SECURITIES AFRICA RESEARCH

June 2011

AFRICA OUTLOOK

INVESTMENT STRATEGY & PERSPECTIVES

Despite elevated geopolitical risk, economic expansion across Sub-Saharan Africa (SSA) will continue

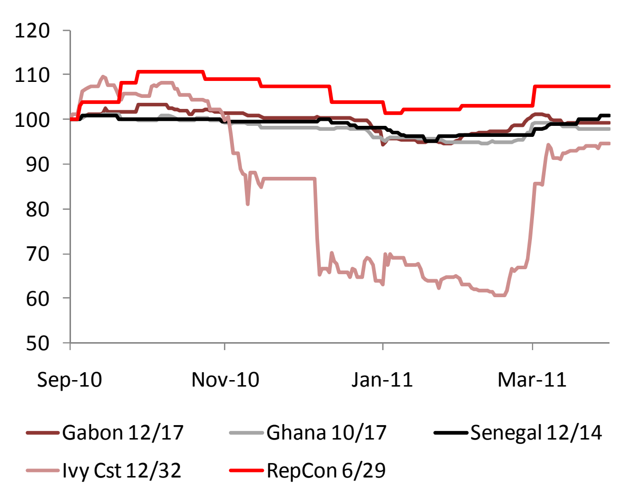
New challenges in response to heightened geopolitical risk across the globe

The unexpected political changes taking place across MENA and the challenging path toward EU austerity have introduced new risks and heightened uncertainty into the growth outlook for SSA. Yet while geopolitical risk may remain elevated for some time, it is unlikely to serve as the determining catalyst of SSA economic performance over the medium-term. By way of example, SSA Eurobond spreads, which widened considerably in the immediate aftermath of Egyptian unrest, have now returned to pre-crisis levels as the risk of contagion appears largely contained. In addition, the Multilateral Investment Guarantee Agency (MIGA) confirms that insurance risk premiums across SSA have firmed considerably in recent weeks while premiums across the MENA region remain elevated. In SSA equities, we remain beta-neutral and are overweight financials & energy. We believe telecom & utilities will command greater interest and may benefit from positive momentum.

African equity markets have held up well amid increased political uncertainty

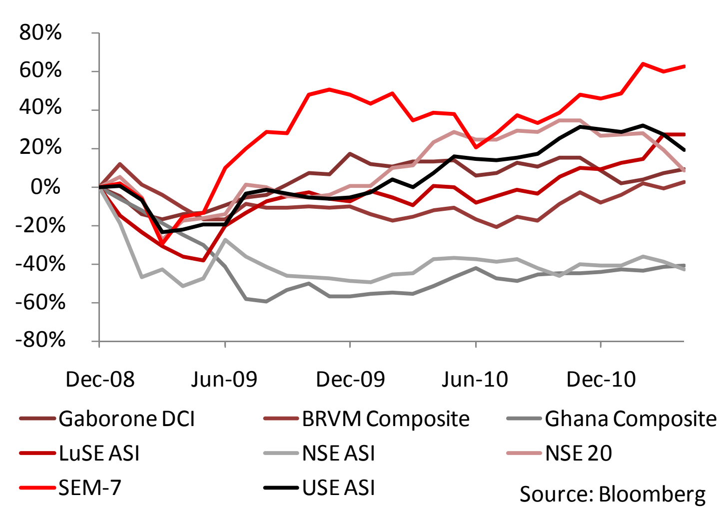
SSA equity markets have held up reasonably well as foreign investors seem better equipped to manage the risks associated with increased political uncertainty. Furthermore, recent equity market performance suggests that foreign investors have grown more discerning in the wake of recent political risk dislocations (e.g. Cote d'Ivoire, Zimbabwe, et al) and appear more adept at both identifying and isolating country risk across the continent. As such, SSA equities are well positioned to serve as a suitable alternative for institutional investors currently facing a shortage of "investible assets" across EM.

Figure 1: Africa Eurobond Performance (USD)



Source: Bloomberg

Figure 2: Africa Equity Index Performance (USD)



Source: Bloomberg

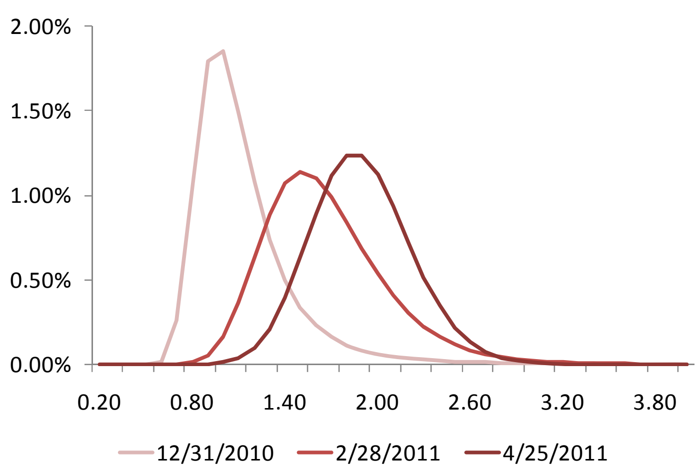
Greater tightening expected from SSA policymakers in the months ahead

We believe the current global growth cycle will continue although investors are likely to embrace a more risk-averse approach as inflationary pressures have intensified and asset valuations are less attractive. Looking ahead, we expect monetary authorities across SSA to grow increasingly hawkish as policy makers attempt to offset rising energy and food prices. Furthermore, the extreme nature of policy settings in the US and Europe suggest that the process toward policy normalization is likely to be much more challenging should inflationary pressures be left unchecked. As evidenced by its recent 25bp rate hike, the European Central Bank (ECB) has grown increasingly confident in the sustainability of an economic recovery. With markets pricing in another 25bp rate hike before year-end, we remain cautious as an overly hawkish response to commodity-driven headline inflation may prove to be a policy mistake.

Despite long-term US Dollar depreciation, shifting policy expectations may result in near-term strength

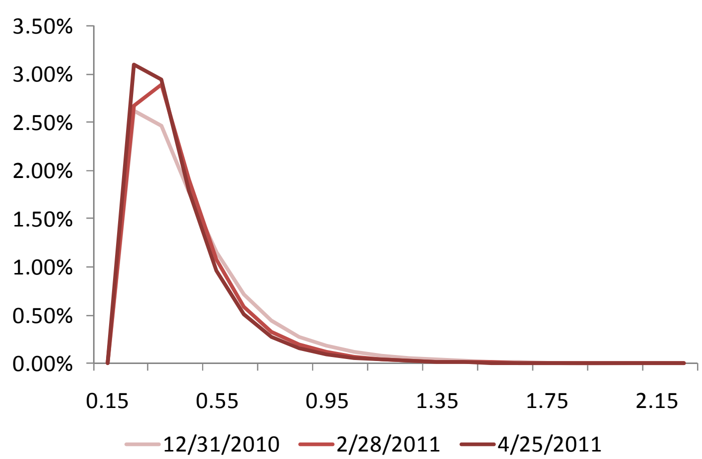
On the other hand, US policy makers remain more cautious of the economic recovery with markets currently pricing in no change to the federal funds target rate. Although the US Dollar is widely expected to trend lower over time, US monetary policy cannot remain loose forever. Should the forward curve begin steepening in line with rising expectations for future monetary tightening, we may well witness short-term US Dollar appreciation. While the aforementioned scenario poses a clear risk to local currency performance across SSA, we believe that US fiscal policy remains untenable and any scope for improvement will be limited ahead of next year's presidential election. As such, we feel that US Dollar strength will most likely prove to be short-lived.

Figure 3: ECB Policy Expectations (6m) — Tightening



Source: Bloomberg

Figure 4: Fed Policy Expectations (6m) — Neutral



Source: Bloomberg

Elevated uncertainty across the MENA region unlikely to impact SSA growth

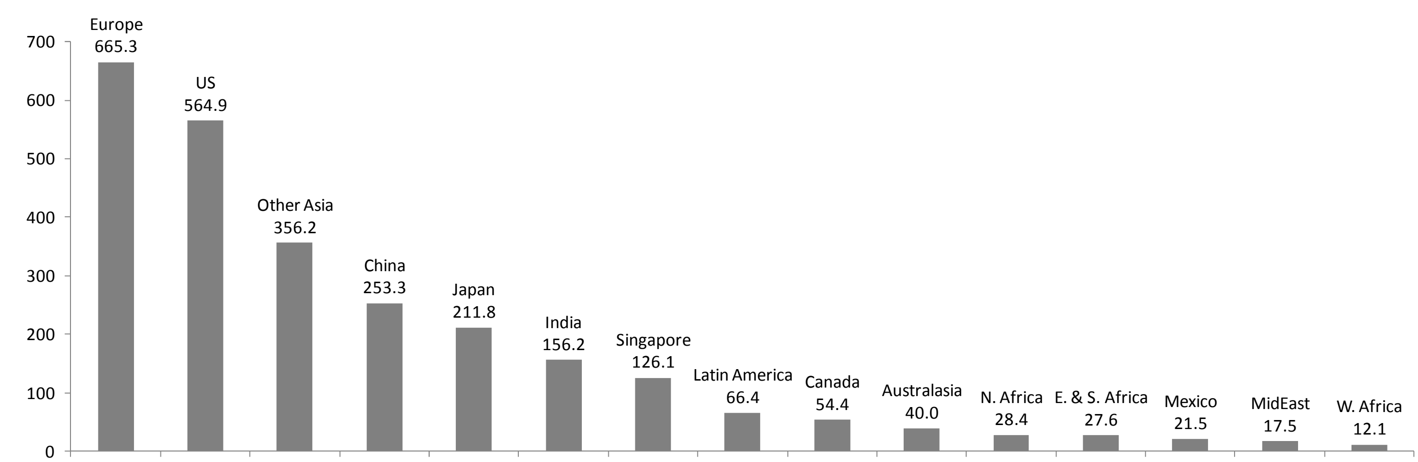
Socio-political change across MENA will likely keep oil prices skewed to the upside

Although the series of events across the MENA region are unlikely to derail SSA growth over the medium-term, the resulting impact is equally unlikely to be short-lived. As a result, we expect a prolonged period of political and economic evolution as the implications for change in Egypt, Libya, Tunisia, Syria and Bahrain have yet to be fully determined. Given MENA's changing political landscape, we adhere to the widely growing consensus that OPEC spare capacity will be constrained in the months ahead. To compound matters, fundamentals have improved considerably with oil demand rising by the largest margin in nearly three decades. Despite the recent pullback, WTI and Brent crude prices are up 8.9% and 22.5% year-to-date. Over the near-term, we believe that oil prices will remain skewed to the upside and would not be surprised to see another 10% increase before year-end. Should such a scenario play out, US and European GDP growth would decline by approximately -0.2% y/y and -0.1% y/y , respectively.

Elevated energy prices unlikely to derail SSA growth trajectory

Although the impact of higher energy prices on global GDP growth can be material, we do not believe it will prove capable of undermining SSA's growth trajectory through the 2nd half of 2011. Nevertheless, another notable increase in the price of oil will undoubtedly have a far greater impact on oil-importing nations, and China in particular, where crude oil expenditure represents nearly 10% of GDP.

Figure 5: World Oil & Product Imports (million tonnes)



Source: BP Statistical Review of World Energy

Inflation and monetary tightening will have the greatest impact on SSA equity performance over second half of year

SSA far more sensitive to commodity price shifts

Controlling inflation has become the focus of monetary authorities throughout SSA. When compared to the rest of the world, Pan-African Consumer Price Indices command much higher food and energy price weightings. As such, the region is far more sensitive to commodity price movement and its financial markets exhibit greater volatility.

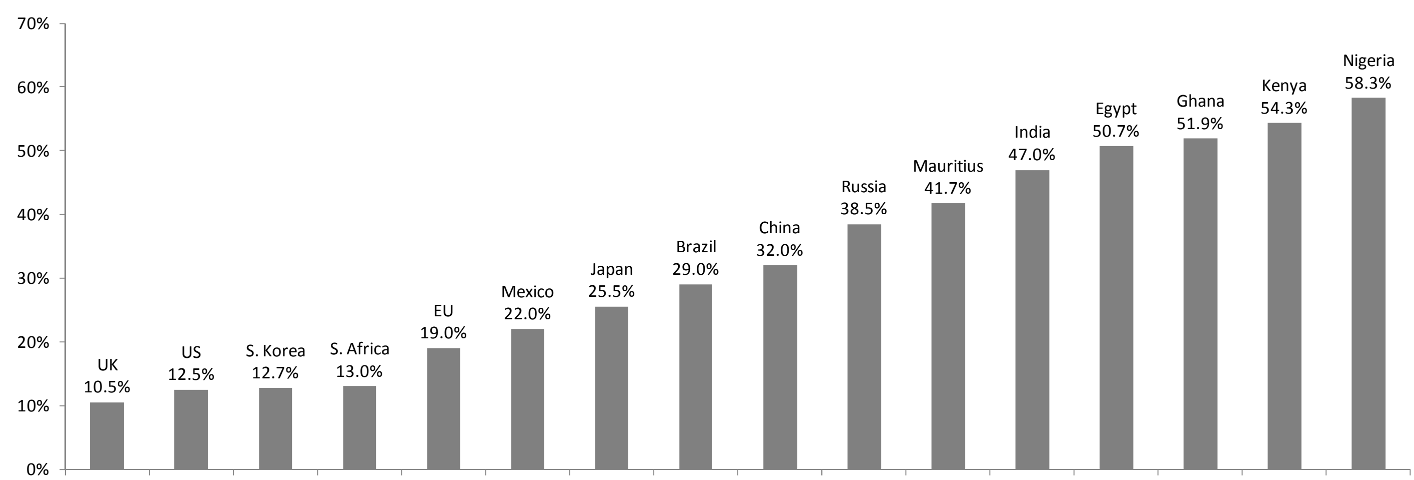
Commodity price risk skewed to the upside

Looking ahead, we believe that global commodity prices will remain skewed to the upside so long as developed G-7 economies continue to promote supportive monetary policies. It should be noted that while energy prices have risen considerably over the past twelve months, agricultural commodities have also climbed amid increasing demand and tightening supply. Yet while fundamental drivers (e.g. weather, acreage, inventories, et al) remain supportive for elevated grain and soft commodity prices, we remain cautious as the agricultural commodity complex has weakened considerably in the wake of recent geopolitical events.

Agricultural prices are likely to remain elevated through year-end

Although much of the recent weakness in agricultural commodity prices may be attributed to the Japanese earthquake, tight supply combined with the potential for rising imports to China are likely to underpin prices throughout year-end. Furthermore, we believe that existing forecasts for record global grain harvests may prove overly optimistic as dry conditions and planting delays will impact crop yields.

Figure 6: Food & Energy as % of Global Consumer Price Indices



Source: Central Bank Data, Securities Africa

Core Inflation to rise on back of higher input costs & rising wage pressure

In the coming months, we expect low cost exporters (e.g. China) to counteract higher input prices and rising wage pressures by tightening monetary policy and engineering local currency appreciation. We believe the People's Bank of China (PBOC) will continue to tighten its reserve requirement albeit at a more moderate pace. As such, breakeven inflation rates in the US and Europe are expected to widen and core inflation across SSA is likely to move higher.

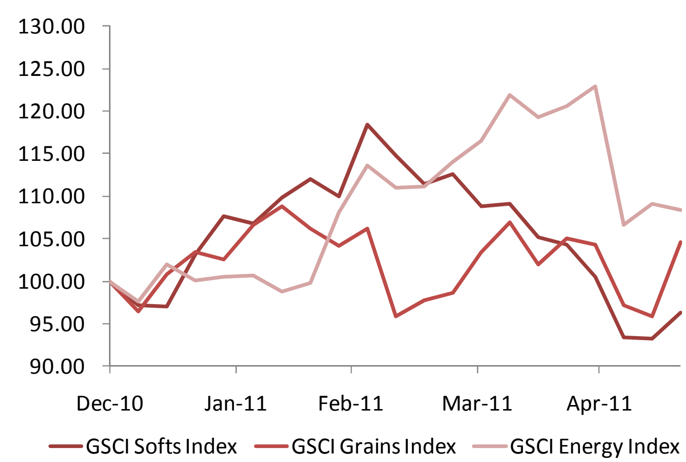
SSA fixed income markets continue to mature & are emerging as a viable alternative for investors

Should inflationary pressures build rapidly across SSA, international investors may look toward fixed income as money supply contracts amid increased central bank tightening. On the whole, fixed income has grown increasingly attractive as liquidity improves and local credit markets attract new issuance. By way of example, the Nigerian corporate bond market will eclipse USD 1 billion in size this year amid a number of newly announced Medium Term Note (MTN) programmes. Similarly, the Kenyan corporate bond market has grown to nearly USD 700 million in size with annual turnover growing four-fold from USD 1.3 billion in FY09 to USD 5.7 billion in FY10.

We remain bullish on SSA equities & advocate exposure to countries that are proactively seeking to mitigate inflation

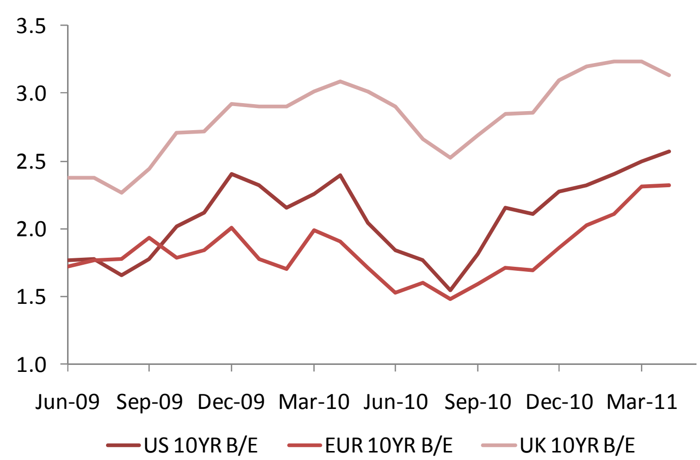
Despite the compelling investment case for fixed income, we remain overweight SSA equities and investors should consider using the current climate as an opportunity to build and/or add to existing positions. From a tactical perspective, equity investors are encouraged to focus their efforts on those markets where policy remains vigilant and headline inflation shows evidence of easing.

Figure 7: Commodity Sector Performance



Source: Bloomberg

Figure 8: G3 Breakeven Inflation Rates (%)



Source: Bloomberg

In terms of country selection, we advocate risk-neutral stance and maintain tactical overweight in Nigeria and Ghana

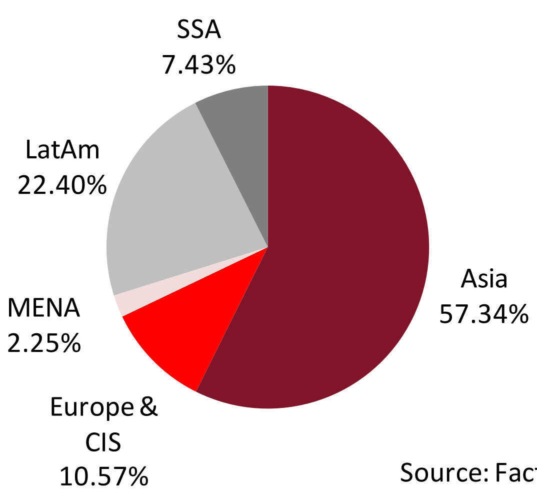
Sentiment has shifted in favour of short-term, directionally-oriented trading strategies

We advocate a "risk-neutral" approach to investment as greater macroeconomic uncertainty and declining market sentiment demands greater caution on the part of investors. As opposed to the "risk seeking" behavior employed by market practitioners over the past year, investors are beginning to focus considerable time and resources toward identifying previously unforeseen sensitivities which may drag down overall performance. In lieu of the greater uncertainty associated with higher inflation expectations and fiscal tightening across the US and Europe, sentiment has now shifted in favour of short-term, directionally-oriented trading strategies at the expense of fundamentally-driven, relative value opportunities. While such a reaction is not at all unusual, recent price action has been quite revealing with trading volumes beginning to trend lower across most markets.

Foreign exposure to SSA ex-ZA equities remains wanting

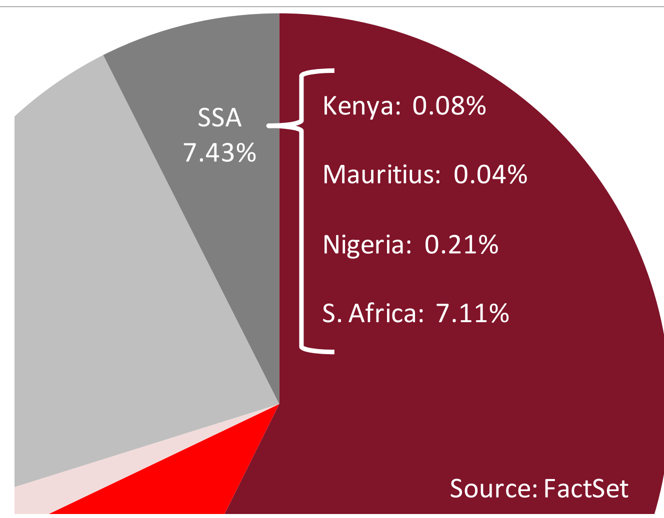
Foreign exposure to SSA ex—South Africa remains lacking as evidenced by the MSCI constituent weights ascribed to Kenya, Mauritius and Nigeria. Moreover, there continues to be a notable absence of investible SSA nations (e.g. Botswana, Ghana, Zambia, et al) from the mix. Given the lack of exposure to SSA equities as an asset class, one may conclude that the case for increased diversification actually works *in favor* of SSA equities. Yet in practice, it would be irresponsible to ignore the high beta environment in which SSA equity investors operate. Thus, we advocate increased country and sector diversification while encouraging investors to take advantage of equity opportunities in some of the less mainstream nations across SSA.

Figure 9: MSCI Emerging & Frontier Market Index



Source: FactSet

Figure 10: MSCI SSA — Individual Country Weights



Source: FactSet

Global capital markets are considerably less leveraged than years past

Although the possibility of a global equity market correction has encouraged us to adopt a more "risk-neutral" approach, capital markets are considerably less leveraged than at any point in recent history. As a result, the magnitude of any loss will be far less extreme when compared to the equity market corrections of 2002 and 2008.

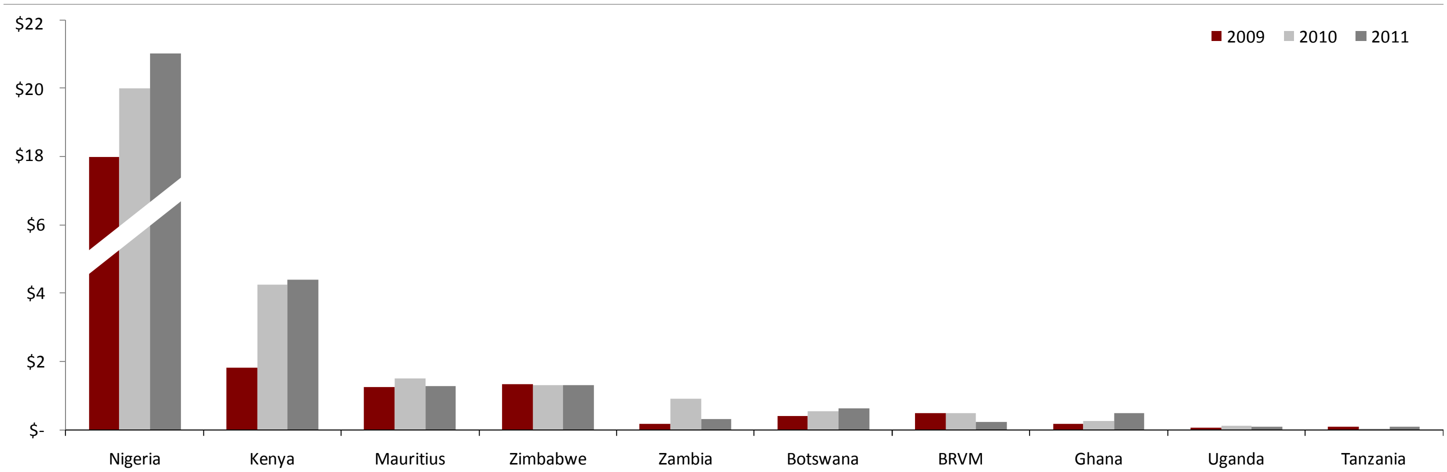
SSA equity markets have exhibited surprising resiliency

Despite our "risk-neutral" stance, we cannot help but take note of the extraordinary resiliency exhibited by SSA equities over the previous two quarters. Certainly, the sanguine market reaction to recent geo-political events suggests that investors remain predisposed toward inherently risky assets. Yet while the inclination to chase yield in an ultra-low interest rate environment remains strong, it is no longer the leading driver of price action across SSA equities. We have witnessed little foreign selling across most SSA equity markets during the first half of 2011. Although one might argue that the equity market's overall resilience is more deeply rooted in structural factors such as heightened sensitivity to liquidity, we contend that foreign investors are far better equipped to manage the risks associated with increased geo-political uncertainty.

Equity market resiliency reflects the extended duration profile of investors

To be clear, we are not implying that foreign investors have successfully offset these risks via short positions, financial derivatives and various hedge-related instruments. Rather, we believe that improved market resilience is a function of long-term positioning and reflective of the extended duration profile held by foreign investors in a post-crisis world.

Figure 11: SSA Daily Average Trading Volume (USD mil)



Source: EDI

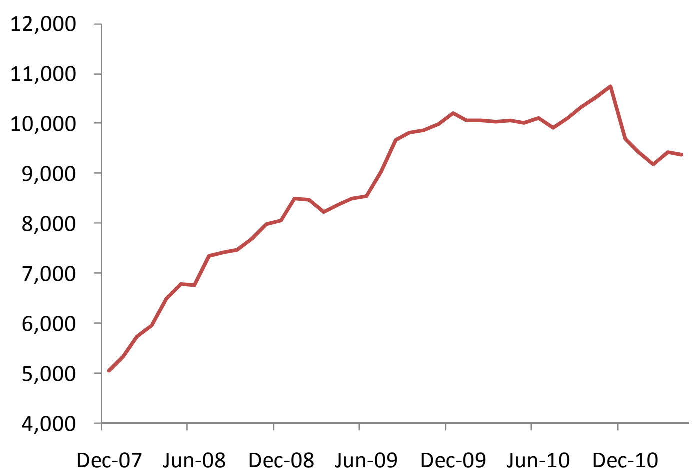
Nigeria to benefit from rising oil prices, an expanding current account surplus & Jonathan's re-election

We believe the Nigerian and Ghanaian economies are well positioned to benefit from the forward-looking beta environment. From a top-down perspective, Nigeria should benefit from elevated oil prices, an expanding current account surplus and the positive outcome of this month's presidential election. Yet while Jonathan's re-election ensures policy continuity and ongoing economic reform, his connection to Delta State reduces the likelihood of MEND-related violence and further diminishes the risk of prolonged oil disruption. As a result, the nation's systemic risk profile could exhibit considerable improvement, and thus attract greater foreign investment over the medium-term.

Ghana to benefit from rising oil production, strong FDI, a benign political environment & declining current account deficit

Similarly, we believe that Ghana is positioned to benefit from rising oil production, strong foreign direct investment and a benign political environment. In terms of oil production, Ghana has now produced more than 10 million barrels since the Jubilee oil field came on stream in Dec 2010 and we expect more than 35 million barrels in total production by year-end. It should be noted that our bullish case for Ghana is heavily influenced by our positive outlook for commodity prices. By way of example, Ghana's current account deficit declined by more than 60% in the first quarter as total exports rose to over USD 3 billion on back of foreign demand for cocoa, gold and oil. As it stands, these three commodities comprise more than 70% of Ghanaian exports—a number which is likely to increase in line with rising oil production. Looking ahead, we expect Ghanaian GDP to grow by 12—16% in FY11.

Figure 12: Nigeria Private Sector Credit (NGN bil)



Source: Central Bank of Nigeria

Figure 13: Ghana Foreign Direct Investment (USD mil)

Source: World Bank, Securities Africa

Sector allocation favors cyclical industries such as financials, energy and materials whilst consumer discretionary and staples are more vulnerable to correction

We favour cyclical over defensive industries over the medium-term

Although we advise a "risk-neutral" approach to investment, we continue to favour cyclical over defensive industries in the short-term. In keeping with our hawkish assessment of forward-looking inflation, we have lowered expectations for both the consumer discretionary and staples sectors as rising input costs are likely to weigh on margins throughout the remainder of FY11. Given our more neutral assessment of equity market conditions, we have upgraded utilities from underweight to market weight.

We remain overweight financials & energy

We remain encouraged by SSA's prospects and are overweight financials and energy. Within the financial sector, Nigerian banks are well positioned to benefit from continued margin expansion, balance sheet improvement and generally robust credit growth. Furthermore, recent Naira depreciation has created an attractive entry point with NGN/USD holding above 156.00 despite a number of failed attempts to test the Aug 2009 high of 158.57.

We expect Tier I Nigerian banks to outperform

Margin Expansion. The shares of large Nigerian banks are positioned to outperform given the rise in short rates and an overall flattening of the forward curve. Tier I players have access to relatively inexpensive funding (via low cost deposits), and as such, will not be compelled to increase their pool of risk assets to generate returns. Furthermore, Tier I banks could benefit from expiration of the Central Bank guarantee on interbank placements and foreign credit lines as yields on more highly liquid assets should improve.

Figure 14: SSA Industry Recommendations

Industry	Recommendation	Sentiment	Risk
Discretionary	Underweight	Negative	Growth Outlook
Energy	Overweight	Neutral	Valuation
Financials	Overweight	Positive	Inflation / Policy
Industrials	Market Weight	Negative	Growth Outlook
Materials	Market Weight	Neutral	Margins
Staples	Market Weight	Negative	Valuation
Telecom	Market Weight	Positive	Margins
Utilities	Market Weight	Positive	Regulatory

Nigerian banks are well positioned to benefit from the current environment

Asset Quality. The quality of bank balance sheets has improved considerably as AMCON has successfully assumed a large proportion of the banking sector's non-performing loans (NPLs). We continue to monitor impairment levels which appear to be trending toward the CBN's stated 5.0% target level.

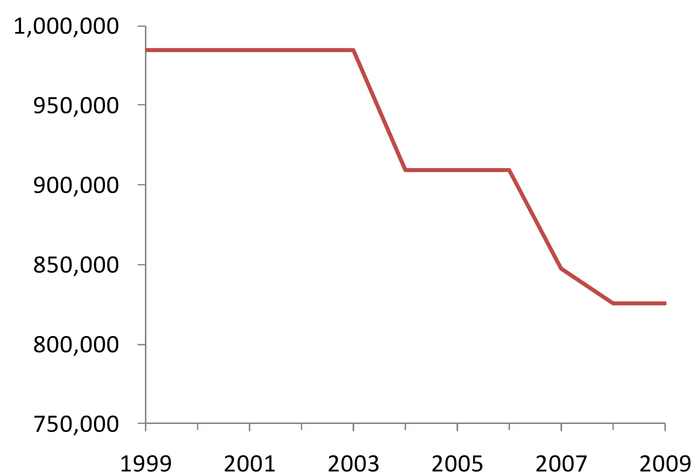
Credit Growth. Although credit growth remains muted year-to-date, we expect conditions to improve considerably post-election. Following President Jonathan's re-election and People's Democratic Party (PDP) majority control, a significant backlog of highly attractive financing opportunities are likely to be unlocked. We will continue to monitor the events surrounding AMCON and its efforts to free surplus liquidity from the intervened banks.

Hyperinflation remains the primary risk to our bullish outlook on the Nigerian banking sector

An inflationary environment in which the Central Bank of Nigeria (CBN) falls considerably behind the curve remains the primary risk to our bullish bank sector outlook. We also remain mindful of the risks associated with MEND-related oil supply disruption and any future delays to financial and power sector reform.

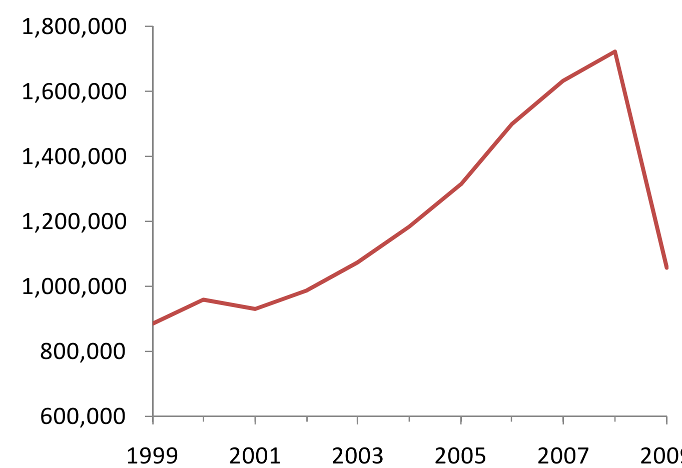
We have grown increasingly constructive on the SSA materials industry, most specifically the diversified metals & mining sector, as demand for base metals is likely to expand at a far greater pace than existing/planned production. Fundamentally, we are particularly bullish on companies involved in the exploration and production of coal, copper and iron ore as these three industries face the greatest risk of near-term shortage in supply.

Figure 15: Global Coal Reserves (million tonnes)



Source: BP Statistical Reserve

Figure 16: Global Iron Ore Production (thou MT)



Source: Worldsteel

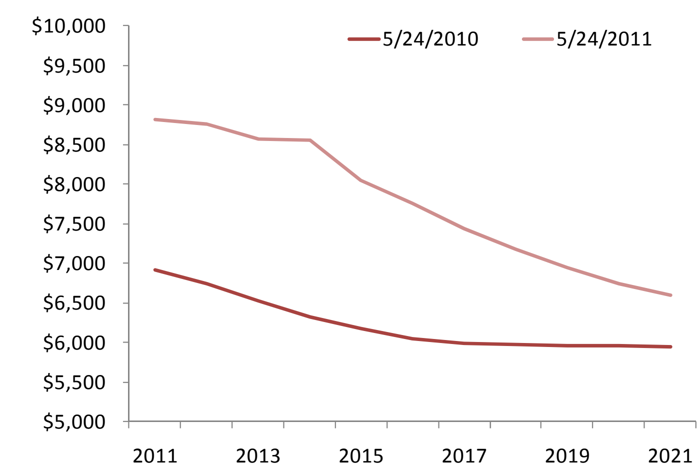
Within the materials industry, we prefer exposure to coal, iron ore & copper producers

By way of example, Western Africa is home to some of the world's richest undeveloped iron ore bodies although it will take time for most of this production to come online. We believe shares of African Minerals, Bellzone Mining and Sundance Resources are well positioned to benefit as current valuations remain depressed amid expectation of further capital-raising exercises. Although the materials industry holds considerable promise for long-term value investors, we remain neutral given a general overhang in the construction materials sector and shares of Dangote Cement, in particular. Despite its market-leading position and the generally supportive macroeconomic environment, the variance surrounding our forecast of Dangote's future earnings potential is high as financial disclosure remains poor and its production targets appear increasingly untenable.

We remain cautious on Kenya as CBK has fallen behind the curve

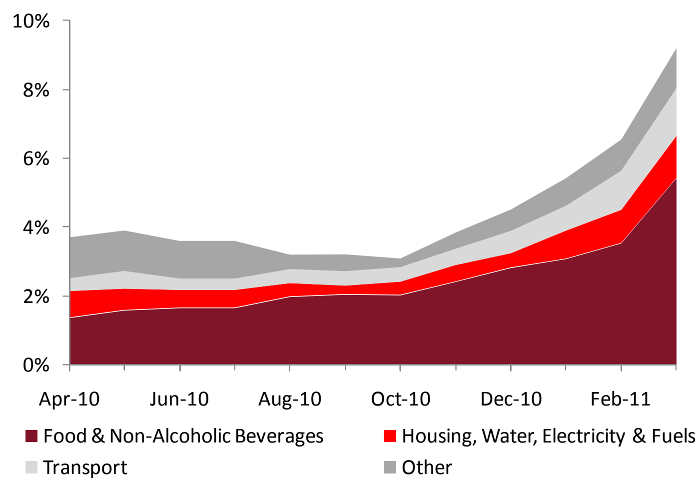
We have lowered our expectations for the consumer discretionary and consumer staples sectors as rising material and labour costs are likely to weigh on margins over the near-term. In addition, we remain mindful of the risks associated with declining levels of discretionary income should inflationary price pressures escalate significantly. We believe that inflationary pressure will be most profound in non-oil exporting countries, most notably Kenya. In our view, the Central Bank of Kenya (CBK) delivered a dovish signal when it elected to loosen policy in Jan 2011 despite rising oil prices and elevated tension across the MENA region. By supporting economic growth and employment at the expense of price stability, the CBK now finds itself behind the curve and will likely need to react more aggressively going forward. Should the recent run-up in Kenyan food and transport prices prove increasingly persistent, we believe that economic growth could come under increased pressure in the months ahead.

Figure 17: LME Copper Price — Forward Curve



Source: London Metal Exchange

Figure 18: Kenya Consumer Price Index — Weights



Source: Central Bank of Kenya

SSA equity investors are advised to respect the tail risks associated with illiquidity and inflation

Country allocation will be the primary driver of portfolio attribution through year-end

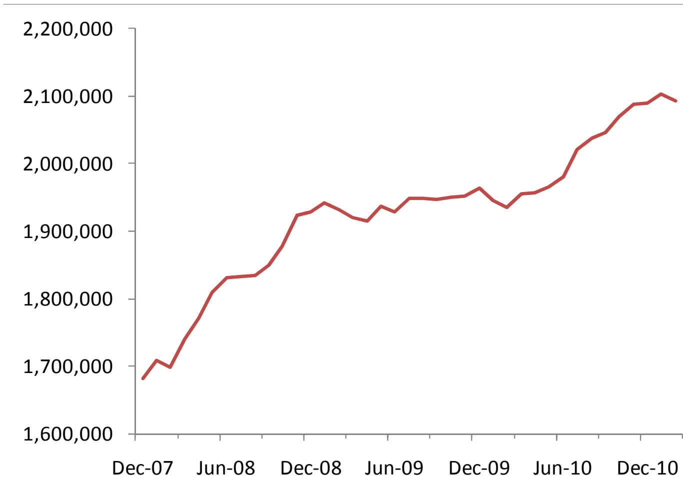
We believe that country allocation will be the single greatest driver of portfolio attribution over the second half of 2011. Although GDP growth across the SSA region is expected to improve significantly in FY11, second half growth may prove more elusive should inflationary pressures weigh on local currency performance. Yet if central banks prove successful in tightening policy and meeting foreign currency demand, local currencies are likely to appreciate when compared to US Dollar and Euro.

For investors who believe that risk appetite will prove increasingly vulnerable through year-end, we advocate overweight positions in USD-benchmarked assets (e.g. Nigeria) at the expense of ZAR-denominated assets (e.g. Botswana, Namibia) given the South African Monetary Policy Committee's more hawkish tone and the continued rise in South African money supply and private-sector credit.

We advocate structures designed to mitigate the negative impact of inflation on local currencies

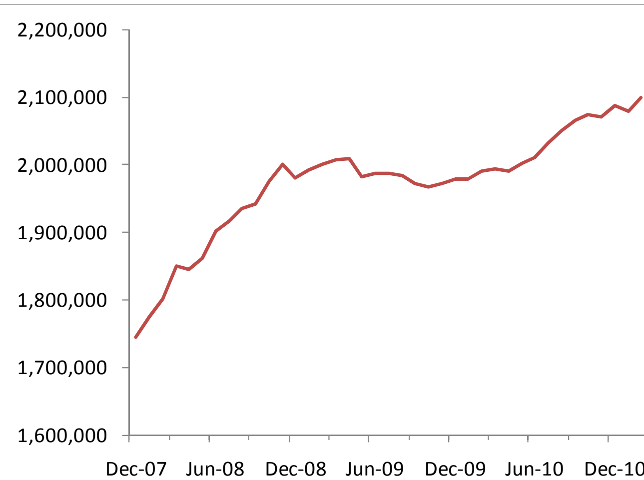
For those looking to hedge against inflation, there are a number of cost-effective options available, including commodity futures and FX forwards. Yet given our view that inflationary pressures will be asymmetrical (e.g. country-specific) in nature, we advocate low-cost option collars on FX forwards as the most attractive option for investors looking to hedge against inflationary episodes in specific countries throughout the SSA region.

Figure 19: South Africa M3 Money Supply (ZAR)



Source: South African Reserve Bank

Figure 20: South Africa Private Sector Credit (ZAR)



Source: South African Reserve Bank

Inflation is least likely to threaten the local currencies of oil exporting nations

From a hedge perspective, the underlying currencies of oil-exporting nations (e.g. NGN, GHS, et al) appear least threatened by rising energy prices and despite higher nominal rates, investors should consider them to be viable funding currencies given the relative richness of implied volatilities across these historically unsteady exchange rate regimes. For those investors with a considerably more bearish view of global risk appetite, flight-to-quality hedges include call options on volatility (e.g. VIX, VSTOXX, et al) and long positions in select precious metals (e.g. gold).

SSA equities are likely to outperform amid stronger-than-expected bank sector earnings

SSA equities likely to outperform amid improved bank sector earnings

Last week's unexpected 50bp rate hike by the Central Bank of Nigeria points to upward pressure on rates and thus reduces the pressure for banks to grow their underlying pool of risk assets. We believe that the Tier I Nigerian banks are well positioned to benefit given their preferential access to comparatively cheap sources of funding (e.g. current accounts, savings deposits, et al). Given that the Tier I Nigerian banks, including **First Bank** (Overweight; Current: NGN 13.50; Target: 16.00), **GTB** (Overweight; Current: NGN 16.20; Target: NGN 23.00), **UBA** (Overweight; Current: NGN 6.0; Target: 8.50) and **Zenith** (Overweight; Current: NGN 15.15; Target: NGN 19.75) are also the largest and most liquid equities in SSA, we believe they will drive regional equity market outperformance over the second half of 2011.

Defensive posturing to result in renewed emphasis on steady cash flows & sustainable dividend yields

Utility companies & telecom operators may see renewed interest in the months ahead

As the current cycle of global expansion enters its third year, investors are more likely to sacrifice earnings growth in favour of sustainable cash flow and dividend yields. These investors are more likely to take renewed interest in utility companies, including **KenGen** (Market Weight; Current: 15.55; Target: 18.50) and **KPLC** (Market Weight; Current: 21.50; Target: 25.00) as their earnings remain shielded from competition amid rising consumer demand. We would also expect outperformance from the telecom operators, most notably **Econet Wireless** (Overweight; Current: USD 4.80; Target: USD 6.65) and **Sonatel** (Overweight; Current: XOF 153,100; Target: XOF 200,000) as value-added services should continue to generate incremental earnings upside over the coming quarters.

IMPORTANT: PLEASE SAVE THE DATE

The 7th Annual Africa Investment Conference
Location: London, United Kingdom
Date: 26th — 27th March 2012
Email: conference@securitiesafrica.com

"The Conference was very insightful and well organized. It gave us the opportunity to showcase our Bank to some of the major investors from Europe and North America. It gave Sub-Saharan Africa an opportunity on the world stage to attract the right attention and investment that is needed."

- Kehinde Durosinmi-Etti, Group Managing Director & Chief Executive Officer, Skye Bank

"The Securities Africa team has organized the conference meticulously with remarkable attention to details. Choice of venue was superb and the facilities were impressive. The forum has given Equity Bank an opportunity to share our strategy and performance with both existing and potential investors and partners. The quality of attendees was impressive. Congratulations to Securities Africa for hosting such a successful event. We look forward to attending next year."

- Mary Wangari, Director of Corporate Strategy, Equity Bank

"The Conference is very well organized and really pulls together international investors with a strong interest in Sub-Saharan Africa. For Safaricom, it is important for us to attend to meet many of our actual and potential investors. We look forward to participating in future conferences. Well done."

- Les Baillie, Chief Investor Relations Officer, Safaricom

"Congratulations to you and the entire team for a successful conference and I very much hope that I will be able to attend many more of them in the future."

- Josephine Ngure, Lead Advisor to Vice President, Infrastructure, Private Sector & Regional Integration, African Development Bank

"The 2011 Securities Africa Conference was a great success. It brought together institutional investors, listed companies from a number of African countries, and players from across the African capital markets to discuss and reflect upon the attractive investment opportunities available on a continent that is slowly but surely emerging as the last growth frontier in the world."

- Sunil Benimadhu, Chief Executive, The Stock Exchange of Mauritius & President, African Securities Exchanges Association

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