Platinum® ASSET MANAGEMENT

Africa Rising

Ten to fifteen years ago it was common to be asked, "What about Africa?" At the time one would grimace and enter into a tirade about its many shortcomings. **The time has now come**. Rather like the spreading of revolution across South America in the first half of the 19th century as the Spanish colonial grip slackened and which was to bring fundamental change, the base line (trend) for change in Africa is now in place. The lesson from Latin America, and for that matter the transformation of the Asia Pacific rim in this last century, was to understand this change of trend. This did not reduce the bumpiness of the ride, which involves significant swings of investor sentiment and hence asset prices, but it can settle one's anxiety in the face of periodic losses of confidence and provide one with an anchor through the turbulence.

What follows is a description of some of the contributing and detracting factors. In the space available this is not meant to be a comprehensive study but to set out markers, some anecdotal, gathered from a recent trip to parts of South Sahara Africa (SSA).

The Internet and mobile phone

Like elsewhere, SSA has been a huge beneficiary of these two leaps in technology. There are the obvious benefits of improved dissemination of information and knowledge at a capital cost that is a fraction of earlier telephonic iterations. With mobile handset prices dropping precipitously, including those of smart phones, market penetration is already typically 80% of the population with outliers in the Democratic Republic of Congo at around 30% and the Republic of South Africa at 150%, a function of multi-sim card ownership. This degree of mobile ownership is remarkable when one considers the lack of electrical supply, and in places like Zimbabwe, there is a roaring trade in small solar panel chargers.

Safaricom, listed in Kenya and 35% owned by Vodafone, has stretched the boundaries of value even further with its 'M-PESA' innovation. Subscribers have been given a safe way to send and receive money via their mobile phones. This is supported by a network of 39,000 agents nationwide. There are now over 15 million Kenyans using the M-PESA platform – and it keeps evolving. Safaricom is extending the facility (and augmenting its income) by allowing users to make payments remotely with their phones and better still, to even earn interest on current accounts and/or to gain access to micro credit via their phone. In countries where many do not have banking accounts, partly because of very limited savings and the high cost of running a bank account, this innovation is a huge breakthrough. As you can imagine, in the past the principal way of delivering funds to a needy relative was to embark on a long, arduous and expensive bus ride up-country. Paying bills was as painful, with long queues and a reward of an indolent clerk. Safaricom's entry into micro finance – where is it takes 7.5% of the monthly 2% lending fee earned by a partner bank, is causing consternation from the leading bank in this area, Equity Bank, which has been earning spreads of over 15% points on this business and which has been growing by over 30% pa!

These changes, however, relate mostly to **economic emancipation**. The more subtle and perhaps more invigorating aspect relates to **awareness of choices**. The manacles of ignorance are being corroded by a developing awareness by the populace of the opportunities in a modern and open(ing) society. This is quite apart from the aspirational aspects of materialism.

Time and urbanisations

Most of the countries in SSA cast-off colonial rule in the 1960s. In some cases the scars were deep but over the last 50 years and with the examples of the enormous economic progress achieved by Asian countries of a similar economic standing at the outset, it has become evident to many that to blame the colonialist is no longer a sufficient explanation for SSA's relative economic under-achievement. In many cases the output per person was higher in SSA than in the countries of the Pacific Rim, India and China in the 1960s. This awareness of social and economic under-performance is made all the more stark by the large movement from the country to ever enlarging urban conurbations. In turn, this is reducing the influence of traditional affiliations. An interesting test of this will be the elections in Kenya at the end of February. This is likely to reveal the sharp distinction of voting patterns between urban and rural dwellers. There may also be revealed a preference for reform by the country's voting youth. While the fertility rate has been dropping (for example, women in Kenya typically would have had an astonishing eight children back in 1960 compared to under five now and with much improved survival rates), the **age pyramid of SSA** resembles that of the early experimental pyramids in Memphis rather than the Michelin man common in economically advanced countries. This tidal wave of new young voters, with all their awareness and aspirations is a force that will not be assuaged by glib promises delivered from the comfort of some presidential palace. Harking back to the ubiquitous mobile phone-come-camera, one can understand the concerns and challenges now facing the most thoughtless political tyrant.

Metal and mineral resources

George Soros wrote a book on the negative aspects of SSA's bountiful resources – arguing that it has simply **encouraged a kleptocracy** to the detriment of the broader population. This has undoubtedly been the case but because of the factors described above, it is probable that this behaviour will ever so gradually subside. Moreover, recent discoveries of oil and gas in countries formerly seen as largely agricultural, like Ghana, Mozambique, Uganda, and probably Kenya is a **transformational event**. Though still nascent, exploration work is revealing whole new energy provinces with Mozambique having perhaps more offshore gas than Australia's NW shelf. Similar surprises have occurred in Uganda with oil discoveries in Lake Albert having *in situ* reserves to date of perhaps 3.5 billion barrels. Ghana is now producing over 110 thousand barrels of oil a day from the offshore Jubilee field, most of which is exported, and there are several other highly prospective areas for both oil and gas. Consider the economic impact of unlocking these huge resources on tiny economies; surging exports, exponential lift in governmental revenues and out-sized capital inflows to fund the necessary infrastructure. In the case of Ghana, GDP per capita has doubled in the last five years to around $1,300 pa.

On our trip we visited Vale's huge open cast coal mine in Tete province of Mozambique. This is a gigantic undertaking with the plan to gradually lift production of both coking and thermal coal to some 21 million tons a year, say export revenues of $3 billion pa. Compare this to current GDP of say $25 billion pa and a population of only 13 million. Moreover, a similar sized project is being undertaken by the likes of BHP which together with the creation of a new port and railway line gives one a hint as to how transformational these projects will be. SSA's average GDP per capita is still below $1,000!

The involvement of huge multi-nationals with their declared policies on ethical business practices, together with relatively clear national investment and fiscal agreements is having the desired effect of reducing scope for side deals.

To avoid excessive leakage and for reasons of their own economic agenda, the Chinese use a model of actually building infrastructure such as roads, railways, bridges and ports in exchange for long term concessions over fisheries, land and minerals etc. Unfortunately, football stadia and flashy new airports have also been a big winner with populist leaders. By sending in their own teams, the Chinese are delivering these projects in record time and apparently to budget. There may be longer term regrets as to the ultimate cost of these deals, with resources being surrendered at very cheap prices but at least these facilities exist and offer immediate utility rather than being vague hopes. There are other issues that arise among such as the staying-on of Chinese workers who then compete against established small holders to the latter's (short-term) detriment.

Having been one of the world's principal producers of copper in the 1950s and 60s, nationalisation and mismanagement saw Zambia's production slip to virtual insignificance by the turn of this century. After spending $2.5 billion on refurbishing the mine and the treatment plant, Vendanta Resources has completely rebuilt the Konkola copper mine at Ndola. The grades are extraordinary at 3.5% contained copper - by way of contrast Chilean grades are running at just over 1% - but the drawback is contact with aquifers. It has to pump 350,000 tons of water a day into the Kafue River. Similarly, other mines are reopening on the copper belt and Zambia could find itself back as the second largest producer at 1.5 million tons of copper a year in 2015.

Apart from metals, Zambia also contains 60% of SSA's water resources which together with huge tracts of unworked land in a country the size of Texas, 750,000 km^2, provides it with huge potential. One listed company trying to exploit this opportunity is Zambeef. Its highly integrated model of food production from field-to-table is producing some remarkable growth rates against less organised competitors. Others are seeing the opportunity too with foreign demand for farm land escalating and Zambeef recently had to pay US$50 million for a 50,000 ha farm against fierce Russian bidding.

Potential is not the problem in SSA; graft certainly is

There are obviously many problems which include undue subsidies, expensive and scarce credit, land ownership uncertainties, unemployment, disease, inadequate infrastructure and the list goes on.

Poor segregation of the powers between the legislature, executive and judiciary, together with a deeply etched sense of entitlement **is stunting development**. Unlike the experience in other parts of the world, where rents are extracted for facilitation, the Africa version focuses more on creating blockages than the need to be facilitated. We came across some jaw-dropping examples that would put the best Monty Python sketch to shame were it not so debilitating. The World Bank's Economic update, edition No.7, has a whole section on corruption with over a dozen first-hand accounts of the experiences of individuals in their daily lives. It goes on to quantify the approximate annual cost of kickbacks for government contracts at Ks36 billion pa (approximately US$425 million) and other bribes paid by firms (alone!) at Ks69 billion, (US$800 million) and estimates that this money could otherwise have been mobilised into creating 250,000 jobs at the average wage.

The encouraging aspect is that **political accountability is improving**. Zambia has now experienced four changes of presidents since Kenneth Kaunda left office in 1990 after his economic experiment of Zambian humanism failed. There are other examples of reform from Kenya to Ghana with notable exceptions in some countries where their all-powerful leaders still seem to have the final say in everything. However, as the Arab has demonstrated, there is no going back.

From our perspective the behaviour of a country's leadership will be the best barometer of a country's medium-term prospects. For this reason we would rather invest north of the Limpopo even though the physical size of these markets is at present much smaller than that of the continent's economic giant, South Africa. On account of its relatively huge economic base, South Africa will obviously benefit from this growing interest in the African continent. However, it is our view that the Johannesburg Stock Exchange is relatively fully priced and the exposure gained through owning these stocks to broader Africa is typically in the low teens at best. This puts them in the same category of other multinationals like Unilever, Heineken and so on. There are some listings elsewhere that we are working on together with the gradual accumulation of stock on various African exchanges.

In summary, the base line is in, the continent vast (with a land mass exceeding that of the USA, China and Brazil *combined*) and the potential enormous. Valuations are acceptable for risk-seeking investors in a world of slow growth.

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