

## Springtime in Africa: *Mozambique and Zimbabwe*

By Larry Speidell

March 2013



*Cashew seller, Municipal Market, Maputo, Mozambique*

In Harare, Tino is getting married. He is the Head of Sales Trading at Imara Securities and is a highly educated professional, but he has chosen an expensive time of year for the traditional ceremony... cow prices are up.

It is springtime in Southern Africa. The price of cows is high because they pull the plows to help planting seeds. In October, the price of a good cow is \$700, but if you can wait until summer (in January) a cow is only \$300. This makes quite a difference, since you need ten cows for a good bride. These days, in urban Africa, money is often accepted by the bride's family in lieu of cows.

A recently married analyst at Imara said: "It's a token of appreciation", adding that the amount doesn't all need to be paid at once. After all, he said: "you can never finish marrying someone."

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I traveled to the southeast corner of Africa to explore two frontier countries that may be entering a springtime of revival. At this point, it's an economic revival rather than political like the "Arab spring" in 2011. None-the-less there could be profound effects for the 23 million people in Mozambique and the 13 million people in Zimbabwe.

Reflecting its rich past, Zimbabwe has a broad stock market that is a lofty 108% the size of its shrunken economy. The potential is there for economic growth to bring things back in balance, perhaps by drawing in some of the informal "underground" economy, estimated at twice the size of the formal sector. Meanwhile, Mozambique's tiny stock market, with only three stocks, is of interest because of upcoming listings of the government owned insurance company and mining and energy companies that are exploiting exciting discoveries in the north.

|                       | Mozambique | Zimbabwe | Tunisia | Argentina |
|-----------------------|------------|----------|---------|-----------|
| GDP Growth (2012 est) | 7.0%       | 5%+      | 0.0%    | 0.0%      |
| Inflation             | 10.0%      | 4.0%     | 3.5%    | 26.0%     |
| Population (mil)      | 23.5       | 12.7     | 10.7    | 42.2      |
| People / km sq        | 29         | 32       | 66      | 15        |
| % Literate            | 56%        | 91%      | 74%     | 97%       |
| % Literate Female     | 43%        | 87%      | 65%     | 97%       |
| % under age 15        | 46%        | 42%      | 23%     | 25%       |
| Life expectancy       | 52.0       | 51,82    | 75.4    | 75.4      |
| % Urban               | 38%        | 38%      | 67%     | 92%       |
| GDP / cap (PPP)       | \$1,100    | \$500    | \$9,500 | \$17,400  |
| Electricity/cap kWH   | 432.9      | 982.7    | 1,163.8 | 2,481.6   |
| % Unemployed          | 21%        | 60%      | 16%     | 7%        |
| Land (km sq)          | 799,380    | 390,757  | 163,610 | 2,780,400 |
| Market Cap (\$ bil)   | \$0.5      | \$10.9   | \$10.7  | \$43.5    |
| Market Cap/GDP        | 3.9%       | 108.2%   | 21.8%   | 6.1%      |
| GDP                   | \$12.8     | \$10.1   | \$48.9  | \$709.7   |
| Military exp % GDP    | 0.8%       | 3.8%     | 1.4%    | 0.8%      |

Source: CIA Factbook



## Mozambique

Musa al Bique was a Muslim leader living on the island where Vasco da Gama anchored his ship in 1498. Seven years later, the Portuguese arrived to claim the island along with a vast territory on the mainland, twice the size of California. They colonized it and called it "Mozambique". Unfortunately, the Portuguese did the country no favors: they exported slaves, applied oppressive labor laws in the gold mines and only provided minimal education and health care to the native population. When an independence movement began, Portugal resisted long after most of Africa had been granted independence. Then in 1975, they pulled out abruptly, sinking ships and pouring cement down wells. The Front for Liberation of Mozambique (Frelimo) was left with little in the way of infrastructure and few educated civil servants. To make matters worse, the government embarked on a socialist program modeled after the USSR that left it bankrupt by 1983. And then the civil war began.

Rhodesia and South Africa funded the Mozambique National Resistance (Renamo) with the goal of destabilizing Mozambique so it could not harbor threats to their white regimes. Fighting was intense and atrocities were all too common. Refugees fled into South Africa, where some had fatal encounters with the lions in Kruger Park.

Finally, in 1992, peace came to Mozambique. Since 1992, Frelimo has governed the country although Renamo has tried to establish itself as the opposition party. Corruption is a problem and indications are that the government leaders intend to help themselves to large shares of the newly discovered resource wealth. A challenge they face, however, is that their power base is in the south, while the coal and offshore natural gas are in the north, a thousand miles away.

Coal is being developed by Rio Tinto (UK) and Vale (Brazil). The map above shows that

the deposits are on two sides of Malawi. Some coal is being shipped down the Shire River in Malawi to the Zambezi, but for the long term, there will be rail lines, with one proposed by China to run across Malawi and then up to Tanzania, where the Chinese have been investing in port facilities,

The natural gas, discovered in 2012, is being developed jointly by Anadarko and ENI of Italy. Plans are for a \$15 billion LNG facility to begin operations in 2018.

Some of the resource wealth will surely be siphoned away by corruption, but we believe that much will trickle down to the people. Cervejas de Mozambique, is the largest company in the stock market, and may benefit from rising incomes and consumption of beer. There is a loose linkage between beer consumption and GDP per capita, as shown in the chart below. At income levels up to roughly \$5,000 per year, branded beer is a true luxury, with annual consumption ranging between 5 and 15 liters per capita. On the chart, consumption is 8 liters in Mozambique and 14 liters in Zimbabwe. Then, between \$5,000 and \$20,000, beer consumption rises in a linear fashion with income. Fortunately for most of us, our beer consumption does not follow this linear relationship as our income rises above \$20,000. It does, however, continue rising in linear fashion in Germany, Australia and Ireland perhaps for cultural reasons. In those countries, beer consumption is greater than 100 liters per year. Considering that some members of the population are not drinking, there must be others consuming more than their fair share...



Bruno Tempo, Operations Manager of the BVM, and his staff are optimistic.



Mauro Katao, Head Trader at Standard Bank, points to his hometown, a 24-hour drive from Maputo. The coal and offshore gas deposits are shown in red.

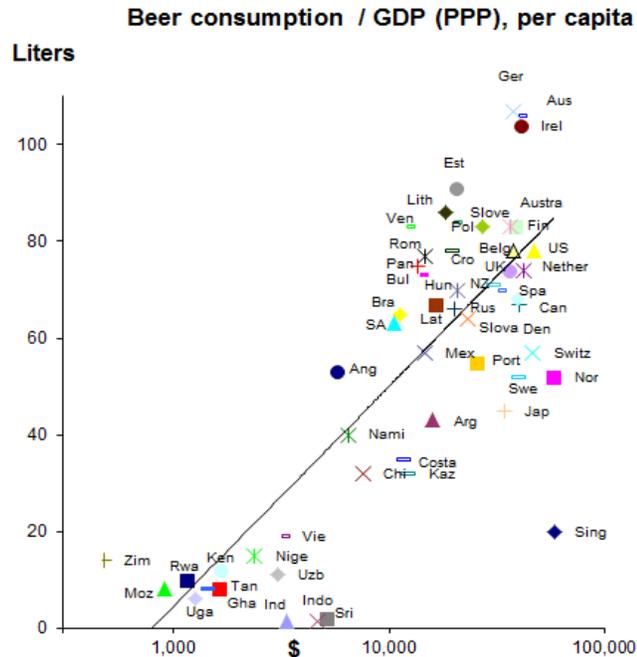
In poor countries like Mozambique, however, there is another problem: "homebrew". A friend in Kuwait once showed me his small but spotless brewery on the counter in his kitchen. In Africa, unfortunately, homebrew is often carelessly made, sometimes including dangerous ingredients with lethal consequences. To reduce this hazard, governments are working with brewers on less expensive products. In Mozambique, this has taken the path of using

cassava (or yuca), which is grown widely in the country. With new technology to prevent spoilage in the manufacturing process, cassava based beer can be brought to market at a price 40% below the regular brands. This should shift people away from homebrew and provide a path to enjoying luxury brands as incomes rise.



Impala Beer, a new Mozambique brew made from cassava

While the Bolsa de Valores de Mocambique (BVM) is small, the government has shown an interest in seeing it grow by requiring the resource companies to list between 5% and 20% of their shares locally. Hopefully, other local companies will be induced to list as well.



Source: World Bank, IMF, Wikipedia, Frontier Market Asset Management



## Zimbabwe

Two hundred fifty Jersey and Freidland heifers arrived in Zimbabwe in September; the first of what Dairibord hopes will be 1,000 cows to replenish the tired stock that has limited milk supplies. These fine cows are expensive, at roughly \$2,300 each, but since they are all 3-4 months pregnant, there are really two cows for one. After waiting years for the government to do something, Dairibord, Zimbabwe's leading milk producer, developed its own Heifer Import Program, borrowing \$650,000 to buy the cows and reselling them to farmers. They hope these 250 cows will increase the country's meager milk supply by 25%. Assuming success with the first heifers, they hope to bring in a total of 1,000 which will double Zimbabwe's raw milk supply.

Zimbabwe's problem with milk is just one symptom of the greater problems of the nation. With Robert Mugabe now 88 years old, the government is paralyzed. No decisions are being made. Infrastructure everywhere is decaying, with interruptions of electricity and water, road construction halted. Liquidity is tight because donor funding from abroad has dropped off.

In February, Dairibord's milk plant in Harare was shut for 14 days because there was no water. In October, operations are slowed because the water supply has been reduced to a trickle. Innscor, a "fast moving consumer goods" company, is installing back-up electric generators at all its operations.



In Bulawayo, Zimbabwe's second largest city, the mayor *Zimbabwe Stock Exchange* ordered all citizens to flush their toilets simultaneously at 7:30 pm in the evening to clear its sewage pipes. BBC News reported (September 24, 2012): "the synchronized flush will now take place at the same time twice a week - on Mondays and Thursdays - though residents will of course be able to flush their toilets at other times too."

Despite the problems, executives say their optimism has increased in recent months. One CEO said, "Everyone is tired of a government that doesn't work." And many said that, "It really doesn't matter who wins the election... having an election will be a win for everyone." A referendum on a new constitution is due in several months and most people believe the election will take place next fall. They point to behind-the-scenes involvement of South Africa and pressure for pragmatism from the IMF and World Bank.

Of course much could go wrong. In the last election, opposition leader Tsvangirai withdrew from the June 2008 run-off to prevent continued violence by Mugabe's thugs against opposition voters. Although there is a large portion of the population in the volatile age group of 15 to 24, Zimbabwe is favored by its high literacy (91% versus 50-60% for its neighbors), and its culture is one of traders rather than fighters.

A visit to the vast mile-square Magabo market near to old center of Harare gives credibility to the size of the informal economy and to the entrepreneurial spirit that Zimbabweans have. The vast market is a maze of tents and shacks selling everything from foods and textiles to lumber, sheet metal, steel and plumbing. It is a giant swap-meet, where pickers will find you anything you need for a fee. None of this frenetic activity is included in the formal economy.



"You can get anything you want..."\* at Magaba Market, Harare.  
Source: "you can get anything you want...at Alice's Restaurant" Arlo Guthrie, 1967

While some bumps in the road are likely on the path to election results and a new government, the optimists may be right this time. Pressure from abroad and exhaustion at home may have reduced Mugabe's support so much that he will seek a graceful exit... or at least an exit. And if he does exit, we may see more than a few of Zimbabwe's estimated 4 million ex-patriots return home, bringing additional skills to a potentially burgeoning economy.

## Growth Factors - 2050 Hindsight

We have done work lately on the economic, demographic and political factors that may influence the success or failure of countries in the coming years. We settled on thirteen factors in three categories that are shown below for Mozambique and Zimbabwe along with the BRICs.

|   | Mozambique   | Zimbabwe      | Brazil        | China        | India         | Russia        |
|---|--------------|---------------|---------------|--------------|---------------|---------------|
| Age 35-49 /20-34 2040/2010  | 28%          | 47%           | 35%           | 13%          | 24%           | 3%            |
| Urban % chg 2000-2010   | 7.7          | 4.5           | 5.3           | 9.1          | 2.4           | -0.6          |
| Literacy rate, adult female (% of females ages 15 and above)      | 41.5         | 89.4          | 90.2          | 90.9         | 50.8          | 99.4          |
| Population ages 65 and above (% of total)                         | 3.3          | 4.2           | 7.0           | 8.2          | 4.9           | 12.8          |
| GINI index  | 45.7         | 50.1          | 54.7          | 42.5         | 33.4          | 40.1          |
| <b>Human Capital</b>  | <b>59.0</b>  | <b>62.4</b>   | <b>54.4</b>   | <b>53.2</b>  | <b>54</b>     | <b>38.2</b>   |
| Gross capital formation (% of GDP)                                | 23.7         | 3.0           | 19.2          | 47.8         | 34.8          | 22.8          |
| Foreign direct investment, net inflows (% of GDP)                 | 8.2          | 1.4           | 2.3           | 3.1          | 1.4           | 2.9           |
| Gross savings (% of GDP)  | 10.8         | NA            | 16.5          | 52.9         | 33.7          | 27.6          |
| Electric power transmission and distribution losses (% of output) | 9.0          | 6.6           | 17.2          | 4.9          | 24.4          | 10.8          |
| <b>Investment</b>   | <b>58.3</b>  | <b>35.7</b>   | <b>31.8</b>   | <b>93.3</b>  | <b>59.3</b>   | <b>64.5</b>   |
| Heritage Economic Freedom   | 57.1         | 26.3          | 57.9          | 51.2         | 54.6          | 50.5          |
| Rule of Law & Corruption  | 79.6         | 3.3           | 115.3         | 77.1         | 90.4          | 39.0          |
| Current account balance (% of GDP)                                | -11.6        | NA            | -2.3          | 5.2          | -3.0          | 4.7           |
| General government final consumption expenditure (% of GDP)       | 12.2         | 19.1          | 21.2          | 13.4         | 11.5          | 19.5          |
| <b>Government</b>   | <b>38.25</b> | <b>14.7</b>   | <b>40</b>     | <b>53.75</b> | <b>48.5</b>   | <b>37.75</b>  |
| <b>Z-Score</b>  | <b>0.26</b>  | <b>(2.49)</b> | <b>(0.69)</b> | <b>1.47</b>  | <b>(0.05)</b> | <b>(0.85)</b> |

What shows up from the table is that these African countries are better than the BRICs in Human Capital. In terms of Investment, none is the equal of China, but Mozambique is respectable and may improve as investment flows in to exploit the new coal and gas discoveries. Zimbabwe has poor investment flows but they go hand-in-hand with its poor Government. A change in government could suddenly move Zimbabwe from the bottom of our list to a strong growth position. Zimbabwe's problems are not with the people or the culture, they are with one man, and he is 88 years old.

## Conclusion

*"Buy when the cannons are firing, sell when the trumpets are blowing"  
"Buy when there's blood in the streets, even if it's your own;"*

*Nathan Mayer Rothschild, 1777-1836*

For nearly a century, professional investors have leveled the playing field, arbitrated mispricing opportunities and made financial markets more efficient. This is the enemy of active investing. It is harder to be first to find the critical scraps of knowledge that say a stock is worth more than its price.

Investing in frontier markets is founded on the goal of going to places that are misunderstood and trying to understand them. Fortunately, these are the roads "less travelled by..." due to sixteen hour flights, plane delays and dicey food. This all means that we don't run across a lot of other investors in the frontier. The chance of discovering something new is relatively high.

On this trip, we found that the price of many stocks in Mozambique and Zimbabwe may more than discount the problems they face. There is always the chance that spring may come late in these countries and there may be storms in the forecast. But we are encouraged by what we saw, and we hope that patience will be rewarded.



*Shrimp seller, a working mom, at the Municipal Market, Maputo, Mozambique*

### 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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