African Intelligence Report

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South Africa

Local equities, particularly Resource counters, rallied strongly after the surprise rate cut in China, but have again retraced somewhat due to falling iron ore prices on mounting oversupply issues. The global backdrop of moderate growth and low inflation is generally positive for South African equities however, given the importance of China as our largest export partner and falling commodity prices, we expected heightened volatility in our stock market, along with other emerging market commodity producers. Slowing local growth and Eskom woes will further add to negative sentiment from both a local and international perspective, which could lead to further agency downgrades and Rand weakness.

The dominant risk factors facing local equities remain "event risks" around the FED and ECB. Tighter monetary policy by the FED and SA being forced to realign its policy are the dominant negative risk factors. Much needed QE by the ECB can be viewed as a positive risk factor as Europe is South Africa's second largest trading partner.

From a sectoral perspective, Resource counters remain inexpensive compared to Industrial counters, but weakening commodity prices and Chinese growth concerns are weighing on the Index. A weakening Rand appears not to be a counter-balance at this stage, given the poor supply-side dynamics for most commodities.

Negative sentiment surrounds local stocks exposed to domestic demand - SA Inc. stocks - due to a weakening consumer environment and weak Rand, which is having a negative impact on company margins. (Most goods are imported, and it is difficult to pass on price increases to consumers). We are also very concerned about what impact the expected blackouts from Eskom and expected higher personal and other taxes in next year's Budget might have on the local economy. Industrial Rand hedges are therefore likely to remain buoyant and "expensive". Around 60% of corporate earnings for listed SA Industrial companies are from offshore, according to research done by J.P Morgan.

On the economic front, pressure to increase local interest rates has diminished substantially due to the falling price of crude oil. Inflation has peaked and is likely to slow further in coming months. Downward revisions in global growth rates are resulting in lower growth forecasts for the local economy. Inflation is trending downwards, along with Government long-dated bonds, which have typically been very accurate predictors of inflation trends. It is interesting to note, moreover, that a very high correlation exists between SA's PPI and that of China given their trading partner status. Chinese PPI remains weak due to slower infrastructure expenditure and declining house prices, which is feeding through to lower consumer confidence.

Depending on the US Federal Reserve, it is therefore likely that local interest rates could remain at current levels for quite some time or increase at a very modest pace, given the inflation outlook.

All is not lost on the local front, as South Africa has an array of great, well-managed companies with good financials. These enterprises have stood the test of time and are likely to continue to deliver good long-term returns, albeit not at the same rates of return we have seen in recent years. That will have to wait for a pick-up in our local economy!

Sub-Saharan Africa

The MSCI Africa Ex-South Africa Index fell by 4.8% in November resulting in a year-to-date decline of 6%. The major drag on the Index this month was Nigeria, which fell by a whopping 15%; of which half was down to a decline in equity prices and the balance down to a devaluation of the Naira. The indices in Zimbabwe and Mauritius fell by 3.5% and 2% respectively, while other regional stock markets were up marginally or unchanged; Kenya and Egypt both rose by 2%.

In Nigeria, the Central Bank chose to officially devalue the currency – on the back of the on-going decline in the oil price. The Naira has effectively been trading at around N164 to the US Dollar for a number of years now. The upper limit set was N177, implying an actual 8% devaluation, less than other currency declines that we have witnessed elsewhere this year against the US

Dollar. The Central Bank has also increased interest rates and tightened reserve requirements for the banks. The Government has stated that it would cut its spending plans going forward - as a result of falling oil revenues - but we will need to wait for the elections to pass (in February 2015) before any real policy measures are revealed. It seems that most stocks in Nigeria, some of the consumer stocks in particular, have become significantly oversold on a technical basis, on a par with the last major sell-off in 2008. The currency also appears oversold, but could fall further before rebounding - depending, of course, on where the oil price goes from here. As for the February elections, the opposition coalition has yet to name their candidate, leaving little time for campaigning!

In Zambia, Interim President Guy Scott has announced that Presidential elections will be held on January 20th 2015, which means that all potential candidates will have to put their names forward by December 20th, at the latest. The ruling Patriotic Front party appears to have split into two factions, although the Courts have declared that the former Defence Minister will lead the party. The opposition party has "booted" out its President in favour of former President, Rupiah Banda, which has also gone down badly. It could be that the electorate might decide to elect a younger candidate, Hakainde Hichilema ("HH"), who is deemed to be the favourite amongst the business community.

Across the Zambezi, in Zimbabwe, President Mugabe - who is going to be 91 years old next February - has publicly "destroyed" his Vice President, Joyce Mujuru, and her supporters, accusing her of trying to take over the Presidency and even of plotting to assassinate him. He has moved to take full control of his party by changing the party constitution to enable him to appoint the Vice Presidents and the Chairman of the party, in addition to his politburo, which will be slimmed down from the current 65, to 25 people. The "succession" issue has been around for decades but has taken centre stage in recent months, as Mugabe gets older. Mujuru has grassroots support in the party and the country but the First Family clearly feared that their future under Mujuru would be at risk, hence her downfall. We doubt that changing the party constitution will resolve the succession issue but, as ever, this is probably Mugabe's intention. We assume that he will now need to appoint a new Cabinet, minus Mujuru and her supporters. He is a smart politician - hence his longevity at the top - but it's hard not to believe that he is playing a dangerous game in his latter years. Interestingly he decided not to announce his new Vice Presidents at the Congress.

Nigeria

The MSCI Nigeria Index fell by 11.3% (US Dollars), most of which was currency related; the Naira was devalued during the month, falling by 7.9% overall. The Nigerian Stock Exchange Index fell by 8% in Naira – and by 14.8% in US Dollars. The fall in the Naira matches the fall in other major currencies (of around 9%) against the US Dollar over the past six months, with only the Yen falling by more.

The Central Bank announced a series of measures to support the Naira, but none worked before they bowed to pressure following the OPEC meeting and devalued. The Naira stabilised as the price of oil settled at around US$75/barrel, but the Naira then slumped further to N186 as oil tumbled to US$67. The current rate of the Naira is around N180 and, in the aftermath of the Naira support operation, the CBN's bank rate (and T-bill and bond yields) is now 1% higher at 13%, reserves have fallen to US$36.7bn (-5.4% since last month) and the cash reserve requirement on private sector deposits is now 20% vs. 15% before. These changes, as well as other regulatory changes last month, are slightly negative for the banks, forcing them to try to maintain margins through cheaper retail deposits or through more (risky) lending. It now seems that the only realistic monetary policy available to the CBN is a dirty float against the US Dollar. The move from a fixed exchange rate to a semi-floating rate should see interest rates fall; although structural changes will then be forced on many of the listed companies that rely on high import content; 45% of the cost of sales in the consumer sector is imported. In the Fund, PZ has the highest import content (72% of cost of goods sold), followed by Unilever (60%), Nestle (37%), Guinness (36%) and Nigerian Breweries (13%). PZ and Unilever import commodities like palm oil and soya, commodities that can ultimately be grown locally. Several banks may also be caught out by a more flexible currency policy following the recent rush to issue Eurobonds; any foreign denominated proceeds not passed on to the oil sector could cause problems. The political response has been a reduction in the 2015 budget oil benchmark to US$65/barrel vs. an original US$78, an announcement by Goodluck Jonathan to encourage import substitution and talk that petrol subsidies might be fully removed. The current subsidy is down to N12/l above a pump price of N97/l (US$0.54/l) vs. N44/l in January 2012, when the subsidy was first cut.

How low can the Naira go? With much of the recent oversupply of oil/gas coming from new producers in the USA, OPEC's strategy looks designed to force these high-cost producers out of the market. This suggests oil in the US$60 range for an extended period. The 12-

month non-deliverable futures rate of the Naira is currently N219; this series has traded at an average 12% discount to the Naira over time suggesting the market expects a future Naira rate of N192, a further 7% devaluation.

Corporate news was sparse; Nigerian Breweries (NB) conducted a conference call to give details on their merger with Consolidated Breweries (CB), but the call was very short on detail. CB owns three breweries of 2.4m hl vs. NB's 12m hl. CB's beer brands are mainly value lagers, so inclusion into NB gives the overall group 70% of the beer market and 30% of the value market (from 20%). A key advantage/synergy of the merger is that all of the group's eleven breweries are able to produce all the group's brands. This should reduce route-to-market costs as transport can be optimised.

Politics – presidential primaries are scheduled for December 10th. It remains unclear who the candidate for the opposition APC will be, but the weak Naira and oil price have reduced potential election spending. Boko Haram remains a wild card; if parts of the affected northern region are disenfranchised from the vote due to violence, this will affect Jonathan, as much of the region is Christian and likely to vote for his PDP.

Zimbabwe

Another weak month for the stock market on the back of low volumes for similar reasons to last month: the introduction of the Central Depositary System that should be completed by year-end and political uncertainty as the Zanu-PF Congress gets underway.

The main event during the month was the Budget for 2015, presented by the Minister of Finance. It was a realistic budget – unusually, in our opinion - in that it assumed little growth in the economy and therefore spending is to be fixed at 2014 levels, at around US$4bn. Much will depend upon the Agricultural and Mining sectors - with the former determined by the forthcoming rainy season. In the Mining sector, Government have decided not to apply a 15% export tax on un-refined platinum, as they realise that establishing a refinery in Zimbabwe will take a number of years. In order to encourage exports in general, Government have also reduced corporation tax depending upon the amount of revenues that a company exports; for example, if exports amount to over 51% of sales, corporation tax falls from 25% to 15%; for exports amounting to 30% of turnover, tax falls to 20%. The Minister also dropped excise duties on beer from 45% to 40% in the hope that a reduction in price will boost volumes and hence tax take. In the December 2012 Budget, excise duties were increased, resulting in a sharp decline in beer sales and (ironically) in tax take.

Elsewhere in the Budget, the Minister mentioned that the approval of Indigenisation Certificates will take place at the line Ministry for each sector rather than at the Ministry of Indigenisation. We see this as a positive sign of a further loosening of the Indigenisation laws.

Over 80% of the US$4bn Budget is allocated to salaries of Government employees, leaving little for capital projects. A reduction in the size of the civil service is not politically viable at the moment, but it was interesting that the Minister suggested that early retirement might be offered to those reaching retirement age, as a means to cut staff numbers. The IMF would see this as a positive first move.

The Minister also announced the establishment of a Land Compensation Fund which will be used to compensate former commercial farmers for the improvements that they made to the land during their ownership. Some payments have been made out of Budget since dollarisation but a lack of financial resources has slowed this process. The Fund will be financed through a land tax to be paid by the beneficiaries of the land reform programme and by "Development partners" (i.e. foreign aid). It also appears that this Fund will be managed by the Ministry of Finance rather than by the Ministry of Agriculture. The establishment of this Fund should be seen the as a step towards legitimacy by international observers.

Politics has continued to take centre stage this month, with the anti-Mujuru rhetoric building over the past weeks in the run up to the Party Congress. Through a change in the Party constitution, Mugabe now has the right to appoint the Vice Presidents, the secretary to the party and his politburo, which itself will be reduced in size from 65 people to 25. In the past, Congress would have elected individuals to these posts but now they will be there at the will (and the mercy) of the President. The theory is to bring an end to the factionalism that has been destabilising the ruling party over recent years as the succession battle "hots" up, as the President ages - he will be 91 in February. Vice President Mujuru and her supporters effectively controlled the provinces, the Central committee and the politburo, implying that she would be the most likely candidate to succeed Mugabe should he die in office. After last weekend's Congress however, she and her team have been "kicked out" in a campaign that some believe was orchestrated by the Manangagwa faction, which played on the supposed increasing paranoia of the First Family and, in particular, Mugabe's wife. Interestingly, despite suggesting that he would make his new Vice Presidential appointments at the Congress, he failed to do so and may do so this coming week. This will likely include a Cabinet reshuffle.

East Africa

On the global macroeconomic front, we saw a sustained decline in global crude oil prices after OPEC refrained from cutting output, despite a supply glut, and mixed market sentiment arising from US monetary policy divergence from Europe and Asia. Rising consumer spending saw the US economy grow at an annualised rate of 3.9% and 4.6% in Q3.14 and Q2.14 respectively, which was the best six-month performance in more than ten years. Across the Atlantic, the European Central Bank (ECB) warned that inflation expectations were declining to very low levels with indications of an expansion in its stimulus program, possibly in early 2015, while the Organisation for Economic Co-operation and Development (OECD) expects the "Euro-zone" to be stuck in persistent stagnation.

These developments had a predictable effect on most of the local currencies, which weakened against the US Dollar; the Uganda Shilling, Kenya Shilling and Mauritian Rupee declined by 2.5%, 0.8% and 0.4% respectively, however the Rwandese Franc gained marginally, by 0.04%.

Kenya's Treasury sought Parliamentary approval to increase the country's external debt ceiling from the current limit of US$13bn to US$27.2bn to finance multi-billion dollar mega-infrastructure programmes. The Government is seeking to increase the recently issued sovereign bond for an amount not exceeding US$740mn to finance on-going development projects, which include the US$3.6bn Standard Gauge Railway (SGR), 10,000km of roads, 5,000 MW of energy projects, LAPPSET and irrigation. The Treasury is finalising the Public Finance Management Act regulations, which propose to set the External debt ceiling at a present value of 50% to GDP, which is also a convergence criterion for monetary union under the East African Community (EAC). External debt - as at the end of September - stood at US$11.4bn. According to the latest IMF country assessment, Kenya's debt is manageable. The major risk is the rising external debt against a slower growth in export earnings.

Despite robust Q3.14 results, particularly in the Banking sector, the Nairobi Securities Exchange (NSE) continued its downward trend, with the NSE-20 Share Index down 1.6% in USD terms (after a drop of 1.2% in October), but up marginally (0.05%) YTD. KCB reported a 15.4% YOY rise in EPS, with the strong performance driven by bad loan recoveries (+222% QOQ and 148% YOY). Fees and Commission income increased by 15.2% during the quarter, on the back of an increase in the number of customer accounts (one million YTD) and increased uptake of mobile banking services (553% YOY increase in M-Benki accounts). Total operating income declined by 6.1% QOQ while total operating expenditure was down 3.1% QOQ. The bank's cost-to-income ratio (CTI) consequently rose to 54.5% in Q3.14 from 52.8% in Q2.14. NIC Bank reported an 18.3% YOY rise in EPS, mainly driven by 65.1% YOY drop in loan loss provision.

Uganda revised its GDP numbers after changing the base year from 2002 to 2009, joining other sub-Saharan African countries (including Kenya and Nigeria) that have already undertaken the exercise this year. The country's GDP expanded by 13% after it rebased its calculation to incorporate new sectors, such as Information Technology (IT) and Entertainment Services, in the economy. The country's GDP stood at US$24.7bn at the end of FY 2013/14, up from a previous estimate of US$21.8bn. With a population of 34.9 million people, Uganda's GDP per capita now stands at USD700. Rebasing is a way of revising the economy by capturing fresh indicators of key activities that translate towards strengthening the GDP and keeps the country on target to meet its commitment under the EAC to have 2015 as the new base year. (The UN Statistical Commission recommends that countries rebase their GDP every five years).

In Mauritius, MCB's Q1.15 earnings increased by 7.0% YOY on the back of 16.0% profit growth in the main banking subsidiary, MCB Bank, and underpinned by a rise of 7.2% in operating income, despite pressures on net interest income, which grew by only 1.2% amidst the excess liquidity situation and subdued domestic private investment. Net Fee and Commission income went up by 16.0%, driven mainly by regional trade financing. 'Other income' was up 23.4% on the back of a 10% growth in profit on exchange and improved receipts from non-banking operations. Growth in operating expenses was well contained at 3.5%, while impairment charges remained stable QOQ and significantly lower YOY, reflecting an improvement in asset quality. State Bank of Mauritius (SBM) reported strong 9M.14 results, largely driven by the non-recurring sale of investments. Normalised results reflected continuing pressures from the excess liquidity environment. EPS was up 9% YOY. Net interest income (+2% YOY) continued to be plagued by excess liquidity, while non-funded income (+31% YOY) benefitted from sale of investments. Impairments declined by 2%, while operating expenditure were up 10%. Loans have contracted by 5% YTD while deposits are up 2% as excess liquidity continued to hamper growth. Cost-to-income (CTI) remained flat at 32%.

The Government of Rwanda issued a 7-year bond worth US$21.6mn, with a subscription level of 187%, at a yield of 12.5% and a coupon rate of 12.475%. Retailers and individual investors accounted for 1.4%, Banks 45.6% and non-financial institutional investors were allocated 53% of the total amount offered. Bank of Kigali announced 9M.14 results, reporting net income of US$20.6mn, a YOY increase of 29.9%. Total Assets grew by 1.6% QOQ and 23.5% YOY to US$709.2mn. Net Loans rose by 4.9% QOQ and 14.2% YOY to US$326.3mn. Client balances and deposits rose by 1.6% QOQ and 34.9% YOY to US$429mn. Shareholders' equity increased by 5.4% QOQ and 24.2% YOY to US$124.7mn. In 2011, the bank became the second domestic company to be listed on Rwanda Stock Exchange.

Resources

November saw yet another month of poor sentiment towards commodities and further downward pressure on the oil price. The MSCI World Commodity Producers Index* (major global mining companies) in turn fell by 6.3% - a strong indicator of the global bearishness towards resource stocks.

We cannot expect to wake up one morning and find, across a range of commodities, that demand exceeds supply; so we need to see cuts in supply and higher levels of expenditure on global infrastructure and manufacturing. On the supply side there are two Sierra Leone junior miners that have just closed down production then, as copper breached the US$3/lb. level, the largest producer (10% share) in the world, Codelco, told Bloomberg that their shipments of copper will decrease by 5%. Rodrigo Toro elaborated, "we cannot continue selling the same amount, as we have less. Not only to China, not only to Asia, we are selling less to the world". Codelco is struggling with aging mines and a weak copper price. To help finance its almost US$30bn capital expenditure programme over the next five years, Codelco is hoping for a US$4bn injection from Government and to issue US$8bn worth of corporate bonds; and this is just to maintain its position as the largest copper producer in the world.

Corporate news of note included the following:

After a three and a half year commodities bear market, the dramatic fall in the iron ore price has put Sierra Leone based London Mining into difficulties, after nine years of exploration, mine development and a ramp up to 5mtpa of iron ore. PwC has been appointed as administrator to find a buyer for the Marampa Mine operations. More bad news for Sierra Leone: post month-end, African Minerals shares have been suspended and the Tonkolli iron ore mine has been put on care and maintenance. "Lack of investment, a slumping iron ore price and having to deal with the effects of Ebola" has put working capital into the red.

In an interesting break with African Rainbow Minerals, its long-standing JV iron ore partner, Assore Ltd has announced that it will acquire a near 30% stake in Ironridge Resources for GBP6.98m. The Australian listed junior holds three prospecting licences in Gabon. This deal gives Assore exposure to an early-stage, high-grade iron ore (DSO) prospect that is located about 60km from the port at Mayumba. The amount payable equates to 0.5% of the company's market capitalisation.

Gold explorer, Hummingbird Resources, has increased its indicated gold resource by 153% (grade of 2.38g/t) to 621kozs at its Yanfolila deposit in Mali. In an upbeat mood, the company comments "that the next twelve months is set to be transformational as we build a mine and bring Yanfolila into production". The next important step, however, is to upgrade the indicated resource into the reserve category.

Aureus Mining has released a resource update for its Ndablama gold project, which lies some 40km from its flagship New Liberty Gold Project in Liberia. Dave Reading, CEO, reports "the company has successfully achieved its aim of doubling the resources for Ndablama to over 900kozs, which raises the company's total resources to over 2.8mozs. From the positive results received from drilling only a 1.2km strike length out of a 13km structure, this is only the beginning of what looks to be a very exciting gold district". Metallurgical test work has confirmed the Ndablama ore as being non-refractory with robust recoveries of above 92%.

In an year-end update, Exxaro Resources described the company as being in "survival mode" and indicated that coal export prices fell 7.4% to R685/t in the five months to November. The fall was mainly due to a 7% fall in the API#4 price to US$63/t "as coal markets continue to be in oversupply". Management also indicated that Tronox (mineral sands) is loss making and it is concerned that Kumba Iron Ore (12 – 3.5%) will not be able to maintain its final dividend payment. (Exxaro has a 20% passive investment in KIO). Taking into account the anticipated % fall in the iron ore price in H2.2014, we think that KIO will indeed be hard pressed to maintain its upcoming final dividend. In a positive move, Exxaro has extended the Mining Convention of its Mayoko iron ore project, in the Congo, by two years. In conclusion, management states "that 2014 had been a challenging year, but that the company was resilient in the face of tough trading conditions".