

Aberdeen Frontier Markets

Significant latent value?

Aberdeen Frontier Markets (AFMC)'s manager has been re-positioning the portfolio by reducing exposure to Sub-Saharan Africa, adding companies in new markets and looking to capture more of the momentum in markets. There is now a greater tilt to the Asia Pacific region, where Vietnam accounts for over a quarter of the portfolio. AFMC holds a concentrated selection of companies that offer the prospect of double-digit earnings growth paired with inexpensive valuations (the weighted average current year price/earnings (P/E) ratio of portfolio companies is 10.0x).

AFMC exhibits a low correlation with its benchmark as well as to emerging (where 68% of returns can be attributed to moves in the benchmark) and developed (61%) equity markets.

The manager feels that a slowdown in the global economy could increase flows into frontier markets (where growth is largely driven by domestic factors) as investors search elsewhere for returns.

Direct investment in frontier markets

AFMC aims to generate long-term capital growth, primarily from investment in equity and equity-related securities of companies listed in, or operating in, frontier markets. Frontier market countries may include countries within the MSCI Frontier Markets Index or additional countries that the investment manager deems to be such.

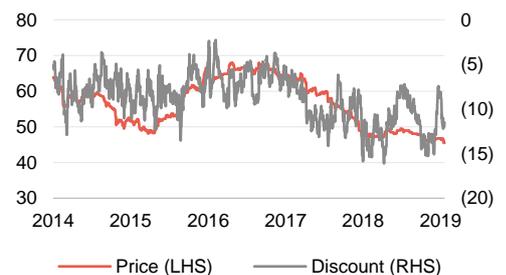
Year ended	Share price TR (%)	NAV TR (%)	MSCI Frontier Markets TR (%)	MSCI Emerging Markets TR (%)	MSCI World TR (%)
31/10/15	(19.2)	(15.7)	(14.4)	(11.1)	6.0
31/10/16	29.1	23.4	23.2	38.7	28.8
31/10/17	(0.8)	0.0	17.7	16.7	13.5
31/10/18	(24.0)	(16.1)	(8.4)	(8.7)	5.7
31/10/19	0.6	(6.9)	9.6	10.9	11.9

Source: Morningstar

Sector	Global emerging markets
Ticker	AFMC LN
Base currency	GBP
Price	45.5p
NAV	51.68p
Premium/(discount)	(11.96%)
Yield	3.4%

Share price and discount

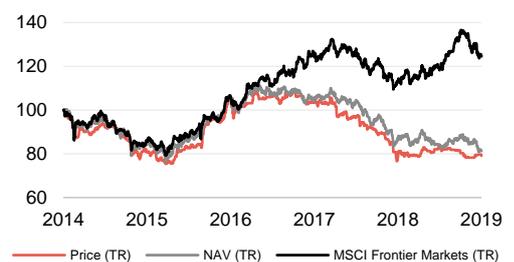
Time period 31/10/2014 to 18/11/2019



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/10/2014 to 31/10/2019



Source: Morningstar, Marten & Co

Domicile	United Kingdom
Inception date	15 June 2007
Manager	Mark Gordon-James and Gabriel Sacks
Market cap (GBPm)	33.7
Shares outstanding	71.9m
Daily vol. (1-yr. avg.)	151,795 shares
Net gearing	Nil

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Fund profile

Long-term capital growth from markets in the MSCI Frontier Markets Index and those with frontier-like characteristics

You can access the fund's website at www.aberdeenfrontiermarkets.co.uk

The investment objective of the company is to generate long-term capital growth, primarily from investment in equity and equity-related securities of companies listed in, or operating in, frontier markets. Frontier market countries may include countries within the MSCI Frontier Markets Index or additional countries that the managers deem to be such due to their characteristics, including many constituents of the MSCI Emerging Markets Index.

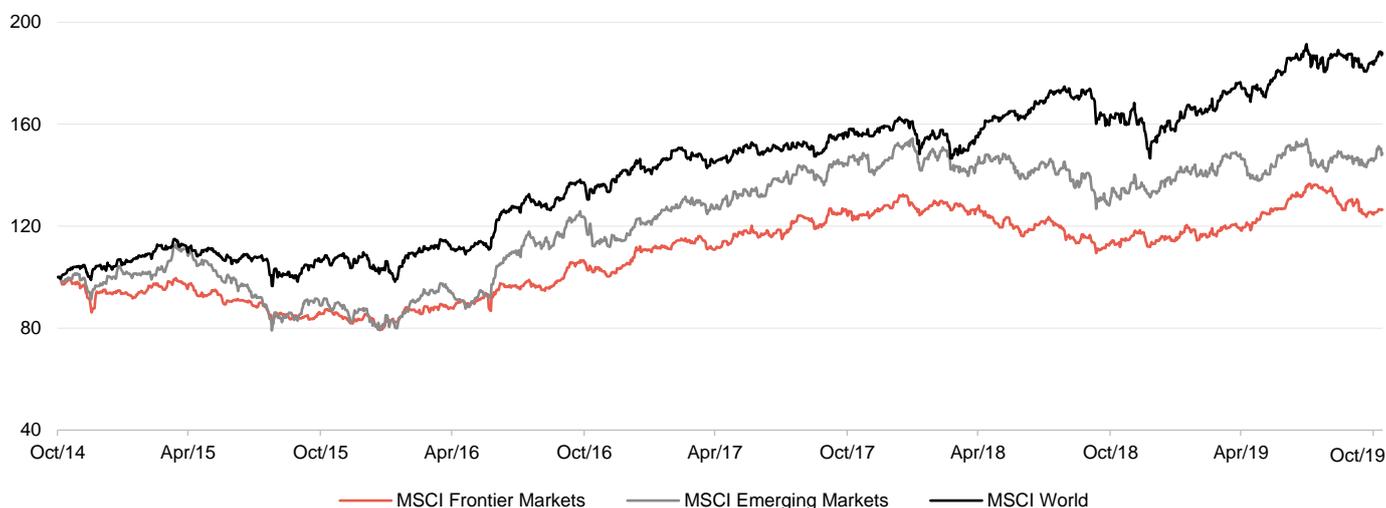
AFMC is managed by Aberdeen Standard Investment's Global Emerging Markets team, which is headed by Devan Kaloo. He joined the team in 2017 following a vote by shareholders to shift the trust's strategy from a fund of funds mandate to direct investing. Devan's team includes Mark Gordon-James, who is a senior investment director and AFMC's lead manager. Mark has been with Aberdeen since 2004, joining from Merrill Lynch's emerging markets team. Aberdeen Standard Investments is well-known for its emerging markets expertise. The global emerging markets team, which is distributed across offices in seven countries, had assets under management of \$33.2bn at the end of June 2019. AAM has been running a dedicated frontier markets strategy since 2009 and has been investing in the area since the 1980s. The frontier markets strategy had assets of \$272m at the end of June 2019.

Why have frontier markets underperformed?

Notwithstanding improved performance so far this year, led by Kuwait and Vietnam, frontier markets have delivered poor relative returns over recent years, when compared to the MSCI Emerging Markets index and the US-dominated MSCI World indices.

Several countries (including Argentina, Ghana, Egypt, Pakistan and Sri Lanka) have had to request large financial assistance packages from the International Monetary Fund (IMF). Foreign capital flows have been predominantly outward since 2015 (see Figure 3), as concerns over fundamentals in many markets have been compounded by the strength of the US equity market, which continues to deliver strong returns, while also possessing a lower risk profile than emerging and frontier markets.

Figure 1: Selected MSCI indices re-based relative performance



Source: Morningstar, Marten & Co

The collapse of the oil price over the second half of 2014, denoted by Figure 2, together with a broader softening in commodity prices, hurt several major frontier markets, while the strength of the US dollar from July 2014 onwards also weighed heavily.

Figure 2: Oil price (Brent) in US dollars

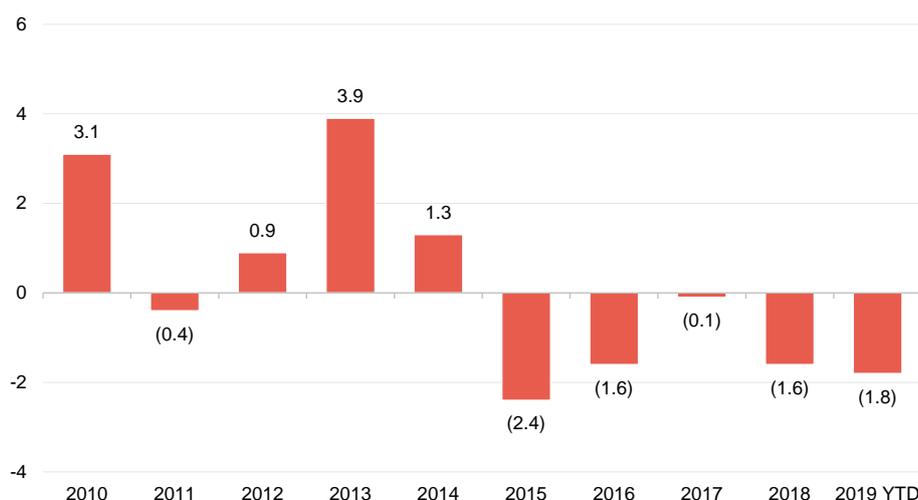


Source: Bloomberg, Marten & Co

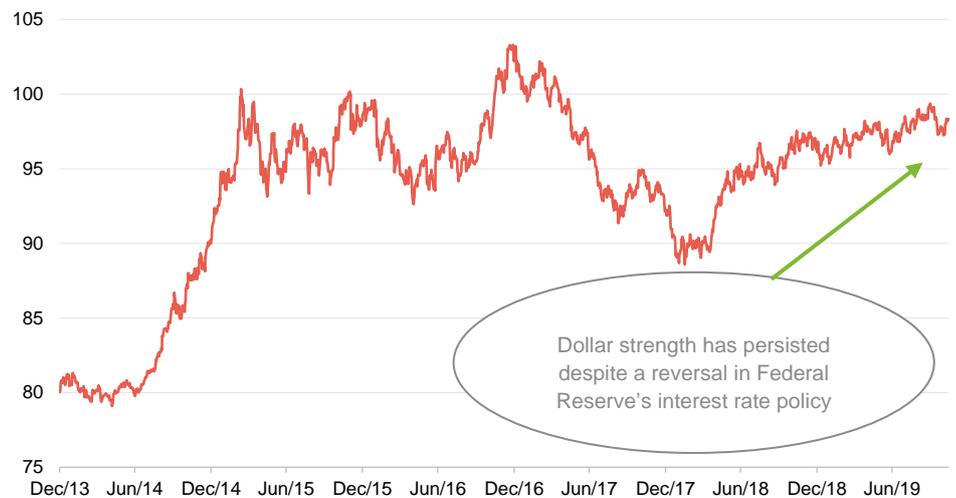
Active funds have been relentlessly withdrawing capital from frontier markets, precipitating steep declines in average daily trading volumes across many markets.

AFMC says that over the past five years, only two markets classified as frontier – Kuwait and Vietnam – have displayed a truly positive narrative. Kuwait has benefitted from its stable oil-based economy, a USD-pegged exchange rate and investors pricing-in an expected upgrade in status from ‘Frontier’ to ‘Emerging’ by MSCI (see page 6). Vietnam’s thriving export sector has been propelling the economy higher, making it one of the best performing emerging/frontier economies over recent years (see page 8).

Figure 3: Annual inflows into frontier market funds since 2010 (USDbn)



Source: EPFR Global, Aberdeen Standard Investments, 31 May 2019

Figure 4: US dollar currency index

Source: Bloomberg, Marten & Co. Note: Dollar index represents the dollar's relative value against a basket of six major currencies.

As concerns about a slowing economy mounted, the US central bank, the Federal Reserve (the Fed), reversed course at the beginning of 2019, moving from promising to toughen restrictions on growth (by pursuing interest rate increases and shrinking its balance sheet) to reducing interest rates. Yet dollar strength has persisted over most of this period, with slowing global growth, geopolitical tensions and trade concerns, reinforcing the currency's safe-haven appeal.

Returns from investing in emerging and frontier markets tend to correlate negatively with the dollar. In late October 2019, the Fed reduced interest rates for a third time this year, finally weakening the dollar index, shown in Figure 4. If the recent weakening were to persist for a period of time, this would likely serve to attract flows from developed markets into emerging and frontier markets.

Benchmark problems

The performance of the MSCI Frontier Markets Index is heavily skewed by countries being promoted or demoted to and from the MSCI Emerging Markets Index. Mark has strong feelings towards some of the major constituent stocks within the MSCI Frontier Market Index. He believes that focusing on quality and value when selecting investments is a better strategy, long-term, than trying to ride the roller coaster and game the index moves. AFMC say that they are 'benchmark aware', without being 'benchmark driven.' The benchmark is used mainly as a reference index for performance comparison.

Mark makes the point that Bahrain and Kuwait, two of the highest-weighted index constituent countries, have a combined population of just 4m – a fraction of the 2bn or so size of the total frontier universe. He also says that with less than 100 securities represented in the index, it is a narrow pool compared to the many thousands of listed companies.

Promotions, demotions and rumours thereof cause gyrations in the MSCI Frontier Markets Index

Country reclassification sensitivities – Kuwait case study

Announcements made by MSCI with respect to upgrades and downgrades between its Emerging and Frontier indices typically exert significant influence on price and volume activity in a country. Using Kuwait as a case study, at the end of September 2019, the Gulf market accounted for 30.2% of the benchmark (the capitalisation of the Kuwaiti market is close to \$100bn). Earlier in June 2019, MSCI announced that Kuwait would be promoted to the Emerging Market Index in 2020. This move was widely priced in, notably after MSCI announced in the summer of 2018 that Kuwait’s promotion candidacy would be reviewed in 2018. Since mid-2018, trading volumes in Kuwaiti stocks have climbed considerably, shown in Figure 5 below.

Figure 5: MSCI Kuwait price, local currency (LHS), and volume (RHS)



Source: Bloomberg, Marten & Co

This rollercoaster ride has been repeated many times and sometimes speculators get caught out. Argentina’s (it was 13.9% of the Frontiers index at end-April 2019) upgrade to ‘Emerging’ earlier this year was shortly followed in August by one of the most severe corrections ever experienced by a stock market, as it entered yet another sovereign debt crisis.

With such rapid change in the country representation of the index, the manager believes the best approach is to focus on selecting quality companies and disregard the gyrations caused by index rebalancing exercises.

Manager’s view – frontiers are cyclically attractive

Foreign investors have withdrawn significant capital from frontier markets in recent years. This situation could reverse as investors reassess the prospects of frontier markets in response to falling interest rates and weaker equity returns across developed markets. This forms part of the manager’s cyclical argument supporting the investment case for frontier markets, at this time.

Many frontier market economies have relatively weak trade linkages with developed markets, with growth driven by domestic and idiosyncratic factors. Counter-cyclical

Many frontier markets follow their own idiosyncratic paths, making them less vulnerable to a global slowdown.

defensiveness in the wake of slowing global growth could support capital flows into many of the countries AFMC invests in, particularly if the US dollar starts to weaken.

The manager also believes the fact that several of the portfolio's main country exposures are currently in IMF programmes means they are following their own idiosyncratic economic paths to an extent, making them less aligned to the global cycle.

The majority of frontier markets are attractively valued, with many trading on steep discounts compared to seven years ago. Mark mentioned Nigeria and Pakistan as examples where valuations are down sharply (two standard deviations below long-term price/earnings ratios). Mark noted that the weighted average current year P/E ratio of AFMC's portfolio companies is 10.0x against expected forward earnings growth of approximately 15%.

The asset class offers a way to capture the long-term growth of pre-emerging countries; many of these economies grow at more than 5% per annum. Figure 6 shows the GDP per capita and forecast real GDP growth for some of AFMC's largest allocations, including a comparison with an IMF grouping of advanced economies. By leveraging newer technologies, such as mobile telecoms and digital money, some of the better-placed frontier markets will aim to accelerate through their development stages.

Figure 6: GDP per capita and estimated GDP growth for some of AFMC's larger frontier market allocations versus advanced economies

	GDP per capita in 2017 (US\$)	GDP per capita in 2018 (US\$)	Forecast annualised real GDP growth rate 2018-2023 (%)
Bangladesh	1,532	1,744	7.2
Vietnam	2,306	2,551	6.6
Romania	10,372	12,285	3.2
Nigeria	2,092	2,049	2.4
Sri Lanka	3,906	4,068	4.0
Kenya	1,678	1,857	6.0
Argentina	14,062	11,627	1.5
Advanced economies	47,977	51,572*	1.8

Source: IMF World Economic Outlook, National Statistics Agencies. *Note: Purchasing power parity; international dollars

Rationale behind low allocation to Gulf economies

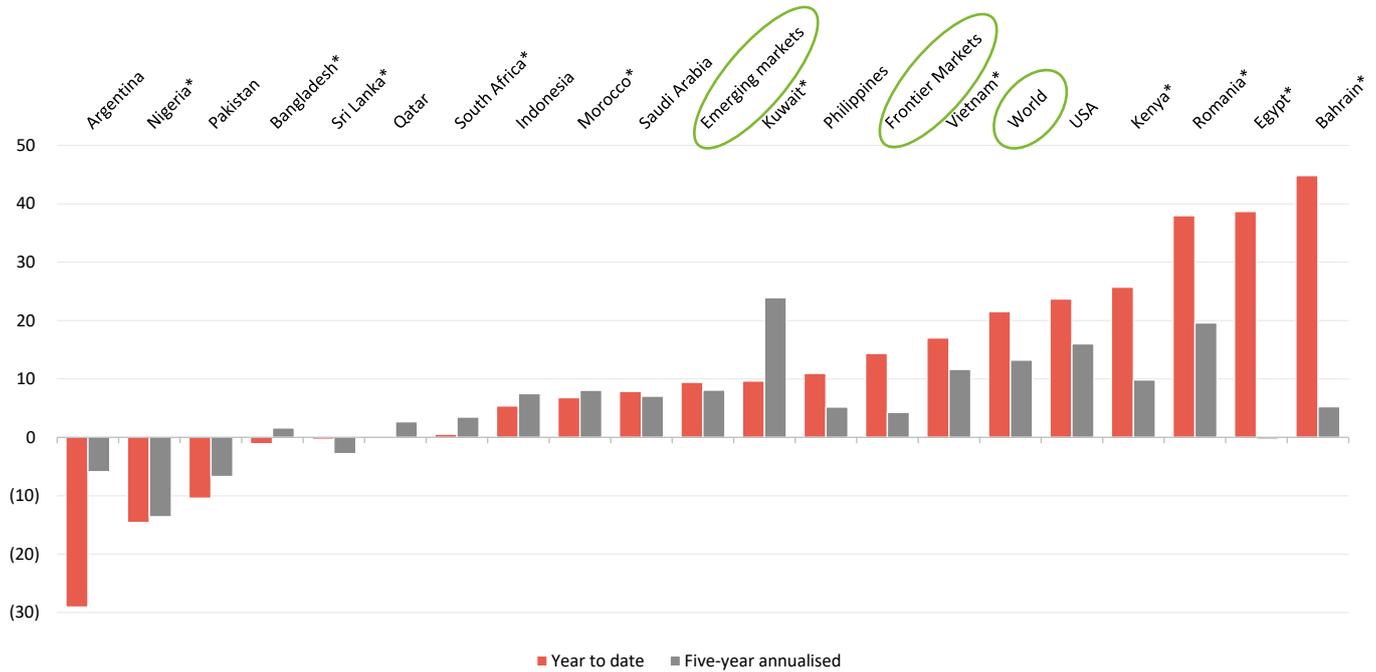
Kuwait and Bahrain have been among the best performing 'frontier' classified markets this year. Kuwait's equity market has been performing very well for some time now (see Figure 7).

AFMC say that their underweight allocation to Bahrain and Kuwait reflects the fact that three banks (National Bank of Kuwait, Kuwait Finance House and Ahli United Bank) account for about two thirds of the combined capitalisation of the markets. Momentum from mergers and acquisitions activity, and index upgrade speculation, has increased the market value of these stocks to about 2-3x book value (the carrying value of net assets held on the balance sheet).

The manager does not see value in Kuwait and Bahrain

AFMC does not believe the banks offer value at these prices, based on their fundamentals. The manager says that similar growth prospects, at more attractive prices, can be found elsewhere.

Figure 7: Performance (%) of selected MSCI Indices 2019 year to date and five-year annualised (in sterling)

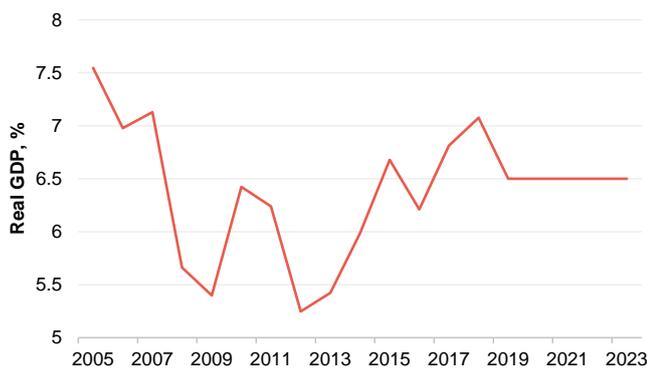


Source: Morningstar, Marten & Co. *Note: Asterix denotes frontier markets

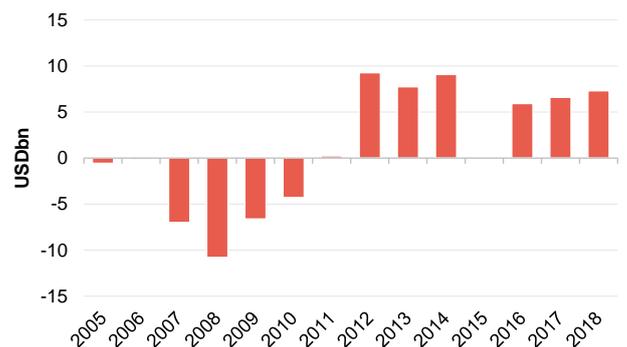
Vietnam – now over a quarter of the portfolio

Vietnam is AFMC’s largest market by a distance, at more than one quarter of total asset value (see the ‘asset allocation’ section). The country, which is still classified as a frontier market by MSCI, has stood out positively over recent years, a period that has been very challenging for emerging and frontier markets. Mark believes that an MSCI upgrade review to ‘Emerging’ is likely to take place by 2021.

Figure 8: Vietnam Real GDP growth – historic and forecast - 2005-2023 | Figure 9: Vietnam current account balance 2005-2018



Source: International Monetary Fund, World Economic Outlook Database



Source: State Bank of Vietnam, International Monetary Fund, World Economic Outlook Database

At close to \$200bn, the market capitalisation of Vietnam's stock market is higher than a lot of markets classified as 'emerging market' by MSCI. It's 95m population economy is growing quickly, with real GDP annual growth averaging 6.6% over 2014–2018, according to the IMF's World Economic Outlook database. The forecast is for a rate of 6.5% to be maintained over the period to 2023.

Vietnam shaping up to be a major beneficiary from the trade war

As a major global exporter, Vietnam is vulnerable to a slowdown in the global economy, though the trade wars taking place present a huge opportunity to bring manufacturing into the country. This is already happening and is a long-term process. China has been actively 'moving in'. A report by the Asian Development Bank, released in September 2019, noted that exports from emerging Asia to the US increased by 10% year-on-year over the first half of 2019. This was in spite of Chinese exports declining by 12%. Vietnamese exports increased by 33%, and Vietnam took market share in electronics.

Investment philosophy and process

Good quality companies at a sensible price

The manager aims to invest in good quality companies at a sensible price. All potential investments are subject to detailed scrutiny. The manager does not try to second-guess short-term macroeconomic movements, play the MSCI upgrade cycle or invest with the herd. The focus is on stock selection and getting to know the companies it invests in.

Long-term appreciation from mispriced value or growth

Mark selects stocks based on fundamental analysis of companies, looking for long-term appreciation from mispriced value or growth. Some ideas are sourced from brokers but most are identified by the management team. The focus is on identifying winning companies participating in themes such as digital payments, generic pharmaceuticals, software outsourcing, and consumer banking. AFMC avoids state-owned companies.

Continuous ESG analysis

The manager places great importance on governance when assessing a company's quality and worth, and continuous environmental, social and corporate governance (ESG) analysis is done once AFMC becomes a shareholder in a company, via a process of proactive engagement. Holdings are subject to ongoing due diligence. The team visits existing holdings at least every six months and includes a Responsible Investing analyst in an integral role. The team will always vote its stock and will explain its voting decisions to companies.

A range of valuation measures is used to assess whether a stock is cheap or expensive. Market volatility is used as an opportunity to trim or add to positions. The portfolio's turnover, historically fairly low, has increased over the past year or so (see page 11). The average holding period is close to eight years. Holdings may be sold if they fail ESG criteria or, alternatively, the manager may engage with management to encourage compliance.

Risk control is about diversification, avoiding low quality companies and not overpaying for investments

Risk control is about ensuring the portfolio is adequately diversified, avoiding low-quality companies and ensuring that AFMC does not overpay for its investments. There is a maximum 10% exposure to any one stock at the time of purchase and 15% in any one country. Index benchmark weights are not considered when constructing the portfolio and there are no sectoral restrictions. Typically, the manager expects that the fund will have between 40 and 70 holdings.

Net cash balances will not generally exceed 10% of NAV and, likewise, net gearing will be limited to 10% of NAV. The manager is permitted to use derivatives and contracts for difference (CFDs) in the management of the portfolio, but does not currently, preferring direct equity ownership.

More exposure to small caps than equivalent open-ended funds

The manager likes the flexibility that AFMC’s closed-end structure brings. Relative to the open-ended funds that the manager runs, AFMC may have slightly more exposure to smaller companies. It cites the example of Purcari Wineries, a Romanian wine producer with vineyards mainly in Moldova. It has a strong domestic franchise but is expanding internationally. As of 30 September 2019, Purcari was AFMC’s 10th largest holding, at 2.6%.

AFMC can invest in non-frontier classified markets

The manager has the discretion to invest in markets that he deems to have similar characteristics to frontier markets, such as Egypt and Pakistan, which now come under MSCI’s ‘Emerging’ classification.

Asset allocation

As of the end of September 2019, AFMC was invested in 52 companies.

Style tilt analysis suggests more exposure to momentum

The manager has been reducing the fund’s negative exposure to the momentum factor

Figures 10 and 11 show an analysis of AFMC’s portfolio by investment style relative to the benchmark. A report by Style Research, as of 31 August 2019, suggests that, while the manager retains an underweight overall exposure to the ‘momentum’ factor, this has been loosened of late, with short and medium-term momentum increasing. This means that the portfolio has more exposure to stocks that other investors are buying than it has previously.

AFMC’s quality-focused style tilts are shown in Figure 10 below. AFMC’s companies have, on average, higher returns on equity, higher cash flow yields, higher sales to price yields, less debt and a lower market beta.

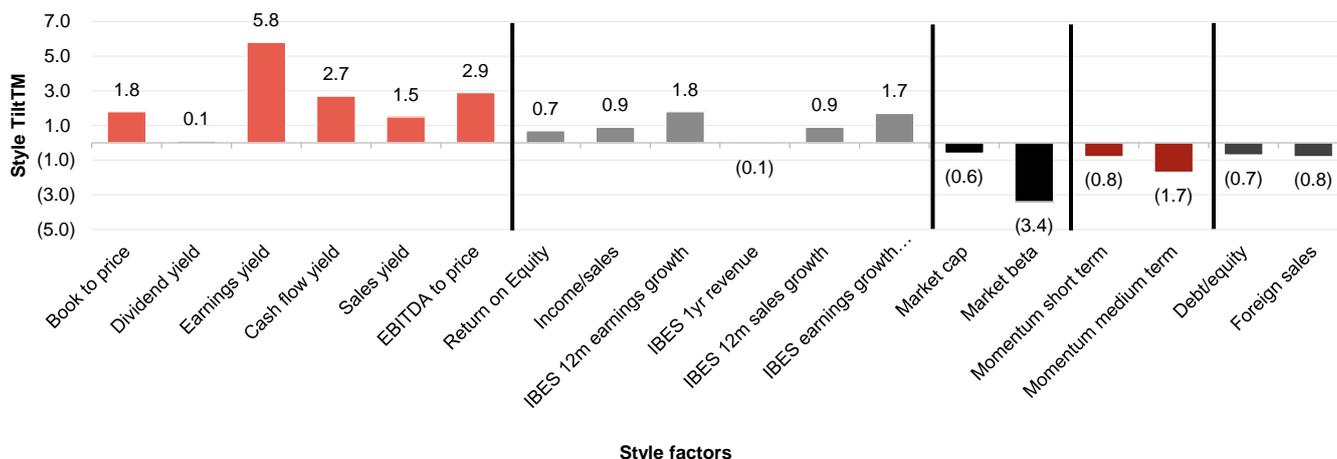
Compared to the index, portfolio holdings tend to be cheaper based on trailing and forward price/earnings ratios, similarly valued in price/book terms and much less geared on a debt to equity basis. There is also a preference for companies with relatively higher return on asset (net income as percentage of a company’s total assets) profiles.

Figure 10: AFMC style tilt

	P/E 2018	P/E 2019	P/E 2020	P/B	Div. yield* (%)	Debt/equity* (%)	ROE* (%)	ROA* (%)
AFMC	10.5x	10.0x	8.7x	1.7x	3.9	8.7**	24.9	9.6
MSCI Frontier Markets	12.0x	11.5x	10.8x	1.8x	4.2	24.1**	21.5	7.4
MSCI Emerging Markets	13.2x	12.7x	11.5x	1.6x	2.9	14.2**	15.6	7.2

Source: Aberdeen Standard Investments, FactSet, Institutional Brokers’ Estimate System (IBES) is a database from Thompson Reuters, 30 September 2019. Portfolio and benchmark P/E ratios based on financial year. *Note: historic, **Note: excluding banks and insurance companies

Figure 11: AFMC Portfolio Style Skyline™



Source: Style Research, Aberdeen Standard Investments, 31 August 2019, IBES

Portfolio turnover elevated as manager re-calibrates

Mark has been reducing AFMC's allocation to Sub-Saharan Africa

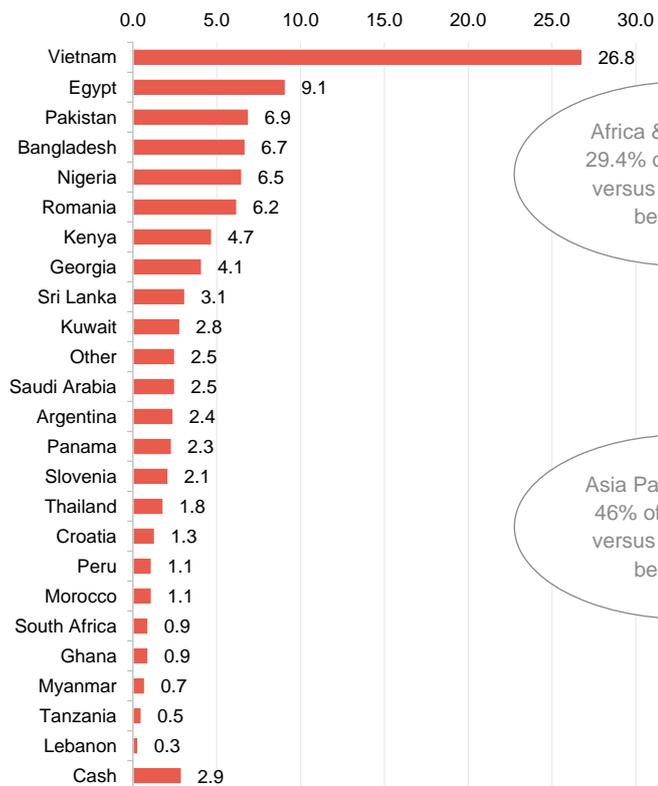
Portfolio turnover, which measures how often assets are bought and sold by the manager, was 34% over AFMC's financial year to 30 June 2019 – a high level for the fund. It reflected activity by the manager to shift the portfolio's focus away from several underperforming markets, principally in Sub-Saharan Africa (SSA). At 30 September 2018, Nigeria and Kenya were in the top-five and SSA markets cumulatively accounted for 23.6% of country exposure.

As of 30 September 2019, SSA's contribution is down to 13.5% while Asia Pacific ex Japan accounts for 46% (Vietnam represents more than half of this). Mark has reduced exposure to Kenya and Nigeria, as well as Argentina and Sri Lanka. Argentina has undergone a severe de-rating while Sri Lanka was hit by a major terrorist attack in April and its growth outlook is sluggish.

The manager is being more pragmatic with his country allocation

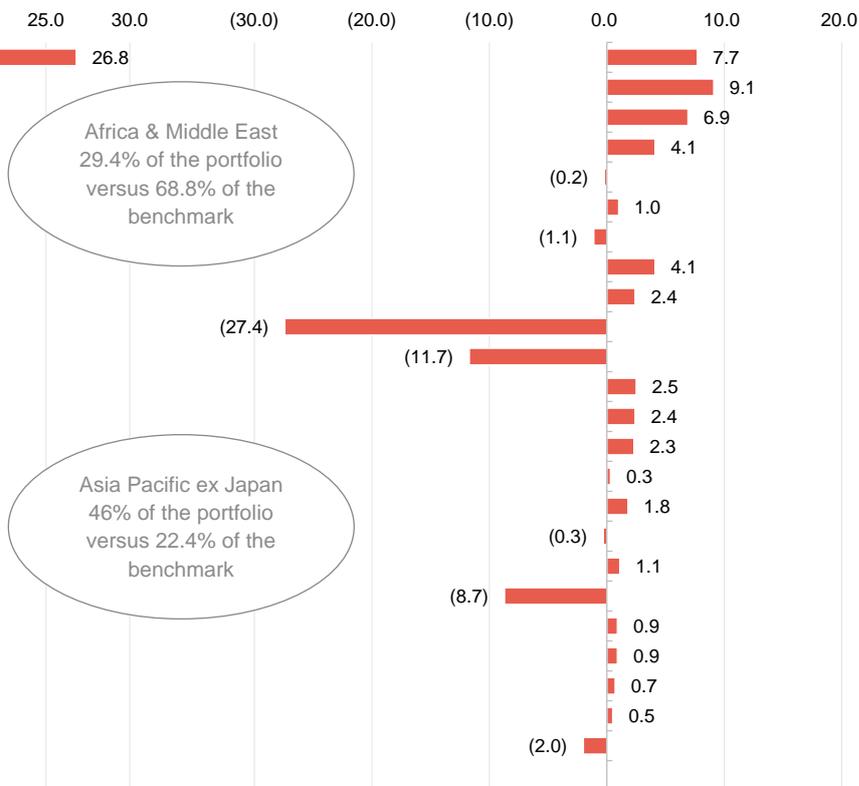
Though the portfolio's geographic makeup predominantly reflects bottom-up stock selection, observable through its significantly different country-makeup relative to the benchmark (illustrated by Figures 12 and 13), Mark says he does have to be pragmatic in finding a balance between the top and bottom-down. Over recent years, weak sentiment has pushed down the value of what were perceived to be fundamentally sound portfolio companies. SSA's risk-reward trade-off was disappointing in over years. Mark has introduced holdings in countries that are perceived to provide a more attractive risk outlook.

Figure 12: AFMC asset allocation by country - 30 September 2019



Source: Aberdeen Asset Management

Figure 13: AFMC geographic weightings relative to MSCI Frontier Markets Index - 30 September 2019



Source: Aberdeen Asset Management

As well as increasing investment into Vietnam, Mark has added holdings in Croatia, Peru, Saudi Arabia and Slovenia. The top-ten country allocation changes over the year to September 2019 are summarised in Figure 14 below.

Figure 14: Top ten changes in absolute country weightings – 30 September 2018 to 30 September 2019

	Change (%)
Argentina	(7.7)
Vietnam	+7.0
Nigeria	(4.3)
Egypt	+3.6
Pakistan	(3.3)
Kenya	(3.1)
Sri Lanka	(3.1)
Saudi Arabia	+2.5
Romania	+2.1
Slovenia	+2.1

Source: Aberdeen Asset Management

Consumer and financials-focused

Figure 15: AFMC sector weightings - 30 September 2019

	Portfolio (%)	Benchmark (%)	Difference (%)
Financials	30.5	47.7	(7.2)
Consumer discretionary	16.0	0.2	+15.8
Consumer staples	14.9	9.1	+5.8
Information technology	9.5	0.0	+9.5
Real estate	7.0	11.4	(4.4)
Health care	6.8	3	+3.8
Communication services	5.7	13.9	(8.2)
Industrials	4.9	4.8	+0.1
Materials	1.5	5.5	(4.0)
Energy	1.1	3.3	(2.2)
Utilities	0.0	1.3	(1.3)
Cash	2.2	-	-

Source: Aberdeen Asset Management

The consumer discretionary, staples and financials sectors account for over 60% of the sector allocation, aiming to capture long-term increases in the spending power and the proliferation of formal banking products.

Top 10 holdings

Figure 16 shows AFMC's ten largest holdings at 30 September 2019. Since our last note, there have been four additions to the top 10: Masan, Humansoft, Grameenphone and Purcari Wineries. They replace BBVA Banco Francés (Argentina – financials) John Keells (Sri Lanka – industrials), Maple Leaf Cement (Pakistan – industrials) and Safaricom (Kenya – communication services).

Figure 16: Top 10 holdings at 30 September 2019

	Country	Sector	Allocation 30/09/19 (%)	Allocation 31/12/18 (%)	Index weight (%)	Difference vs. Index at 30/09/19 (%)
Mobile World Investment Corp.	Vietnam	IT software	7.8	5.3	0.0	+7.8
FPT Corporation	Vietnam	Technology	7.5	4.9	0.0	+7.5
Square Pharmaceuticals	Bangladesh	Health care	3.9	3.2	1.5	+2.4
Guaranty Trust Bank	Nigeria	Financials	3.1	3.2	1.2	+1.9
Zenith Bank	Nigeria	Financials	2.9	3.8	0.8	+2.1
Masan	Vietnam	Consumer staples	2.8	2.0	1.3	+1.5
Humansoft	Kuwait	Education	2.8	2.9	0.0	+2.8
Equity Group	Kenya	Financials	2.8	2.7	1.0	+1.8
Grameenphone	Bangladesh	Communication services	2.7	2.4	0.4	+2.3
Purcari Wineries	Romania	Consumer discretionary	2.6	1.9	0.0	+2.6
Total top 10 holdings			38.9	36.7	-	-

Source: Aberdeen Asset Management, Marten & Co.

Figure 17: Top 10 holdings - valuation multiples at 10 October 2019

	Market cap (£m)	Total return. local currency, YTD (%)	2020e earnings per share growth estimate (%)	2020e dividend yield (%)	2020e P/E ratio	PEG ratio*
Mobile World Investment Corp.	1,879	44.7	25	1.2	11.7	0.5
FPT Corporation	1,312	52.5	16	3.6	10.6	0.6
Square Pharmaceuticals	1,719	(8.4)	18	1.7	14.7	0.8
Guaranty Trust Bank	1,465	(18.6)	7	12.2	3.7	0.5
Zenith Bank	1,141	(14.9)	10	17.3	2.7	0.3
Masan	2,890	(7.3)	15	0.5	16.0	1.1
Humansoft	966	(0.8)	3	6.6	10.8	4.0
Equity Group	1,217	26.5	13	5.9	5.4	0.4
Grameenphone	3,960	(8.2)	11	8.4	11.3	1.1
Purcari Wineries	80	30.2	23	7.3	8.2	0.4
Average	1,663	9.6	14.1	6.5	9.5	0.6**

Source: Aberdeen Standard Investments, Aberdeen Frontier Markets Investment Company, Morningstar. *Note: PEG ratio is the trailing 12 month price/earnings ratio/divided by forecast earnings growth rate. **Note: median value.

Figure 18: Mobile World Investment Corp (VND)



Source: Bloomberg, Marten & Co

Mobile World Investment Corporation

Mobile World Investment Corp (Mobile World) (mwg.vn/eng) is the leading home appliances and mobile phone retailer in Vietnam by sales, with a market share of around 35%. It is also a leader in e-commerce and is targeting organised food retailing with its relatively new fresh produce-focused convenience stores format (Bach Hoa Xanh).

It has been an excellent performer for AFMC over the year-to-date, with the shares up around 45%. Mark believes the shares are undervalued by about 50%, based on a target P/E ratio of 18x (currently about 12x – see Figure 17). The manager says a catalyst for an increase in the P/E ratio could be the launch of domestic index-tracking exchange-traded fund (ETF) focused on growth companies, which would increase the company’s accessibility to foreign investors. Currently, Mobile World’s valuation is constricted by limits on foreign ownership that restrict liquidity in the shares. When a limit has been reached on foreign ownership for a stock, a foreign investor can only acquire the shares from another foreign investor.

Figure 19: FPT Corporation (VND)



Source: Bloomberg, Marten & Co

FPT Corporation

FPT Corporation (FTP) (fpt.com.vn/en) is split into three main divisions: IT software outsourcing, education and home broadband services. The manager says that IT outsourcing is the largest contributor to earnings and the fastest growing segment. FTP’s outsourcing client base includes companies in based across Europe and the US. Mark says the company will also be part of the domestic ETF and as with Mobile World, which could be a catalyst for a re-rating in the value of the shares (FPT is affected by the same ‘liquidity discount’ as Mobile World). FTP’s share price has increased by more than 50% so far this year.

Figure 20: Zenith Bank (NGN)



Source: Bloomberg, Marten & Co

Zenith Bank

Nigeria's Zenith Bank (Zenith) (www.zenithbank.com) is one of Nigeria's two leading banks, alongside Guaranty Trust Bank (also an AFMC holding). Nigerian banking stocks have been performing poorly for some time now, in keeping with the wider Nigerian economy. AFMC's manager told us that the banking sector has been holding a lot of capital on balance sheets; subsequent to our meeting with him, Zenith has announced plans to increase lending over the second half of the year. This comes after its loan-to-deposit ratio fell to 51.2% (from 54.6% a year earlier) in the six month period to June 2019. Nigeria's Central Bank has briefed the banking sector to lend out at least 60% of deposits, to try and revive credit growth. For there to be a sustained turnaround in the sector, Mark says policy reform and the [free-float](#) of the naira currency are required. In the meantime, the manager says there is minimal further downside risk for their Nigerian banking holdings. Zenith's shares are currently yielding 16.5%, making them a major contributor paid out by AFMC.

Figure 21: Equity Group (KES)



Source: Bloomberg, Marten & Co

Equity Group

Equity Group Holdings (Equity Group) (www.equitybankgroup.com) has banking operations across East Africa, including in the Democratic Republic of Congo. It is Kenya's biggest bank by market capitalisation and was awarded the designation of 2018 'SME (small and medium-sized enterprises) Bank of the year' by the International Finance Corporation. The bank, through its subsidiaries, focuses on the retail and small and medium enterprises sectors with a number of products tailored to the markets it operates in. It also has a corporate division that handles large enterprises.

Since 2016, Kenya has applied an interest rate cap on lending rates, making it very hard for borrowing to access credit. However, there appears to have been a major breakthrough in the removal of these caps. On 30 October 2019 lawmakers lent their support to President Uhuru Kenyatta's intention to do away with the caps to stimulate loan growth. Equity Group's shares soared on the news.

Figure 22: Square Pharmaceuticals (BDT)

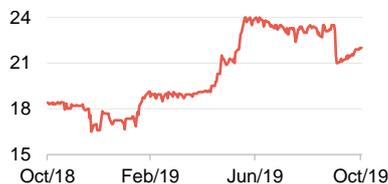


Source: Bloomberg, Marten & Co

Square Pharmaceuticals

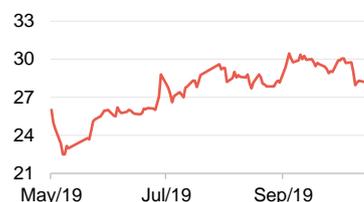
Square Pharmaceuticals (Square) (squarepharma.com.bd) is Bangladesh's leading generic pharmaceutical manufacturer. The company's facilities are compliant with the Food and Drug Administration's (FDA) standards. AFMC increased its allocation to Square earlier in the year. The manager believes the company is undervalued by around 25%, noting that Indian generic pharmaceutical companies with comparable characteristics trade on trailing P/E ratios in the high 20s.

Figure 23: Purcari Wineries (RON)



Source: Bloomberg, Marten & Co

Figure 24: Arabian Centres (SAR)



Source: Bloomberg, Marten & Co

New holdings added in Saudi Arabia, Egypt, Slovenia and Peru

Shareholders to be offered cash exist in 2020 if relative performance does not improve

Purcari Wineries

Purcari Wineries (Purcari) (purcari.wine/en) is a Moldovian-Romanian based winery with a well-established presence across Central and Eastern Europe (CEE). The company owns over a thousand hectares of vineyards regionally; it has been growing its export business strongly outside of CEE as well.

Revenues are growing at around 20% per year, with exports to Poland and China a growing contribution. The manager believes the company's growth will increase liquidity in the shares, which will make it a more attractive offering for a wider set of institutional investors. Mark believes the shares are substantially undervalued based on a target P/E ratio of 16x.

Elsewhere in the portfolio – Saudi Arabian shopping centre tops new additions

The manager has made a number of additions to the portfolio since our last note. In June, Saudi Arabia was added to AFMC's country exposures through Arabian Centres (2.5% of the portfolio at end-September), a shopping centre developer. Mark says the company is well positioned to benefit from the gradual opening up of Saudi society, with more women entering the workforce and driving. The malls are popular meet-up points, as they are across much of the region where high temperatures mean people spend a lot of their time indoors.

Arabian Centres has a refreshed management team, led by the former CEO of Westfield Europe, to oversee a repositioning of their malls to provide more food and beverage and entertainment options. The shopping mall experience is not being disrupted by e-commerce in Saudi Arabia and most of the wider Middle East and North Africa (MENA) region due to the idiosyncrasies mentioned.

Elsewhere, Mark added Egypt-based CIRA and Cleopatra Hospitals Group in July. CIRA owns and operates several schools and universities in Cairo and other parts of the country while Cleopatra is the leading private hospital operator in Egypt.

Away from MENA, Mark made two banking sector allocations: to Austria-based Addiko Bank (which focuses on Central and Eastern Europe) and Slovenia's largest bank, NLB. Mark also added Peru-based Grana Y Montero, an engineering, construction and infrastructure provider.

Performance

AFMC is a highly active stock picking fund with its manager stressing that the benchmark only offers a loose basis for comparison (we discussed this in the 'benchmark problems' section). That being said, after consistently underperforming the index and its peer-group since shifting to direct investing in mid-2017, AFMC must deliver outperformance in total return share price terms over a two-year period to 30 June 2020, or shareholders will be offered a cash exit.

AFMC's geographic asset allocation has been the largest detractor from its returns in recent years. Relative performance has been weighed down by lower allocations to Kuwait and Bahrain, greater exposure to Sub-Saharan Africa and the underperformance of Pakistan.

Figure 25: Total return NAV performance of AFMC versus the MSCI Frontier Markets Index



Source: Morningstar, Marten & Co

Figure 26: Cumulative total return performance to 31 October 2019

	1 month (%)	3 months (%)	6 months (%)	1 year (%)	3 years (%)	5 years (%)
AFMC NAV (TR)	(6.2)	(8.1)	(3.3)	(6.9)	(21.9)	(18.7)
AFMC share price (TR)	1.1	(1.5)	(4.4)	0.6	(24.2)	(20.9)
MSCI Frontier Markets (TR)	(4.0)	(7.9)	5.2	9.6	18.1	24.5

Source: Morningstar, Marten & Co

Attribution - Pakistan drags down Asia Pacific ex Japan

Figure 27 shows a geographic attribution breakdown of AFMC's returns over the period from 31 December 2018 to 30 September 2019. Pakistan, classified as 'Emerging' by MSCI, was responsible for the bulk of the relative underperformance of the Asia ex Japan region.

Figure 27: AFMC attribution returns by region, year to date to 30 September 2019

	Portfolio		Benchmark		Net management effects			Total (%)
	Weight (%)	Return (%)	Weight (%)	Return (%)	Currency (%)	Allocation (%)	Selection (%)	
Total	100.0	0.9	100.0	11.0	(0.4)	(11.5)	1.8	(10.1)
Equities	97.8	1.1	100.0	11.0	(0.5)	(11.0)	1.8	(9.7)
Latin America	5.8	(13.0)	--	--	0.1	(0.6)	(0.4)	(0.9)
Europe Ex UK	13.8	11.4	10.7	20.3	(0.4)	0.1	(0.7)	(1.0)
Africa & Middle East	29.4	3.5	66.8	11.6	(0.3)	(1.8)	(0.3)	(2.4)
UK	2.9	(30.7)	--	--	0.0	(1.6)	0.0	(1.6)
Asia Pacific Ex Japan	46.0	1.3	22.4	10.1	0.1	(7.1)	3.2	(3.9)
Cash	2.2	(4.4)	--	--	0.1	(0.5)	0.0	(0.4)

Source: Aberdeen Standard Investments. Note: the benchmark is the MSCI Frontier Markets Index and returns shown are gross of fees, in USD terms.

Mark believes Pakistan has started to turn the corner, noting that this has begun to positively impact foreign capital flows, which have edged up over the past three months. An IMF-supported adjustment programme is under way, as the country looks to rein in

Sentiment is beginning to improve in Pakistan, from a low base, following a hugely challenging few years.

the current account and budget deficits. The manager believes that the structural reforms taking place, including the launch of a privatisation programme, will see the macroeconomic picture steadily improve, paving the way for earnings to tick up and the currency to strengthen.

Figure 28 shows the depressed state of valuations for the AFMC's Pakistan holdings. The equity market has been concerned about high interest rates and slowing corporate earnings. Small & mid cap names have underperformed large cap names by a considerable amount.

Figure 28: AFMC Pakistan holdings – 11 October 2019

AFMC equities held	2018 ROE (%)	2020 price/earnings ratio	Alternative valuation metric
Maple Leaf Cement	16.8	6.0x	<\$40 enterprise value/ton of capacity
Jubilee Life	24.0	11.0x	2.8x book value
Indus Motor Packages	38.8	7.4x	5.8x ex-cash price/earnings
HBL	1.5	17.6x	0.4x book value
Shell Pakistan	7.5	5.8x	0.9x book value
	-	6.0x	\$230k enterprise value/retail outlet

Source: Aberdeen Standard Investments

Figure 29: AFMC attribution returns by sector, year to date to 30 September 2019

	Portfolio		Benchmark		Net management effects		
	Weight (%)	Return (%)	Weight (%)	Return (%)	Allocation (%)	Selection (%)	Total (%)
Total	100.0	0.9	100.0	10.9	(0.7)	(9.4)	(10.0)
Equities	97.8	1.1	100.0	10.9	(0.2)	(9.4)	(9.6)
Energy	1.1	(60.5)	3.3	17.3	(0.2)	(2.1)	(2.3)
Materials	1.5	(56.0)	5.5	(10.7)	0.7	(1.6)	(0.9)
Industrials	4.9	(1.2)	4.8	4.8	(0.1)	(0.3)	(0.4)
Consumer discretionary	16.0	19.7	0.2	(4.0)	(0.9)	2.8	+1.8
Consumer staples	14.9	(3.0)	9.0	2.1	(0.8)	(0.8)	(1.6)
Healthcare	6.8	3.6	3.0	(0.0)	(0.1)	(0.0)	(0.1)
Financials	30.5	(9.1)	47.7	14.2	(1.3)	(6.5)	(7.8)
Information technology	9.5	75.9	--	--	2.7	(0.0)	+2.7
Utilities	0.0	--	1.3	(14.5)	0.3	0.2	+0.4
Communication services	5.7	15.1	13.9	14.7	(0.2)	(0.1)	(0.3)
Real estate	7.0	6.3	11.4	19.3	(0.2)	(1.0)	(1.2)
Cash	2.2	(4.4)	--	--	(0.4)	0.0	(0.4)

Source: Aberdeen Standard Investments. Note: the benchmark is the MSCI Frontier Markets Index and returns shown are gross of fees, in USD terms.

Led by FPT, technology has been the best performing sector for AFMC over 2019 (to end-September). Financials have been weighed down by banking holdings in Nigerian.

Figure 30: AFMC stock attribution, top five contributors, year to date to 30 September 2019

	Country	Closing portfolio weight (%)	Closing benchmark weight (%)	Contribution to relative return (%)
FPT	Vietnam	7.5	-	+2.3
Mobile World	Vietnam	7.8	-	+2.1
Pucari Wineries	Romania	2.6	-	+0.5
CIRA	Egypt	1.4	-	+0.5
Arabian Centres	Saudi Arabia	2.5	-	+0.4

Source: Aberdeen Standard Investments. Note: the benchmark is the MSCI Frontier Markets Index and returns shown are gross of fees. *Note: Grupo Financiero Galicia is based in Argentina, which is part of the MSCI Emerging Markets Index

Figure 31: AFMC stock attribution, bottom five contributors, year to date to 30 September 2019

	Non-hold	Country	Closing portfolio weight (%)	Closing benchmark weight (%)	Contribution to relative return (%)
Shell Pakistan	-	Pakistan	1.1	-	(2.0)
Maple Leaf Cement Factory	-	Pakistan	0.8	-	(1.7)
Ahli United Bank	Non-hold	Bahrain	-	4.3	(1.1)
BBVA Banco Frances	-	Argentina	0.0	0.0	(1.0)
National Bank Of Kuwait	Non-hold	Kuwait	-	10.2	(0.8)

Source: Source: Aberdeen Standard Investments. Note: the benchmark is the MSCI Frontier Markets Index and returns shown are gross of fees.

Vietnam's FPT and Mobile World contributed a combined 4.4% to AFMC's active return while new 2019 holdings CIRA and Arabian Centres have added value immediately. Pakistani holdings as well as non-holds in Bahraini and Kuwaiti financials hurt relative performance.

Peer-group comparison

Comparing AFMC to its peers, in Figures 32 and 33, there is no disguising its poor performance record over recent years against its direct and wider peer groups. Picking out a couple of funds from the group, BlackRock Frontier Markets includes allocations to MSCI Emerging Markets Index countries such as Indonesia, UAE and Thailand. The MSCI Emerging Market Index has outperformed the Frontier Markets Index over the past three or so years.

Fundsmith Emerging Equities also has a greater focus on emerging markets, though it does share some similarities in its investment approach to AFMC; these include underweight exposure to financial stocks and overweight exposure to consumer-focused companies.

Figure 32: Global emerging markets AIC sector comparison table – performance data to 31 October 2019

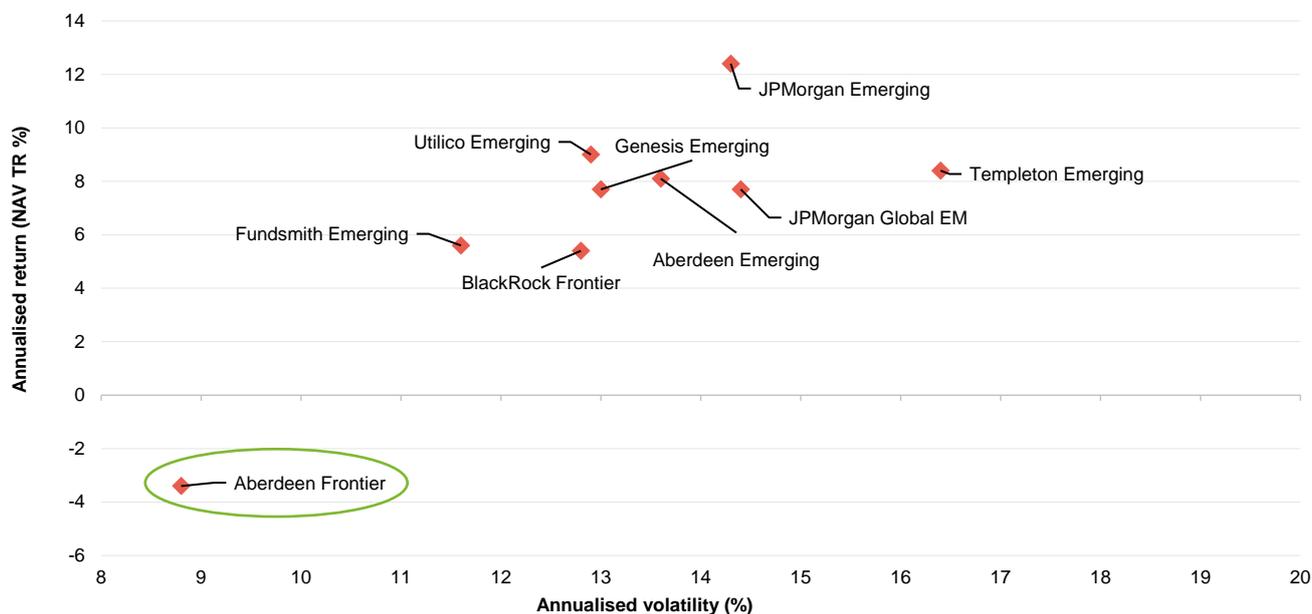
	Market cap GBPm	Premium/Discount (%)	Yield (%)	Ongoing charge (%)	Cumulative NAV TR performance to			
					3 months (%)	YTD (%)	3 years (%)	5 years (%)
Aberdeen Frontier	34	(11.0)	2.8	2.0	(8.1)	(4.3)	(21.9)	(18.7)
Aberdeen Emerging	268	(13.6)	0.0	1.0	(6.5)	12.2	14.4	43.1
BlackRock Frontiers *	321	0.9	5.0	1.4	(11.0)	2.6	6.6	31.1
Fundsmith Emerging *	320	(5.2)	0.2	1.5	(1.1)	4.7	9.2	27.4
Genesis Emerging	1,039	(10.5)	0.0	1.1	(3.5)	16.7	16.5	41.5
JPMorgan Emerging	1,187	(8.7)	1.6	1.0	(5.3)	14.5	27.7	68.8
JPMorgan Global Emerging	386	(5.2)	3.8	1.3	(5.1)	12.6	17.7	39.4
Jupiter Emerging & Frontier*	91	(5.2)	4.3	1.4	(2.3)	12.8	-	-
Mobius	92	(3.0)	-	-	(5.9)	(8.3)	-	-
Templeton Emerging	1,928	(11.9)	1.8	1.0	(5.0)	15.0	27.8	47.9
Utilico Emerging	534	(10.1)	2.0	1.0	(7.4)	11.4	18.3	46.4
Direct peer group* average/rank**	191	(5.1)	3.2	1.6	3/4	4/4	3/3	3/3
Wider peer group average/rank**	563	(7.6)	2.0	1.3	10/11	10/11	9/9	9/9

Source: Financial Times, Morningstar, Marten & Co. *Note: AFMC's direct peer group includes BlackRock Frontiers, Fundsmith Emerging and Jupiter Emerging & Frontier.

**Note: Total return performance data shown as a ranking.

AFMC is the smallest fund in the sector by some margin. This is reflected in its ongoing charge rate of 2%, which is above average compared to both the direct and wider peer groups.

Figure 33: Risk versus returns for selected global emerging funds over the five years ended 30 September 2019



Source: Morningstar, Marten & Co

Over the past five years, AFMC has been the sector’s anomaly, as Figure 33 illustrates. Negative annualised total NAV returns as well as a significantly lower volatility profile. Mark notes that the portfolio has a relatively low portfolio correlation with emerging markets and developed markets.

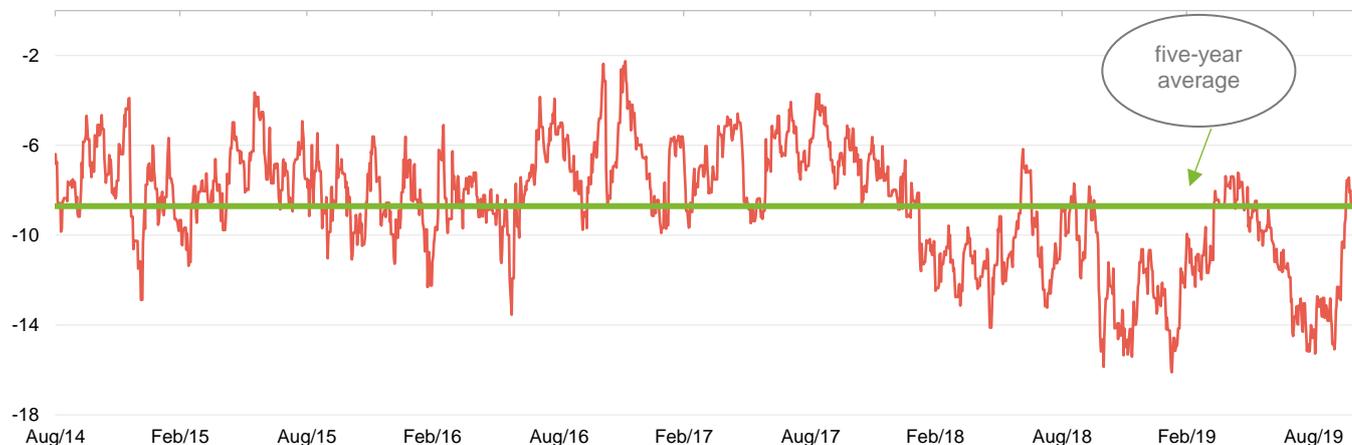
Dividend

Semi-annual dividends declared in US dollars

The board considers that dividends are an increasing part of the rationale for investing in frontier markets and the portfolio has a yield in excess of 3%. Dividends are declared semi-annually in US dollars. AFMC pays out dividends in July and December. In December 2018, a final dividend of 1.0 cent per share was paid out. An interim dividend, also of 1.0 cent per share was paid in June 2019. For the year to 30 June 2019, total dividends of 2.0 cents were 0.65x covered by earnings.

Premium/(discount)

Figure 34: Premium/(discount) over five years



Source: Morningstar, Marten & Co.

Over the 12-month period to 31 October 2019, the discount moved within a range of (7.2%) and (16.1%). It was mostly recently at (12.0%) on 15 November. Widening over the summer months reflected increased risk aversion – it has since narrowed back near to its lowest (most expensive) value this year.

On a longer-term basis, AFMC has mostly been on a widening discount trend since shareholders voted in March 2017 to shift the trust from a fund of funds mandate to direct investing (see the ‘Fund profile’ section). This likely reflects some shareholders’ frustration with AFMC’s relative performance.

Performance-driven exit opportunity

AFMC must outperform in share price terms by June 2020 or shareholders will be offered a cash exit

Shareholders approved the adoption of a new discount control policy in October 2018. Discount triggered tenders or other [discount control mechanisms](#) will no longer be pursued. Instead, if AFMC’s share price total return for the period from 1 July 2018 to 30 June 2020 does not exceed the total return in sterling of the FM index, shareholders will be given the opportunity to fully exit their investment in the company. Shareholders could then opt to exchange the shares for cash at the prevailing NAV less applicable direct costs (including any realisation costs of underlying investments).

The board also intends to seek annual renewal of the usual authority to buy back shares in the market. It will buy back shares where it believes it is in the best interests of shareholders to do so.

Fees and costs

The manager is entitled to a base management fee at the rate of 1.0% per annum of the NAV, payable monthly in arrears. There is no performance fee. The management agreement is terminable by either party giving to the other not less than six months’ written notice.

Vistra Fund Services (Guernsey) Limited is the administrator and secretary to the company. PraxisIFM Fund Services (UK) Limited has been appointed by Vistra to act

as the UK administration agent. Vistra receives a fee at a rate of £30,000 per annum, plus a monthly fee equal to one twelfth of £20,675 plus 0.075% of the net assets subject to a current monthly minimum fee of £5,500. With effect from July 2017, AFMC has agreed to pay a fee to Aberdeen Asset Managers Limited for the provision of promotional activities. The annual fee over the financial year to June 2019 was £22,000, down from £26,000 the year before.

The company's ongoing charges for the year ended 30 June 2019 were 2.0%. AFMC allocates management fees and finance costs as follows: 66.6% to capital and 33.3% to revenue. The board previously noted that it had secured an agreement from the manager to limit the company's ongoing charge ratio to no more than 2% when calculated annually as at 30 June. Should the 2% threshold be breached, the manager will rebate an equal amount of its management fee to the company. However, any rebate should not represent more than one third of the annual management fee payable for the relevant year.

Capital structure and life

AFMC has one class of ordinary share in issue. These are listed on the AIM segment of the London Stock Exchange

AFMC has a simple capital structure with one class of ordinary share in issue. Its ordinary shares are listed on the AIM segment of the London Stock Exchange and, as at 30 September 2019 there were 71,910,117 in issue with 1,302,500 held in treasury.

The trust did not have a loan facility over its most recent financial year

No loan facility over the last financial year

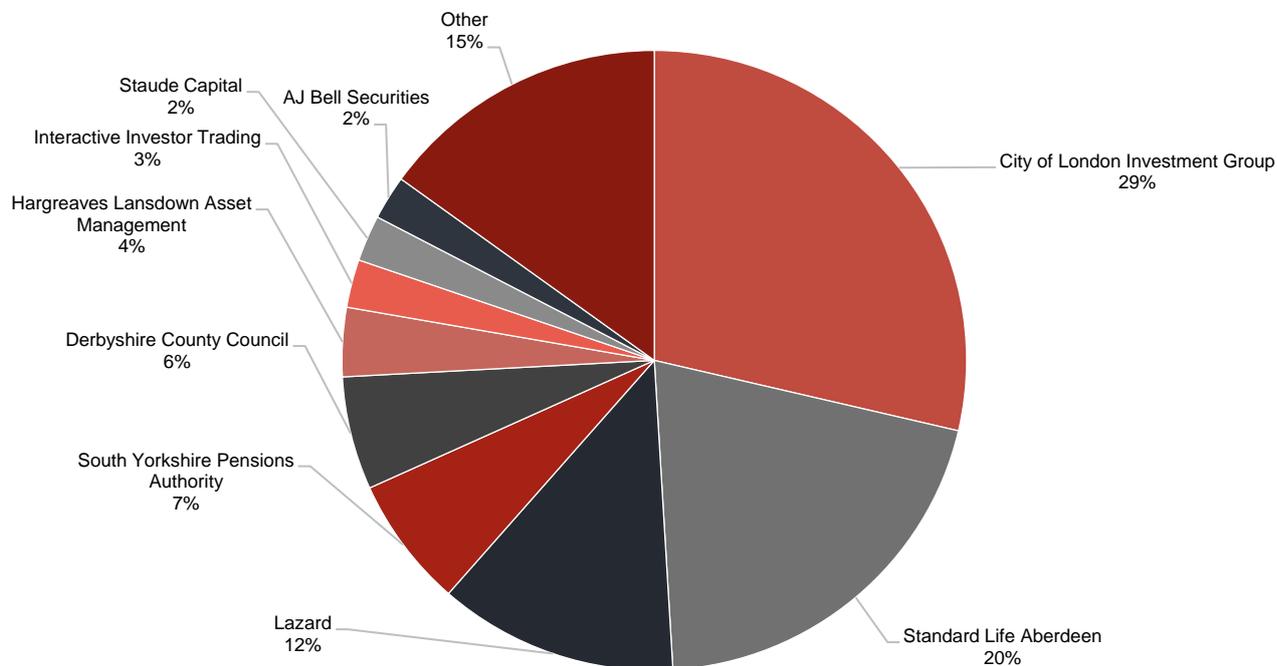
AFMC is permitted to borrow; borrowings, for investment purposes, are limited to 10% of net assets at the time of drawdown. The trust is not leveraged at present and did not have a loan facility during the year to 30 June 2019.

AFMC is permitted to use an overdraft or another short-term borrowing facility to meet its working capital needs. This was most recently used between 24 May and 14 June 2019, through a \$600,000 facility with Northern Trust Limited.

Major shareholders

Figure 35 shows AFMC's major shareholders, at 27 August 2019.

Figure 35: AFMC major shareholders as of 27 August 2019, % of shares held



Source: Bloomberg, Marten & Co

Financial calendar

The company's year-end is 30 June. The company's annual results are usually released in September (interims in February) and its AGMs are usually held in December of each year. The company makes semi-annual dividend payments. It is anticipated that an interim dividend will be paid in June and a final dividend paid in December of each year.

Board

The board comprises three non-executive directors, all of whom are deemed independent of the investment manager. A fourth director retired on 31 March 2017 and the board decided that, given the size of the company, he would not be replaced. The board considers that, collectively, the current directors demonstrate a breadth and depth of skills and experience required to steward the company.

The company's articles of association require that one-third of the directors put themselves forward for re-election, on an annual basis, and that all directors automatically stand for election at the first AGM following their appointment.

Figure 36: Board member - length of service and shareholdings

Director	Position	Year appointed	Length of service (years)	Annual director's fee (USD)	Share-holding
John Whittle	Chairman	2012	7.8	47,433	18,350
David Warr	Audit committee chair	2015	4.2	40,657	-
Lynne Duquemin	Director	2016	3.7	33,880	-

Source: Aberdeen Frontier Markets Investment Company, Marten & Co

John Whittle (chairman)

John Whittle was appointed to the board on 1 February 2012. Some of his professional career highlights include his time at Close Fund Services, where he was finance director. He successfully initiated a restructuring of client financial reporting services and was a key member of the business transition team. John also spent time at PriceWaterhouse before taking his career in the direction of business services, where he was mainly involved in telecoms. He was a co-lead in the turnaround of Talkland International (now Vodafone Retail). John is a Fellow of the Institute of Chartered Accountants and holds the IOD Diploma in Company Direction. He also holds the role of executive director for a number of offshore investment funds and other companies.

David Warr (audit committee chair)

David Warr is the second-longest-serving member of the board after John; he was appointed on 9 September 2015. Following his appointment as a partner at Reads & Co, a Guernsey-based firm of chartered accountants. David helped grow the firm into a more broad-based financial services business, until its sale in 1998. He is also a Fellow of the Institute of Chartered Accountants and serves as a non-executive director for a number of UK-listed entities.

Lynne Duquemin (director)

Lynne Duquemin has served as independent director for three and a half years; she has over 30 years of investment experience, with a particular focus on investment management and advisory services. Lynne is a member of the CFA Society of the UK and holds the ASIP qualification, and has also completed the IOD Company Direction Programme, passing both the Certificate and Diploma examinations. Lynne is currently a director at Asset Risk Consultants Limited, which provides investment consulting, manager research and performance reporting to private clients, charities, family offices, professional trustees and their trusted advisers.

Previous research

Readers interested in further information about AFMC may wish to read our previous notes, which are summarised in Figure 38 below. You can read them by clicking on the links below or by visiting our website.

Figure 37: Marten & Co. previously published notes on AFMC

Title	Note type	Date
Long-term growth opportunity?	Initiation	10 November 2016
Direct investing	Update	6 March 2017
No closet-tracker	Annual overview	26 March 2018
Incentivised to perform	Update	29 November 2018

Source: Marten & Co.

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