

## Under the Southern Cross...barely: Kenya, Uganda & Zambia

By Larry Speidell

Our taxi was a small battered Mitsubishi station wagon, but the driver was good. We crested a small rise on a muddy road in light rain and there, on the left, less than ten miles from downtown Nairobi, were three lions lounging among the bushes.... Welcome to Africa.



All Photos: Frontier Market Asset Management

Nairobi is a small city by world standards, three million people, and you can see most of it from the 30 story tower of the Convention Center. Look to the west and there is the suburb of Westland, with the house of Karen Blixen, author of Out of Africa, and the Nairobi National Park where, you can drive an ordinary car into the "bush" to see zebra, giraffe, eland, ostrich and, if you're lucky, a pride of lions.

But we were not on safari. This was a research trip, with one of our clients and his business partner, to look at stock markets and companies in two countries that straddle the equator, Kenya and Uganda, and Zambia further south. Only Kenya is included in the S&P/IFC Frontier Market Composite. The other markets are small, with one or two dominant stocks. Still many good things are happening in these countries, and there are attractive investments to be found.

	Kenya	Uganda	Zambia	Emerging Mkts	USA	EAFE
RGDP Growth (2007e)	6.5%	6.7%	6.7%	4.4%	2.8%	2.0%
GDP/Capita	\$652	\$270	\$350	\$4,427	\$36,655	\$26,229
Inflation	10%	7%	7%	3.8%	2.0%	1.4%
Population (mil)	36.1	28.8	11.7	4756.6	296.5	582.2
Population % <15 years	43%	50%	46%	29%	21%	17%
Population % > 65 years	3%	2%	3%	7%	12%	15%
Corruption (10=best)	2.1	2.5	2.6	3.9	7.6	8.3
Market Cap (\$ mil)	\$12,000	\$594	\$4,278			
Float (S&P/IFC)	\$2,953	\$133	\$1,500			
PE	20.9	18.0	14.5	15.4	17.3	15.7
PB	4.7	5.0	3.6	2.5	2.9	2.4
ROE	22.5%	27.8%	24.8%	15.9%	16.6%	15.4%



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## KENYA

At 5500 feet, Nairobi is cool in October, the season of short rains. But it is hot and stuffy in the small auditorium outside the Kenya Stock Exchange where a hundred punters sit staring at the screen projection of stock trading activity. The equity culture has taken root here, following the ouster of President Moi in 2002 after 24 years of rule. Under President Kibaki, economic growth has accelerated from a miserable 0.5% to 6.5% currently. Recent privatizations have excluded foreigners because of the goal to maximize political gains for the administration. The under-priced offerings have provided instant gains for the new shareholders, and companies complain that the results are cumbersome. Eveready East Africa Ltd. (batteries) came public in late 2006 expecting 25,000 shareholders - they ended up with 200,000. And the tiny float of their stock is less than \$7 million.



Now the Kenyan stock market is laboring under the overhang of the coming Safaricom offering. Although delayed by lawsuits and appeals, this leading cellular company will likely come to the market in early 2008, prompting investors to raise cash in advance to get in line for Safaricom stock, expected to pop on the IPO and account for 25% of the capitalization of the entire market.

As if this weren't enough, the December presidential election has heated up, with Raila, the opposition candidate, leading in the polls. He is viewed as anti-business and was behind the suit to block the Safaricom offering. Beyond the election, there are other challenges as well. Generous wage grants several years ago have pushed up costs in an economy that depends on exports, 40% of which are tea, coffee and flowers. Meanwhile, the currency has been strong despite inflation running at 10%, while the central bank has kept the t-bill rate at only 7.2% to avoid strengthening the currency further. While classical economics says that high interest rates strengthen a currency while low rates weaken it, in today's world of globalization this could go badly wrong. Kenya's low rates may attract more investment into real estate and other forms speculation leading to a boom/bust cycle.

Kenya's stock market has risen 280% in five years, and some wonder where this buying power has come from... corruption or criminal activity? Still, there may be attractive stocks for patient investors among the consumer, finance and technology related companies.

Security	Industry	Market Cap	P/E	ROE	P/BV
Barclays Bank Ltd	Banks	131,259	35.2	28.3%	9.96
East African Breweries	Food Beverage & Tobacco	83,953	15.6	39.8%	6.2
Bamburi Cement	Materials	68,962	32.0	20.2%	6.46
Standard Chartered Bank	Banks	51,946	21.2	25.6%	5.42
Kenya Commercial Bank Ltd	Banks	46,906	29.7	15.7%	4.65
Kenya Airways	Transportation	35,544	9.2	31.4%	2.88
BAT Kenya Ltd	Food Beverage & Tobacco	18,400	13.3	35.5%	4.73
Nation Media Group	Media	17,684	24.7	21.8%	5.38
Kenya Electricity Generating	Utilities	17,147			
CFC Bank	Banks	16,560	24.9	26.4%	6.56
Kenya Power & Lighting Ltd	Utilities	16,538	-5.7		
Mumias Sugar Company	Food Beverage & Tobacco	14,790	18.7	14.7%	2.74
ICDC Investment Company Ltd	Diversified Financials	14,711	49.8	7.9%	3.92
Diamond Trust of Kenya Ltd	Banks	11,250	68.6		
Kenya Oil Co. Ltd.	Energy	10,068	13.9	32.5%	4.52
E. African Portland Cement	Materials	9,900	16.3	33.7%	5.49
National Bank of Kenya Ltd.	Banks	9,500	11.1	26.7%	2.95
NIC Bank Ltd.	Banks	8,571	32.8	9.9%	3.24
Athi River Mining Ltd	Materials	6,882			
CMC Holdings Ltd	Automobiles & Components	3,399	7.8	5.6%	0.44
Unga Group Ltd	Food, Beverage & Tobacco	776			

Source: S&P/IFC June 2007



## UGANDA

Although Uganda is poor in terms of GDP per capita when compared with Kenya (\$270 versus \$652), it actually has a higher GDP per capita on a Purchasing Power Parity basis (\$1600 versus \$1200). In other words, the cost of living is lower in Uganda.

Set attractively on seven hills, Kampala's 1.5 million people are noticeably poorer than those in Nairobi. With deep pot-holes in most streets, there are few office towers, and there is no "downtown" with tree lined avenues. In fact, there are no avenues or even sidewalks. While it is difficult to compare crime statistics with Nairobi, there are lots of guns around, with security guards toting semi-automatic weapons at the banks and even the upscale restaurants.



When most people think of Uganda, they think of Idi Amin, the despot who laid waste to the country in the 1970s (including kicking out all the foreign management talent). We heard of one foreigner who was lucky to escape the country instead of being jailed simply because his name was misspelled on the police list.

Today, however, conditions are much improved. President Museveni may have changed the constitution to give himself a third ten year term, but his policies are pro-reform, anti-corruption and pro-business. He promises to use the recent oil discoveries to make the Ugandan people richer. Watch dog organizations like EITI (Extractive Industries Transparency International) may help to make that happen when oil comes on stream in two to four years. And oil may cure the power rationing that forces companies to use generators one day out of three. Another positive for Uganda these days is its position as a trading partner with South Sudan, which has distanced itself from the Sudanese government in Khartoum and now sources many of its goods from Uganda. As a result, even used car prices are up in Uganda as a result.

From a macro standpoint, Uganda is in a better position than Kenya. Labor costs are as low as \$100/month, inflation is only 6% and the 90 day t-bill is 8%, giving the monetary authority some room to lower rates. The upside potential of economic growth is clear. Presently there are only 350,000 televisions in Kampala, and in all this nation of 29 million people, the circulation of daily newspapers is only 100,000 copies.



The stock market is small and dominated by Stanbic Bank which came public late last year. Still there are some attractive valuations compared with other markets in the region.

Uganda Stocks	Mktcap \$		
	Mil	Float	\$ Float
Stanbic Bank Uganda	\$448.5	20%	\$89.7
Dev Finance Co of Uganda	\$69.6	40%	\$27.8
Bank of Baroda	\$39.6	20%	\$7.9
New Vision Printing	\$13.9	20%	\$2.8
British American Tobacco	\$13.5	10%	\$1.4
Uganda Clays Ltd	\$8.8	40%	\$3.5
	\$593.9		\$133.1

Securities Africa Limited, 20007



## ZAMBIA

“Lusaka is a sprawling, swollen city that has grown too fast and has little appeal for travelers...” \*  
 Adding to its woes, the top half of one of the tallest buildings in Zambia’s capital city was gutted by fire ten years ago and has not been repaired. The insurance money was spent on government salaries and perks. Today, it is shrouded in giant red banners advertising Celtel (yet another example of the ubiquitous ads for mobile phones through out Africa these days). Still, the city has a quick pulse, lots of traffic and shopping centers that would look at home in Southern California. For years, the local banks refused to finance the development of shopping centers. “Too radical for Africa”, they said. Now however, the success of centers like Manda Hill proves that a middle class of consumers is rising here and elsewhere on the continent.



\* [www.lonelyplanet.com](http://www.lonelyplanet.com)

Despite its problems, Lusaka is home to many fine companies, and its country is rich in natural resources, wildlife parks and ambitious people. Zambia, formerly Northern Rhodesia, has the unique distinction of being bordered by eight countries (Tanzania, Malawi, Mozambique, Zimbabwe, Botswana, Namibia, Angola and the Congo). Last year's election was a bit of a scare as the challenger, Sata, was a critic of China's investments in Zambia and an admirer of Mugabe's policies that have ruined Zimbabwe. Fortunately, Mwanawasa won a second term, although it is still an uphill battle against corruption and mismanagement. Administration of land titles was so corrupt that he had to fire the whole Ministry to fix it. The country's 7% growth in real GDP seems likely to continue on the back of a huge backlog of investments in the mining industry that includes copper (10% of GDP), nickel and uranium. It would be good if the government can renegotiate its meager 0.5% royalties toward 3% without having to resort to threats of nationalization. And it would also be good if the government can streamline its maze of regulations that require 15 different licenses to open a simple restaurant. Businessmen fear that if Zimbabwe ever gets rid of Mugabe, economic activity and tourism will flee south to escape Zimbabwe's burdensome taxes.



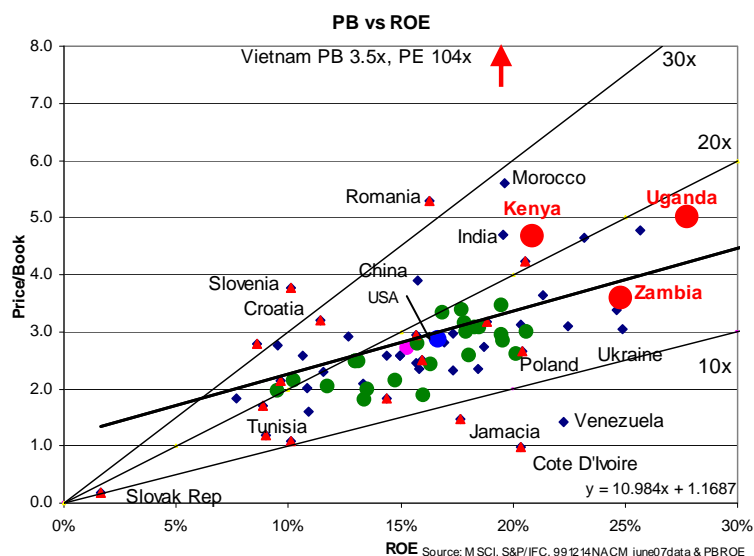
Among the companies in Zambia, is one of Africa's blue chips: Zambeef, an agricultural conglomerate that boasts of selling every piece of the cow, including even the hides through its subsidiary, Zamshu. Starting as a cattle company, Zambeef has diversified into chicken, farming and restaurants as well as running nearly 100 butcher shops including those in Shoprite's supermarkets. For investors who prefer lower multiples, there are a number of banks, natural resource companies and real estate companies that trade on the small Lusaka Stock Exchange.

Zambia Stocks	PE	P/BV	ROE	Yield	Mktcap \$ Mil
SHOPRITE Retail	13.77	3.94	29%	3.78	\$2,090.31
ZSUG	21.14	6.63	31%	3.30	\$548.26
SCZ	24.14	11.20	46%	2.75	\$457.80
CHIL	19.22	4.37	23%	-	\$266.79
ZAMBREW Beer	19.74	4.60	23%	3.55	\$224.00
ZAMBEEF Cattle	32.12	7.77	24%	1.35	\$161.71
NATBREW	19.58	22.28	114%	5.11	\$132.54
BPZAM Fuel	46.78	6.17	13%	0.80	\$128.33
ZCCM-IH Copper	3.00	-	-	-	\$103.03
BATZ	7.71	13.29	172%	18.00	\$54.48
INVESTTRUST Banl	16.56	6.53	39%	1.51	\$38.76
ZAMEFA	117.67	1.70	1%	2.84	\$30.56
Farmers House	21.37	2.87	13%	1.47	\$18.63
AELZ	11.16	1.75	16%	-	\$9.50
CCHZ	29.79	3.28	11%	-	\$9.34
PAMODZI Hotel	317.15	1.63	1%	1.50	\$4.36
	19.05	4.53	24%	3.33	\$4,278.40

Source: Lusaka Stock Exchange, 2007

## CONCLUSION

This trip was a study in contrasts, from suave Nairobi to scruffy Kampala to sprawling Lusaka. The stock markets here require careful analysis, because they are quite inefficient. Popular stocks sell at high PE multiples, often over 20x, that are difficult to justify, even with Africa's high GDP growth rates. Furthermore, low nominal prices can trigger overvaluation, since local investors often confuse a low price per share with some indication of value. On the other hand, there is a great dispersion of valuations in these markets and often cheap stocks turn out to have excellent quality and strong fundamentals. These markets are definitely worth a trip... and not just because one can find lions in the suburbs.



### About Frontier Market Asset Management

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