |
| Information ratio | 0.9 |
| Up market capture ratio | 98.4 |
| Down market capture ratio | 40.8 |

Based on since inception monthly gross of fees composite returns against the benchmark (NDR) unless indicated otherwise.

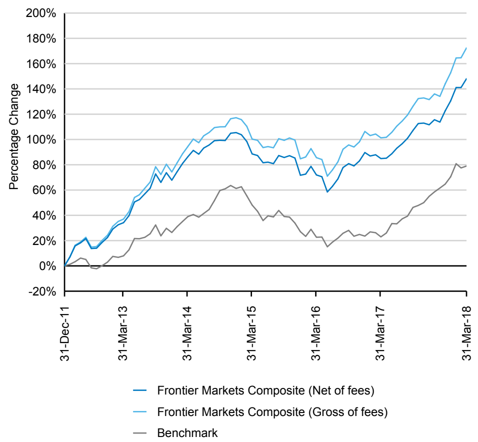
## Market cap (US$bn)[2]

| | Strategy | Benchmark |
|---|---|---|
| < 1 bn | 21.1% | 6.0% |
| 1-5 bn | 67.4% | 52.8% |
| > 5 bn | 11.5% | 41.1% |
| Weighted Average (US$bn) | 3.1 | 5.9 |

## Discrete performance as at 31.03.2018 (%)

| | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|
| **Strategy** | 24.60 | -7.54 | -6.67 | 16.50 | 26.14 |
| **Benchmark** | 17.98 | -4.11 | -12.06 | 12.49 | 30.45 |

## Performance since 1 January 2012[1]




## Performance as at 31 March 2018 (%)[1]

| | Gross* | Net* | Benchmark |
|---|---|---|---|
| YTD | 7.8 | 7.6 | 5.0 |
| Last month | 3.0 | 2.9 | 0.9 |
| **Annualised Performance** | | | |
| 1 year | 27.0 | 26.1 | 30.4 |
| 3 years | 12.1 | 11.1 | 8.9 |
| 5 years | 11.0 | 9.6 | 7.9 |
| Since 1 January 2012 | 17.4 | 15.6 | 9.8 |

*Gross/Net of fees.
Benchmark: 50% MSCI Frontier Markets & 50% Frontier Markets ex GCC (NDR)
Performance since 1 January 2012. Please see full GIPS compliant performance disclosure at the end of this document.

Performance data is in USD $ terms. Investors should be aware that past performance should not be considered a guide to future performance.
Discrete performance data is net of management fees.

## Risk warning

The value of investments and any income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested. Securities in emerging markets and frontier markets may involve a higher degree of risk. These markets are typically less liquid and may experience greater volatility in prices and currencies than more established markets. Investments in smaller companies carry a higher degree of risk as their shares may be less liquid and investment values can be volatile.

[1] Performance and risk statistics shown are supplemental to the Frontier Markets Composite. Please see full GIPS compliant performance disclosure at the end of this document. Please note that the strategy is currently soft closed (with effect from 23 October 2017).

[2] Supplemental performance information. The above strategy characteristics are for a representative account and shown for illustrative purposes only. Each account is managed individually. Accordingly, account characteristics may vary. Portfolio composition is subject to change.

[3] Totals may not be exact due to rounding. [4] Risk Free Rate: US T-Bill 3 Month.

[5] Based on dividends received during the latest full calendar year divided by the dividends received during the previous full calendar year.

[6] Calculated over 3 months.

[7] Based on 3 months daily average.

[8] Measured as the lesser of purchases or sales divided by the average strategy size for the rolling 12 months

*ROIC - Return on Invested Capital; ROE - Return on Equity; P/E - Price to Earnings



LGM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## Portfolio managers

Thomas Vester, CFA Chief Investment Officer and Portfolio Manager. Thomas joined LGM in September 2011. Prior to this, he was at BankInvest in Copenhagen for over 6 years, initially specialising in Latin America and then Eastern Europe and was the Portfolio Manager of the BankInvest Eastern European Fund. Thomas has also covered Asian equities and was seconded to BankInvest's Singapore office. From September 2007, he was responsible for the BankInvest Frontier Market mandates. He holds a MSc in Applied Economics and Finance from Copenhagen Business School and has a distinguished academic career including studying at Harvard Business School, London School of Economics, University of Southern California and National University of Singapore. Thomas is an Associate of the Brenthurst Foundation in South Africa. In 2014 Thomas was appointed CIO of LGM.

Dafydd Lewis, CFA, Portfolio Manager. Dafydd graduated with a BSc (Hons) in Economics from the University of Bath. He began his career in HSBC's emerging market equity strategy team in 2005 and relocated to Dubai at the beginning of 2007 to cover Middle Eastern equity markets. In 2008 he joined GAM's emerging market team in Dubai as an investment analyst with a primary focus on global frontier markets. Dafydd joined LGM in December 2011 as an Analyst focusing on Frontier Financials and in 2014 he became Portfolio Manager to support Thomas Vester.

## Investment Process

Within our universe, ideas are generated through a proprietary quality ranking tool, travels, interpretation of information available in annual reports, local industry studies and other sources. LGM's investment team then analyses these ideas in depth, considering the quality of the company at the outset and thereafter valuation.

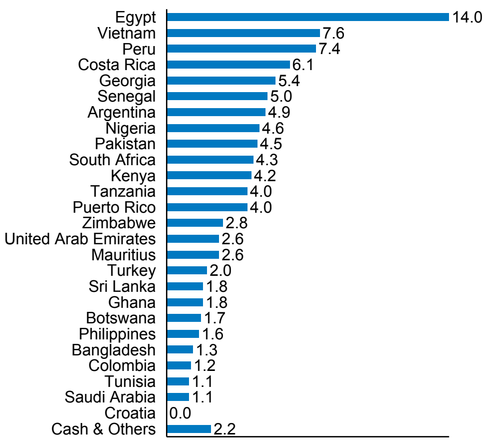
Primary research is the cornerstone of our investment process. We research companies with a long-term view and wait for the opportunity to buy high quality companies without overpaying for their inherent quality. Our focus on quality companies with sustainable business models generating substantial excess returns over their cost of capital through the cycle leads us towards asset light business models with modest capital needs; robust balance sheets; and proven management teams with disciplined capital management. We seek clear and fair alignment between majority and minority shareholders. Before a company can enter an LGM portfolio it needs to be both high quality and not overvalued at the time of purchase.

Portfolio positioning at the country level is reflective of our bottom-up approach, and top down overlay. Certain countries are screened out due to the high risk of expropriation or political risk whilst others countries we are watchful of.

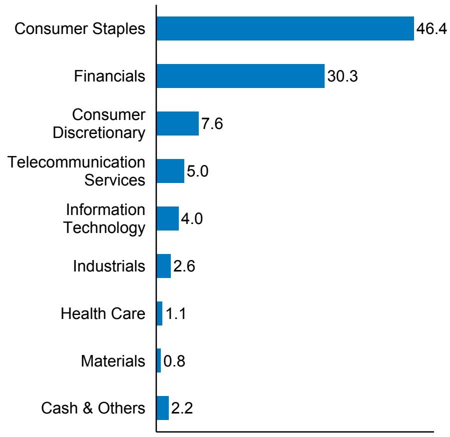
The investment team implements long-term investment decisions to build conviction portfolios with a high active share. Final weightings in the portfolio are determined by reference to the strength of the investment case and the upside anticipated and liquidity. Our objective is to build a portfolio of approximately 30-60 holdings with performance potential. We aim for low turnover, aiming to hold an investment for the long-term, typically over a business cycle.

The benchmark of our Frontier Markets Strategy is a composite index comprising 50% MSCI Frontier Markets Index and 50% MSCI Frontier Markets ex GCC countries Index.

## Geographic breakdown[2,3] (%)




## Sector breakdown[2,3] (%)




## Commentary*

There are many companies we look at where, in our view, changes in capital allocation would clearly lead to better long-term returns for shareholders. If we were the owners, some of these changes would be easily done. However, we will never be majority shareholders and so cannot simply enforce change from the top. Companies with a track record of poor capital allocation tend to be bad long-term investments, as leopards rarely change their spots. However, there are numerous reasons why improvements can happen, such as a change in management, a change in ownership or an event which leads majority shareholders to question how capital has been allocated in the past. As quality investors, the majority of our investments have a track record of strong capital allocation and we will never buy low-quality companies on the basis that one day things may suddenly change. However, good long-term returns can be made from owning a strong underlying business, where the way capital has been allocated in the past is improving. These changes can come about with or without our help, but where we think we can engage with management or majority shareholders to improve capital allocation decisions, we will do so.

We certainly adopted this pragmatic approach with Eastern Tobacco. We have spoken at length over the past year about Eastern and the ongoing engagement we have had with management, the majority shareholder, and also the Egyptian government, to improve capital allocation and efficiency within the company. Our efforts had been rewarded so far with an increased dividend in 2017, tighter capital expenditure and improved financial accounting. Much of this change was driven by the previous Chairman of Chemical Industries (the majority shareholder) and so it seemed a setback earlier this year when he was replaced overnight, along with the Minister of Public Enterprises. However, we continued our engagement activites with the new appointees and were pleased to see that the decision to allow for interim dividends was adopted at the AGM during March – and shortly afterwards, a special dividend of EGP30 per share was announced. This equates to a c5.2% yield, which is very pleasing to see, especially when one considers that this is on a share price which over the past 12 months has increased c.175% in Us dollars. Combined with the annual divided of EGP11.5 per share, which was paid out earlier this year, the total yield would be c.7.2%. However, even more important than the size of the interim dividend is the clear improvement it shows in capital allocation and the signal it sends about maximising shareholder value. During the month, we visited both Dubai and Egypt, where we had the opportunity to attend the company's AGM and also meet with a number of the key decision-makers, including the new Chairman of Chemical Industries, and twice with the new Minister of Public Enterprises. Both come from private-sector backgrounds, understand what can be achieved with the 'right' changes and appear to have the willingness to make these important decisions. There is still a lot more that can be done from an operational and governance perspective to improve the performance of Eastern Tobacco, and we will continue to push for these changes to be made.

The other company where we have seen a significant improvement in capital allocation decisions over the past two years is Alicorp, the leading consumer company in Peru. Since the new management team took over, we have seen significant changes to improve cash conversion, strengthen the balance sheet and return cash to shareholders. We have also seen a more focused expansion strategy, which was one the primary reasons we had not been investors before the company ran into problems and the management was replaced. The company is currently embarking on its first international transaction since the new management team took over. Our preference is for any opportunities to further consolidate in Peru, divestment in some of its existing international and non-core investments and to return cash to shareholders. However, lessons clearly have been learnt from the past in terms of the need to expand abroad only if such a transaction makes you a market leader and is done at a reasonable price. Management are also acutely aware that this is their first international acquisition, and as such will be examined very carefully given the company's track record. We have a lot of respect for what management have accomplished so far and will continue to engage with them and the board to provide suggestions for where we think capital allocation can continue to be improved, going forward.

As at 31 March 2018

*A representative account has been used throughout this commentary

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| GIPS Composite statistics and performance | | | | | | |
|---|---|---|---|---|---|---|
| **Calendar year ended** | **2017** | **2016** | **2015** | **2014** | **2013** | **2012** |
| Gross annual returns (%) | 25.3 | 9.5 | -7.6 | -0.5 | 40.2 | 42.9 |
| Net annual return (%) | 24.5 | 8.6 | -9.0 | -2.1 | 36.9 | 39.8 |
| 3-year composite deviation (%) (gross) | 10.0 | 10.0 | 11.3 | 11.9 | N/A | N/A |
| 3-year composite deviation (%) (net) | 9.9 | 9.9 | 11.2 | 11.8 | N/A | N/A |
| Benchmark return (%) | 35.3 | 2.6 | -14.2 | 1.8 | 24.8 | 12.7 |
| 3-year index deviation (%) | 11.0 | 11.3 | 12.7 | 11.6 | N/A | N/A |
| Composite dispersion (%) (gross) | 0.7 | 0.5 | 0.5 | 0.6 | 0.5 | N/A |
| Composite dispersion (%) (net) | 0.9 | 1.1 | 0.9 | 0.9 | 1.7 | N/A |
| Composite assets ($mm) | 1214.5 | 861.7 | 755.8 | 844.1 | 803.4 | 269.2 |
| Number of accounts in composite | 6 | 6 | 6 | 6 | ≤5 | ≤5 |
| % of firm assets | NA | 24.6 | 22.6 | 32.0 | 30.7 | 10.4 |

LGM claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. LGM has been independently verified for the period from 1 January 2007 to 31 December 2016. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

LGM Investments (LGM) is a brand name used by LGM (Bermuda) Limited and its subsidiaries to define the portions of its business specialising in Asian, Global Emerging Markets and Frontier Markets equities. The 'LGM investments' brand is used primarily by LGM Investments Limited (based in London) and the active portfolio management division of BMO Global Asset Management (Asia) Limited (based in Hong Kong). LGM (Bermuda) Limited is a wholly-owned subsidiary of the Bank of Montreal (BMO), a Company listed on the Toronto Stock Exchange and the New York Stock Exchange.

LGM has been independently verified for the period from 1 January 2007 to 31 December 2016.

This composite was created on 1 January 12. A complete list and description of firm composites is available on request.

The Frontier Markets Composite includes all portfolios which invest principally in equity securities of companies established in, or deriving a significant amount of their income and profit from frontier markets worldwide. The benchmark is the MSCI Blended Index made up of 50% MSCI Frontier Markets & 50% MSCI Frontier Markets ex GCC Countries (Net Dividends Reinvested) Index, rebalanced daily. The MSCI Frontier Markets Index captures large- and mid-cap representation across 22 Frontier Markets countries. The MSCI Frontier Markets ex GCC Index captures large- and mid-cap representation across Frontier Markets countries excluding those countries in the Gulf Cooperation Council. Investments cannot be made in an index.

Gross of fees performance is calculated gross of investment management fees and where available, administrative fees. Gross of fees performance is net of all trading expenses. Net of fees performance is presented net of all investment management, administrative fees and trading expenses. This composite uses actual fees. A full breakdown of fees for this composite is available on request.

The standard investment management fee scale per annum is as follows: 1.5% p.a. + Performance Fee of 20% (relative to benchmark) with high water mark.

Sources of exchange rates and share prices may differ between the benchmark and the individual portfolios contained within the composite.

Weighted dispersion is calculated using the asset-weighted standard deviation of all portfolios that were included in the composite for the entire year. Composite dispersion is only calculated if there are more than five accounts included in the composite for the full year.

Additional information regarding the firm's policies and procedures for the valuation, calculation and reporting of performance returns is available on request.

As of 1 July 2015 LGM amended its GIPS policies in three areas: 1) for Non-UK domiciled funds, LGM now recognises each share class as a separate portfolio (previously only one share class was recognised as a portfolio for each vehicle); 2) three-year standard deviation is now calculated using sample standard deviation (previously population standard deviation); and 3) net-of-fees performance is now calculated using a weighted average of the underlying portfolios' net returns (previously the highest fee in the composite was applied). As a result of these amendments to the firm's policy, the standard deviation, net-of-fees returns, number of portfolios in a composite, and internal dispersion may have changed from those presented historically on compliant presentations.