

04 August 2015

Executive Summary

The Minister of Finance Mr Patrick Chinamasa released the 2015 National Budget Review Statement on Thursday the 30th of July 2015. He revised downwards the projected GDP growth for the year 2015 from the initial 3.4% to 1.5% on the back of underperformance in the agriculture sector predicated mainly on the back of poor rainfall patterns across the country. Notwithstanding the projected decline in GDP, modest growth was recorded in the mining, tourism, construction, finance as well as public services during the first half of the year 2015. In the paragraphs, below we discuss implications of budget measures on investment markets as well as other selected sectors.

Investment Markets Implications

Stock market implications

- I. We do not expect the introduction of the SME exchange to make a significant impact in facilitating capitalization of small and medium sized business given the liquidity constraints in the economy and the dwindling investor participation on the exchange. Foreign investors who dominate stock market activity have historically favoured blue chip counters while the penny stocks have been left to locals who mainly invest for speculative purposes.
- II. The introduction of the duty of \$0.50 per litre on carbonated soft drinks is expected to bring about a minor relief to Delta's soft drink volumes. The company's first quarter trading update indicated that soft drinks were the hardest hit (15% decline) due to strong competition from imported products. However whether or not the duty will bring about a significant difference in the soft drink volumes is yet to be seen as the rand continues to weaken against the dollar and also because the importers of these products may choose to absorb these costs as most importers are known to charge high margins for their products.
- III. We expect the effects of the complete banning of second hand products and shoes to cascade some benefits to Edgars which owns JET stores, which caters for the lower end of the market. However this effect is expected to be minor as they already face a lot of competition from the increasing number of boutiques and cross border traders.
- IV. Listed property companies like Dawn Properties who own the buildings in the city, where a large number of boutiques are located are also expected to derive some benefits. Second hand clothes have been posing a serious threat to the revenues of many formal businesses which have to bear rental expenses by taking away a lot of business thereby forcing them to vacate

VI. The fruits of the automation of the ZSE are already being seen by the 41% month on month increase in turnover levels in July. Going forward, we expect that the improvement in turnover levels will translate to improving share prices through increasing trading interest.

Money Market Implications

- I. The capitalization of National banks that is ZB Bank, Agribank, IDBZ and the RBZ is critical in improving the confidence in the financial sector as country image is severely affected by under-capitalized government banks. These banks are important participants to the money market and their capitalization strengthens investor confidence in money market products and therefore increases activity in that assets class.
- II. The effect of the activation of the interbank market through Afrades is already being felt through the softening of money market rates through unlocking deposits held by banks with surplus funds. Although the level of NPLs has reduced to 14.5%, they still remain relatively high and as such banks are expected continue to lack aggressiveness in picking up deposits. The long awaited establishment of a Credit Registry system is expected to address the current level of NPLs by improving information asymmetry in the credit market and reducing over indebtedness in multi banked clients. As this measure is still in the pipeline, our outlook for money markets rates remains inclined towards softer rates.
- III. The import reduction measures instituted by the government are expected to have some positive effects in improving money circulation in the economy which ultimately filters into the banking system thereby improving lending and money market activity.
- IV. We expect that a well-crafted Financial Consumer Protection Policy will encourage consumer confidence in financial products which, confidence has been severely shattered by the increased failure of financial institutions and a poor economy that has led to severe loss of wealth for a lot of investors.

Sector Review/Policy Measures	Implications
<p>Agriculture Sector</p> <ul style="list-style-type: none"> • The sector’s growth rate was revised downwards from a targeted growth rate of 3% to -8.2% in 2015. • This was on the back of declining yields among the country’s major crops which include but not limited to maize, tobacco, cotton among others. • Production of maize, tobacco and cotton is expected to decline by about 49%, 9% and 63% to end the year 2015 at 195,000 tonnes, 742,200 tonnes and 90,000 tonnes respectively. • On the positive, meat production (both beef and chicken) is expected to marginally improved in 2015. 	<ul style="list-style-type: none"> • Underperformance of the sector will exert some pressures on the country’s coffers. The government will import agriculture products to ensure food security in the country. • Our view is that agriculture productivity may be improved by some of the following measures: <ul style="list-style-type: none"> 1) Timely provision of financial resources, agriculture inputs, irrigation facilities and on-going training programmes for farmers. 2) Setting up of a commodities exchange which facilitate price discovery through forces of demand and supply as well as shortening the turnaround time for the payment of agriculture produce.
<p>Manufacturing Sector</p> <ul style="list-style-type: none"> • The sector’s growth rate was revised upwards from 1.2% to 1.6%. • The marginal improvement is predicated on recovery of subsectors in foodstuffs, drinks, tobacco and beverages, textiles and ginning, clothing and footwear, wood and furniture, paper, printing and publishing, chemical and petroleum 	<ul style="list-style-type: none"> • Despite the marginal increase in the forecast growth rate, the sector remained beleaguered due to supply side rigidities, antique equipment, and high cost of capital among others. • Our view is that resuscitation of the manufacturing sector greatly depends on bolstering the supply

<p>products, non-metallic mineral products and other manufactured goods.</p> <ul style="list-style-type: none"> • Capacity utilisation improved marginally from 37.2% to 39.1% between January and May 2015. 	<p>side (in particular agriculture), refurbishment of antique equipment, provision of cheap finance and drafting and implementing framework for increasing productivity.</p>
<p>Information Communication Technology</p> <ul style="list-style-type: none"> • A notable development in this sector is that both fixed and mobile operators need to shift their business models more towards internet data with pricing models in line with international best practise from the traditional voice models. • Some of the major ICT projects during the first half of 2015 included: <ul style="list-style-type: none"> 1) Net One Expansion Phase 2 2) Tel one Fibre Optic 3) ZBC Analogue Digital Migration 4) E Government 	<ul style="list-style-type: none"> • Our view is that ICT remains a key driver of economic growth. In other words, enhancements of ICT investments result in positive economic growth. • Our view which is guided by empirical evidence (on the relationship between ICT Investments & Malaysia's economic growth) shows that ICT based investments of the private sector are better drivers of economic growth when compared to government based ICT Investments. Premised on that, we believe the government should go a long way in promoting private sector ICT based investments.
<p>Mining Sector</p> <ul style="list-style-type: none"> • Mining growth is projected above 3.5% against the initial projection of 3.1% due to increased production of gold, nickel, platinum and palladium. • Half year gold production was up 	<ul style="list-style-type: none"> • The objectives of consolidating diamond companies is noble in terms of increasing accountability and transparency of diamond operations, we believe that more harm than good may come from

<p>29.3% to 8.8tons, Nickel production was down 2.2% to 8419 tons, Coal expected at 2.8million tons against 3.2million tons, Diamond production down to 1.44million carats against 1.447 million carats due to a reduction in alluvial deposits in Marange.</p> <ul style="list-style-type: none"> • Consolidating the Diamond mining companies still in the pipeline. • Pursuing value addition in gold, platinum, chrome and diamonds. • Capitalization of the Minerals Exploration Company. • Negotiation of a financial facility for small scale miners. • Removal of export tax on un-beneficiated diamonds and chrome ore. Removal of a ban on export of chrome ore. • Further review of royalties of gold for small scale miners from 3% to 1%. 	<p>this decision.</p> <ul style="list-style-type: none"> • These companies are different in size, operations and in strategy. All the companies currently have their own Board of Directors which basically means there is going to be an altogether significant structural change from the Board level up to the operational level. These inevitable changes have not been met with enthusiasm in the industry as has been observed by the recent exit of Rio Tinto from the Zimbabwe market. The policy further indicates lack of policy predictability and consistency which factors are very critical to encourage investment in the country. • The expected increase in mineral production in the second half is critical in the support of company revenues as commodity prices are expected to keep declining. • We believe that the provision of a financial facility for miners together with the lowering royalties will further increase gold deliveries to government coffers. The earlier instituted reduction in gold royalties has already shown significant fruits as deliveries have increased from 993 kgs in the first
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	<p>6 months of 2014 to 3117 tons from January to June 2015. This measure shall also assist to curb leakages of gold through smuggling and side marketing.</p>
<p>Financial Sector</p> <ul style="list-style-type: none"> • RBZ capitalized to \$110 million with the use of long term debt instruments. • Further capitalization efforts include assumption of the \$1.35billion RBZ debt and mobilization of \$150 to \$200 million. • Banking sector aggregate core capital base at \$899.1 million from \$753.3million. • As at 31 March 2015, 13 out of 16 banks were in compliance with regulatory requirements. • Agribank and ZB bank have been capitalized to the tune of \$30million and \$20 million respectively. • Non-performing loans at 14.52% as at 30 June 2015. • IDBZ debt has been fully transferred to Zimbabwe Asset Management Company (ZAMCO) and the bank was capitalized to the tune of \$32.3million as at 31 December 2015. It now under the supervision of the RBZ. 	<ul style="list-style-type: none"> • Although attempts to capitalize the RBZ come at the expense of increasing an already high government debt bill, they are expected to bring a slow turnaround in the RBZ taking on its lender of last resort function. • The capitalization of the national banks also comes at the expense of a higher debt bill as it was done through the issuance of Treasury Bills. This step was however critical as country risk significantly increases if its National banks are under capitalised. These banks also play a major role in increasing money market activity and in providing long term funding to key economic contributors like mining and agriculture. • Non-performing loans recorded a minor improvement from the December levels of 15.92%. At 14.52%, this figure is still unreasonably high in comparison to international standards of 5%. • A slow improvement to the level of

<ul style="list-style-type: none"> • Credit Reference Unit is now in place to operationalize credit registry. • Interbank operational since 19 March 2015. • As at 30 June 2015 deposits were up 14.2% to \$5.6 billion predominated by demand deposits whilst loans grew from \$3.8billion to \$4billion with lending skewed towards individuals. • \$5million set towards establishing Women’s Bank. • Proposed Development of a National Financial Consumer Policy. 	<p>NPLs is expected as ZAMCO progresses in its exercise. IDBZ is already enjoying the fruits of this operation. However we believe that ZAMCO’s progress will be hindered by the constrained government budget and an already high debt bill.</p> <ul style="list-style-type: none"> • The Credit Reference operation is also moving at a snail pace and as such it may take a while for its operations to be fully functional in improving credit risk management. • Local and foreign investor confidence has been significantly reduced by the alarming bank failures in the country. We believe that a Financial Consumer policy is critical and is a right move to improve investor confidence in financial products as it will in increasing recourse processes for consumers upon bank failure.
<p>Insurance companies</p> <ul style="list-style-type: none"> • Proposed increase in minimum capital requirements for reinsurers from \$1.5million to \$5million. • Proposed upward reviews of levies charged by IPEC to improve its operations. • Attempts of attaining membership 	<ul style="list-style-type: none"> • Membership in the ATI will go some way to enhance the country’s ability to borrow from international financial markets by reducing the country’s sovereign risk premium. • We believe that increasing the capitalization levels for insurers is

<p>in the African Trade Insurance (ATI). Government has secured \$4million of the \$15million required to join.</p>	<p>a critical move in increasing their ability to underwrite business.</p>
<p>External trade and BOP</p> <ul style="list-style-type: none"> • Trade deficit stood at \$1.87billion as at 30 June 2015 and is projected at \$3.1billion for 2015. • Exports are expected to decline by 5% in 2015 due to softening commodity prices and lower agricultural output. • Imports are expected to increase by 6% in 2015 due to an increase in maize and wheat imports. • Diaspora remittances were up 3% to \$409.5 million. • Public debt and publicly guaranteed debt stood at \$8.4 billion comprising of \$6.7 billion (47% of GDP) external debt and \$1.7 internal debt. • The criteria of issuing guarantees are to be tightened and their issuance limited in order to reduce contingent liabilities. 	<ul style="list-style-type: none"> • The steps to tighten corporate governance of public entities and the selection criteria of debt guarantees is essential to reduce negligence given that 24% of external debt are called up guarantees by the Government after responsible entities have failed to pay. This poor governance is posing a substantial threat to the fiscus and has severely limited the availability of external lines of credit available to the government.
<p>Tax measures</p> <ul style="list-style-type: none"> • Increase of duty to from 10% to 30% for pharmaceuticals that can be produced locally. • 25% duty on imported Compound and Blended fertilizer which can 	<ul style="list-style-type: none"> • The increase in duty for pharmaceuticals is critical to lower the import bill as pharmaceuticals are the second most significant contributor to the import bill. Local contribution to pharmaceutical

<p>be adequately produced locally.</p> <ul style="list-style-type: none"> • Specific customs duty of \$0.50 per litre on Carbonated soft drinks • Manufacturing rebate on raw materials imported by approved manufacturers for the local Printing and Publishing industry and Ad Valorem and Specific Duty on finished products. The same measures apply for the Furniture industry. • Manufacturing rebate on critical inputs for approved Textile manufacturers. • Blankets are removed from Open General Import Licence for 2 years. • Customs Duty on sugar has been increased from 0% to 10% plus \$100 per ton. • Groceries that include maize meal, sugar, flour, meat among others have been reduced from the Travellers Rebate. • Removal of second hand clothing and shoes from the Open General Import Licence. • Removal of Tax Free Export Quota of 25% on raw hides to ensure adequate supply of raw hides and skins to the local tanneries. • Income from profit oriented 	<p>manufacturing has over the years declined from 40% to 8%. Part of the decline is because of increased donor supplies and as such the government must try to ensure that some of the donor funds are used to boost local manufacturers by buying locally.</p> <ul style="list-style-type: none"> • Pharmaceutical manufacturing has important linkages with packaging and distribution and thus has the potential of creating employment. • The 25% duty on certain types of fertilizer is essential as at the present moment there is no fertilizer company in Zimbabwe that is operating at a capacity that exceeds 33%. This indicates that there is abundant potential to increase capacity if local demand is created. Fertiliser companies must also be faithful to the commitment that they have made of reducing prices by about 20% so that they are competitive against imported products. • The banning of the second hand clothes shall see an improvement in revenue collections from formal clothing traders like boutiques and companies like Edgars who pay tax to the government. These
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<p>business instituted by Ecclesiastical institutions that is churches are now subject to income tax.</p> <ul style="list-style-type: none"> • Increase in surtax from 25% to 35% for second hand vehicles aged more than 5 years. 	<p>formal businesses have lost a lot of business to these informal traders whose revenues are not captured by the fiscus.</p> <ul style="list-style-type: none"> • The Beverages industry is one of the few remaining key manufacturers in the country which also has strong linkages with agriculture and other business particular the sugar industry. The duty on carbonated soft drinks will certainly increase cost of sales for imported products thereby providing support to the local industry especially big companies like Delta which has recently instituted some measures to rationalize operational expenses. One of the measures was to stop hiring more workers and students for attachments. • The sugar industry currently has an excess production of 180 000 tons which needs to be exported. The international market for sugar is however quite saturated at the moment thereby leading to low prices. • The import duty on sugar will provide support for local manufacturers like Hippo. • Attempts by the government to continue to try and support local
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	<p>industry through rebates for imports of important raw materials are appreciated. These measures are however incapacitated from bearing the desired fruits as local companies are unable to harness capital at low cost to be able to take advantage of these benefits. The government must continue to try and address cost of borrowing through tackling national debt and taking a stable stance in its policies so that the country can access cheaper lines of credit.</p>
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