

Mount Kenya¹ and the Land of a Thousand Hills *Kenya and Rwanda*

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Last October, I set out on a research trip to Kenya and Rwanda. Much has changed in the world since our last visit to Kenya in March 2010. The European debt crisis made headlines. The Arab Spring that originated in Tunisia in December 2010 and quickly took hold in Egypt, Libya, Yemen, Bahrain, Saudi Arabia and Jordan had profound impact on the region and the world. In March 2011, the catastrophic earthquake and subsequent tsunami hit the east coast of Japan, causing tens of thousands of people dead and huge economic losses. These are a few examples of the tumultuous world that we live in and why people are leaning towards risk aversion when investing. The Kenyan market was among the worst performing markets in 2011, so it was timely to visit the country, meet and talk to local people and find out the truth from the ground. Rwanda is a new market with two stocks just listed in 2011, and we participated in both the IPOs. It was a real adventure for me to travel to the country and explore the beautiful landscape, the culture and the life of ordinary people...

	<i>Kenya</i>	<i>Rwanda</i>
GDP Growth 2011est	5%	7%
Inflation	18.9%	7.7%
Population (mn)	41.9	11.4
People/km sq	73.7	460.9
% Literate	85.1%	70.40%
Education % GDP	7%	4.1%
% Under age 15	42.2%	42.9%
Life expectancy	59.5	58
% Urban	22%	19%
GDP/Cap (PPP)	\$1,621	\$1,193



Kenya

2011 was a very tough year for Kenya. Inflation went up from under 5% in 2010 to 18.9% (as of October 2011). Most of the upward pressure came from food inflation (68% of Kenya's inflation basket) as a result of the drought conditions affecting crop production. Higher fuel prices and pass-through impact from the exchange rate also pushed up the inflation rate.

Currency depreciation is another contributor that damaged the overall economy. Kenyan shilling (KES) depreciated by more than 30% from January to October of 2011, resulting in a significant increase in fuel costs and imported raw materials, putting further pressure on inflation.



Map of Kenya

Source:
<https://www.cia.gov/library/publications/the-world-factbook/geos/ke.html>

¹ Kenya is named after Mount Kenya, the highest mountain in Kenya and the 2nd highest in Africa.

These fluctuations in the economy are affecting everyone, including the exporters who are supposed to be benefiting from the strong foreign currency income. For example, BAT Kenya, a subsidiary of British American Tobacco in Kenya, shared concern that continuously high inflation may constrain their customers' purchasing power despite their export of tobacco bringing in significant revenue for them. The companies who need to import considerable amounts of raw materials from abroad have been hurt really badly. The management of Kenolkobil complained about this tough environment. The collapsing KES and the cap on gas selling prices (to control inflation) have made it difficult to maintain margins and limit foreign exchange losses. Kenya Airways has recently decided to charge their airfare in U.S. Dollars in order to curb the pressure from currency depreciation.



The old Nairobi Stock Exchange

The next Presidential Election is reported to be scheduled for December 2012. People are cautious and a lot of investors are holding a wait and see attitude. Together with the financial crisis in the global market, the stock market has declined by more than 30% YTD on very thin volume.

However, is Kenya really out of hope? Shall we all stay away from the market? I actually see the opposite and hold a cautiously optimistic view on the country and the companies. Below are the reasons I see for optimism and hope in Kenya's impending future.

1. It is likely that we are close to the peak of the food inflation crisis. It is reported that rainfall conditions are approaching normal patterns in the food growing regions, which will dramatically help the food supply to increase, therefore decreasing inflation. In addition, the government has lifted the ban on genetically modified maize, which is making it easier to import and plant GMO maize. Tanzania has lifted its six month ban on grain exports, opening doors for cheaper grain imports into Kenya. All of these factors will increase food supply in the country and hence reduce pressure on the inflation.
2. Two days after my visit (10/5/2011) in Kenya, the Central Bank raised the benchmark rate by 400bps, which exceeded all analysts' expectations, but has been long called for. This is an encouraging sign, indicating that the government is moving aggressively to rescue the shilling. On November 1, 2011, the Central Bank raised its benchmark rate again by 550bps to further curb the shilling's weakness. Additionally, the government is working on other measures to help strengthen the currency, such as the Finance Minister's proposal to lower FOREX exposure by commercial banks from 20% to 10% so as to limit speculation. The government is also entering into talks with the IMF for additional USD loans in order to restore confidence in the shilling. As of November, the KES has been successfully strengthened to the KES90 level, up from KES107 in October.
3. On the ground, I found that some people are cautious about the upcoming election. However, I found that more people were confident and optimistic about it. In fact, there have been some positive developments in the country with respect to the impending election. A referendum to vote on the proposed constitution was held on August 4, 2010 and the new constitution passed by a wide margin (67%). The entire process was considered to be transparent, fair and merit based. I was also told that the government is working on a fingerprint system which will eliminate possibilities of cheating and manipulation.
4. Fundamentally, many companies in Kenya are strong and have good growth prospects. The banks have reported very impressive loan growth and are actively expanding into new markets. Kenya Commercial Bank reported 41% loan growth as of September 2011 and was also able to sustain high Net Interest Margin at 9%. With the interest rates creeping up alongside the increases in the benchmark rate, we will

most likely see a slowdown of the credit growth. However, the banks are still expecting to see 20% loan growth in 2012.

5. Last, but not the least, I was superbly impressed with the Kenyan people. They are hard working, smart and professional. The overall population is young, with 73% of its residents below 30 years old. I was able to experience this first hand: the local analysts I met with were early 20s, energetic, and extremely knowledgeable. The management teams of the companies are open-minded, down to earth and willing to share insights to investors.



People busy walking on the street in Nairobi



City view outside the window of Hotel Sarova Stanley

After my trip to Kenya, I am more optimistic about the country's future. Things are still tough and it will take time to get back to normal again. However, with the recent price corrections, I think it might be a good shopping window. Some of the companies are fundamentally sound while offering incredibly cheap prices. Given time, they will be rewarded.



Rwanda

Rwanda is most often associated with the horrific genocide in 1994. It was one of the most intensive killing campaigns in human history. The roots of Rwanda's genocide lie in its colonial experience. The Germans arrived first (1895-1916). During World War I, the country was taken over by Belgian troops. Traditionally, Hutu, Tutsi and Twa² were just socio-economic classifications within eighteen different clans, which could change with personal circumstances. However, utilizing the strategy of "divide and rule", the Belgians made the distinctions racial by introducing the identity card in 1932 and granted preferential status to the Tutsi minority. In 1959, the Belgian backed King Rudahigwa died, leaving chaos in his wake. During this time the Belgians switched support to the Hutus from the better educated Tutsis who were struggle for independence. More than 700,000 Tutsis were exiled between 1959 and 1973 as a result of the ethnic

² Hutu: 84% of total population
Tutsi: 15% of total population
Twa: 1% of the total population



Map of Rwanda

Source:
<https://www.cia.gov/library/publications/the-world-factbook/geos/rw.html>

cleansing encouraged by the Belgian colonialists. Some of these people then joined the Rwandan Patriotic Front (RPF), a rebel group founded in Uganda, which invaded Rwanda on October 1, 1990. Civil war ensued. In August 1993, the Rwandan government and RPF signed an agreement known as the Arusha Peace Accords which intended to push for a transitional government preparing for a democratically elected government. However, the Hutu extremists in the government didn't want the agreement to work and signed the largest-ever Rwandan arms deal with French company for USD 12mn with a loan guaranteed by the French government. On April 4, 1994, President Habyarimana's plane was shot down and within 24 hours, roadblocks sprang up around Kigali, houses were being searched, and shots began to echo through the streets. In just 100 days, approximately 800,000 Tutsis and moderate Hutus were murdered. Tens of thousands were tortured, raped, and mutilated. On July 4, 1994, Kigali fell to RPF and the genocide finally came to an end.



Mass grave at Kigali Genocide Memorial Center

Seventeen years have passed, but this tragedy will never be forgotten. Most importantly, people have learned their lesson and the country has taken giant strides towards recovery. The driver who gave me a city tour is a Tutsi and lost his father in the genocide. He told me that people no longer differentiate themselves, considering themselves all Rwandan. During my visit in the country I was very impressed by the beauty of the landscape, the fast development of the city, the effectiveness of the government and the friendly people who give this country life.

Rwanda is most commonly known as the "land of a thousand hills", which is a very vivid description of the country's terrain – mostly grassy uplands and hills. The country is incredibly green with endless mountains and stunning scenery. The volcanic Virunga Range in the northwest is home to what is estimated to be a third of the world's remaining 750 mountain gorillas. Tourism is now Rwanda's primary foreign exchange earner. Contrary to most of the capitals in frontier and emerging countries, the capital of Rwanda, Kigali was incredibly clean, peaceful and well organized. The roads are new and equipped with the



Land of a thousand hills

modern traffic lights with signals utilizing a counting down system. There are not a lot of automobiles on the roads yet, but people do follow traffic signals. The government is one of the most environmentally conscious governments in the world; in fact what they have promoted is far beyond what the developed world has done. For example, plastic bags are banned, community work is encouraged, and on the last Saturday of every month, people will voluntarily come out and help with community work from 7a.m. to noon.



Typical house in rural Rwanda surrounded with small farm lands

Rwanda is a presidential unitary republic, based upon a multi-party system. The incumbent President, Paul Kagame, rose to prominence as the leader of the RPF. He won the 2003 election by 95.1% majority and was reelected in 2010 by 93% majority. From my conversations with the local people, I can see that people are very supportive and proud of their government. They showed much respect to their President and the government indeed deserves some applause. Under President Kagame's leadership, Rwanda has been called Africa's

"biggest success story". "In 2010, Transparency International ranked Rwanda as the 66th cleanest (out of 178) countries in the world and 8th out of 47 in Africa."³ In addition to being physically clean, they have a very low corruption rate.

Economically, there has been significant development since the genocide. The per capita GDP has increased from \$416 in 1994 to an estimated \$1284 in 2011. GDP has rebounded with an average growth of 7-8% since 2003.



Typical houses in Kigali

Inflation has been reduced to single digits. The majority (90%) of the population is still engaged in the agricultural sector, which has reported impressive productivity growth in the past 3 years. In 2010, Rwanda was self-sufficient in food production. According to "World Bank Doing Business Report 2012", Rwanda has improved its position from the 139th in 2008 to 45th based on 2011 data, out of 183 countries⁴ surveyed in the world. The first phase of the modern Special Economic zone in Kigali is near completion and 90% of it has already been booked by local and international investors. The country has successfully attracted and received foreign investments and aid money. The World Bank, for instance, pledged \$600mn to support projects in the sectors of agriculture, energy and transport in the next 3 years. China is also going to loan and grant \$15.7mn to Rwanda encouraging economic development and trade with China.

When people are depressed by the European debt crisis, frustrated by the high unemployment rate and slow economic growth in US, fearful of the likely slowdown of China's economy, and when many African countries, like Kenya, have been experiencing skyrocketed inflation rate and struggling to control collapsing foreign exchange rate, Rwanda is considered an example country. Its tactics have proven to weather the aberrant economic storm relatively well. According to IMF 2011, real GDP is estimated to reach 7% by year end. The Central Bank of Rwanda is expecting even stronger growth at 8.8% due to good growth in various business sectors. Although inflation is slowly rising, it has been steadily maintained at 7.7% as of October 2011. According to the Central Bank of Rwanda, Rwandan Francs (RWF) depreciated by 0.9% against USD between December 2010 and September 2011. In comparison to some of its peers in the region, the local currency has not been as volatile. In fact, RWF appreciated considerably by 14%, 15% and 9.5% against the KES, Ugandan shilling (UGX) and Tanzanian shilling (TZS), respectively.



Construction underway in Kigali

Rwanda is still poor. As a land-locked country in central and eastern Africa, it is slightly smaller than the state of Maryland, but has a population of around 11.37mn (double the population of Maryland). Not surprisingly, it is considered to be one of the most densely populated countries in Africa. High energy costs, lack of adequate transportation linkages to other countries and instability in neighboring countries are all challenges that Rwanda is currently facing.

Nevertheless, during my visit I saw many potential growth opportunities. As with Kenya, the overall population is very young, with 63.5% of the population under the age of 24 and a median age of only 18.7 years old. The current literacy rate is 70.4% (up from 58% in 1991), and the government has taken dramatic steps to improve education.

³ Country Information- Rwanda: <http://www.umubanotours.com/index.php/country-information-rwanda>

⁴ The World Bank, Doing Business 2012 <http://www.doingbusiness.org/-/media/fpdkm/doing%20business/documents/annual-reports/english/db12-fullreport.pdf>

They now offer free education in public schools for nine years, as well as supporting the private schools that are available. People are aware of the importance of education and are willing to spend money on their children. This young population will soon become the major labor force as well as being consumers who will drive further development of the country.



A bicycle taxi driver waiting for business



Kids playing on the roadside

The fact that Rwanda is bordered by Uganda, Tanzania, Burundi and the Democratic Republic of Congo has offered it unique opportunity to become a regional trade center similar to Kenya. The country joined the East African Community and is aligning its budget, trade and immigration policies with its regional partners. That said, there are still improvements that Rwanda can make to increase the efficiency and decrease costs of international trade. As of 2011, the country has no railways and only one small international airport. However, it is reported that funding has been secured for a feasibility study into extending the Tanzanian Central Line into Rwanda. I was also told that there is a plan to build a second airport.

The Rwanda Stock Exchange was publicly launched on January 31, 2011 with the first Initial Public Offering (IPO) of Bralirwa. Bralirwa is 75% owned by Heineken and is an absolute monopolist in Rwanda with 94% market share in beer. It has large distribution channels and wide coverage throughout the country. I saw shops with Bralirwa's brand names almost everywhere. The subscription rate of the IPO was 274%. The stock price surged 62% when trading began and now it is 2.3x the offer price. After the success of the Bralirwa IPO, Rwanda's largest bank – Bank of Kigali was listed on the exchange on September 1st, 2011 and it was 174% oversubscribed. The government is planning on privatizing more companies in the near future. I met with a bank, an insurance company and an investment company who are all hoping to be listed. Unfortunately, it is probably not going to happen until some time in 2013.



Shop with Bralirwa's well-known brand "Primus"

I left Rwanda with a very good impression. The country is still at an early stage of development; its infrastructure needs to be upgraded, education needs improvement, the country still heavily relies on foreign aid, but it is on the right track. The government is effective and with low corruption level, and the country is safe and stable, better than most of the countries in Africa. "The land of a thousand hills" is incredibly beautiful with unique wild life and wonderful people. I do believe that Rwanda offers great potential as a frontier market.



Mountain gorillas are Rwanda's leading tourist attraction

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