IMARA
Asset Management

Imara Funds Quarterly Report

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Region:	**Africa ex South Africa**
Issued by:	**Imara Asset Management Limited**
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Performance Review:

For the most part the major African markets continued on their recovery path during the third quarter. In our view, this is a combination of a fairly benign global economic backdrop and firmer commodity prices, as well as improved economic policy in certain key African countries. Our markets are well positioned to revert to growing above the global average and providing attractive investment opportunities for investors. The overall result is that Africa ex South Africa had a strong quarter with the S&P Africa ex SA up 9.7% and the MSCI Africa ex SA up 2.4%, despite adjusting to the NAFEX Nigerian Naira exchange rate, which cost each index approximately 3% in August and the quarter. Encouragingly, most African currencies continued their slow, but positive appreciation against the USD. Relative to MSCI EM, which is up 25% for the year, the MSCI Africa ex SA stands at 19% and the S&P Africa ex SA also at 19%. Still comfortably ahead of developed markets, where the YTD performance of the MSCI World is 14%. The MSCI Nigeria index lost 6.2% in the quarter, due to adoption of the NAFEX rate in August. Excluding this adjustment for the new rate, the index rose approximately 10% during the quarter. As a reminder, the Imara Funds adopted this rate in May. Egypt, Kenya and Mauritius all rose by between 4 - 7% using MSCI data.

The performance has unfortunately been overshadowed by FX liquidity constraints and hyperinflation fears in one of our smaller markets, Zimbabwe. While the stock market performed very strongly, as investors rush for hard assets, the demand for USD liquidity has been overwhelming, resulting in our new valuation method, the Old Mutual Implied Rate (OMIR) rate, requiring a 72% discount to be taken on our Zimbabwe assets. This issue was covered in our Communique dated 15 September 2017. We would like to emphasize that our underlying shares in Zimbabwe are all in high quality companies, with sustainable barriers to entry, excellent management teams and strong balance sheets, which allow them to generate strong cashflows and returns, through this cycle.

The Imara African Opportunities Fund ('IAOF'), fell by 16.4% over the last quarter and is 1.2% YTD, largely as a result of the OMIR impact on Zimbabwe. The Kura Africa Fund (soon to be renamed the Imara Africa Fund) and managed by our new team, was up 4.4% for the quarter and is up +17.5% YTD, reflecting a significantly lower Zimbabwe exposure of below 5%.

Looking ahead, we believe there will be continued negative attribution from Zimbabwe in October, as the OMIR discount has risen to 81% at the time of writing. The impact on the IAOF however should be tempered by a now reduced exposure to Zimbabwe and as we repatriate cash, previously stuck in the queue, back to USD through the OMIR mechanism.

The tables show Zimbabwe share performance against the OMIR for the IAOF and the Imara Zimbabwe Fund ('IZF').

Imara African Opportunities Fund

Security Name	YTD 30 Sep	MTD SEP	% of August NAV
Axia Corporation Ltd	391%	106%	1%
Simbisa Brands Ltd	337%	48%	4%
Hippo Valley Ltd	300%	45%	6%
OM effective move	***289%***	***145%***	
Innscor Africa Ltd	275%	129%	6%
Delta Corporation Ltd	211%	93%	7%
Barclays Bank Zimbabwe Ltd	106%	82%	3%
British American Tobacco Ltd	98%	66%	5%

Imara Zimbabwe Fund

Security Name	YTD 30 Sep	MTD SEP	% of August NAV
Ariston Holdings Ltd	671%	184%	3%
Axia Corporation Limited	392%	107%	2%
Simbisa Brands Ltd	338%	49%	5%
OK Zimbabwe	323%	114%	6%
Masimba Holdings Limited	312%	19%	3%
Hippo Valley Estates Limited	300%	46%	2%
Old Mutual Zim effective move	***289%***	***142%***	
Innscor Africa Limited	275%	129%	8%
Delta Corporation Ltd	211%	94%	15%
Econet Wireless Holdings Ltd	183%	74%	7%
Seed Company	180%	57%	14%
Daribord (DZL) Holdings Limited	175%	49%	6%
Zimre Properties Investments Ltd	160%	62%	1%
Barclays Bank of Zimbabwe	106%	83%	4%
British American Tobacco	98%	67%	12%
Proplastics Ltd	81%	15%	3%
Lafarge Cement Zimbabwe	59%	24%	1%
Truworths	30%	18%	2%
Edgars Stores Ltd	4%	11%	3%

For IZF, we believe that the OMIR discount should start to plateau toward the end of October, at which point we believe the Fund becomes a highly attractive opportunity for new investment. The Fund can come into the country through the Old Mutual mechanism, this time at a premium, and purchase high quality, growing companies at very attractive multiples.

As mentioned above, we remain positive on the main markets, particularly Nigeria and Egypt, where we expect strong fourth quarter results.

Portfolio Review:

The portfolios of our various Africa funds are largely driven by our investment approach. We aim to buy good companies with high returns on invested capital and with sustainable business models at the right price wherever they might be listed in Africa. In this way we are index agnostic. The liquidity terms of the Funds allow us to invest in such businesses that may trade less often than the blue chips in the more liquid markets that make up much of the various African indices. As a result, the Funds have exposure to a number of the smaller markets and companies in Africa that more benchmark orientated portfolios might miss or ignore altogether. We choose to hold a focused portfolio of businesses that currently number less than thirty. Our aim is not just to pick the winners, but to avoid the losers as best as possible. This approach has allowed the portfolio to sustain less volatility than the indices and outperform them over the medium to longer term.

Since our focus is primarily on investing in strong business models rather than speculating on market sentiment or economic outcomes, neither of which we have any expertise in, our portfolio turnover is low....often less than ten percent. We have added no new core holdings to our African portfolios over the quarter. Indeed, in many instances weighting changes reflect the movement of the underlying asset values within the portfolio. Over the past quarter we have taken advantage of the strong rise in Zimbabwe to reduce exposure there although repatriating the proceeds has proved difficult to date.

Commentary:

In **Nigeria**, we see a number of positive data points. The quarterly PMI reading continues its uphill march, rising from 55.2 in June to 58.1 in September, while recently released data suggest that Q2 real GDP grew y/y for the first time in five quarters. Without getting too excited, it is refreshing to be able to dust off and use terms like green shoots, turning the corner and upward trajectory again. What was encouraging is in the commentary around the PMI release, it was noted that "*Furthermore, there has been improved utilization of local substitutes for inputs by manufacturers (particularly in the food and beverages segment)*". This is important, as the overreliance on imports for food production, has long been one of Nigeria's, and positions in our portfolio like Nigerian Breweries and Nestle Nigeria's, Achilles Heels'. We highlight the Federal government's recent approval to pay salary and pension arrears. In our view, this is a very significant development, as the non-payment of civil servant salaries materially impacts consumer disposable income and hence demand for goods and services. With interest rates still elevated, we do not anticipate an inflation shock. Payment of pension arrears is also a positive move and will add to an already rapidly growing domestic pension pool. Notably, AuM of the Nigerian pension industry stand at USD22bn, up 23% y/y.

Along with firmer oil prices and improved oil production, we believe the creation of the Importers and Exporters FX window (IEFX), has been a success and dramatically improved ease of doing business for all participants in the economy. It is also worth noting, that after a prolonged absence, foreign fixed income investors are flooding into the country to take advantage of high yields. Their confidence in the carry trade, bodes well for the stability of the Naira. FX reserve data just released show a healthy uptick to USD32.5bn.

In **Egypt,** the market remains buoyant as the country moves on from the devaluation and ahead with the reform program. We noted in the recent IMF country report that "*The launch of Egypt's reform program was a reversal from past policies, which had led to a buildup of large external and fiscal imbalances. With the liberalization of the foreign exchange (FX) market, the parallel market was eliminated and FX shortages virtually disappeared. The ongoing fuel subsidy reform, wage restraint, and significant revenue gains from the new value-added tax (VAT) underpin fiscal consolidation, which is critical for debt sustainability. Structural reforms to revive growth and employment are progressing well. The reform program received strong approval from the business community, international development partners and foreign investors*". In terms of on the ground stats, the annual national accounts for the year to 30 June 17 show a BoP surplus of USD17bn from a deficit of USD 3bn at 30 June 2016. We also note that an important source of FX, remittances from Egyptians working abroad, increased by 45% to USD 3.5bn in July and August y/y. The liberalization of the FX market has facilitated this, as remitters were not incentivized to send money back at an artificially strong EGP rate. Census results released in the month. Egypt has a population of 104 million. 95 million living in Egypt and 9 million living abroad. Another important source of FX is tourism revenues, where we note that in July year to date, tourism revenues are up 170% in USD. Tourism revenues typically have a far greater trickle-down effect and are more evenly distributed than other forms of FX inflows. FX reserves have increased to USD36bn, from their low of USD 15bn last year.

In **Kenya**, the exciting prospect of a second term, unencumbered President Kenyatta, eager to press on with anti-corruption and economic reforms, has been dampened by an annulled election. After what was generally deemed to have been a free, fair and efficient election, the runner up, NASA, filed a petition to the Supreme Court, which ruled in favor of annulment and reelection within 60 days. While the annulment demonstrated judicial independence and institutional strength, subsequent events have turned these elections into a roller coaster ride for investors. Local investors bought opportunistically from exiting foreigners, however as events have dragged, even their enthusiasm has dried up. The latest developments suggest that the reelection will go ahead, despite the opposition threatening to pull out.

Zimbabwe is currently facing a Balance of Payments crisis that is further compounded by fiscal indiscipline. Put simply you have the following:

- Export Proceeds + Foreign Loans + Remittances < Import Payments (supply of foreign dollars<demand for foreign dollars).
- Fiscal Revenues < Fiscal Expenditure.

Normally this wouldn't and shouldn't be too much of a problem, however Zimbabwe uses the United States Dollar (USD) as its main currency, a fiscal deficit is not an ordinary budget deficit, it is a USD deficit. As we have seen from the equation above, the foreign dollar supply from export proceeds, foreign loans and remittances isn't enough to cover import payments (foreign dollar demand). The result is that there is a USD shortage from these twin deficits (current and account and fiscal) and there isn't enough FDI and external debt available to cover this. The government, instead of cutting back on expenditure, has issued domestic T-bills to fund this budget deficit. However, the domestic market isn't deep enough, so the Reserve Bank of Zimbabwe (RBZ) has created an overdraft facility to plug this gap. As a result, the RBZ has in-effect monetized the fiscal deficit, creating electronic dollars (local dollars) in the process, that are not backed by hard currency assets. These local dollars are used to primarily fund recurrent expenditures, which further fuels inflation as local dollars are viewed as inferior to foreign dollars. The T-bills in turn crowd out domestic borrowings and facilitate an even bigger government and an even greater supply of local dollars at the expense of crowding out investment in sectors that would generate foreign dollars. At the time of writing, money supply growth is now over 30%, quasi currencies/local dollars are trading at a 35-50% discount to foreign dollars. Domestic Investors fearing a return to hyperinflation have flocked to safe haven assets such as equities and property. The Zimbabwe stock exchange rallied 78% in September.

Since foreign investors cannot trade in the quasi-currencies/local dollars via the black market, the only way for them to exit Zimbabwe is buy purchasing Old Mutual shares on the local stock exchange and then selling these shares in South Africa or the UK and repatriating the funds to USD. This ratio of the Old Mutual price in Zimbabwe (USD) to Old Mutual price in UK or SA (converted to USD) is called the Old Mutual Implied Rate (OMIR). The ratio between the two, other things equal, should be close to 1 because the shares are fungible. As at the end of September however, the ratio was 3.57 Zimbabwe dollars:1 US dollar! Using this ratio, the result was that the local dollar was trading at a 72% discount to the US dollar. Valuing our portfolio this way is the most conservative and perhaps the most accurate, as there is no other way to officially obtain hard foreign currency from Zimbabwe.

Tony Schroenn, Craig Bandason, Rainer Orth - Portfolio Managers, October 2017