African Intelligence Report

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Sub-Saharan Africa

Not a great end to 2014 for the African stock markets or, for that matter, for their larger global emerging market peers. For the year, the MSCI Africa Ex-SA Index declined by 9% against a fall in the MSCI Emerging Market index of 4.6%. The damage to performance was done in the final quarter of the year when the Africa Ex-SA Index lost a whopping 15% against a 5% decline for emerging markets.

The final quarter of the year saw Nigeria as the biggest “culprit” among African indices - losing over 25% of its value, of which 10% can be attributed to a devaluation of the Naira. The Nigerian Index fell by 30% over the calendar year. The next worst offender was Zimbabwe, which declined by 16.5% over the quarter, contributing to a 19.5% fall for the year. Egypt lost 11% over the quarter, trimming its annual return to 20% - making it the best performing of the larger markets in 2014, closely followed by Kenya. Zambia was unchanged on the year, in US Dollar terms, while Botswana and Mauritius declined by 3% and 6.5% respectively.

At Corporate level and on a more positive note, the share price of Eastern Tobacco, in Egypt, rose sharply on the back of local institutional demand. Kenyan share prices staged a small rally in December, with big volumes going through the stock market, largely driven by domestic investors who may have been undertaking ‘bed-and-breakfast’ trades in anticipation of the introduction of a capital gains tax of 5% to be introduced on January 1st 2015. This will cover both property and stock market investments. Namibian Breweries gained a further 5% over the month, continuing its recent rally after a long dormant period. In Nigeria, StanbicIBTC, which has remained relatively stable throughout the period, declined by 13%. The stock market had fallen sharply by mid-month but rallied strongly in the second half of the month as both the currency and the oil price stabilised. As we head into 2015, the oil price has declined even further and shares have retreated once again. If stability in the oil price can be restored, confidence should return, although investors would prefer to see the result of the forthcoming elections, in February, before committing themselves. The authorities have so far handled the ‘oil crisis’ sensibly and have been commended by the IMF. A win by Goodluck Jonathan would therefore be seen as positive for the stock market. Another notable decliner over the month was Delta, in Zimbabwe, which fell by 10%. This came as a surprise, as the excise tax on lager beers was reduced in the latest budget to entice a recovery in volumes. The political upheaval that we saw in the run-up to the ZANU-PF Congress is now over, with two new Vice Presidents and a number of new Ministers introduced. We hope that the ‘new team’ will focus back on the economy rather than upon themselves so that positive policy decisions will be made.

Parliamentary elections in Mauritius in December resulted in a clear win for the opposition led by none other than 84 year-old Sir Anerood Jugnauth, former President and also Prime Minister. He promised to bring a second economic miracle to the country, but we wonder how he might go about that. In our opinion Africa needs new blood, not old.

The introduction of capital gains tax in Kenya from 1st January is likely to result in reduced volumes until the mechanics of the tax are better understood. It appears that foreign investors will also have to pay the new tax. Interestingly, the stockbrokers are supposed to collect the tax on behalf of the tax authorities when investors make sales, while book values will be supplied by the central depository of scrip, for calculation purposes.

As we start the New Year, there is much to consider in Africa: the sharp fall in the oil price, the strength of the US Dollar (as well as certain African currencies), upcoming elections and volatile stock markets.

Nigeria

The MSCI Nigeria Index fell further this month, by 4.6% in USD terms. Half of this fall was due to the weak Naira, which fell by 2.7%. The Nigerian Stock Exchange Index (NSE Index) fell by a lesser 2.3% in USD, following a sharp rise in Dangote Cement (see below). The MSCI Index and the NSE Index fell by 29.7% and 26.7% respectively for the year. Equity prices are down around 30% in USD terms since early August, while the oil price is down 51%.
The Naira has now been stable at around N185 to the USD since the start of December, however the oil price has dropped by a further 28% since then. The stock market therefore expects further Naira weakness (to perhaps N200) as foreign exchange reserves continue to fall - the Naira is actually down in line with the 12%

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devaluation of the Euro, Yen and Sterling over the past six months. The non-deliverable forward Naira weakened further last month to around N233 (from N219); a further devaluation of the spot rate to N200 would bring the discount of the non-deliverable forward rate close to its historic average.

The Government cut the reference price of oil used to calculate the Federal Budget again - to US$65/bl. (vs. US$77.5/bl. in 2014). A further cut is likely now that Brent is trading at US$50/bl. The decision to devalue the currency but to tighten monetary policy to weigh down on imported inflation (as the CBN did by raising bank reserve requirements) was the correct one (and was praised by the IMF after month-end). Although a tighter monetary policy and potentially higher tax collection, point to slower domestic consumption ahead, the latest official estimates suggest an economic growth rate of 5.5% this year (vs. 6.4% in 2014), a current account balance of around zero and a fiscal deficit of 1%. These numbers sound less catastrophic then the fall in the price of oil suggests, possibly because financial intermediation is very low (loans are 18% of GDP) and total fiscal expenditure is only 5-6% of GDP. The sharp fall in the petrol price will be even more important for domestic consumption.

The opposition APC finally nominated General Buhari as its presidential candidate, his fourth tilt at the title. He has a strong following in the Muslim north although a poll taken in mid-December suggested 58% support for Jonathan. The long-term challenge is to continue to deregulate the economy, to reform public services (electricity, subsidies) and to encourage non-oil industrial and agricultural production. Jonathan has done quite well during his term in this respect - especially given vested interests in oil.

Dangote Cement reacted swiftly to the devaluation by raising cement prices 36% to US$169/t despite its recent cut to deter new entrants. This is supposedly to maintain import parity, even though the Naira has only devalued by 15% since last year. The current rate of inflation (to November) was 7.9% YOY, a fall from 8.1% the month before but, if big corporates push through price rises of this magnitude on sensitive products like cement, expect further tightening by the CBN; with weak oil prices, the politicians will, however, be turning to commercial allies for election funds; we don't expect much of a political outcry.

The outlook: the CBN and the Government seem to be managing both the economy and expectations quite well; the currency has more flexibility (although recent administrative changes by the CBN to limit open FX positions held by the Banks smack of panic at the altar of a fixed exchange rate) and the budget is being cut progressively as oil prices fall. As there is little leverage in the Nigerian economy, we don't expect there to be serious damage to balance sheets during this crisis; unlike in 2008/09, when the banks had lent to everyone to buy shares on margin. We would therefore expect equity prices to re-bound quite sharply once the oil price is seen to stabilise. The CBN has already issued a warning to banks to keep NPL's below the limit of 5% of risk assets and to start demanding repayment of loans. Current NPL's are around 4% and the breakeven oil price backing exploration and production loans is understood to be around US$40-45/bl.

Zimbabwe

A disappointing end to the year after what looked like a positive start with the national elections out of the way, thereby enhancing the prospect for continued economic reform. As it turned out, we underestimated the importance of the Zanu-PF Congress in December (usually a damp squib) which resulted in key politicians spending their year jockeying for position and ignoring their Ministries and, crucially, the economy. The two ministers who have worked hardest in 2014, in hindsight, were the Minister of Tourism and significantly the Minister of Finance. The latter must have been tearing his hair out as he re-engages with the international community while politics overshadows his work. More on this below.

December saw the stock market fall by 5%, once again on very low volumes, as investors chose to watch the Congress and its initial outcome. For the final quarter of the year, the Industrials Index fell by nearly 17%, representing much of the 2014 decline of 19.5%. The "blue chip" shares took the biggest knock during December: mobile phone operator, Econet, which has held up relatively well over the year, declined by 13%, while Delta fell by 10%. The fall in Delta's share price was despite the Government reducing excise tax on lager beers in an attempt to boost volumes and hence Government tax take. The bottom line is that these two stocks are the most liquid and most favoured by foreign investors, attracted by their strong business models and low valuations relative to the region. Innscor managed to end the month unchanged. Over the final quarter, Delta lost 21%, Econet 22% and Innscor 9%. Only twelve counters rose in Q.4 and all of those were small and illiquid.

Looking at the full year, sixteen shares rose, but only two of them, Seed Co and Bank ABC, have any liquidity; among the blue chips, Delta fell by 27% while Innscor declined 25% and Econet was unchanged. Barclays was down by 39% despite a significant increase in profitability. On the upside, Seed Co gained 6% as

French multinational Limagrain acquired 25% of the company. Bank ABC rose 39% as Bob Diamond's Atlas Mara took the company private; interestingly, in December, the entire senior management of Bank ABC was replaced, suggesting a few skeletons may have been discovered in the closet since the deal! Two other top performers were also subject to corporate action, with Masawara attempting to buy out TA Holdings which gained 129% over the year and Hunyani gaining 125% as Nampak South Africa consolidated its Zimbabwean assets into Hunyani renaming it Nampak Zimbabwe.

With the ZANU-PF internal elections now behind us, we hope that politics will take a back seat to the economy. After the Congress, President Mugabe fired Vice President Joyce Mujuru and replaced her with Emmerson Mnangagwa as First Vice President, while a former diplomat and relative unknown, Phelekezela Mphoko, took the second Vice President position. Mnangagwa has significant influence in the security services and is believed to be responsible for "engineering" a win for Mugabe in both the 2008 and 2012 national elections. He has little popular support but he is a businessman and he is known for getting things done. Over the coming weeks, we should be able to gauge where he wishes to take the economy but, positively, his long term ally is the Minister of Finance. Mugabe also changed a number of his Ministers who were linked to the "Mujuru faction", but we may yet see another Cabinet reshuffle on his return from holiday. Mnangagwa may well be influential in this line up. The donor community, the IMF and World Bank have much faith in the Minister of Finance and support what he is attempting to do. If they see that the new Cabinet moves united in the same direction, then this will be highly significant for Zimbabwe.

In the Agriculture sector, an interesting announcement suggests that the new leaseholders of land can now legally enter into joint ventures with anyone - including white farmers. This flies in the face of the pronouncements from Congress but, if it is true, is a hugely positive change and could trigger a new wave of investment into agriculture, driven by corporates in particular.

We understand that the international donor community are excited about the prospects for Zimbabwe and have the funds lined up. They need to see the committment of Government as a whole which last year's factionalism put on hold.

East Africa

December marked the end of a confounding year for global financial markets: a dramatic drop in oil prices amidst stability in both the global economic outlook as well as the supply and demand fundamentals for oil; declining US interest rates despite the Federal Reserve (Fed) winding down its bond-buying programme; impressive returns from the US stock market; strong performance of the US Dollar against virtually all major currencies and a lower global inflationary outlook. Most local currencies - with the exception of the Uganda Shilling, which gained by 0.4% - predictably weakened further against the US Dollar; the Mauritian Rupee, Rwandese Franc and Kenya Shilling declined by 0.8%, 0.6% and 0.5% respectively.

Kenya's economy is estimated to have grown by 5.5% in Q3.14 compared to the revised 6.2% growth recorded in a similar period in 2013. The growth was mainly driven by expansion in the following sectors: Finance & Insurance, Wholesale & Retail Trade, Information & Communication, Construction and Agriculture. All sectors of the economy registered positive growth except the Hotel & Accommodation sector, which has seen a decline since 2013 due to insecurity concerns. The overall Balance of Payment deficit stood at USD855mn against a surplus of USD193mn recorded in the same period last year, attributable to lower foreign reserves used to service government debt and interventions by the Central Bank of Kenya to stabilize the Shilling.

As the year came to a close, the Nairobi Securities Exchange (NSE) maintained its downward trend. Following a 1.6% drop in November, the NSE-20 Share Index declined further by 1.4% in USD terms. The index lost 1.4% for the full year, which was largely attributable to a depreciation of 4.7% in the local currency. The NIC Bank rights issue, through which the bank sought to raise US$23.7mn to bolster its capital base and fund future growth plans, was oversubscribed by 121%. The bank's previous rights issues in 2012 (raised US$24.5mn) and 2007 (raised US$16.7mn) had been oversubscribed by 238% and 49% respectively. In September 2014, the mid-tier lender offered a US$33.8mn bond (US$22.5mn green shoe option) which raised US$56.3mn, after attracting bids worth US$73.2mn. Centum Investments is set to increase its total shareholding in Almasi Beverages Limited, a holding company for three Coca-Cola bottling companies, by 3% to 50.95%, subject to approval by the Competition Authority of Kenya. Almasi has the second largest share of the Coca Cola bottling business in the country after Nairobi Bottlers, where Centum has a 27.6% stake. The intended acquisition of a controlling interest in Almasi is in line with the investment company's strategic objective of expanding presence in the FMCG sector. Equity Bank's venture into the mobile money transfer sector encountered headwinds after a court order stopped the bank from introducing slim SIM cards, intended for use by subscribers on its mobile

operator business *Equitel* on the basis of a separate legal case seeking to reverse the prior regulatory approval until a full audit of the technology's potential risks to confidential subscriber information is done. The transfer of frequency spectrum, meanwhile, from YuMobile to Safaricom (after the full transfer of YuMobile's assets to both Safaricom and Airtel) was concluded, and will boost Safaricom's capacity to roll out its 4G network across the country. The new 4G system will also provide broadband internet access to smart phones and faster IP Telephony, gaming, video streaming and cloud computing.

In Uganda, the economy ended the year on two sobering notes: a widening current account deficit (US$808mn in the three months to October) largely attributable to upfront government expenditure on key energy projects amidst shrinking export revenues and remittances; and a 40% drop in international crude oil prices, which does not bode well for the nascent oil producer at a time when the country is seeking funds for a petroleum refinery and crude export pipeline. The target date for announcing a lead investor in its planned crude oil refinery was delayed to February 2015 after bidders requested an incentive package. Crude reserves are estimated at 6.5bn barrels. Two consortia, one led by South Korea's SK Group and a second by Russia's RT-Global Resources, had been selected as the final bidders for the US$2.5bn project. These developments come ahead of a politically charged year, with nomination of parliamentary and presidential aspirants for the 2016 General Election scheduled for August. There is concern that government spending may go overboard, triggering mop-up measures that will squeeze the economy.

In Mauritius, the opposition coalition (Alliance Lepep) led by former President, Sir Anerood Jugnauth, won a surprise landslide victory in the December parliamentary elections. The vote was largely seen as a referendum on constitutional reform, with a majority of voters apparently rejecting a recent government proposal to boost presidential powers by holding direct elections for the post, which is largely a ceremonial position and whose holder is currently elected by parliament. Mauritius Commercial Bank (MCB), meanwhile, received authority from the Central Bank of Kenya to open a representative office in Nairobi, as the bank seeks to explore potential business opportunities and support the growing trade and investment flows between Kenya and Mauritius.

In Rwanda, following the adoption of the East African Payment System (EAPS) by the National Bank of Rwanda (BNR), local businesses can now pay suppliers in the region using the national currency and will no longer have to convert the Rwandese Franc (RWF) into Dollars in order to pay for goods or services procured in Kenya, Uganda or Tanzania.

Resources

We think many mining company CEOs fully understood what Queen Elizabeth II had in mind, when she said that 1992 had turned out to be an "annus horribilis". After a year of solid downside resistance, all bets were off from mid-2014 as commodity prices and currencies reacted negatively to the strong rally in the US Dollar. The subsequent relentless negativity and selling continued through December with the Fund falling 6.8% and the MSCI World Commodity Producers Index* (major global mining companies) falling 1.8%.

As a broad indication of what metals and minerals did in 2014 - most of the bad news was linked to the USD strength in the H2.14 - the Reuters Jefferies Commodities Index fell 18.8%. At an individual level: oil and iron ore fell close to 50%; coal almost 30%; silver 21%; tin 17%; lead 16%; copper 15%; platinum 13%; and antimony 9%. On the positive side: aluminium was up 4%; nickel and zinc around 6%; palladium 10%; and rhodium 34%. Some might see gold's performance for the year as intriguing; ending the year (London AM fix) marginally down at US$1,199.25; however, many will see the selling of COMEX paper gold futures in mid-late December as manipulative. It seemed that gold just had to end the year in negative territory.

The relatively strong performance by gold in 2014 will not have been lost on all non-USD investors. The (conspiracy) theme of manipulation was highlighted in a recent Reuter's article on the imminent launch of a Hong Kong gold futures contract by the CME Group. The report noted that "Asia is the top consumer of physical bullion in the form of jewellery, bars and coins, but there is growing disenchantment with benchmark prices set in the West, which tend to be influenced by speculators". It will, however, take a big effort for gold-backed instruments to compete against paper-backed futures contracts. Overall, we think that gold is fairly well underpinned by the increasing amount of gold production that is vulnerable below US$1,200/oz.

With no plausible change in oil demand fundamentals, the price plunged 50% in H2.14. This is a replay of the iron ore market, with a fight between low-cost producers (led by Saudi Arabia) and the United States' emerging energy independence. The question now is whether the oil price will test the late 2008 low of US$34/bl.?

The Zambian Minister of Mines has announced the introduction of a 20% and 8% royalty on open pit and

underground mines respectively. Since there is no tax payable, mines will not be able to redeem the massive amounts of upfront and ongoing capital expenditures. We think this is political suicide and expect serious repercussions by way of temporary mine closures and project delays. On the other hand, the Zambian elections are due shortly; there could also be a “Kevin Rudd / Australian moment”.

The substantially lower oil and commodity prices should bolster the demand side of the equation. On the supply side, the flushing out of excess production that we have called for is starting to happen. In the coming months we expect competition in the global market to become increasingly fierce; just what is needed to underpin commodity prices.

Corporate news of note included the following:

First Quantum Minerals reported that a structural failure occurred to the atmospheric leach tank at its Ravensthorpe nickel operation in Western Australia. The tank contained acid-leaching nickel in slurry. The spill, resulting from the failure, has been contained within the plant's protective bunded area. The plant is currently shut down and no adverse environmental effects are anticipated. Investigations to determine the cause are being undertaken. At this point, the Company is unable to provide estimates on the duration of the shutdown or the impact on the operation's production. We have heard unconfirmed reports that FQM has already taken steps in reaction to the above announcement.

In early December, Nevsun Resources experienced power supply disruptions at its Bisha mine process plant. Since then, third party contractor, Aggreko Power Systems has “reliably restored power supply to the process plant”. The financial results will not be negatively impacted as the mine was able to draw down and sell from concentrate stock-piles. The company has just declared a quarterly dividend of US0.04c (yield of 3.6%) and released positive results from exploration drilling completed on the Harena License area, located 10km south of the Bisha Mine and processing plant. The drilling is part of the 2014 Bisha Regional Exploration programme. CEO Cliff Davis says, "Our exploration program is demonstrating the enormous growth potential of the Bisha VMS District”. No comment from management, but there is market talk of a suitor.