IMARA INVESTING IN AFRICA

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South Africa

A major theme at present is the severe weakening of the Rand due to the strong US Dollar and the large current account deficit. In the latest MPC meeting, the SARB decided to leave the repo rate unchanged, but remained cautious on their outlook for inflation; however, their less hawkish stance was before the weakness in the currency. The current weakness in the currency could pose a material threat to inflationary expectations and it is highly likely that local interest rates will have to be raised in order to alleviate the selling pressure on the Rand, despite poor economic growth and little consumer price inflation.

Household consumption expenditure slowed further to 1.5% QOQ in Q2. Inflationary pressure is currently being driven by administered prices, which consumers can do nothing about. The problem, however, is that a 0.25% or even 0.5% hike in interest rates will - in our view - not be enough to reduce inflationary pressure by strengthening the Rand; the realignment of our rate cycle with that of the US will furthermore be a main feature in order to attract foreign funding of our current account deficit. In theory, higher interest rates should reduce the deficit on the current account, as consumers will spend (import) less; in many respects, therefore, raising rates is really all that the SARB can do.

The local economy only just escaped a “recession” in Q2 with a 0.6% increase in GDP, after contracting 0.6% in Q1. Consensus amongst economists is for GDP to average 1.9% in 2014, but this number is steadily decreasing with some large investment banks - like Morgan Stanley - dropping their forecast growth rate down to 1.3% from 1.8% previously. We expect more downgrades to come through in the next couple of months.

The JSE All-Share Index declined by 5% (in Rand terms) in September, with heightened volatility. Foreign selling is likely to put further pressure on our stock market in the short term as indicated by the weakening Rand. The currency impact on earnings however should be positive. The stock market currently trades on a trailing price earnings ratio of 17x after reaching a high of 19.2x in May this year, and is offering far better value at current levels.

Reported corporate earnings remain very robust but our view remains that the stock market will be driven largely by interest rate expectations in the US and the reaction from the SARB. We remain confident that – on a one-year view - equities will outperform interest-bearing instruments as real yields will remain low despite higher interest rates and the risk of capital loss in bonds in particular has increased due to potential higher interest rates.

Sub-Saharan Africa

Despite the weakness in global Emerging Market indices over the past month – which were down 7.6% - and, in our region, South Africa - down 3% - the rest of the African equity indices were largely stable or even managed to post positive returns. South Africa’s losses were all currency related, as the Rand fell by 6% - not helped by a worse than expected current account deficit. Related to the Rand, the Botswana Pula fell by 4% and the Zambian Kwacha by 4.5%. Other African currencies were weaker as well, falling by around 1% on the month.

At stock level there were some strong gains from Guinness Nigeria, which rose by 16% despite announcing poor annual earnings figures (by now well discounted) and BAT Kenya, whose share price gained over 12%, following on from the 21% gain in August. Among the Financial stocks, Stanbic IBTC (in Nigeria) and CIB (in Egypt) gained 12% and 10% respectively. In Botswana, Sefalana, the retailer, gained a further 5% as the stock remains "bid only".

Over the past quarter, Egypt has been by far the strongest of the local equity markets, despite the political events taking place in and around the Middle East. As we mentioned in last month's report, repatriating US Dollars has become more difficult and that may explain why foreign investors are reluctant to sell shares, despite recent gains. Among the other larger regional stock markets, Kenya was up 7% over the quarter, followed by Zimbabwe, which was up nearly 5%. Zambia gained just under 4%, but that was largely driven by a recovery in the Kwacha. Nigeria had a tougher quarter ending down 3.5%.

The news this month in the region has been dominated by the continued spread of the deadly Ebola virus, which has been affecting a number of smaller West African countries. This outbreak has to-date, thankfully, been contained in that region and has not spread to other parts of Africa. It has not been an issue for the African equity markets at this stage but it must be hoped that the disease can be contained and hopefully eradicated, as it is badly affecting the economies of those countries concerned.

Among the commodity producing nations – Nigeria, Angola and South Africa in particular – concerns have been focused on the decline in global commodity prices, likely the direct result of a strengthening US Dollar. As the US, furthermore, continues to ramp up oil production in 2014, the price of oil is under increasing pressure. As we write, Brent Crude is approaching US$90/barrel - back to the same levels as 2012. In the case of Nigeria, their budgets are based on an oil price of US$75/barrel, but the impact will be on the currency flows should the oil price fall further. The "flip-side" to this is, however the benefit to the oil-importing nations - such as Kenya - which already have a large current account deficit. Falling oil prices should also allow petrol prices at the pumps to fall, which should help to boost consumer spending.

The rise in the trade-weighted US Dollar is usually bad for Emerging Markets as a whole. In the past in Africa, South Africa and Egypt have been the worst affected by an appreciating US Dollar, while the beneficiaries have been the likes of Botswana – as a result of their US Dollar-denominated diamonds and their Rand imports - and Morocco - which typically prefers a weak Euro, given their close economic ties with Europe. The impact of a rising US Dollar is, however, felt less keenly by most other African countries, outside of the 'commodity effect' mentioned above.

Nigeria

The Nigerian stock market was extremely quiet but, at stock-level, there were some interesting developments: Guinness, weak for so long, rose by 16%; StanbicIBTC also rose sharply, by 12%. The Domestic Consumer shares were flat, with the exception of Unilever, which fell by 4.4%. Our two main Bank holdings, GT Bank and Zenith (10% weightings), were down around 2%, in line with the Index.

There were two corporate news stories of note: Access Bank announced a 1:3 rights issue. They are the first of the banks to announce a capital issue following stress tests implemented by the CBN; and Guinness reported FY.14 earnings. These numbers were indicative of the continuing poor demand environment (Q4.14 revenues were down 9% YOY while net profits were down 19% YOY). The fall in net margin was mainly due to a rise in interest charges. Guinness attributed the poor results to a fall in volume sales of both Harp and Guinness, following the decision to raise prices in the first half of the year - these price rises have now been reversed. In their result's conference call, management were confident for FY.15, with a programme in place to increase marketing and advertising, especially surrounding the core Guinness brand. The company is also increasing the number of outlets and increasing oversight of its sales force.

The ROAE of the banking system in aggregate is expected to fall by 0.75% to 17.7% this year. This is reasonable, given the swathe of regulatory changes that have been imposed by the CBN – the rise in the cash reserve ratio, the removal of the charges on transactions and the Amcon levy. PBT for the sector fell 1.1% YOY during H1, compared to a full year growth rate of 10.7% in 2013. The outlook appears quite good against a reasonable forecast of 6-7% economic growth with stable inflationary pressures. The Federal Government is also paying the debt owned by the now defunct Power Holding Company of Nigeria (US$3bn), which will help the banks, and, in an unusual twist, the banks will be paying clients and customers to use "e-payment" platforms. This move is also likely to bring the informal sector into the formal economy. There are however, two potential clouds on the horizon; further tightening through the non-government cash reserve requirement as elections approach and exchange rate uncertainty following the sharp fall in the price of oil.

An extraordinary Bill looking to compel private companies to list is in the pipeline. We found it hard to take this idea seriously when it was first mooted but the Bill is now being fast-tracked. The idea is that companies like MTN and the oil and gas companies with sales or assets greater than US$480mn should list, possibly as soon as 2015. Closer inspection suggests that Nigeria is suffering from the age-old problem that most of these companies avoid paying tax - the idea is that a listing will increase transparency.

The Government of Dubai bought a 1.3% stake in Dangote Cement during the month. This takes the free float to 8% vs. the 20% stake, which needs to be held by third parties under stock exchange rules. This acquisition followed a move by the Qataris to buy a 12.5% stake in Ecobank.

Finally, this coming month marks the end of QE tapering in the US. We do not think this will have a significant impact on Nigeria, since this event has been well “telegraphed” and, judging from the fairly weak Naira, portfolio outflows that are likely to happen have already occurred. The effect of a strong US Dollar on commodity prices and on global economic growth is likely to prove more significant, as too is recovery in domestic demand in Nigeria.

Zimbabwe

A rather dull month with little stock market activity and not much in the way of news to enlighten investors.

The Minister of Finance, in his drive to re-engage the foreign investment community, hosted a breakfast with the IMF representative and local businessmen, supported by the State-owned national newspaper (The Herald). Such an event would have been unheard of in the past. This coincided with the end of the IMF Mission to Harare to review the existing Staff Monitored Programme and to discuss a new SMP for the next fifteen months. At the end of the Mission, the IMF issued a press release which was again positive. It read:

“The reform efforts have started to lay the ground for stronger, more inclusive, and lasting economic growth and addressing the economic challenges remains a priority for the government. It is encouraging that the authorities have come to the conclusion that Zimbabwe cannot address these challenges without the support of the international financial community. The authorities’ policy reform agenda, which they will monitor with the help of IMF staff under a proposed new 15-month SMP to end December 2015, consist of the following major areas:

- *Balancing the primary fiscal budget. This will send a strong signal that Zimbabwe’s government intends to live within its means. Moreover, fiscal policy will focus on raising the efficiency and quality of public spending and rebalancing the expenditure mix toward infrastructure and social outlays. Scarce public resources need to be used appropriately, underscoring the importance of containing pressures on the wage bill, stepping up reforms in the taxation of the mining sector, amending the Public Finance Management and Procurement Acts and approving the Public Debt Management Bill.*

- *Restoring confidence and stability in Zimbabwe’s financial sector. The approval of the draft operational framework for the acquisition of nonperforming loans by the Zimbabwe Asset Management Company and other private asset management companies by the RBZ Executive Committee/Board, submission to Parliament of amendments to the Reserve Bank of Zimbabwe Act, and amendments to the Banking Act, will be instrumental in restoring confidence and bringing stability to the sector.*

- *Addressing the country’s debt challenge by stepping up re-engagement with all creditors with the objective to normalize relations. To this purpose gathering support to define a strategy for clearing arrears with multilateral institutions will be essential.*

- *Clarifying the Indigenisation and Economic Empowerment Laws. This will encourage mutually beneficial partnerships between domestic and foreign investors. This step will go a long way toward allaying negative perceptions on the security of investments and property rights, provide legal transparency and predictability, and reassure markets of the government’s open invitation to invest in Zimbabwe."*

This is arguably the most positive statement from the IMF in many years and, encouragingly, the key issues raised above for the reform agenda are already being addressed to some extent; indeed, in his Mid-term budget last month, the Minister of Finance suggested that a change to the Indigenisation regulations was imminent. He also raised taxes on fuel and mobile phone calls, as a means of taxing the informal sector, which is currently thriving. The Government - for the time being - looks to be moving in the right direction, albeit slowly!

East Africa

This month saw signs of waning risk appetite in global equity markets as the economic outlook in Eurozone and China (exacerbated by wide-spread pro-democracy protests in Hong Kong) weighed on investor sentiment. This gloomy outlook contrasted with signs that the US economy continues to gather momentum, as evidenced by an upward revision of GDP growth from an initial estimate of 4.2% to 4.6%. In line with stronger prospects for the US markets, all regional currencies weakened vis-à-vis the US Dollar, albeit in varied margins. The Mauritian Rupee, Uganda Shilling, Kenya Shilling and Rwandese Franc declined by 1.8%, 1.2%, 1% and 0.4% respectively.

Kenya revised its GDP numbers after changing the base year from 2001 to 2009. Rebasing revealed that the economy (at US$55.3bn in 2013) was larger by 25.3%. New sectors gained significance - although there was no dramatic difference in the economy's structure - Real Estate is 8.2% of GDP while ICT is now a standalone sector. The five-year average share of Agriculture to GDP (2009 to 2013) increased from 24.1% to 25.4%, while the Manufacturing share climbed from 9.5% to 11.3%. The new GDP per capita is US$1,246 compared to US$994, raising the country from a developing country to a lower middle-income country. The new base year has compiled measures of GDP with a new more recent price structure, taking into account any potential new sectors, new products and technologies and evolution of consumer behaviour and tastes over time. The GDP growth rate for 2013 was revised upwards to 5.7% from 4.7%; the highest growth rate recorded in over ten years for Kenya under the new numbers is in 2010 when the economy grew 8.4% (versus a reported figure of 5.8%). The rebasing keeps the country on target to meet its commitment under the East African Community of having 2015 as the new base year. The UN Statistical Commission recommends that countries rebase their GDP every five years.

The Nairobi Securities Exchange (NSE) continued its upward momentum - though at a slower pace - with the NSE-20 Share Index up 1.2% in USD terms (compared to 4% in August) and up 2.8% YTD. Safaricom, Equity Bank and KCB continued to attract significant interest and dominated trading. Equity Bank appeared to have won the first round in its high stakes battle in the mobile money transfer space, after the Communications Regulator finally approved the bank's use of SIM overlay technology on a one-year trial basis in its Mobile Virtual Network Operator (MVNO) business. Safaricom has previously opposed the use of SIM overlay technology on the basis that it may pose a threat to confidential subscriber information. Following the grant of approval to Equity Bank, Safaricom indicated it will review some of its legal commitments to its subscribers and mobile banking partners with a view of addressing potential legal exposures. There was an added twist to the matter after a parliamentary committee directed that the launch should be halted until the safety of confidential subscriber information can be ascertained however, it remains unclear whether the National Assembly's directive will supersede that of the regulator.

Uganda is seeking a US$8bn loan from China to build a railway network to revamp the country's transport infrastructure ahead of starting commercial oil production, which follows the earlier signing of a MOU with China Harbour Engineering Corporation (CHEC) for a feasibility study on the new project. Earlier in the year, EA leaders and China formally signed agreements related to the construction of a new multi-billion dollar, standard gauge railway to run from the Kenyan port of Mombasa to Nairobi and on to neighbouring states, including Uganda. The country plans to start pumping its crude - estimated at 6.5bn barrels in reserves, in 2017. Inflation, meanwhile, maintained it's downward trend for the seventh consecutive month, falling by 1.4% in September; attributable to increased food supply and subdued demand from the lag effects of a tight monetary stance deployed by the Bank of Uganda to tame inflationary pressure. Core inflation declined to 2.0% in September, down from 3.1% in August.

In Mauritius, MCB Group released FY.14 results indicating marginal growth in EPS. PBT rose 4.0%, boosted by rising net interest income (up 3%) and fees and commissions (up 13%). Performance was affected by reduced private investment in Mauritius, excess liquidity leading to shrinking margins owing to low yields from Treasury bills and a substantial increase in impairment charges. Meanwhile, the country maintained its 2014 growth forecast at 3.5%.

Standard & Poors (S&P) revised Rwanda's rating outlook to "positive" from "stable" on fiscal consolidation and affirmed the 'B' credit rating on both long and short-term foreign and/or local currency. The revised outlook reflects S&P's opinion that Rwanda's fiscal consolidation path is on target after donor support resumed, and that total debt stock is maintained at low levels compared to peer countries. According to the rating agency, overall Government deficits will gradually decline to 2.6% of GDP by 2017, while total debt will average 3% over the same period, compared to 4% during 2010-2013.

Resources

Last month we noted a long list of negative issues that had unsettled the resource market. This was aside from a list of geopolitical issues that were equally negative. This negativity now has stocks in free-fall. as a stronger USD/weaker commodity prices added to market concerns. At last we are seeing miners cutting back on production/projects, a factor in stopping this bear market.

The McKinsey Global Institute estimates that the global urban population is growing by 65 million a year and that nearly half of global GDP growth between 2010 and 2025 will come from 440 cities in emerging markets, mostly unknown by business executives today. To materialise, McKinsey's forecasts are going to need going to need a huge amount of new infrastructure built. This is all good news for resources, but some strong ‘triggers’ are needed to turn this very bearish commodities market around.

As the ‘climate change and carbon emission’ debate has gathered momentum over the past decade, it has probably contributed to delays and indecision by the global public and private sectors to spend on infrastructure. During the past month the Global Commission on the Economy and Climate set out “compelling evidence” that economic growth and action on climate change can be achieved together. The Commission has since published a global outreach study-guide calling for US$90tn in investment in cities, land use, and energy infrastructure that will take place over the next fifteen years to spur economic growth. This is the type of strategic thinking that the resource sector needs - now we need some action!

In recent months the Zambian Revenue Authority has held back almost US$600mn in VAT refunds following a dispute with mining companies. This could have serious repercussions for the local economy if the spat continues. Earlier last week, Glencore’s Mopani Copper Mine announced that it was suspending part of its US$800mn expansion plans. This was then followed by Glencore, which called a halt to their Sable zinc mine operations; due to the current economic environment and the withholding of VAT refunds by the Zambian government.

Africa Mining Intelligence (AMI) reports that Zimbabwe sold 500k carats at the latest diamond auction in Belgium and “raked in US$110mn in three earlier auctions this year”. The next auction, in November, is due to be held in Harare, ahead of the planned opening of a local diamond-cutting centre.

AIM reports that mining companies in the Katanga Province of the DRC are being drawn into the battle between the DRC President Joseph Kabila and “strongman”, Moise Katumbi, the Governor of the copper-rich Katanga Province. Unbeknown to Katumbi, Kabila has urged copper miners to contribute to his new fund that will “bankroll development in Katanga”. With “little choice”, large miners such as Komoto, Glencore, Tenke Fungurume and Freeport McMoran have agreed to contribute, subject to a list of requirements. It has been widely reported that both men are intent on contesting the 2016 Presidential elections. This is evidence of yet more unwelcome Government interference!

Corporate news of note included the following:

Petra Diamonds reported impressive all-round results for the year to June 2014. Carats produced increased 17% to 3.1mcts and revenues, operating profit and profit after tax increased by 20%, 36%, and 142% respectively. Adjusted EPS from continuing operations increased 31% to US$14.8cps. After purchasing five non-core operating mines from De Beers (2007–2011), management is doing a great job in rejuvenating the various operations. Petra has defined the fourth largest global diamond resource base and has a carefully mapped out plan to organically increase annual production by 66% to 5mcata by 2019. Much of this increase in production will significantly come from an increase in grades, as new undiluted ore blocks are accessed. As capital expenditure reduces sharply after 2016, Petra is forecast to generate significant free cash flows.

Middle Island Resources has begun legal proceedings against the Niger Government over two permits near the Samira Hill Gold Mine. This is yet another example of Government getting directly involved in mining and then being conflicted when decisions are made on exploration or mining permits.

Aureus Mining has raised US$16m at 32p – nearly 50% below the month-end share price - in a private placement. The proceeds will go towards funding exploration activity, whilst the New Liberty Gold Mine is being constructed.