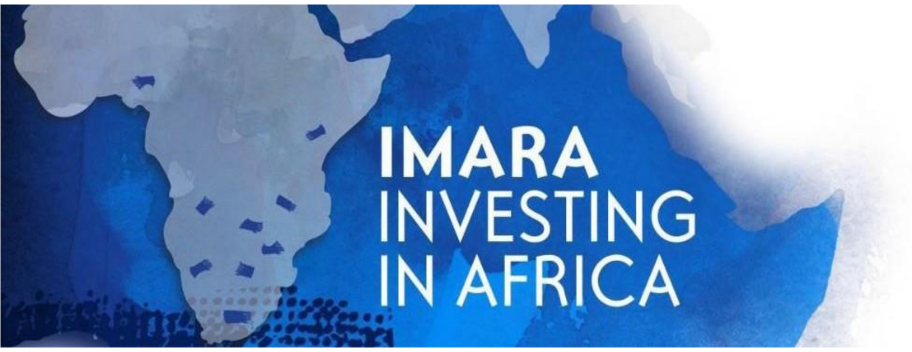

Zimbabwe Investment Notes

Edition Update

Region Zimbabwe

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So Far, So Good ……..

In our last Investment Notes which we wrote barely one month after the change in Government, we wrote about the significant and positive policy measures that the new President and his Minister of Finance had outlined in the 2018 Budget and subsequent policy proposals. We also suggested that we should not expect to see any change to the fundamental problem concerning the banking system and Zimbabwe's currency until after the elections given the difficult and sensitive nature of Government's dilemma. That view still stands. Indeed we firmly believe that the currency issue can only be resolved by a credible economic reform programme backed by the IMF and other multilateral lenders which can only happen post a free and fair election. As a result we opined that the Government would have little choice but to muddle through with the 'US dollar illusion' (See July 2017 Investment Notes) until after the elections and hence banking queues would continue and offshore transfers would remain problematic. Unfortunately from a political perspective this is the one key area that the electorate wants resolved whilst it is less interested in the long term policy measures that Government can implement now to ensure Zimbabwe is "open for business".

The Finance Act which brings into law the policy measures announced in the 2018 budget was signed last month. As a result, Indigenisation, the cornerstone of Government policy during the latter years of the Mugabe era, is legally all but gone. All that remains is the need to indigenize the diamond and platinum sectors, but even here we suspect that the requirements will be watered down or even removed at a later date. Our own and others' experiences with foreign investors dealing with the likes of the Zimbabwe Investment Authority highlight a significant and fundamental shift in attitude toward foreign investor requests and implementation. This is highly positive. Government's commitment to reduce its spending is also apparent with measures in place to reduce the size of the civil service through voluntary redundancies, retirement at 65 and dismissals currently underway. Demands by doctors, nurses and potentially teachers for more pay are not being met hence the recent strikes in the medical sector. This again is being felt by the electorate directly.

Government has been on an extensive drive to promote Zimbabwe internationally as being "open for business" with highly successful delegations visiting Davos in Switzerland and the Mining Indaba in Cape Town and more recently the UK and the US. As we had expected, we have also seen a continual stream of international delegations visiting Zimbabwe to assess what is happening on the ground. At Imara we have met with officials from the IMF, the CDC, UK's Dfid, the EIB, the World Bank and the IFC. Closer ties with the UK foreign office and Government have also been noticeable. The critical need to be seen to hold free and fair elections in 2018 has prompted the Government to invite international election observers for the first time in over twenty years; to date the UN and the EU have sent initial delegations to undertake the necessary ground work. All of this is positive for the medium to long term but for now is inconsequential for the electorate.

Since the budget we have not seen much action with regard to the commercialisation or privatization of state owned enterprises although we recognize that this is not a short term fix. We also understand that it is potentially a political hot potato and hence we may only see any measures post an election. We have been encouraged by action in the agricultural sector with a move by Government to issue 99 year leases to commercial farmers. This is critical if we are to see a return of title enabling financial institutions to resume lending backed by credible collateral. Whilst this policy measure has not been fully implemented, the noises on the ground suggest progress is being made. Further, compensation for commercial farmers whose farms were taken during the land reform programme is at least on the table and we believe is being discussed as part of a post-election reform package to include foreign backers. Again this will be critical if Zimbabwe is to be seen to uphold the law of contract.

As far as the economy is concerned currently, recent statistics from the Reserve Bank (RBZ) date back to December and so we are not able to see more up to date numbers post the December budget. As far as the monetary indicators are concerned, broad money, M3, grew by 44% over the year which was less than we had feared but is still a high number and is ultimately inflationary. The government's overdraft/loan from the RBZ – ultimately the creation of electronic dollars – grew by 70% in 2017 to RTGS$4billion dwarfing treasury bills held by financial institutions which amount to $2.4billion.These numbers will continue to grow into 2018 unless and until the Government can reduce its budget deficit which of course will take time. We look forward to reviewing the 2018 economic bulletins to enable us to assess any change in momentum. Turning to the assets of the banking sector, we note that *nostro* accounts have improved slightly which we assume is related to the AfriExim bank loans being drawn down. Cash on the other hand remains pitiful at a mere $12m of bond notes and $58m of foreign currency held, a sharp drop on 2016 despite a 35% increase in deposits over the year. Meanwhile official CPI inflation fell back to 3% in February 2018 from 3.5% in January largely due to the reduction in fuel prices, the result of Government cutting its excise tax on petrol and diesel. We expect official inflation to remain subdued due to the bulk of the inflation basket being controlled i.e. fuel and food.

Recent results from listed companies have been highly positive reflecting a strong turnaround in the last quarter of 2017. If we were wrong about anything in the first quarter, it has been to under-estimate the improvement in both volumes and revenues. That is despite our investment team meeting regularly with management teams in a cross section of sectors. Whilst most management teams have been cautiously optimistic, none of them were suggesting such a strong period as we are now seeing in results' presentations and on our current company visits. Whilst initially an uptick in consumption was due to inflationary buying of goods and services as a means to utilize RTGS bank balances, there has also been a definite improvement post the change in Government in November last year due to a 'feel good factor'. Recent management contacts suggest that this has continued into 2018 and Delta's recent trading statement for their last quarter (Jan to March 2018) was highly positive. That said we also need to remember that the first quarter of 2017 was a very weak one for a number of companies due to the heavy rains and floods which caused major disruptions. Consumer companies are looking forward to buoyant second quarter sales driven by civil service bonuses that are due to be paid over this period. Of significance the results season has shown just what a sharp and positive impact on profitability a small increase in revenue can bring about. Put another way, corporate operational gearing is very high. Much of this can be explained by managements' efforts in recent years to reduce costs and improve efficiencies. This has resulted in our Investment team increasing their earnings estimates which is having a positive impact upon valuations. Whilst the ZSE looked fairly valued or even expensive after last year's 130% increase, our revised earnings estimates are now suggesting much better value. In addition dividends have been increased accordingly providing us with a higher yield. Should the economy start to accelerate post elections, this phenomena will become ever more apparent to investors as profitably rises sharply. This will ultimately drive share prices higher.

Our strategy to overweight equities has worked well over the past twelve months and will continue to do so in our view going forwards. If events over the coming months go badly, investors will prefer to hold equities as an inflation hedge over and above poorly yielding money market assets. If on the other hand we see positive change and a return of international lenders and investors, the economy will grow sharply thereby boosting corporate earnings and confidence thereby driving the ZSE to higher levels. The coming few months will be critical for Zimbabwe's long term future. We remain optimistic but also realistic as much work needs to be done. As ever we hope for the best but need to be prepared for the worst. Zimbabwe has muddled through for too long now but has the potential to do so much better under a strong and reform minded leadership that has the opportunity to improve everyone's lot.

John Legat – Chief Executive