



FRONTIER MARKET
ASSET MANAGEMENT

DRAINING THE SWAMP – ZIMBABWE, ZAMBIA AND KENYA

Larry Speidell

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“When you're up to your ears in alligators, it's hard to think about draining the swamp.”

BAM!

My camera dropped to the dirt, and my hand vibrated like a tuning fork. As the pain reached my brain, I finally noticed the electric fence in front of me. A worthwhile precaution lest someone climb the fence to jump into the crocodile pit, but a significant deterrent to photographers. Having just walked among 100,000 crocodiles in Padenga's farm (no photos allowed), I had finally managed to capture a shot of the big breeder crocs from outside the gate.



Kariba Crocodile Farm livestock range over lands leased from the Zimbabwe Parks and Wildlife Management Authority. Operated by Padenga Holdings Limited, the facility dates to 1965 and serves as the main support facility for the company, which produces meat and hides.

Photo: L. Speidell

Padenga in Zimbabwe, supplies the high quality crocodile skins to Hermes for its handbags that sell for \$30,000 or more. Each September, the farm hires brave “collectors” to steal fresh laid eggs from crocodiles in the wild. Then the wild eggs, along with some from their breeder crocs, are incubated. By March, the three-month-old hatchlings are a foot long. Then for nearly three years, these animals live pampered lives before being harvested for their skins and meat.

7776 Ivanhoe Avenue, Suite 150
La Jolla, California 92037
Telephone: (858) 456-1450
Fax: (858) 456-2040
www.frontiermkt.com

These days, the crocodiles live better lives than many humans in Zimbabwe and Zambia, countries that share a border on nearby Lake Kariba. The man-made lake stretches 250 miles upstream from the Kariba Dam on the Zambezi River. Built in 1953 to provide power to both countries, the hydroelectric facility is operating at only 50% of capacity and Lake Kariba stands only 42% full, all as a result of El Nino effects. Also because of El Nino, the region's maize harvest has dwindled by 35%. Farmers are in trouble and drinking water is scarce.

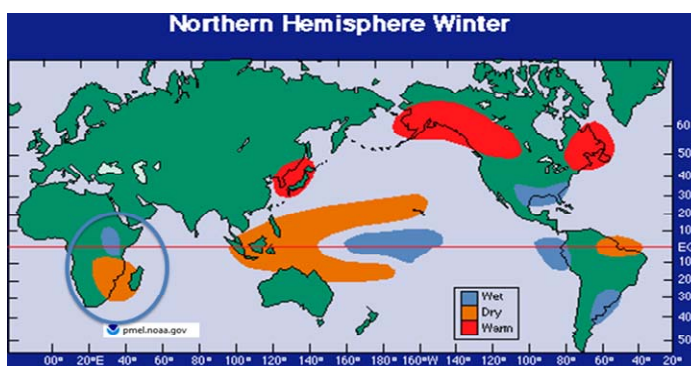
	Zimbabwe	Zambia	Kenya	Vietnam	Bangladesh
GDP Growth (2015 est)	0.0%	3.5%	5.5%	6.0%	6.0%
Inflation	-1.0%	22.0%	6.7%	2.0%	6.0%
Population (mil)	13.8	14.6	45.1	94.3	169.0
People / km sq	35	19	78	285	1138
% Literate	84%	61%	87%	95%	62%
% Literate Female	80%	52%	84%	93%	59%
% under age 15	38%	46%	42%	24%	32%
Life expectancy	55.6	51.8	63.3	72.7	70.9
% Urban	39%	39%	24%	34%	34%
GDP / cap (PPP)	\$600	\$1,800	\$1,800	\$5,600	\$3,400
Electricity/cap kWh	912.9	543.8	136.4	1,124.6	212.8
% Unemployed	60%	14%	40%	2%	5%
Land (km sq)	390,757	752,618	580,367	331,210	148,460
Market Cap (\$ bil)	\$10.9	\$3.0	\$14.8	\$38.2	\$41.7
Market Cap/GDP	92%	13%	33%	28%	19%

In Africa, Kenya is a winning economy. Zambia is struggling with plunging copper prices and its currency. Meanwhile, Zimbabwe dollarized its economy in 2009, so it has suffered from the sharp decline in South Africa's Rand. This exhibit compares key economic statistics of countries visited on this trip with those of the countries visited in our most recent previous travel report.

Source: *The World Factbook, CIA*,
<https://www.cia.gov/library/publications/the-world-factbook/2015>

The table above includes countries from this trip plus those we visited in Asia last fall for reference. In Africa, Kenya is a winning economy, while Zambia is struggling with the plunge in copper prices and the Zambian Kwacha. Meanwhile, Zimbabwe dollarized its economy in 2009, so it has suffered from the plunge in South Africa's rand from 10 rand to the dollar in 2013 to 16 rand to the dollar today. Imports have flooded Zimbabwe, hurting local manufacturers.

Part of the reason for Kenya's economic prosperity is that El Niño has had the opposite effect from that in Zimbabwe and Zambia. There is more rain than normal up north, while the south is dry. The map at right that forecasted El Niño weather has proven prescient for Africa.



This trip started in Harare where I needed to get a Visa on arrival (because the Zimbabwe Embassy in Washington had run out of Visa stickers). Downtown, the Meikles Hotel is a time warp, unchanged since the 1950s. A fine dinner of steak au poivre with mushroom soup and a chardonnay came to only \$28.

El Niño Effects – Precipitation anomalies arising from water temperature conditions in the Pacific Ocean extend to Africa are causing unusual localized weather, both unusually wet and dry, in Sub Saharan Africa. Kenya has benefited from excess rainfall while Zambia and Zimbabwe have been visited with drought.

Source: *Pacific Marine Environmental Laboratory, NOAA.gov*

In visits to companies, the economic pain was clear. Pearson Gowero, CEO of the brewer Delta (38% owned by SAB Miller), said that the wholesale price of their Lion Lager is now higher than the retail price of beer in South Africa. Also, the drought has lowered the level of the Zambezi River, making it easier for smugglers to walk across. On its input side, Delta will be buying maize from Ukraine at \$340 / ton versus \$275 / ton locally because of a 35% drop in the harvest. Fortunately, Delta brews a high quality beer that has earned a loyal following in its home market. At an estimated PE of 8x, the stock is a good value.

There is deflation in Zimbabwe and CBZ, the largest bank, said that its IT and other service providers are lowering prices 10% to keep the business. While there are concerns about loan quality, CBZ seems cheap at a PE of 1.7x and Price/Book of 0.22x

Following our day of company meetings, Itai Chirume, our broker, spent the next day driving us 350 miles across Zimbabwe and Zambia to Lusaka. It was a thirteen-hour trip including the two hours with crocodiles and an hour and a half with Zambian border officials who seem to be a related species. Fortunately, our car had enough African music to keep everyone awake the whole way.

In Zambia inflation is at 22% but Madison Financial Services, a leader in insurance, asset management and brokerage, is optimistic that inflation will fall to single digits after the August election. Equity investors could be rewarded when pension funds are forced out of short-term fixed income by falling rates. Another positive for the country is the indication that mines are cautiously increasing production.



Itai Chirume, a broker we work with in Zimbabwe and Zambia, helped facilitate our trip, arranging meetings, interpreting customs, transporting us within the two countries and providing many hours of African music for the journey. Here, he is standing in front of CBZ headquarters.

Photo: L. Speidell



Crossing the Zambezi – Our route from Harare to Lusaka through Zimbabwe and Zambia.
Source: wikimedia.org

After a short flight to Nairobi, I checked in to the Stanley Hotel, where Teddy Roosevelt stayed during his safari in 1909 and Ernest Hemingway stayed in 1934. Having hosted tourists for more than a century, Kenyans make visitors feel at home. Fine restaurants abound, including Tamarind, in Karen, where Karen Blixen, the author of Out of Africa, lived.



Two Rivers Mall will be the largest facility of its kind in Sub Saharan Africa, outside of South Africa. Centum's 62,000 square meter retail center is scheduled to open this year. Here Katie Bach of Open Capital, Michael Tiriku, the Lead Tenant Coordinator, and Francis Mwangi of Standard Investment Bank visit the worksite.

Photo: L. Speidell

In two days of meetings in Kenya, a highlight was visiting Centum's Two Rivers Mall which will open in mid-2016. The project's 102-acre tract, 10 miles from downtown Nairobi, will house 62,000 square meters of development - the largest mall in Sub-Saharan Africa outside of South Africa. It will even include a water park with the first dolphins ever in Nairobi.

Another highlight was a meeting at HF Group (Housing Finance Group) for discussion of the potential for the mortgage market in Kenya. Presently there are only 22,000 mortgages in all of Kenya, and 95% of people in Nairobi rent rather than own. In addition to being a lender, HF Group is building two-bedroom condos that will sell for \$50-80K, with 100% financing, albeit at the floating short-term rate. While a bubble could occur someday, this may be a good time to buy a few Nairobi properties.

Impressions accumulate during a week in Africa. I have a habit of finding everything strange on my first day in country, but then on the second day, everything seems normal. Still some key themes stand out from this trip and are summarized below: China in Africa, security, tolerance, innovative solutions and finally the oft-heard expression "This is Africa."

China In Africa

With China's economy in trouble, there are concerns that China's interest and investment in Africa may be declining as has the price of its commodities. On the ground, however, we found evidence that China is not pulling out. In fact, the opposite is true:



"A Warm Welcome to fellow leaders" – says this banner at the Two Rivers Mall project. AVIC, the Chinese aviation and engineering conglomerate, serves as general contractor for the project.

Photo: L. Speidell

- At Centum's Two Rivers Mall the general contractor is Chinese, with 110 of the total of 1,400 workers. Among twenty sub-contractors, glazing is being done by a Chinese firm, while all the others are local African companies.
- Arriving at the Zambia airport in one of the few driving rainstorms of the season, Cecilia Suabusu, of Madison Stockbrokers, commented on the construction site, saying: "Chinese contractors are more honest, especially compared with a relative of the ex-president who took airport contract money and bought an estate with a golf course in South Africa!"

- In Nairobi, Chinese builders are paying some \$4 mil USD for homes in the Upper Hill District and tearing them down to put up ten story condo towers.
- At the Kariba Dam, the Chinese are constructing a new spillway and turbine system to capture water power from the lower lake level.

Security

Two Rivers will install sensors underground to x-ray each vehicle entering the property for explosives or weapons. Inspectors will wipe and analyze steering wheels to see if vehicles show any traces of explosives. Facial recognition software will be used at Mall entrances. However, Michael Thiribu, Lead Tenant Coordinator, reports that the system is not very accurate for African faces, or Asian. Perhaps they will need a system designed by Africans.

At the Nairobi airport entrance all passengers must exit their vehicles and walk through a security building for individual screening. Meanwhile, all vehicles entering the airport pass through a twelve lane x-ray scanning system. This was especially comforting after hearing at the TPS East Africa hotel group meeting that Al-Shabaab had threatened the airport in the past week.

Tolerance

Africa is viewed from the outside as fraught with conflict and tribal rivalries. These erupted in Kenya during the 2008 elections with 1,500 people killed as a result. Today, however, things are changing. Kenya's 2017 election is not causing alarm, although some companies may stock up on supplies in advance and defer big spending plans until after polling is complete. Similarly, in Zambia, where the election is in August 2016, any corporate caution is likely to be offset by government largesse to influence the vote.

While Boko Haram continues to perpetrate atrocities in northern Nigeria and Somalia's Al-Shabaab threatens terrorism in Kenya, the broad population seems to favor peaceful coexistence. In Lusaka traffic, I was greeted with a surprising sight on the back of a bus:

*"Allah is the Best of Providers
I am Muslim and I love Jesus"*



Despite Sectarian and Tribal Strife the owner-operator of this Zambian motor coach offers this personal endorsement of multiculturalism: "I am Muslim and I love Jesus."

Photo: L. Speidell

Innovative Solutions

Africa is a pioneer of innovative solutions. "Necessity is the mother of invention" and poverty makes invention urgent.

- **mPesa**, introduced by Safaricom/Vodafone in 2007, revolutionized the transfer of money by turning mobile phones into banking terminals. Now the banks are jumping into mobile loans. Equity Bank provides its own slim SIM card that customers can add to their phones to bypass Safaricom and deal directly with Equity Bank. Using "psychometrics" (whatever they are!) and information from the central credit bureau, Equity undercuts typical rates of 7% per month by charging "only" 3%. These are typically small short term loans of \$20 that allow traders and merchants to buy inventory and then sell it. So far, 400,000 of Equity's 10.6 million customers are using M-Banking, but the cohort is growing rapidly. Equity sees the loan size going to \$100 or more with terms of up to 36 months.

- **Chibuku**, a sorghum beer, is another kind of creative solution. It addresses the affordability of safe, low-priced alcoholic beverages. Since fermentation was invented, people have been brewing all kinds of strange drinks. In Africa, homebrew has often had half the beer market, but at the cost of consumer safety. People have died from a toxic batch, as did twenty people in India recently.

Delta in Zimbabwe developed Chibuku in response to this. Initially, it was a perishable, “live” product, requiring vented containers and having only a few days shelf life. Delivery trucks even exploded due to improper loading.

Then in 2014, a scientific breakthrough was made leading to Chibuku Super, a homogenized drink, packaged in 1.25 liter plastic bottles. They keep refrigerated for a month and sell for \$1, compared to \$3 for Delta’s top quality Lager.

Given the package size, Chibuku is definitely not intended to be consumed alone. In fact, most Africans have the custom of sitting in a group to share their drink.

With three of us in the car headed to the crocodile farm, we took advantage of this African custom, but not to excess. Otherwise, we’d still be somewhere in the bush.

Chibuku Super is not a bad drink at all, with its slightly earthy taste and somewhat mealy texture... no doubt laden with nutrients. It might not be my first choice, but in a pinch, give me a Chibuku any day!



Chibuku – a sorghum beer designed for the price point of African consumers and packaged for a sharing culture offers good value and the promise of camaraderie. (Editor’s note: The author is clearly enjoying this beverage from the passenger’s seat.)

- **Bond Coins** - When Zimbabwe dollarized in 2009, they made no provision for small change. Merchants changed their prices to round dollars and in some cases adjusted package sizes to fit. For rides on commuter omnibuses (minibuses), however, the cost of a ride works out to 50 cents. Initially drivers would give change for a ride in big wads of worthless Zimbabwe notes, but then they shifted to using the South African Rand. When the Rand was 10/\$ this worked, but then the Rand dropped to 16/\$ so making change this way became unworkable. Drivers started giving change in candy! In late 2014, the Central bank began issuing “Bond Coins,” tied to the US Dollar and backed by the African Export-Import Bank. Initially greeted with skepticism, these coins have now been accepted. As shown in the picture, they are somewhat smaller than USD coins, but they work well to smooth the flow of transactions. Interestingly, a set of four coins (1, 5, 10 and 25 cents) is listed on eBay for \$5.61. At the bottom of picture is a tired US Dollar bill, typical of what is circulating in the country these days. I traded a few fresh bills from my wallet with Itai to help things out.



Bond coins (center row) enable Zimbabweans a way to make change from US paper currency.

Photo: L. Speidell

“This is Africa”

- 1) Four traffic circles lock up Nairobi at rush hour every day, twice a day. At each circle, police halt all traffic in two of the four directions for up to 15 minutes without coordination with the other circles only a block away. Leaving the hotel at 6:20 pm for a 7:30 dinner in Karen, I finally arrived at 8:50 - a 2 ½ hour journey for a mere 14-mile trip. Commuters are stuck in such traffic for at least two hours a day. With roughly one million workers, of a population of 3.3 million, this accounts for up to 400 million wasted hours a year. Even Bangladesh has built flyovers in the past few years to eliminate this nonsense.
- 2) Worms with onion anyone? Tough, chewy and the size of your pinky finger... but nutritious.
- 3) President Mugabe is 92 and has held office since 1987. He plans to run again in 2018 for another 5-year term, so he could still be governing the country when he is 99!
- 4) Six lions escaped from Nairobi National Park on February 16th. Nearby neighborhoods were warned to keep their children and pets inside. Within a day, four were caught, and the story dropped from the news. People assumed the others were caught as well, until several days later when a motorist saw the pair, who seem to have adapted to suburban life quite well.



Matter of Taste – Worms at the Southern Sun Hotel in Lusaka seeks to accommodate many palates.

Photo: L. Speidell



Traffic tie up – Escaped lions from Nairobi National Park add to Kenyan commuters' woes.

Source: ma3route.com

Draining the Swamp

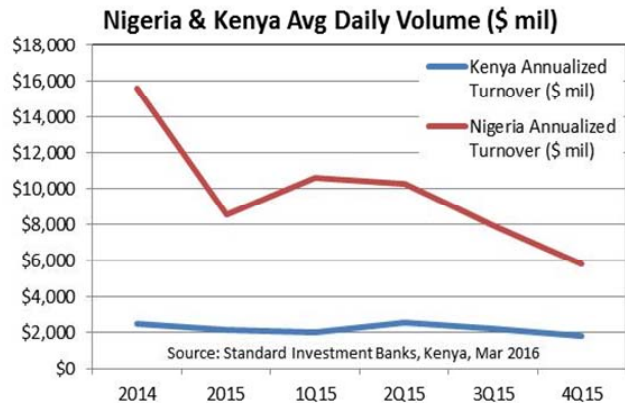
"The art of being wise is knowing what to overlook"

William James, 1890, The Principles of Psychology, Ch. 22

Investing in Africa requires distilling the overload of impressions into a vision for the investible horizon. These days there is a drought of foreign investors and a drop in trading volumes across the African markets.

In Kenya, February trading volume was down 50% from the 2014 high, while in Nigeria in 4Q15, annualized volume was down 63% from 2014. In addition, brokerage commissions in Kenya are down from 1.2% to 0.9%.

Clearly, investors have drained a lot of liquidity from these markets, as well as others in the frontier. The negatives of El Niño and the strong US dollar may soon dissipate. Economic activity continues steadily. Entrepreneurial spirit and the drive for a higher living standard unite and motivate Africans and infuse the economy with energy and enthusiasm. Even China may recover. We believe the alligators and crocodiles have gone off to other financial swamps. Frontier Africa is attractive.



Trading declined in many African markets in 2015 as many foreign investors liquidated positions, creating compelling valuations in attractive franchises



Powerline Road, Kariba, Zimbabwe

About Frontier Market Asset Management

Founded in 2006, Frontier Market Asset Management holds more than 35 years' worth of investment experience including work in Emerging and Frontier Markets since 1987. For more information, please contact us at (858) 456-1440.

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