African Intelligence Report

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South Africa

Along with other major markets, the JSE All Share declined by 8% in September but staged a 3% recovery in early October. A notable feature has been Rand weakness as the local equity market experienced net foreign selling during this period, as a result of a strong dollar and week commodity prices. The Rand has however recovered some ground at the time of writing, trading towards the key technical level of R10.80 relative to the US Dollar.

On a more positive note, inflation in September on a year on year basis was 5.7%, the first time it was below the upper target band of the SARB since February this year. Declining oil prices should further aid the downward trend in inflation if the Rand does not weaken materially from these levels. The lower oil price may also improve SA’s burgeoning current account deficit, which should in turn be Rand positive and is likely to ease concerns of the potential impact of tightening by the Federal Reserve. The authorities will have to hike interest rates along with the Fed to maintain foreign funding of the current account deficit.

Interpreting the latest press release by the FED, as anticipated QE has come to an end on the back of continuing improvements in the job market and a gentle rise in inflationary expectations. However, the outlook for higher interest rates still remain uncertain with fairly dovish comments indicating that interest rates could remain low for a considerable time. To quote: “ The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run”.

Given that local inflation appears to have peaked and relatively poor growth prospects there appears to be little pressure on the SARB to raise interest rates any time soon which will support local equity prices and foreign funding of the current account deficit.

On the equity front, the main sectors that continue to outperform remain Industrials, Retail and Banking stocks. Retail stocks, in particular, remain popular with foreign investors and have mostly reported impressive earnings numbers despite the poor consumer environment. The expansion of our retailers into Africa remains an important theme much liked by foreign buyers. Resources, despite the weaker Rand, remain in the doldrums due to local labour concerns and falling commodity prices. Construction stocks are being influenced by a “wait-and-see” attitude among investors, as the expected large infrastructure expenditure by Government has not really kicked off yet.

In terms of valuation, the All Share Index de-rated by 11% in September in the wake of the global market sell-off. Resources de-rated by 26% during the same period, despite a weaker Rand. Given good earnings prospects for the next twelve months (forecast to be +16%) and the likelihood of a stable interest rate environment, the overall stock market is offering better value after the recent retracement but we emphasize that good stock selection remains a key factor.

GDP growth for 2015 continues to be revised downwards with estimates ranging between 1.3% and 1.5% mainly due to a deteriorating consumer expenditure environment particularly in the durable and non-durable space, so very much across the board. Consumer expenditure constitutes 78% of GDP growth.

Sub-Saharan Africa

October was a horrible month for the African (Ex South Africa) equity markets, with few exceptions; indeed the falls were not dissimilar to those in the developed markets ten days before month end, however African equities never recovered in line with their larger peers. The biggest losers - in stock market terms - were Nigeria, which declined by 12%, Zimbabwe by 9% and Egypt by 7%. Kenya fell by 3.5%. The smaller regional markets fared better, with Zambia down 1%, Botswana up 2% (mainly currency) and Mauritius down by almost

1%. The MSCI Africa (Ex SA) Index fell by 8%. In the Currency markets, the South African Rand and the Botswana Pula rallied against the US Dollar, gaining 2% and 1% respectively. The weakest currency was the Nigerian Naira, which declined by 1.2%.

Share prices in Nigeria were particularly hard hit - Guinness and Unilever in Nigeria declined by 25%, GT Bank and StanbicIBTC fell by 16% and 12% respectively and Nigerian Breweries fell by 8% - but not to the exclusion of Zimbabwe where Delta and BAT fell by 10%. We were informed by sales from AMCON in Nigeria - the asset management company that was formed to rescue the banking sector in 2009 – that, in sharp contrast to the rest of the world, Nigeria started its decline ten days before month end, There were few gainers in October, with the notable exceptions of Sefalana and BAT Kenya which rose by 8% and 22% respectively.

Nigerian investors were clearly spooked by the rapid fall in the price of oil - the country's main foreign exchange earner - over recent weeks. The Central Bank is maintaining its tight monetary policy and indeed we may even see them tighten reserve requirements further still over the coming months. On a positive – and unusual – note, the fiscal taps have not been turned on this time around, despite an upcoming election. Both policies suggest that the Naira, which is not overly out of line on a real exchange rate measure, should not devalue by much from here, as compared to 2008, when the oil price last collapsed. The elections are due in February and, with Goodluck Jonathan standing again, there is a good chance that he will win another ticket and hopefully continue with the reform programme that his team has pursued these past years. The opposition has yet to name a leader.

We visited Kenya and Tanzania this month and came away excited (as usual!) by the huge growth potential for the East African region. A meeting with the Central Bank in Tanzania reinforced how serious the region is about a monetary union, with the IMF advising the Governments on convergence. The objective is to move the region to inflation targeting. The region has three big populations (Uganda, Kenya and Tanzania) with a market of around 170 million people (and a hinterland of almost double this with South Sudan, Ethiopia and northern DRC included); and a GDP of over US$115bn. This region would have its financial and manufacturing centre of gravity in Kenya and a large offshore oil and gas industry in Tanzania - and potentially in Kenya as well. Inflation is manageable and below 7.5% in the main three countries, with growth of over 6%. Over 50 private equity firms are now based in Nairobi to take advantage of these boom conditions. The Kenyan state pension fund is, in addition, expected to at least triple assets in the next couple of years as statutory contributions rise; and pension assets are already over 50% of GDP in Tanzania. Finally, we explored the vulnerability of Kenya to outflows given macro conditions in developed markets. The main risk, of equity outflows, is an unknown-known, but the main risk exposed in 2009 – of foreigners shorting the Shilling – has now been closed off. Diaspora inflows remain strong and foreign debt is mainly long term and on concessionary terms.

In Zambia, President Sata has died and Deputy President, Guy Scott, has taken over until elections are held in three months' time. The opposition and the ruling parties are both divided, so it may take a while for Presidential candidates to be agreed upon; ironically, if Guy Scott was not of Scottish descent, and therefore unable (constitutionally) to stand, he would probably win!

Nigeria

The MSCI Nigeria Index (in US Dollars) and the Stock Exchange Index (in Naira) fell by 12.9% and 9.9% respectively – the difference being the small 3.1% fall in Dangote Cement, which is illiquid and comprises a third of the SE Index. The Naira fell by 1%. The investible companies therefore took the brunt of the selling as the oil price collapsed; the largest falls over the month (in Naira) were PZ Cussons (-31.9%), Guinness (-24.9%) and Unilever (-22.9%). Nigerian Breweries "outperformed", falling by 8%. The Index is now down around 16% YTD and YOY - i.e. most of the fall has happened in the past two weeks.

While the oil price fall was a factor, bottom-up factors have not helped. Many Q3 results reported this month point to continuing weakness in earnings – top lines and gross operating profits are flat (which is impressive since raw material import content is often quite high), but higher marketing costs - to combat cheap Chinese imports - have then weighed heavily on bottom lines. The Banks have even announced lacklustre earnings, however the trend here seems to show a sharp increase in loans (from the end of H1.14) to offset the impact of the higher cash reserve ratios on government deposits. Finally, the fall seems to be due to AMCON and foreign selling, especially of the banks. Volumes have been low, as they always are in a sell-off; for example, PZ Cussons fell on a total monthly volume of only US$2.1mn.

Share prices are now trading, needless to say, under their fair value levels, although PE multiples remain high due to flat sales with higher capex and marketing costs coming together to hit earnings. We had hoped that this cycle had already troughed, but, paradoxically, a cheaper (imported) petrol price could have the desired effect on corporate earnings and hence equity prices. The oil price itself seems to have stabilised at around US$80; this is just above the reference price used for the Budget and around the level where the current account falls into deficit. This is not a disaster by any means, but it is a sharp change in expectations, especially with respect to confidence in the Naira.

Among Corporate Results announced:

- **Guinness** - Q1.15: Sales -6.6% YOY; EPS -19%, due to higher tax and finance costs. Operating profits rose 7% and market share was stable - a sharp improvement.
- **Nestle** - Q3.14: Sales +8% YOY but EPS -15%, due to foreign exchange charges. Both "Milo" and "Maggi" brands seem to be doing well despite cheap Chinese competition.
- **Unilever** - Q3.14: Sales -10% YOY; EPS -55% - these were poor despite coming off a low base. The only bright spot was a rise in the gross profit margin from 37% to 40%, but higher advertising charges to combat Chinese imports took their toll, especially in detergents.
- **PZ Cussons** - Q1.15 (to August): Sales -0.3% YOY but EPS -30%, caused by high advertising and distribution costs. Sales of soaps and electrical appliances have been strong in Lagos but weak in the North. UK parent raised its stake from 70.4% to 70.6%, a slightly smaller increase than in previous years; 75% triggers a full bid.
- **Nigerian Breweries** - Q3.14: Sales -5.7% YOY; EPS -3.7%; a good result in a tough environment. Volumes and operating margins are stable but consumers still continue to "trade down" to value brands and there has been no pre-election boom.
- **GT Bank** - Q3.14: PAT +3.9% YOY; Loans +15% YTD vs. flat deposits; ROE 26.4%.
- **StanbicIBTC** - Q3.14: EPS +59% YOY, with interest income rising 28%. Good results.
- **FBN** - Q3.14: EPS -6% YOY; Net interest margin down 1% YTD to 7.4%; ROE 15.4%.
- **Zenith** - Q3.14: EPS +5.6% YOY; ROE 18.4%.

On the Political front, Goodluck Jonathan has shown his hand and is now standing unopposed for the PDP. The APC will choose their candidate in December for the election in February. It will be a close race for the Presidency and Governorships, however the odds favour Jonathan. This would be good for the Delta and the "oil patch" but, because it is still unclear whether Boko Haram is a political or a religious vehicle, an APC victory could bring calm to the North, but also vice versa, in what looks a zero sum game.

Zimbabwe

October saw an awful month for the stock market but, primarily on the back of low volumes and with the declines coming toward the end of the month, ironically in sharp contrast to the rest of the World, which had recovered it's own substantial losses of early October by month end. We are not reading too much into this decline given the lower volumes traded on a daily basis, sometimes under US$500,000. Over the past several weeks, the Stock Exchange has been introducing a Central Depositary System (i.e. electronic settlement) and the old physical share certificates are therefore being handed in to be replaced by electronic scrip. This will necessarily take some time, especially for private clients who may hold their certificates in their "bottom drawers", as opposed to institutional investors whose scrip is held by their custodian banks. Interestingly foreign investors have registered the bulk of their shares through their custodians already, which is a positive. The ZSE's electronic trading platform, unfortunately, looks unlikely to be in place until April 2015, at the earliest, and it is expected that, only when the two systems are working well together, will we see stock market volumes rise well above levels of the old "scrip" days. We expect volumes, for now, to be largely driven by pre-market arranged deals. On a positive note, Zimbabwe is finally coming out of the "dark ages" with regard to stock exchange technology, lagging far behind most other African exchanges to date.

Politics was centre stage of the news this month with the First Lady's - Grace Mugabe - entry into politics taking the form of a 'Meet the People' roadshow around the country as the new head of the Women's League. Far from being a dull affair, this took the media by storm, with the President's wife accusing Vice President Joyce Mujuru and her supporters of underming the ZANU-PF Party as well as her husband as President. Her speeches were "no holds barred" affairs, with widespread media coverage and (in particular) the State media, which is apparently on the side of the other faction looking to succeed Mugabe. The independent media is suggesting that her actions are driven by panic. Grace is fearful that - should her husband die in office and Joyce be elected by the party in his place - then she could lose everything, hence her determination to undermine Mujuru. Does she know something that we don't with regard to timing? This is all occurring just a month before the ZANU-PF Party Congress, when key members will be appointed to the various open positions. It is only after this that the public will have a better idea of the shape of the party going forward, but, not necessarily, who might be the next President. President Mugabe has spent his long political career keeping the various factions at bay and fighting with each other, moving his own support from one faction to another should anyone become too powerful simply as a means to preserve his own position. The media suggests that using his wife to attack the Vice President may simply be a continuation of the same strategy or it could point to his own fears that Joyce's faction may actually take him on sooner rather than later. Time will tell, but it's an interesting soap opera! From our perspective it suggests that we are now moving into the political "end-game", and the sooner the focus moves back to the economy, the better.

It was interesting to see Econet's H1 results which, although they reported a 4% increase in total revenues, this hid an 8% fall in voice revenues, largely compensated by "EcoCash" - their mobile money brand. With costs still rising and with high depreciation following recent capex, EPS actually fell by 29% - more than expected. The fall in voice revenues suggests that the consumer remains under pressure, a situation that Delta confirmed in their quarterly update last month, where beer volumes remain depressed. What is of interest, in addition to these numbers, is that both Econet and Delta provide substantial tax revenues for the Government. We estimate that Delta is paying at least 30% less in excise duty than it did last year. This begs the question as to how Government is currently able to fund their monthly civil service wage bills, which they appear to be doing, unlike earlier this year – even more so as it is difficult for Government to borrow through the markets.

East Africa

Regional equity prices fell this month, against a global backdrop of declining oil prices, with indications that accelerating US production could outpace growth in demand and force prices further down, while the US Federal Open Market Committee (FOMC) announced closure of its monthly bond-buying program following substantial improvements in the outlook for the labour markets. Meanwhile, the European Central Bank (ECB) could expand its asset purchase program to include corporate bonds, which could help boost slowing inflation rates and spur much-needed economic recovery in the Eurozone. Among the local currencies, most held their own vis-à-vis the US Dollar with the exception of the Uganda Shilling, which declined by 2%. The Kenya Shilling remained unchanged, while the Rwandese Franc and Mauritian Rupee gained 0.1% and 0.4% respectively.

Kenya's rebased Q2.14 GDP numbers indicated that the economy expanded by 5.8% compared to 7.2% in Q2.13, with growth mainly supported by: Construction (18.9%), Manufacturing (9.1%), Financial & Insurance (8.3%), Information & Communication (6.4%) and Wholesale & Retail Trade (6.8%). Accommodation & Tourist activities declined by 18.6%, which was the sixth consecutive quarterly decline however, an improvement from a 32.7% contraction in Q1.14. The Tourism industry continues to suffer low arrival numbers from key source markets on the back of security concerns and travel advisories. The trade deficit widened by 28%, attributable to a 22.5% YOY increase in the import bill, due to increased imports of fuel and lubricants. Total exports, meanwhile, increased by 13%. Despite the current account worsening by 49.5%, the overall balance of payments position improved from a surplus of US$557mn in Q2.13 to US$1.9bn, due to the build-up in foreign exchange reserves from the proceeds of the Eurobond issued in June 2014.

The Nairobi Securities Exchange (NSE) reversed its upward trend - despite strong corporate earnings - with the NSE-20 Share Index down 1.2% in USD terms (compared to a rise of 1.2% in September) and up 1.6% YTD. Safaricom released H1.15 results, reporting a 31.1% rise in EPS. Service, voice service and messaging revenues were up 14.1%, 6.4% and 12.9% respectively, assisted by a 4.9% increase in customer numbers to 21.85mn and continued investment in the network. Mobile data revenue grew by 52.94%, likely supported by increased penetration of smart phones and bundle offerings. MPESA revenue increased by 24.7%; with 58.5% of the total customer base being 30-day active MPESA users. Total revenue grew by 14.6%, while direct costs increased by 16.7%, attributable to selling handsets at subsidized rates to support its mobile data strategy. Management indicated that focus will be on increasing the number of active MPESA merchants and customers to maximize the current network and also to embark on a Retail Point-of-Sale Integration Programme (E-POS) targeting Tier 1 and Tier 2 supermarkets, key merchants and SMEs to grow its "Lip na MPESA" platform. The company's earnings outlook remains strong.

In Uganda, a**n increase in non-food prices lifted headline inflation rate to 1.8%, from 1.4% in September.** The rise was anticipated as pressure on the Uganda Shilling was bound to spill over into prices and appears to confirm the fears that led the Central Bank to hold its policy rate. Monetary policy is therefore unlikely to change if the depreciation pressure exacerbated by Uganda's widening trade imbalance remains. The Central Bank has forecast annual core inflation at a range of 2% to 4% over the next three months and GDP growth for the fiscal year ending June 2015 at 6%. Core inflation, which excludes the prices of food, fuel and utilities, rose to 2.4% in October, down from 2% in September. Non-food inflation increased to

4.1% for the year to October from 3.5% in the previous month. Monthly headline inflation for October rose by 0.4% from the 0.3% rise recorded in September, due to a monthly rise in non-food prices. Meanwhile, oil discoveries, and industries related to commercialization of the resource, are part of the key factors that will boost the ranking of Uganda's economy once rebasing is announced at the end of November. Nigeria, now Africa's largest economy, and Kenya have just completed similar rebasing exercises.

The World Bank's "Doing Business 2015" Report places Mauritius top in Sub-Saharan Africa (SSA) economies and it is ranked in 28th position Worldwide on Overall Ease of Doing Business, up one place compared to its 29th position for 2014. Mauritius has the region's highest ranking followed by South Africa (43) and Rwanda (46), out of the 189 economies rated by the International Finance Corporation and the World Bank. The country's trade deficit, meanwhile, widened by 21.1% in August from a year earlier, largely driven by higher imports of fuels and lubricants. The value of imports rose by 13.6%, with the cost of fuels and lubricants up 46% from August 2013. Exports rose by 7.5%.

Rwanda's economic growth in H1.14 rebounded to 6.8%, with a broad-based sectoral contribution to the pickup - including Agriculture, Construction, Real Estate and Services. The Services sector contributed 47% of the total GDP followed by Agriculture and Industry, which contributed 33% and 14% respectively. The IMF projects growth at 6% and 7.5% for 2014 and 2015 respectively. Q2.14 GDP growth was 6.1%. Rwanda was ranked as the most competitive economy in the region by the World Bank Economic Forum report 2014.

Resources

The dramatic +US$20 fall in the oil price signalling weak global demand and the Fed's end to Quantitative Easing has conspired to keep resource prices under pressure. This past month, the MSCI World Commodity Producers Index* (major mining companies) fell by 5.0% as a stronger US Dollar added to market concerns.

Independent observer of China steel, Mysteel, has labelled Q4.14 as a "hard winter" for steel-related commodities. They believe that an "obvious mismatch between low demand and abundant supply and a weak local economy is poised to weigh on the prices of iron ore, coal and coke".

So what are the two global mining giants doing in the face of a "hard winter". In the nine months to September, Rio Tinto reported the following production numbers: iron ore +11%; copper +15%; aluminium and coking coal 0%; bauxite -2%; thermal coal -3%; and titanium dioxide -11%. BHP Billiton, meanwhile, reported: zinc +42%; coking coal and manganese alloys +25%; iron ore +17%; manganese ore +10%; petroleum products +7.5%; copper -3%; thermal coal and uranium -11%; nickel -12%. BHP Billiton's "production guidance remains unchanged and we are on track to deliver overall production growth of 16% over the two years to the end of 2015". Rio Tinto CEO, Sam Walsh, was more confrontational: "now is not the time for the best iron ore producer in the world to take a step back. Now is the time for others to really feel the consequences of the price against their operating costs and for them to make decisions". Clearly the gloves are off!

In an earlier AI Report, we said that "blood" will need to flow to trigger a turnaround in the commodity bear market. A look at the iron ore production stats above, suggests monopoly practice and an implicit war against the junior and mid-tier iron ore projects. In the face of weak global demand and widespread fears of deflation in Europe, we think that a turnaround in the commodity bear market still appears some way off.

Corporate news of note included the following:

Mozambican based Baobab Resources is focused on the development of its pig-iron and ferro-vanadium project. Under extremely difficult market conditions, recent test results have not only confirmed the chosen technology route, but also identified areas where process optimisation has the potential to significantly improve the already robust economics of the 2013 Pre-Feasibility Study. Chemical analysis of the final pig-iron alloy product returned an average grade of Fe99%, with very low impurities.

Kumba Iron Ore reported a 37% YOY increase in Q3.13 iron ore production to 12.9mt. Waste removal increased 14% as part of the plan to reconfigure the open-pit design; the ratio of waste to ore should normalise by the end of Q1.15. Sales for the quarter were down 5%, with exports accounting for 89% of total sales. The decrease in exports was due to the annual Transnet maintenance shutdown in August and a slow restart, not due to market conditions.

Zimplats reported a 13% fall to 52kozs in platinum matte produced in Q3.14 following the major fall of ground at the Bimha Mine in August. By successfully redeploying six out of the eight Bimha mining crews to other areas, platinum output in FY June 2015 will be negatively affected by 30kozs, compared to the original guidance of 70kozs.

First Quantum Minerals reported a marginal fall in EPS to US$0.23 as copper production fell 11% due to anticipated lower grades and a temporary plant shutdown. FQM is building several large projects and expects to spend about US$2.3bn in 2014. A major focus is in Zambia, where operations are constrained by smelting capacity, the availability of competitively priced sulphuric acid and access to ore. On a positive note, the cold commissioning of the Kansanshi smelter in Zambia is either complete or well advanced in many areas. Another important milestone will be reached in mid-2015 when the company expects to have a surplus of power. There are, however, concerns. VAT refunds are still outstanding and the Government has proposed that the 6% royalty and 30% corporate tax rate be scrapped and replaced with an 8% revenue royalty for underground mines and 20% for surface operations. We are totally opposed to revenue royalties; given the recent death of the Zambian president, the uncertainty around tax and VAT is unlikely to be resolved any time soon.