INVESTMENT OPPORTUNITIES AND IMPEDIMENTS

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17 September 2013

When faced with a topic with this heading it is easy to revert to the tried and tested stereo types.

I could tell you about the bounteous but largely unproven mineral resources - about some of the largest reserves of platinum in the world, decent gold reserves with current production far below records achieved in past years, or of course diamonds, of which we in the non mining private sector know very little.

We could talk about what I believe to be the real game changer, the recovery of intensive agriculture, a theme I feel to be 'Real Big Theme' for the whole of Africa in the next two decades.

I could tell you how our tourism potential is unparalleled, or about our hard working people, better educated than most in the world and forming the backbone of a SME driven dynamic economy.

But you have heard all this before and most of you know the statistics better than I do.

Similarly, you bankers, retailers and industrialists well know the impediments to doing business in Zimbabwe.

Limited liquidity means capital is scarce, relatively expensive and generally of too short in tenure to allow for efficient recapitalisation of industry.

Power and water supplies are sporadic and routes to market inefficient. A weakening South African Rand and poor global economic health impact on demand for our manufactured products.

Everyone in this room understands these issues - which we in Zimbabwe like to call 'Challenges'.

Ladies and Gentlemen, in light of the fact that the broad macro opportunities and impediments to investment are well understood, I thought I would rather approach the topic speaking from personal experience from the last few years, incorporating experiences from our stockbroking and corporate advisory businesses.

The stock market is often overlooked as a source of investment flows; most see it merely as a place for investment speculation. This overlooks the fact that net foreign investment inflows into the ZSE since the introduction of the multi currency regime is currently US$360 million, comparing favourably with much of the investments made in the real economy over the period.

In the initial stages of the Multi-Currency Regime the market was dominated by foreign buyers, with local investors being mainly sellers. This provided liquidity to companies that were holding ZSE stocks bought in Zimbabwe dollars as a hedge against hyperinflation, allowing these companies to kick start their operations under the new dispensation.

Local institutions, such as pension funds and insurance companies also benefitted as they sold stocks to foreigners and used these dollar inflows in their property and money market investment classes.

Many feel that the introduction of the Multi-Currency Regime kicked off foreign investment in Zimbabwe. This is, however, a fallacy, as foreign buying, driven by interest from the United States in particular, dates back to around 2006, when the Old Mutual Implied Rate allowed for a mechanism for both valuation and transmission during the dark days of hyperinflation. In fact, Imara visited the US in October 2006 to market the ZSE, and hosted a delegation of investors in Harare in June 2008.

The key point here is that, even in those difficult and uncertain times, investors were seeing an opportunity to invest here, because of the very attractive valuations in the market.

This market place was fairly limited back in those days, but has grown steadily on the back of growing interest in the African investment case.

These investors weigh many issues in asset allocation, but key among these are valuations, growth prospects, and governance and regulatory issues.

Valuation

Among our stock picks for that October 2006 roadshow were Delta at 27c a share, Innscor at 31c and Econet at 19c. A million dollar investment in these three stocks at that point would now be worth $3.2 million, despite the market correction since 31 July.

The winning stock pick from that visit, however, was Circle Cement, now LaFarge. This stock was trading at 7 cents a share, a market capitalisation representing a third of sales! The share price is now US$1,15, a 16 bagger for the brave investor.

In point of fact, we had a client give us an order to buy a million dollars worth on the strength of our presentation. Limited liquidity meant we could not fill the whole order, but he bought enough to make him very happy indeed!

It is important to note that this value based buying was not predicated on that usual metric of stock market investment, the price earnings ratio. Indeed, the uncertainty of earnings in hyperinflation made forecasts impossible and historic earnings ratios varied hugely depending on whether they were one month, three months or 12 months old!

Indeed, on that trip Delta's historic PER was 11x (compared to 14 now) while Econet's was 20x against the current 6. Circle had been loss making.

In this environment the investors were looking at the US dollar value of our stocks on a market capitalisation to volume basis. In the case of Delta, to hectolitres produced, while Econet was valued against subscriber numbers and Circle against tonnes of cement produced. These are metrics that all investors use across the world.

Although the Multi-Currency Regime has brought stability to pricing, leading investors to pay more attention to price earnings ratios, and even attempt discounted cash flow valuations, the discount to absolute asset values, or to regional comparative stocks remains a widely spread tool.

On this basis the likes of Delta still offer a reasonable discount to regional peers, while Econet is one of the cheapest stocks in its sector in the world.

Similar sentiments drove enquiries into private equity investments. In the first eighteen months of the Multi-Currency Regime we had one foreign PE funds on average every 10 days, all asking us to show them the $50 million to $70 million dollar opportunities.

Growth Prospects

Over the last four years Zimbabwe has registered good growth in general economic terms. The cause for this impetus can be almost ENTIRELY attributed to the introduction of the Multi-Currency Regime. The obvious effects of this were the immediate halting of hyperinflation, but other resulting effects were probably more important.

The Multi-Currency Regime was accompanied by an effective 'hands off' approach from government, who no longer had the power to allocate foreign currency, impose prices or apply subsidies. This put the decision making process where it should be – in the hands of the private sector. Business could allocate resources to best usage, generating profits while providing goods and services at market prices.

This might seem obvious at the level of Delta, Innscor and Econet, but I would argue that it was most important in encouraging small scale farmers to produce cash crops, which surpluses were then able to be spent in the wider economy.

We believe it is VITAL that our new government remains cognisant of the ability of the private sector to best allocate resources to the benefit of all.

Further, the Multi-Currency Regime had the effect of completely doing away with the biggest cause of corruption during the late Naughties – the arbitrary allocation of scarce foreign currency. In the new regime corporates sold their product in hard currency and used those proceeds for import of raw materials.

This had the effect of allowing businesses to concentrate of their core businesses, and we saw Delta dispose of its shareholding in Ariston, and Innscor distribute their crocodile business to their shareholders, as examples of this trend. Dollarisation also removed the turnover tax on exporters that the retention rate implied.

In our opinion the GPA missed a trick during this period. While the ushering in of the Multi-Currency Regime largely restricted effective exchange controls, the government should have taken the opportunity to vastly liberalise, and even completely remove this vestige of the Rhodesian days. We continue to encourage government to further liberalise in this sphere.

Growth in the period 2009 to 2011 was a factor of this liberalisation, combined with good agricultural seasons, and statistically impressive multiplication off a low base.

Further impetus during 2011 and 2012 was provided by rapid expansion of lending to the man in the street by both mainstream banks and micro finance institutions. This gearing of the consumer economy fed double digit volume growth in FMCG, clothing and white goods retail, and an increase in building activity in the country.

We believe this gearing was over extended, with many borrowers finding themselves with real cash flow problems over the 2012 Christmas period and into this year. This has led to a slowing of credit creation during 2013, exacerbated by tightening liquidity in the financial sector ahead of the elections.

Growth prospects have officially been downgraded, but evidence from companies reporting financial results over the last few months points to zero growth at best. Indeed, Delta and BAT have both reported lower sales volumes following the imposition of diminishing return excise tax hikes. Lower world prices and operational problems point to a decline in mining contribution to GDP too.

We encourage the government to stimulate growth in Zimbabwe through a mixture of lower and more simplified tax rates and regime – we have actively lobbied for a flat tax similar to Mauritius and many of the Eastern European success story countries, - and a significant liberalisation of exchange controls.

Regulatory Issues

When working on any corporate action, particularly a capital raise, I always have manage my clients' expectations regarding timing of execution of any transaction. Almost without exception we have to interact and receive approvals from the ZSE (and by extension the SeCZ), the Exchange Control Authorities (a committee including the RBZ and MoF, who do not often seem able to meet to discuss issues), the Indigenisation Ministry and, usually, the Competition and Tariff Commission. All of these add time and complexity to any deal, which naturally increases the cost of doing deals.

It is our feeling that Excon is the single biggest regulatory inhibiting factor from a foreign investment perspective, impacting not just on equity investment, but also on being able to attract lines of credit into the economy. I have discussed this already, and will not labour the point further.

Indigenisation has obviously been a hot topic in the years since introduction of the Act in 2010. I think it is fair to say that the concept of citizen empowerment is a current topic in many parts of the world, as is mineral nationalism (as differentiated from Nationalisation). We will not, at this stage, get involved in discussion around the concept beyond making a couple of observations.

First, the I&EE legislation IS an impediment to investment. At its most basic it is another grouping of bureaucrats that have to be submitted to, followed up with, responded to and waited upon. All with no definitive understanding of the decision making process.

At its most extreme it calls for a 51% equity stake in a business, with an absolute obligation to comply with this onerous requirement. The legislation allows for variance from this position and for a time scale to comply. We have, however, seen dictates and proclamations from the Ministry that are at variance with the legislation.

This is the biggest issue with this legislation with most investors we talk to. All corners of the political process have defended one aspect of this legislation. "Come talk to us - everything is negotiable". This is not an incentive to investment, it is a hindrance. It introduces an element of opaque decision making and a lack of accountability. This is never investor friendly.

I often hear, at conferences similar to this, that we have a very user friendly Zimbabwe Investment Authority. The main selling point here is that one can get seven, or so, approvals in the 'One Stop Shop'. My feeling, whenever I hear of this is "How can we have so many hoops for an investor to jump through?" We have to be competitive with the best environments in the world. This does not require massive think tanks of bureaucrats and captains of industry sitting here and chewing the fat. Download it from the Rwanda Investment Board.

In Zimbabwe we like to talk about development, and income generating projects. This terminology reflects a paucity of thought - we are not shooting high enough. We have to be generating employment, value add, surplus profits, dividend flows and re-investment. This is the language of investment. In a dollarised environment we cannot stimulate investment by looking inwards and using monetary policy. We HAVE to attract new capital inflows to GROW the size of the pie.

Zimbabwe has every opportunity to outperform for the next decade. We have huge amounts of valuable resource. We are strategically located in the centre of one of the fastest growing regions in the world. And we are behind the curve with great out performance options just on a catch up matrix. But we will not realise this potential by looking inwards. We have to craft the most attractive investment environment in the world to attract and capture international capital.

Thank you.