



ZAMBIA UPDATE

Trip down memory lane

Today, with bond yields approaching 12%, Zambia is generally recognized as having displaced Ghana as the weakest sovereign credit in sub-Saharan Africa. But 12 months ago, the sell-side consensus was that Zambia should be considered “a core holding (sic) in any SSA portfolio”.

On Dec. 3, 2014 Rhombus recommended that its clients go short the credit, targeting the 8.5s of 2024, then bid at 113.5 – a price we considered irrationally exuberant.

Below we reproduce our original arguments.

Time to go short the Zambia 8.5s of 2024

This is clearly a contrarian position but **the fact that this bond is trading at a spread of only 430 b.p.** (i.e. 150 b.p. through Ghana), **strikes one as both insane and a serious opportunity**, given the situation on the ground. A quick recap, to set the stage:

1) The turmoil within the ruling PF is set to intensify now that there are now two ‘duly elected’ claimants to the party’s nomination, as predicted.¹

2) In the interim, the propensity for political violence among Lungu’s followers has been on full display:

- Yesterday a triumphant motorcade led by Miles Sampa was attacked in Lusaka’s central business district by a group of Lungu supporters wielding machetes, their weapon of choice.
- A separate contingent of the same *de facto* militia attacked employees of the United Party for National Development (UPND) who were putting up posters of the party’s candidate, Hakainde Hichilema (hereafter, HH)².
- This morning, when two employees of Lamise Advertising were removing posters of Lungu that had been affixed to the company’s electronic billboards outside the Manda Hill mall, they were chased off at gun-point.

¹ A court hearing is scheduled for Friday to consider a petition by Miles Sampa, who was elected at Monday evening’s ballot, to enjoin Edgar Lungu (elected by a show of hands at an inordinate gathering on Sunday), from passing himself off as the party’s nominee.

² It is worth recalling that on Sunday 23rd Nov., a mob led by senior PF officials (including sports minister Chishamba Kambwili), burst into the studio of the state-owned broadcaster, shouting abuse and issuing verbal threats against the director of news programming for “daring to discuss the HH’s electoral platform”. Two days later, shortly before independent Millennium Radio was to broadcast an address by HH, officials of the state-run utility ZESCO orchestrated a black-out in Lusaka with the transparent objective of minimizing his audience.

3) Not surprisingly, the eight weeks since the draft 2015 budget was presented have been marked by a **pronounced sense of policy drift**. Among the most urgent issues awaiting attention are:

- Mining sector - a final decision on **outstanding VAT refund claims (ca. USD 600 million)**, as well as the implementation of the new schedule of royalties (projected to generate ZMW 1.7 billion in 2015).
- Agricultural sector - the state-run Food Reserve Authority (**FRA**) **is still carrying payment arrears of as much as ZMW 530 million** in respect of white maize delivered in July and August. Over the last fortnight in particular, farmers have repeatedly occupied the premises of rural FRA offices demanding settlement of their invoices, only to be forcibly removed by police.

4) Clearly, even after a new government takes office in Lusaka, **no discussions with the IMF can be envisaged while these matters remain unresolved**.³

5) **None of these potent risk factors is reflected in the bond's current pricing**. While the 10 days following Sata's Oct. 29th death did see a modest pull-back, the overall price action on the 2024 bond seems to have been driven by a sense of blind optimism. Indeed, in the last fortnight prices have actually strengthened ... in willful disregard of the gathering storm.

On the basis of the foregoing we feel - as strongly as we did about the outlook for GHS last Jan. - that **a bid of ca. 113.50 is just asking to be hit**.

³ It is also worth pointing out that the Fund is far less vested in Zambia than it is in Ghana (which, for so many years has been as ill-chosen a poster child as was Argentina in the mid-late 1990s).

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