IMARA INVESTING IN AFRICA

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South Africa

The challenging macro environment in South Africa continues to dominate from a geopolitical as well as an economic perspective; meanwhile, communication and action by the US Federal Reserve looks set to remain the primary driving force for global investment markets.

Despite an improving trend in unemployment numbers coming out of the US, the Federal Reserve continues to voice concern regarding the low rate of wage growth and slack in the labour market and may only start raising interest rates once these two measures improve on a sustainable basis. Inflation remains very subdued on a global basis, with consumers still deleveraging and it looks likely that inflation will remain low for some time due to the lack of consumer confidence. Economic indicators from "Euro-land" continue to deteriorate; a situation that is not being helped by the Ukrainian crisis from a consumer confidence point of view. Unemployment in the Eurozone remains elevated relative to the US.

The local economic backdrop in SA remains poor with consumer demand continuing to decline and GDP growth weakening. Recorded growth for the second quarter was 0.6%. Mining and manufacturing in particular, which together account for 20% of total GDP, were severely impacted by the five month-long labour strikes. Given the current nervousness of asset managers locally and abroad, as far as share prices are concerned, together with the improving global economic backdrop, a severe correction in local equities is unlikely – but one of some sort is widely expected. The outlook for a relatively modest correction is further supported by the lack of inflationary pressures on a global basis. Interest rates thus could remain lower for a while longer.

Sub-Saharan Africa

The past month saw strong stock market performance from Egypt, Kenya and Zimbabwe; Nigerian equities, meanwhile, gave back some of their July gains. Among individual stock names, BAT Kenya was particularly strong, gaining 21%, followed by CIB (Egypt) +9%, while Delta (Zimbabwe) and Sefalana (Botswana) were both up +8%. In local currency markets, the Zambian Kwacha appreciated by a further 2.5% MOM.

The Egyptian stock market has been by far the best performer in our region this year, gaining 33% in US Dollar terms, and over 70% over the past twelve months. This appears to have been mainly driven by local retail investors rather than by foreigners, although the latter have also been rebuilding positions since exiting after the Arab Spring. Egypt's foreign exchange position however remains precarious, as the country has been running large fiscal and current account deficits. Egypt's Arab neighbours have fortunately been willing to provide substantial balance of payments support, which has allowed the currency to enjoy some stability. We do understand, however that, once again, repatriating US Dollars following sales of Egyptian equities is proving very difficult, suggesting that foreign investors will remain wary of investing too much into the market – similar to a lobster pot, it's easy to get in, but rather harder to get out!

For the first time in a while, the Kenyan Shilling came under pressure, but received support from the Central Bank of Kenya (CBK). Kenya – similar to Egypt - has been running high fiscal and current account deficits but has been able to finance these through capital inflows from the multi-lateral agencies and, of course, the recently issued Eurobond. Kenya's exports however, are under significant pressure: tea accounts for 30% of net exports but tea prices are down by 30% since the 2013 peak. In the Tourism sector, Kenya's beaches and safari parks

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have been emptied by on-going travel warnings from the US and Europe in the face of potential terror attacks. Inflation has also been rising and credit demand has been growing at 25%, implying some inflationary pressures are building, although this is partially explained by rising food prices after a poor rainy season. The CBK chose to hold interest rates level in its recent meetings. Treasury bill rates, meanwhile, have fallen back towards 8.2%, having been as high as 11% a few months ago, suggesting little stress in the system. Kenya's recently issued Eurobond furthermore, trades at a premium to issue price. It will be important that the CBK doesn't fall behind the curve again as it did in 2011.

In Zambia, the local currency, the Kwacha, has meanwhile continued to recover from the collapse earlier this year. The authorities appear to be sending the correct signals to the market, having eased exchange controls at the height of the currency's depreciation. This month the Government has resolved its issues with the mining companies with regard to tax refunds owed to them; this has held up investment into the Mining sector for some time now. President Sata is apparently very ill and is confined to State House, having received treatment in Israel in July. Sata was influential in implementing increased exchange controls soon after he came to power and has been on the "war-path" as far as the mining companies are concerned - his illness is perhaps allowing his Ministers to reverse some of those negative policies. There is meanwhile evidence of "jockeying" for position in his ruling party, not least because his Vice President, Guy Scott, is not actually Zambian, his parents having been born in Scotland – and, as such, he cannot automatically take over should Sata die in office.

In Zimbabwe, on the political front, the various factions within the Zanu-PF ruling party continue to fight for position in the run-up to their all-important Congress in December. Vice President Joyce Mujuru appears to have the upper hand as far as becoming Mugabe's successor is concerned but, then again, who knows when that day may come! Also of interest was the new Central Bank Governor's monetary policy statement, which, amongst other matters, is removing restrictions on foreign investors buying local bonds in the primary and the secondary markets. With high US interest rates on offer in Zimbabwe, this could be attractive to "yield-hungry" foreign investors.

Nigeria

The onset of the northern hemisphere summer holiday period saw interest in Nigeria dwindle along with volumes; these fell to around US$8mn/day at one point, down from around US$25mn on a more "normal" day and over US$100mn back in 2008. Among some of the larger "movers" in the stock market were PZ Cussons, which fell by 10.5%, Guinness, which fell by 5.4%, StanbicIBTC, which fell by 4.3% and FBN, which rose by 3.5%. PZ's decline followed publication of its audited accounts (FY to May 2014) which showed a fall in margins due to higher palm oil prices, increased spending on marketing, route-to-market investments and automation. It clearly remains tough going for domestic consumption stocks, although companies like Nigerian Breweries and Nestle are now showing reasonable top-line growth. PZ itself is growing the top-line by around 3% with electrical appliances growing by 9%.

The underlying news has actually been reasonable this month despite the market's stupor; foreign exchange reserves are building (to US$39.4bn) and money supply growth has shot up to +10.9% in July YOY, after "flat-lining" for twelve months. Currency in circulation outside the banks rose strongly too (+8.4% YOY). Pension fund inflows have also been strong: rising to US$27.2bn as at June 2014 with 6.12mn workers registered and 14.4% invested in domestic equities. The main negative news related to Boko Haram again – with no real impact on equities - and the threat from Ebola, with four deaths recorded (at the time of writing) in Nigeria. We suspect a treatment for Ebola will soon be developed, given the rapid recovery of people who have received treatment in the developed world.

On the corporate front, Shell announced their plan to sell four "blocks" in the Delta as well as a major pipeline for around US$5bn. In parallel, banks - including StanbicIBTC - continue to raise US Dollar funds for "on-lending" to the oil sector.

Dangote Cement announced their results for H1.2014; while sales grew by 5.3% YOY and EPS fell by 11.1% (due to a higher tax charge and higher fuel costs), what was interesting was the announcement that the company would be spending US$250mn on construction of coal-fired power stations. Dangote currently uses a mixture of gas (which is proving to be an unreliable source of fuel) and Low Pour Fuel Oil (LPFO), which is imported and expensive relative to gas. The Nigerian Electricity Regulatory Commission (NERC) announced a gas price rise from US$1.50/mcf (one of the lowest in the world) to US$3.30/mcf to encourage producers to raise supply. This level is closer to - but still below - US prices at Henry Hub and considerably lower than prices in the EU and Asia. At the retail level, the plan is to raise retail electricity tariffs in line with US inflation and to allow tariffs to be reviewed twice a year. This month, Ibadan Disco (an electricity distributor) proposed a 25-30% tariff rise to US$0.154/kWh, which is around the usual global retail rate for coal-powered generation. Nigeria, however, doesn't have coal fired power stations and a plan was announced this month to invest money to prove up coal reserves; the hope is that coal fired

stations will eventually supply 30% of Nigeria's energy needs.

Broadband penetration is roughly 7%, although 39% of the population access the internet via mobile operators, compared to an average across Africa of around 16%, according to McKinsey. The World Bank estimates that, for each 10% increase in broadband penetration, GDP grows by an extra 1.4%. The e-commerce potential in Nigeria is large but currently held back by broadband speeds, an effective (postal) distribution system and, until recently, expensive "smart phones" and inaccessible electronic payment systems. The collapse in "smart phone" prices and the move to biometric identification has the potential to remove some of these hurdles and it will only be a matter of time before Nigeria exploits these technological developments more fully.

In nearby Ghana, the top-down view for some time now has been that the politicians are unable to manage their economy. The stock market has fallen sharply in US Dollar terms and the Cedi continues to fall in response to large twin deficits. The weak currency is now starting to feed through into prices, with the latest producer price index showing a rate of inflation of 47% YOY in July. Similar to Zambia, things really started to get out of hand (in February 2014) when "de-dollarisation" rules were introduced; these, like those in Zambia, have now been reversed.

Zimbabwe

This past month, the equity market was dominated by the ZSE Index "heavyweight" stock names: Delta and Econet rose by 7.1% and 5.7% respectively and Barclays share price added 9.5%. Also of note was continued foreign demand for Seed Co shares, which saw it's price rise by 17.5% after months of flat trading up to June of this year.

There was not much news of note this month, although the new Governor of the Reserve Bank gave his first Monetary Policy Statement via email - rather than at a presentation! The most significant aspect of his Statement was the establishment of the Zimbabwe Asset Management Company (ZAMCO), whose role will be to acquire all bad debts from the Banking sector which are backed by collateral. Non-performing loans are estimated at 18.5% of total bank loans, or US$700mn in absolute terms. This number grows as penalty interest rates accrue. (In 2009, Nigeria implemented a similar vehicle (AMCON) after the collapse of their Banking sector). ZAMCO will issue bonds to back the purchase of bad loans from the banks, which will be undertaken on a commercial basis. ZAMCO will then be tasked with the job of recovering the loans as best it can. ZAMCO will be supervised by the RBZ. If this plan works, then it should assist in "reliquifying" the Banking sector which, at the moment, is unwilling or, in some cases, unable to issue new loans.

ZAMCO will need to raise sufficient capital to undertake this role. Domestic sources will no doubt be called upon to play their part, not least the Pension Fund industry. We thought it was also interesting that, later on in his Statement, he eased all exchange control restrictions on foreign investors holding money market instruments; foreigner investors could previously only acquire up to 35% of any bond issue and were not able to buy any bonds in the secondary market at all. Now that Zimbabwe uses the US Dollar, interest rates in US Dollars are extremely attractive in Zimbabwe as compared to almost anywhere else in the World; for yield-seeking investors prepared to take additional risk, such rates could be of great interest on a risk-adjusted basis. The Stock Exchange is keen to promote a bond market for both Government and Corporate bonds and this will assist them greatly, especially as foreign investors have lately dominated trade in the equity market. This could also have the effect of reducing interest rates on the local market which must surely be encouraged.

The Governor emphasised – on a number of occasions - the need to attract foreign direct investment into the country as a means to recapitalise businesses and provide technical support. He clearly recognises that the domestic capital markets are too small to undertake such a task. He even suggested that the Country's Indigenisation and Empowerment Regulations had been misunderstood and badly marketed!

On that note, President Mugabe, having missed out on an invitation to the US for the US/Africa Investment Summit, undertook a full State visit to China, no doubt hoping to return with much needed credit lines to finance the economic turnaround. Media speculation, including an article in the Financial Times, suggests that the Chinese failed to provide that support and, what little investment was announced had strings attached. If this is true, then it may have come as a shock to him and his Government, although his Minister of Finance - since he took over his post - has been struggling to raise any significant foreign capital. On a positive note, the IMF, the World Bank and the African Development Bank are engaging positively with Government, but still reiterating the need to implement further policy reforms.

Internal factional battles within the ZANU-PF ruling party appear to be intensifying in the run up to their December Congress which, some commentators suggest could provide answers to the whole issue of the Presidential succession. We have no idea, but believe that a clearer picture on this issue would be helpful for the all-important foreign investors!

East Africa

The US-Africa Summit (4th-6th August) in Washington, saw the largest ever gathering of African leaders with a US President, and dominated the headlines during the month. A key outcome of the Summit was the extension of the Africa Growth and Opportunity Act (AGOA) for fifteen years for all 55 African countries and US$4bn for maternal health. East African leaders returned with a mixed bag of pledges. Kenya was included in the US27bn "Power Africa" initiative, which will finance renewable energy projects in geothermal, wind and hydro. Kenya and Tanzania, along with several other countries, will benefit from a wildlife protection initiative and a counter-terrorism programme, each worth US$65mn, while Rwanda sealed a deal with Symbion Power for a 50 MW methane gas plant at Lake Kivu. The Summit signalled a major shift in engagement between the US and Africa, from aid and governance issues to trade and investment, and appears to be an effort by the US to play catch-up with China, whose footprint on the continent has grown rapidly in the past decade.

The month saw a turnaround in the performance of the Nairobi Securities Exchange (NSE), with the NSE-20 Share Index up 4% in USD terms (compared to 0.2% in July) and is now up 1.6% YTD. There was renewed foreign investor activity in blue-chip counters such as KCB, Safaricom and East African Breweries (EABL), with stock market activity significantly boosted by strong half-year earnings results across various sectors. While EABL reported a 3.9% decline in EPS for FYY14 results, overall revenues grew 3.8% y/y and gross profits rose 9.8% The business incurred a one-off US$13.6mn restructuring charge related to cut-back in production of the price-sensitive Senator Keg following implementation of excise duty that has significantly affected volumes (down 75%) and resulted in a 1% YOY decline in Kenya revenues. Finance costs increased by 10% due to additional borrowing to finance working capital and capex. In response to looming competition from Equity Bank's Mobile Virtual Network Operator (MVNO) service, Safaricom significantly reduced charges for users of the popular M-PESA mobile cash system for transfers of amounts up to US$17 to a flat fee of US$0.29, similar to the charges proposed by Equity Bank. The two companies are currently engaged in a dispute over Equity Bank's plan to use ultra-thin slim SIM cards to be housed adjacent to existing SIM cards, thus targetting all mobile phone subscribers. Safaricom has filed a petition with the regulator challenging the proposal on the basis that it poses a potential threat to the security of its existing subscribers' confidential information. A ruling by the regulator is expected soon.

The Uganda Shilling recovered and gained ground, after the Constitutional Court rescinded the "anti-gay" law that had drawn significant criticism from Western countries and halted international aid. The local currency was also supported by healthy inflows from offshore investors who participated in the country's Treasury auctions. The stock market also improved, albeit marginally, with the Uganda Securities Exchange (USE) All-Share Index up 0.8% MOM and 11.4% YTD, both in USD terms. Umeme, the country's electricity distributor, continued to dominate trading, with a turnover of US$0.8mn, which accounted for 62% of total turnover. The company reported a 17.2% decline in EPS for 1H14, attributable to a 102% YOY increase in repair and maintenance costs and US$2.6mn in forex losses. DFCU also released 1H14 results, reporting 2.5% growth in EPS largely attributable to a 10.3% YOY increase in Net Income; the loan book expanded by 6.9% YOY.

In Mauritius, State Bank of Mauritius (SBM) reported an 8% YOY decline in 1H14 EPS, due to a substantial increase in credit impairment, lower fee income and higher non-interest expenses. While interest income increased by MUR47.6m, advances stagnated due to the current economic environment. The bank's Net Interest Margin (NIM)-to-average assets declined from 3.9% for 1H.13 to 3.6%. Meanwhile, New Mauritius Hotels (NMH) published 9M.14 results, indicating 0.9% YOY contraction in EPS. Revenue grew by 4.9% YOY, reflecting higher occupancy but at a lower average revenue per guest. Rolling 12-mth ROE hit a new low of 2.9%.

In Rwanda, the World Bank cut its 2014 growth forecast, from 7.2% to 5.7%, blaming delayed spending on energy and transport and a slowdown of credit growth to the private sector. Meanwhile, Bralirwa's 1H.14 results indicated growth in revenue and volume of 2.3% and 2.8% respectively, with revenue growth driven by a positive sales mix and the impact of limited price increase on Mutzig and Turbo King in 2H.13. Growth in beer volumes was 7.8%, while soft drinks declined by 8% due to reduced exports. A similar volume growth trend is projected for 2H.14.

Regional currencies reported mixed performance; the Rwandese Franc and Kenya Shilling declined by 1.3% and 0.7% respectively, while the Uganda Shilling and Mauritian Rupee both appreciated by 0.1%.

Resources

The sector reacted sharply to a raft of negative news that unsettled investors; this news included: weak Japanese household data; poor German unemployment and retail sales numbers; French political disorder and a stagnant economy; a threat of deflation in Europe; the notion of an income-less recovery in the US where only 57% of citizens now consider themselves middle-class, compared to 72% in 2008; and a "dimmer halo" around the Chinese steel market as 76% of steel output went to stocks in the first ten days of August. Add to the above

list the geopolitical concerns around Russia/Ukraine, Syria, Iraq and Palestine and Israel.

The Ebola virus continues to spread with – at the time of writing - over 3,000 reported cases and over 1,500 deaths collectively in Liberia, Sierra Leone, Guinea, Nigeria and Senegal. A further negative knock-on effect is the banning of trucks from the DRC by Botswana.

While Gold takes a "back seat" in the face of heightened, global geopolitical tension, weaker than expected Chinese steel demand is taking centre stage in the resource market. The Chinese industry publication, "Mysteel", reported that, "the downturn in the housing market is certain to deal a heavy blow to steel demand". Furthermore, "the slowdown in steel demand within other industries means that the conflict between demand and supply won't be solved in the short term". The Chinese policy of a series of mini-stimulus measures, together with a falling iron ore price has served to increase crude steel production (year to July) by 2.7% to 481mt, with the output of finished steel up 5.8% to 647mt. Of concern is that state steel mills carry some social responsibility and can't easily cutback output. In turn, private steel mills are maintaining higher production levels to meet bank repayments. The mix of Government policy and a demand / supply mismatch suggests pressure on steel and related input prices.

Corporate news of note included the following:

PAN African Resources has indicated that EPS and HEPS for FY June 2014 will be lower, respectively, by around 45% and 33%. The main reason for cautioned lower earnings is that the Evander Gold Mine stopping operations are transgressing a known low grade zone within the high grade 'Kinross Payshoot". We estimate that grades will normalise over the next fifteen months. PAR should also benefit from additional gold from vamping operations at Evander and the Evander Retreatment Project. Management has also indicated that the final dividend will at least match last years' in Rand terms (13.4cps).

Zimplats' controlling (87%) shareholder, Implats last week reported its FY June 2014 results. The five-month 'platinum strike' clearly had a devastating effect on its overall results. The woes of the South African platinum miners should have played into the hands of the Zimbabwe platinum miners. Zimbabwe has sadly, however made no progress in enacting an investor-friendly Indigenisation policy. In reply to a question on Indigenisation, the Implats CEO was 'lost for words' and simply had no answer for the audience.

Petmin has indicated that FY June 2014 HEPS will include the impairment of the Verona project (R181m) and the Iron Bird project (R19m), whereas normalised EPS are expected to be 24% higher at 17.6cps – 12x PE. Despite weaker export prices, the Somekele Anthracite Mine exceeded production of 1mtpa and revenues of R1bn for the first time; and has firm sales in place for the coming years. A further positive is that the NAIC (pig iron) project is 'firmly' on track as is the listing and unbundling.

Tiger Resources has announced the proposed acquisition of the outstanding 40% interest in its flagship Kipoi Copper Project from the DRC Government for US$111mn. The 25ktpa Kipoi SXEW plant should shortly achieve nameplate capacity. We believe that this deal will speed up the increase in the SXEW capacity to 50ktpa of refined copper. The company has proposed a US$19.5mn share placement and an entitlement offer of US$53.9mn as part of its equity funding strategy. The balance of the purchase price will come from a US$100mn facility provided by the Taurus Mining Fund.