African Intelligence Report

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South Africa

The main event locally was the 2015 Budget Speech by Minister of Finance, Mr Nhlanhla Nene. It was a positive speech in the sense that most analysts (including ourselves) were expecting far more aggressive increases in personal taxes. The top marginal personal income tax rate increased to 41% from 40%; with other taxpayers, earning more than R181,900 per annum also suffered increases. The “big gun”, however, was the 80.5c increase in the fuel taxes.

The positive impact of the lower oil price, currently at US$60/barrel - after reaching a low of US$46/barrel in January 2015 - is likely to continue to positively impact consumer expenditure and confidence, as well as CPI. Annual CPI inflation dropped to 4.4% in January 2015 from 5.3% in December 2014, the lowest level since April 2011, when CPI stood at 4.2%. Given a sluggish world economy and continuing rig closures by shale oil producers in the US, we expect oil to be range-bound between US$40 and US$70/barrel for some time to come.

Following the last MPC meeting, the SARB’s inflation outlook has improved significantly. They expect inflation to average 3.8% in 2015 from 5.3% previously. Projected GDP growth for 2015 was also revised downwards to 2.2% from 2.5% previously, however we think that might still be too optimistic and expect growth of around 2% this year.

On interest rates, the SARB voiced concern at the potential consequence of tightening by the Federal Reserve, meaning that they will follow suit, despite there being no economic reason to do so; but, as discussed in previous communiqués, the foreign funding mechanism of the current account deficit will need to remain in place.

The combination of recent Rand strength, if it is maintained, and the lower oil price should significantly reduce the deficit on the current account which in turn could cause the Rand to remain stronger for longer.

The local JSE stock market Index continues to defy gravity, reaching yet another record high on the back of a 7% rise in February.

Sub-Saharan Africa

In sharp contrast to the developed markets - which rose strongly in February – and, indeed, relative to the MSCI Emerging Markets Index - which gained 3% - African equity markets put in a mixed performance over the month. The MSCI Africa Ex-SA Index declined by 1.1% - considerably better than might have been expected with Egypt and Nigeria falling by just under 6% apiece. These declines were compensated, to a certain extent, by gains in Kenya and Morocco, which rose by 4.7% and 3% respectively. Among the smaller regional markets, Botswana and Zimbabwe rose by 1.5% in US Dollar terms, while Zambia fell 5.9% - almost entirely due to the weakness in the Zambian Kwacha. While the US Dollar has been strong against almost all African currencies, the biggest devaluation was the Nigerian Naira, which declined by 7.5% over the month.

The devaluation in the Naira was not unexpected, as the Central Bank has, for some time now, been trying to defend it, despite the fall in the oil price. In addition, on 9th February, the Presidential and State Elections were postponed by six weeks, until the end of March, adding to uncertainty in financial markets. The Central Bank effectively chose to float the currency on 18th February, allowing it to fall and stabilize at around N.202 to the US Dollar. At these levels, interestingly, the Naira is down by around 19% over the past twelve months, which is less than the Euro’s decline against the US Dollar. The devaluation, together with the stabilization and bounce in Brent crude oil prices, allowed the equity market - in particular the blue chip banks - to bounce sharply - the Index ended slightly up over the month in local currency terms. The stock market has continued to recover into March and the currency has remained stable. The elections are now due to be held on March 28th, having been delayed for six weeks by the Electoral Commission - on the advice of the security services, as a result of the disturbances in Northern Nigeria. While the Opposition took the delay badly, it has actually worked out in their favour; furthermore, former President Obasanjo, a senior member of the ruling PDP party, publicly came out in favour of the Opposition! Whoever wins will need to accelerate any reform programmes; the Opposition will likely attack corruption as well. By the time of next month’s report, the election results should have been declared.

The results season is now under way. The BAT Group companies were among the first to report their year-end numbers. BAT Kenya reported an earnings increase of 14.5%, on the back of rising export volumes and an improvement in operating margins, on the back of productivity gains. They maintained their 100% payout ratio, which puts the stock on a 5% yield, however the PE is now up at 20x. The share price is up over 50% over the last twelve months. BAT Zimbabwe also reported strong results, despite a stagnating economy, declaring a final dividend that took their payout ratio to 120%! BAT Zimbabwe ended the year with over US$5mn in the bank and is generating net free cash before capex of nearly US$9mn. Capex is running at US$2mn, largely focusing on improving efficiencies. The dividend will likely remain on an upward trend for the year ahead.

East African Breweries announced their H.1 numbers to end of December, which were better than expected, having disappointed investors over recent years. Net profits rose 11%, driven by a number of factors including rising volumes in beers and spirits as well as improvements in both product mix and efficiencies. Cash generation was also strong, enabling them to reduce their short-term debt; their long-term debt however, remains high but stable. The stock trades at an estimated 35x earnings, yielding below 2%, which is expensive relative to Nigerian Breweries - or even Delta in Zimbabwe, which is more than 50% cheaper.

In Mauritius, MCB announced their H.1 numbers, which were stronger than expected, showing a 17.6% growth in earnings per share. Earnings were driven by continued strong growth in non-interest revenue on the back of the growing trade finance that they are generating in the region. Operating costs were also flat. The stock trades on a PE of 11x, with a 3% yield. The share price was up 3.5% on the month, recovering recent losses. One of the best performing shares was Barclays Bank Zimbabwe, which is due to report within the coming week or so. The stock gained 29% this month. Barclays Africa is looking to acquire the bank from the parent Barclays PLC in 2015.

Nigeria

The MSCI Nigeria Index (USD) fell by 3.3% over the past month. The Naira fell by 8.0%, so stock prices, in Naira, actually rose overall. The Nigerian SE Index fell by 5.8% (USD). Buyers were evident in the stock market in the second half of the month, following the devaluation; data published during the month also showed that foreigners had turned net buyers of the market in December after a large outflow in November.

Over the month, GT Bank and Zenith Bank shares both rose, despite the fall in the Naira, by 9% and 2% (USD) respectively. The Consumer names were largely flat in Naira, but fell due to the currency, with Nestle doing better as a result of its lower import ratio. The laggards were Guinness and StanbicIBTC, which fell by 11.8% and 10.7% (USD) respectively. StanbicIBTC's fall was somewhat surprising as pension fund assets continued to grow strongly in 2014, but the shares have lagged in the recent market downturn. Assets under management now amount to US$23bn, with under 10% invested in equities.

The "main event" this month was the decision to effectively float the Naira, with the Central Bank now supplying the market with US Dollars at the interbank rate rather than through its twice-weekly retail "Dutch" auctions, at the official rate. The Naira has since settled down to a level of around N200/US Dollar. The non-deliverable forward rates rebounded sharply on the news, as did equity prices. Equity prices are now down around 30% from their peak in late 2014 in local currency terms, with the currency down a further 19% against the US Dollar. The Fund and the two indices (all USD) are down around 42% from their peak in July 2014. At this level, interestingly, the Naira is actually down in line with the Euro against the US Dollar so, despite the focus on the weak Naira by global investors, the Naira is simply adjusting to the strong US Dollar. During this period, the price of oil has also fallen by 40% while the price of Dangote Cement – a major constituent of the local index – is down by 38.7%.

The next test for the currency will be the Elections on March 28th, delayed to allow the security forces to ensure security (ostensibly) for the poll. Whatever the reason for the delay, Jonathan is starting to demonstrate a degree of incompetence in managing security as well as the economy! The senate, meanwhile, approved a new reference price of oil for the 2015 Budget of US$52/barrel (vs. US$67/barrel previously) at an exchange rate of N190. These budget assumptions are actually now more realistic than for any budget in our recent memory - although Nigeria does tend to underspend on the investment budget due to problems with absorption.

Several Consumer companies reported earnings during the month. Nigerian Breweries reported sales down 0.8% YoY and net profits down 1.3% for the year to December 2014. These figures were in line with expectations; the firm's parent, Heineken, had earlier reported that volume sales in Nigeria had risen in "single digits". Guinness, by contrast, reported sales up 4.7% for Q2.15 (to end-December) with profit after tax down 31.9% - although net profits actually fell by a much smaller 9% YoY when adjusted for one-off items. The main adjustment related to de-stocking by the supply chain to a more appropriate level for the underlying economic conditions. Volumes apparently rose by "double digits" during the first half of the year due to the successful launch of new value brands, so it may well be that Guinness has at last "caught the wind". Nestle reported Q4.14 sales up 8% and profit after tax up 4% YoY; these were overall in line with expectations, however the figures were flattered by a large tax credit.

Zimbabwe

A much better month for the ZSE Industrial Index, which rose by 1.4%, resulting in a 2.7% YTD gain. Natural trading on the stock market, however remained subdued, much to the angst of the stock broking community. Among the best performing stocks was Masimba Holdings, which gained 33% on the back of a "cautionary" that they currently have out in the market place. We will wait to hear news as to what this might involve. Among the blue chip shares, Barclays Bank continued its recent run, gaining 29%, resulting in a return of 67% YTD. Seed Co and Dairibord added over 10% and 7.5% respectively. Foreign favourites such as Delta, Innscor and Econet rose by 3% to 3.5%; while much of the rest of the market was unchanged.

The results season is upon us and BAT Zimbabwe announced some excellent numbers considering the stagnant economy that they are operating in. Volumes rose by 4% with their premium Dunhill brand growing 37%, albeit from a low base. They have been investing heavily in improving their operations and efficiencies, allowing their operating margins to rise. Cash generation was, once again, very strong at US$8.5mn net of tax. The firm allocated US$2mn to capital expenditure; a number which will likely remain the same for 2015. The rest was paid in dividend, leaving cash in the bank at over US$5mn. After cutting the dividend in the previous year - based on a one off share option cost that was taken through the profit and loss account - the directors this year announced a 120% payout ratio, as opposed to the usual 100%. This resulted in a dividend yield at current market prices of 7% in US Dollars, which would be a good rate in the money market. The outlook was also relatively upbeat suggesting a similar or greater dividend next year. The PE is 17x.
Barclays Bank usually reports in February but this has been delayed this year to fall in line with Group results. We undertstand that Barclays Africa based in Johannesburg (i.e. ABSA Bank) are negotiating to buy Barclays Zimbabwe and Barclays Egypt from the parent company, Barclays PLC. It will be interesting to see what valuation is put on the local subsidiary, which is currently capitalised in the market at US$87mn. Results are due in the coming week or so.

CBZ, Zimbabwe's largest bank, reported a 10% fall in their net profits on the back of a relatively slow growth in deposits (+6%) while loans increased by 9.5% which, in nominal terms, amounts to around US$100mn. This says much about the current level of credit available in the economy. The bank impaired a further US$18mn for bad loans. Forecast loan growth for 2015 is 5% which implies an increase of around US$60mn. AfrAsia Zimbabwe (formerly Kingdom Bank) and recently taken over by AfrAsia Mauritius, meanwhile, surrendered its banking licence as it was unable to meet its capital or liquidity obligations.

Since there is no interbank market to speak of in Zimbabwe, there is very little, if any, contagion within the banking sector and hence its closure, along with other small banks in the past twelve months, has had little impact. The banks with relatively low loan-to-deposit ratios, such as Barclays, now have the ability to "pick and choose" whom they lend to while their competitors, such as CBZ, hold back on their lending. The Barclays numbers should therefore be interesting in this respect.

MASH Holdings, in the Property sector, reported at their AGM that their revenues in the first four months of their current financial year were down 17%. Rents continue to come under pressure in Zimbabwe and rental debtors continue to rise as rentees struggle to pay on time. The office park in which our offices are located belongs to Old Mutual. There are four blocks. Our block is now half empty and Block 4 was rented by a now failed bank; yet this is one of the more modern and well located office parks close to the City. Fortunately the UN or FAO is in Block 1! This effectively highlights how tough and depressed the sector is at the moment. In the longer term, however, property remains cheap within the region and, given the lack of development over the past fifteen years, it will do well when the economy finally takes off, which - of course - we are all waiting for!

East Africa

Global share prices rose broadly on improved housing and factory data from the US and China respectively, and testimony by the Federal Reserve (Fed) Chair, Janet Yellen, that the Fed was not in a rush to raise rates, though not ruling out an early rate hike in June. Global equity markets surged to record highs after Euro-zone finance ministers agreed, in principle, to extend Greece's financial rescue by four months. All local currencies – with the exception of the Kenya Shilling, which strengthened marginally by 0.3% - weakened further against the US Dollar: the Mauritian Rupee, Uganda Shilling and Rwandese Franc declined by 2.9%, 1.2% and 0.7% respectively.

After eight years at the helm, Prof. Njuguna Ndung'u ended his term as Governor of the Central Bank of Kenya on 4th March 2015, leaving a legacy of financial services regulation and largely successful and progressive monetary policy. During his tenure, Kenya made great strides in key areas, such as financial inclusion, the highly successful experiment in mobile money (M-PESA) and stability in the banking sector. It is no mean achievement that there was no bank failure under his watch, particularly cushioning Kenyan banks from the 2008 global financial crisis, exacerbated by local post-election violence earlier that year. This could be attributable to a more conservative approach to regulatory obligations that required lenders to boost their capital and adopt stricter credit approval processes, however the turbulence in 2011 - when Kenya experienced sharp currency fluctuations, strong inflationary pressure and high interest rates - remains difficult to forget. All in all, his eight-year tenure has been described as one full of pragmatism, innovation and risk aversion.

The stalemate between the Kenya Revenue Authority (KRA) and the Kenya Association of Stockbrokers and Investment Bankers (KASIB) over implementation of Capital Gains Tax (CGT) appears to have been resolved, with indications that investors will be required to file their tax returns after the relevant legislation is passed by the National Treasury. The new development will shift the tax accounting responsibility away from stockbrokers, which was proving a major bone of contention. The tax, paid at 5% on all gains made on the transfer of capital items, including marketable securities, is to be collected under the Income Tax Act. The tax may therefore not apply until the next fiscal year, starting July 2015, as an amendment to the Tax Act can only be enforced then. Earlier on, the market had reacted negatively to news of the introduction of CGT effective 1st January, resulting in a steady decline in trading activity, as investors adopted a wait-and-see approach to trading in the stock market.

The earnings season kicked off with East African Breweries reporting net profits up 11% in H1.15 EPS. Turnover was up 9.1% YoY, attributable to the growth in spirits, premium beer and improved performance in both Tanzania and the export markets. The brewer later announced the first tranche (US$55mn) of a US$120mn Medium Term Note (MTN) debt programme, possibly aimed at partially reducing the related party, arms-length foreign-denominated shareholder loan payable in 2017. KCB reported a 23.9% growth in FY14 figures. Net interest income was up 9.0% YoY on the back of a 14.1% YoY increase in interest income, outweighed by a 33.6% YoY increase in interest expense. Loans and advances increased by 24.6% YoY, while deposits were up 23.4% YoY. Non-Interest income grew 28.5% YoY supported by a 21.3% YoY rise in Fee & Commission income and an 11.8% YoY increase in Forex income. BAT Kenya reported 6.9% growth in gross revenue, driven by incremental contract manufacturing volumes in the DRC, benefits in forex movements from export sales and improved performance in the domestic market. The company maintained its 100% dividend payout policy.

In Uganda, headline inflation increased to 1.4% in February compared to 1.3% in January, which was mainly attributed to a 3% rise in annual core inflation, driven by the demand for money by the general public to carry out activities in various economic sectors and reflected in a pick-up in interest in commercial loans and government securities. In the bond auction, rates went up to trade at 16.7% for the two-year bond and 17.4% on the 15-year bond, with strong expectation of renewed offshore interest in the debt market that would open up inflows and improve forex supply.

In Mauritius, MCB's H1.15 PBT rose 16.0% YoY, boosted by higher Net Interest & Commission incomes. Growth in the loan book resulted in a 6.2% YoY rise in Net Interest income, while Net Fee & Commission income increased by 18.0%. EPS was up 18%. NMH released Q1.15 results, reporting 4.6% revenue growth. Villa sales in Morocco redeemed the revenue line following a decline in revenue for the Hotel & Other segments. EBIT was down 10.2% YoY. Finance costs increased by 24.5% YoY, owing to debt costs in Morocco, resulting in a 19% drop in PBT. Management decided to deal with its debt load through capital restructuring, with the first step involving listing of convertible redeemable preference shares.

In Rwanda, Bank of Kigali announced FY 2014 results, reporting an increase of 23.5% in Net Income to US$26.7mn. Net interest income increased by 11.5%, driven mainly by an increase in Forex-related income and Net Fee & Commission income, which rose by 3.3% YoY and 1.9% YoY respectively. Total Assets grew by 14.3% YoY to US$703.4mn while Net Loans & Advances increased by 17.3% to US$340.3mn. Operating income increased by 8.2%, while operating costs reported slower growth of 7.2%. Cost-to income ratio improved to 47.9% from 48.4%.

Resources

After six consecutive down months, the MSCI World Commodity Index rose 6%.

The series of commodity presentations at the 21st Mining Indaba were of a high standard: coal and iron ore are under more pressure than most, whereas the looming supply shortage over the next few years, augurs well for diamonds. Miners and explorers around the world, generally, find themselves in one of two camps: either in a fight for survival or desperately cutting costs and capital expenditure. All of this will surely perpetuate the boom/bust commodity cycles that we have come to know.

Many miners complain that the Mining Indaba has become a large trade fair, bereft of long term investors; we would argue, to a degree, that they have brought this on themselves. Our point is that many miners have: appeased bankers and brought debt onto their balance sheets;

encumbered inventory against off-take agreements and equipment against supplier debt. Now that “all hell has broken loose’, equity investors are left for dead.

In the recently released 2014 Fraser Institute Survey of African Mining Companies, Botswana and Namibia were ranked as the top two countries in terms of Policy Performance Index. Poor performers - ranked in the bottom ten in the world are: South Sudan, Zimbabwe, Nigeria, Sudan, CAR and Ethiopia. In turn, Angola, Ivory Coast and Sierra Leone moved up the rankings.

China still “calls the shots” for now in the commodity markets. On a negative note, China’s Ministry of Industry & Technology says that “China’s crude steel output has entered a peak area and that overcapacity in the steel and non-ferrous sectors will long persist under the ‘new normal’ China”. The CISA Composite Steel Price Index, which fell 7.2% in January and is down 21% YoY supports the notion of oversupply. The iron ore story is the same: the Chinese Customs show that the average imported iron ore price has fallen for twelve consecutive months to US$71.66/t. Little wonder then that the PBOC cut the deposit rate by 0.25% this week to try and further loosen liquidity.

Corporate news of note included the following:

For the six months to December 2014 Pan African Resources reported gold output down 13%, cash costs up 30% and HEPS down 63%. Much of the lower production was due to the transition through the known low-grade zone within the high-grade Kinross pay-shoot at Evander Gold Mines. The good news is that, by Q3.2015, the low-grade zone will have been exited. Another negative was the Section 54 stoppages at both Evander and Barberton Gold Mines. These are safety related stoppages imposed by Government mine inspectors. This is happening right across the South African mining industry and, in our opinion, verges on abusive official behaviour. We are confident that PAR is in recovery mode and we believe that gold output should be at least 25% higher in twelve months’ time.

While still recovering from the massive ‘fall of ground’ at its Bimha Mine, Zimplats produced an annualised 206kozs of platinum in the six months to December 2014. Platinum output was 11% lower, whereas gross profit was 26% lower than in the same period for 2013. A respectable gross margin of 21% was posted. A substantial redevelopment programme is underway at Bimha to restore mining flexibility and to ultimately grow annual platinum output to 260kozs by 2016. Management has warned, however, that its production target is dependent on PGM market prices, power supply and regulatory certainty.

Petra Diamonds reported EBITDA up 22% to US$85mn and basic EPS up 26% to US$5.94cps for the six months to December 2014. These solid results were achieved despite softer rough diamond market conditions and a 2% fall in carats produced. On a positive note, management reports ‘good demand levels’ at the first sight in 2015 and has announced its intention to pay a maiden final dividend of 2p for the 2015 financial year. Petra’s expansion plans to grow its annual diamond output by 60% to 5mcts by 2019 remains on track.

Baobab Resources has received an offer of 6pps from its major shareholder Redbird (+31% on three month VWAP). The non-executive directors, who support the offer, note the failure of the market to recognise the value of the magnetite project, near term working capital requirements and that the project is best funded via an unquoted company. A takeover will result in the delisting of Baobab.