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Renaissance Capital

Charles Robertson
+44 (207) 367-8235
CRobertson@rencap.com

Thoughts from a Renaissance man

Rwanda – An African inspiration

- **A visit to Rwanda on 6 April provided the greatest positive shock in this analyst's professional career.** If you have any doubt that an African country can emulate the best performance seen in emerging Europe or Asia over the past few decades, then please allow us to take you to Kigali to challenge these assumptions. From the ease of visa-free travel and a well organised and hassle-free airport, to the reassuring presence of police and security forces, streetlights, low crime, good roads and broadband (due from the end of this month), we suspect there will be much to impress you. A side trip to see the gorillas would be helpful for the country's strong tourism revenues, too.

- **To be a Singapore of Africa** is Rwanda's ambition – and in our view, it is succeeding. The country is politically stable, with the next presidential elections due in 2017. There is a zero-tolerance attitude to corruption, and we heard this is effective. It was the world's best reformer, according to the World Bank's 2010 Doing Business survey (*click here* to view); in 2010, 6,000 companies were registered in this country of 11mn people, about equal to the number registered over the previous five years. Keen to dispense with foreign aid by 2020, the country is a darling of the aid agencies, with highly effective implementation and use of foreign inflows. We saw clear evidence of forward planning and a strategy for the country. With access to a market of 130mn people in the East African Community (Kenya, Uganda, Tanzania, Rwanda and Burundi), Rwanda aims to be a hub for investment for both East and Central Africa. Lastly, and much to the distress of any macro/strategist, we failed to find significant macro risks for the economy.

- **How is this happening?** Undoubtedly, President Paul Kagame has played a very significant role, and we'd not be surprised if Lee Kuan Yew's book *From Third World to First* has as well. Singapore in the 1960s had per capita GDP of around $400, was vulnerable to ethnic and ideological conflict in a region beset by wars, was excessively dependent on foreign aid (UK military bases), and most CEOs could not find it on a map – but it was transformed by vision, infrastructure planning, the creation of an economic development bank, industrial parks to attract investment, and even beautification of the airport and city to give foreign investors a positive first impression, all underpinned by sound macro policies. The Rwandan Development Bank, the use of privatisation proceeds to roll out a fibre-optic broadband network, and the recent launch of a Special Economic Zone for industry/technology and warehousing just a kilometre from the airport might all be seen as following Singapore's example. Like Singapore at first, Rwanda is keen to attract any investors and is changing its requirement that investors export 80% of production, though an Indian pharmaceuticals company's $60mn investment (worth 1% of GDP) is targeted at exports to the region. We believe the concentration of GDP in a small area –Kigali, the capital – could be a significant advantage.

- **What's next?** The government intends to turn Rwanda into a service economy and a conference hub. The ongoing construction of a $300mn conference centre, a planned new airport and the privately funded Marriott hotel under construction will allow continued expansion of the roughly $100mn earned through business tourism (roughly the same value as tea and coffee, or all mining exports). Roads have been upgraded across the country, including to Burundi and Tanzania, with a route to northern Congo to be finished in mid-2012. The next transport projects include extending the rail line from Tanzania to Rwanda by 2015. The government intends to boost power generation from a sufficient 85 MW to 100 MW in 2012, and as much as 1,000 MW by 2017 through tapping methane gas in Lake Kivu and using peat. It plans to improve energy supplies through extending a 1,200-km oil pipeline from Kenya. Access to Uganda's oil production is possible from 2015-2016. At present, all petrol is trucked from Mombasa, which is one reason why a litre of gasoline costs $1.67 in Kigali (vs about $1 in the US); improved access to energy could dramatically improve Rwanda's competitiveness. On the fiscal side, the cabinet just approved plans to introduce a flat 15% income tax rate, for individuals and corporations, to take effect in 2012. To improve the country's skill levels, free schooling has been extended from age 12 to 15, and a German company has been brought in to continue the roll-out of colleges, which will focus on vocational skills. In the meantime, Rwanda is open to immigration to provide the skills the country needs.

- **The economy** today is quite different from where Rwanda expects to be in 5-10 years. Services are expected to rise from 40% to 60% of GDP. Today agriculture represents a third of GDP, half of merchandise goods exports and 35% of the CPI basket, and it employs 80% of the population in largely subsistence farming, with high dependence on the short and long rainy seasons that do so much to drive inflation – in December, inflation ended the year at zero, due to ideal weather in 2010. Recent value-added developments include fully washed coffee beans that sell at twice the normal price, and a move into horticulture that may challenge other exporters, from Kenya to Colombia. Land reform, the application of fertilisers and allowing land titles to be used as collateral might all support the country's ambitions to become a regional exporter of agricultural products.

- The mining sector, with its exports of tin and tungsten, is responsible for roughly $150mn in exports, more than agriculture but less than the $200mn from business and retail tourism. Within four-to-five months, the government expects to be able to reassure the US that its mineral exports do indeed come from Rwanda and are not just re-exports from the Democratic Republic of the Congo.

- As in Kenya, mobile phone banking has taken off. The first entrant to the mobile phone market, MTN, began operations in the 1990s and has 3.6mn subscribers, of which 260,000 have joined a money transfer service launched in 2010. Two competitors with a combined 1.2mn subscribers have applied for authorisation from the National Bank of Rwanda (NBR) to offer a similar service, though the smaller of these just had its licence rescinded by the regulator due to its failure to meet investment plans.

- The conventional banking sector looks to us to be in very sound health, with a loan/deposit ratio of some 75%, and huge scope to grow. Private sector credit is at 12% of GDP, one of the lowest levels we have come across. Since the global financial crisis, credit growth has been modest and would appear to offer no threat to macro stability. It is not contributing to the current account deficit. Unlike in other countries around the world, we see no overheating risk at present, with lending rates around 17% and deposit rates at about 7-8% on term deposits (above three months). Mobile phone banking is expected to boost deposits in conventional or mobile phone banking systems, providing domestic resources for lending in the future.

- The ruling party (Rwandan Patriotic Fund) has its own investment company, Crystal Ventures (formerly Tristar), which is an additional source of investment in the economy. In the 1990s it provided most of the initial funding for the MTN investment in Rwanda, bringing mobile telecoms to the country earlier than would have otherwise happened, and benefiting domestic capital when it succeeded. Its capital is re-invested, and the company – a little like Temasek, in Singapore – may contribute to the country's longer-term success.

- Rwanda received debt forgiveness in the early 2000s and cannot take non-concessional funding. As a result, we see minimal risk of the country building up an external debt burden of any size in coming years. This also means the government is not in a position to borrow more than foreign donors are prepared to cover.

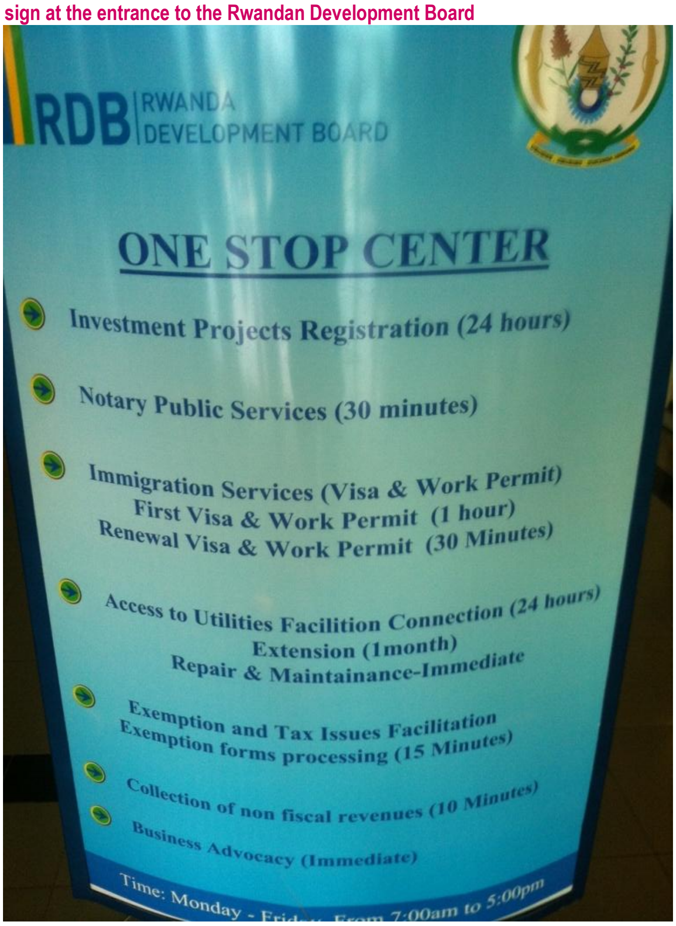
- Covering the current account deficit – a potential Achilles' heel for Rwanda – should not be problematic, as the aid agencies are committed to supporting the country. As the current account deficit is driven by aid and investment, any reduction in either should reduce the current account gap. Therefore, the only risk to the current account would come from an explosion in bank lending, which is not happening. In any case, with FX reserves at a very healthy 5.2 months of import cover, there is plenty of protection for Rwanda at present.

- Overall macro numbers include annual GDP growth of 8% on average over the past five years; a 37% jump in per capita GDP from 2007 to 2010; and low budget deficits, within 0-2% of GDP in most years (including aid). The currency is in a managed float, and the NBR aims to avoid significant volatility. Inflation fell to zero in 2010, but may rise to 8-9% in 2011, as the growing season is unlikely to be excellent two years running.

- Conclusion: Rwanda needs to achieve three things – it needs to build better transport links to the coast (although problems with ground transport are partially mitigated by the airport), ensure that it does not run out of electricity in coming years, and attract foreign direct investment. We see no reason to expect a change of policy from the reform-minded leadership, nor any reason to assume that foreign donors will change their support for this success story. The macro backdrop is highly supportive.

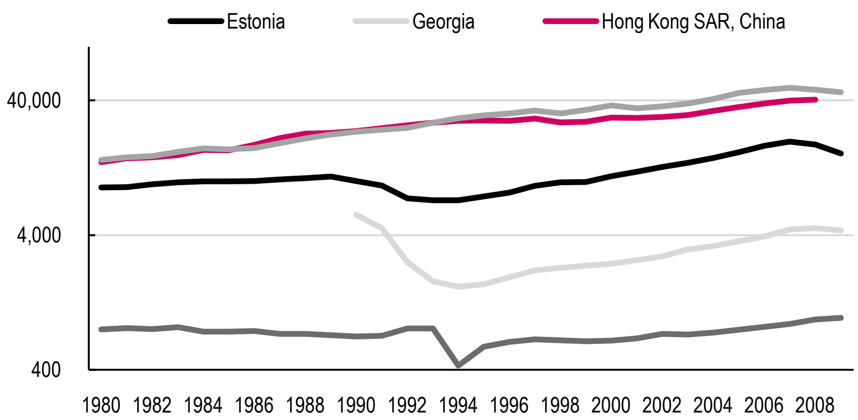
- The only problem for portfolio investors is getting access to this story, but here we believe more than just the current brewery will become available.

Figure 1: The sign at the entrance to the Rwandan Development Board



Source: Renaissance Capital

Figure 2: Per capita GDP in constant 2005 dollars, log scale



Source: World Bank

Figure 3: Southern Africa rail network

Source: http://www.reliefweb.int/rw/fullMaps_Af.nsf/luFullMap/BC0EF176D6BCADE385256C0800474100/$File/wfp_safr_rails0702.pdf?OpenElement

Figure 4: Key economic indicators

	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Activity													
Real GDP (%YoY) - calendar year	0.3	5.3	7.1	5.5	7.7	11.5	6.1	7.5	7.0	7.2	7.2	7.3	7.5
Gross Investment (% GDP)					18.0	22.7	21.6	20.8	24.2	20.9	20.4	20.3	20.3
Nominal GDP (FRW bn) - fiscal year					1,883	2,307	2,765	3,136	3,448	3,886	4,390	4,938	5,532
Nonimal GDP (FRW bn) - calendar year	955.0	1,137.9	1,331.6	1,583.0	2,049	2,565	2,990	3,282	3,676	4,128	4,652	5,224	5,839
Nominal GDP (EURbn)	1.6	1.6	2.0	2.3	2.7	3.2	3.8	4.2					
Nominal GDP ($bn) - calendar year	1.8	2.1	2.4	2.9	3.7	4.7	5.3	5.6	6.0	6.5	7.0	7.7	8.3
Population (mn)					9.5	9.8	10.1	10.4	10.7	11.0	11.3	11.7	12.0
GDP per capita ($)					394	479	521	541	562	590	623	656	694
National savings (% of GDP)					12.7	15.7	13.5	14.0	14.4	14.0	14.1	14.1	14.1
Stock of bank credit to corporate/household sector (% of GDP)					12.6	13.3	11.9	12.1	12.8	14.4	13.7		
Private sector credit growth % ch YoY						31.9	4.8	11.1	18.6	25.9	7.6		
Loan to deposit ratio								75.0					
Prices													
CPI (average % YoY) - calendar year	7.5	12.0	9.1	8.9	9.1	15.4	10.3	2.3	3.9	6.5	5.3	5.0	5.0
CPI (end-year % YoY)								0.2	8.5				
Fiscal balance (% of GDP)													
General government budget balance - fiscal year	-3.5	-1.7	-0.5	-0.6	-1.4	-0.2	-2.6	-1.3	-4.2	-1.8	-0.9	-0.3	-0.3
Total public debt													
External balance													
Exports ($bn)		0.098	0.125	0.147	0.177	0.268	0.235	0.300	0.376	0.411	0.436	0.470	0.497
Imports ($bn)		0.276	0.354	0.446	0.581	0.881	0.999	1.084	1.400	1.389	1.397	1.480	1.580
Trade balance ($bn)		-0.178	-0.229	-0.299	-0.404	-0.613	-0.764	-0.784	-1.025	-0.978	-0.961	-1.010	-1.083
Trade balance (% of GDP)		-9	-9	-10	-10.8	-13.1	-14.5	-13.9	-17.0	-15.1	-13.7	-13.2	-13.0
Current account balance ($bn)		0.0	-0.1	-0.2	-0.08	-0.23	-0.38	-0.43	-0.35	-0.38	-0.43	-0.44	-0.47
Current account balance (% of GDP)		-1.7	-2.4	-7.1	-2.2	-4.9	-7.3	-7.6	-5.8	-5.9	-6.1	-5.8	-5.6
Net FDI ($bn)					0.082	0.103	0.119	0.042	0.112	0.066	0.080	0.095	0.114
Net FDI (% of GDP)					2.2	2.2	2.3	0.8	1.9	1.0	1.1	1.2	1.4
Current account balance plus FDI (% of GDP)					0.0	-2.7	-5.0	-6.8	-3.9	-4.9	-5.0	-4.6	-4.2
Exports (% YoY, value)			27	18	20	52	-12	28	25	9	6	8	6
Imports (% YoY, value)			28	26	30	52	13	9	29	-1	1	6	7
Foreign exchange reserves (ex gold, $bn)					0.2	0.3	0.4	0.5	0.7	0.6	0.6	0.6	0.7
Import cover (months of merchandise imports)					4.7	4.7	5.4	5.1	5.6	4.9	5.1	5.2	5.4
Debt indicators													
Gross external debt ($bn)	1.4	1.6	1.5	0.4	0.6	0.7	0.8	0.8	1.0	1.2	1.3	1.4	1.4
Gross external debt (% of GDP)	78	76	60	14	15	14	15	15	17	19	19	18	17
Gross external debt (% of exports)		1,619	1177	285	324	252	329	279	269	303	308	291	278
Exchange rates													
Avg T-bills - 4Q	12.7	12.3	10.2	8.1	5.9								
Exchange rate (FRW/EUR) year-end	697	751	638	724	795	780	818	795					
Exchange rate (FRW/EUR) annual average	592	697	679	686	750	804	792	774					
Exchange rate (FRW/$) year-end	554	554	539	549	545	558	571	594	625	651	671	691	711
Exchange rate (FRW/$) annual average - calendar year	523	560	546	546	547	547	568	583	611	636	661	681	701

Source: National Bank of Rwanda 2002-2006, Bloomberg, Ministry of Finance, Renaissance Capital

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Renaissance Capital Moscow T + 7 (495) 258 7777	**Renaissance Capital Ltd.** London T + 44 (20) 7367 7777	**RenCap Securities, Inc.** New York + 1 (212) 824-1099	**Renaissance Securities (Cyprus) Ltd.** Nicosia T + 357 (22) 505 800
Renaissance Securities (Nigeria) Ltd. Lagos T +234 (1) 448 5300	**Renaissance Capital** Nairobi T +254 (20) 368 2000	**Renaissance Capital Ukraine** Kyiv T +38 (044) 492-7383	**Renaissance Capital** Almaty T + 7 (727) 244 1544
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