IMARA Asset Management

Monthly Market Report

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Region:	**Africa ex SA**
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Market snapshot

Markets (MSCI indices in USD/currencies vs the USD) –

Aug Performance (%)	LCY	USD
Egypt	7.2	7.9
MSCI World	6.5	6.5
Kenya	4.8	4.4
Tunisia	2.8	3.7
Nigeria	2.6	3.7
BRVM	1.5	2.7
MSCI EM	2.1	2.1
Morocco	-0.9	1.3
Botswana	-0.6	-0.2
Mauritius	-0.9	-1.4
Zambia	-0.6	-7.0

August was a mostly positive month, with performances from Egypt +7.9%, Kenya +4.4%, Nigeria +3.7% and Morocco +1.3%, offsetting a negative performance from Mauritius -1.4%. Markets continued easing restrictions for the most part, and saw increased economic activity.

Economic and political overview

Nigeria – GDP contracted -6.1% y/y in 2q20 (1q20: +1.9%). The non-oil sector slumped -6.1% y/y as COVID-19 measures disrupted normal business. Major non-oil sectors experienced contractions, namely manufacturing -8.8% y/y, trade -16.6% y/y and construction -31.8% y/y. The oil sector shrunk by -6.6% y/y. Unemployment rose to 27.1% during the quarter (last data point 3Q18: 23.1%), with the younger population recording the highest rate of unemployment. 28% of the population is underemployed, highlighting a major employment gap.

The Central Bank of Nigeria (CBN) has dropped the savings account interest rate from 30% of the monetary policy rate (MPR) to 10%. This effectively means the rate is now 1.25% down from 3.75% for all Deposit Money Banks. This is fundamentally supportive for the sector, and will have a positive impact on margins. The CBN has also announced the supply of FX to Bureau De Change operators once international flights resume. Phase 2 of the COVID-19 National Response was extended with modifications to September. Essentially international flights resumed on 5 September and civil servants returned to normal working hours. Social distancing measures, the nationwide curfew and use of face masks continues.

The CBN has also stated that more licenses for payment service banks will be offered to telecom firms, banking agents, retail chains and postal services. The primary obstacle is the capital base which is set at a minimum of USD 13m, which is to be set up as a separate company from the existing operation. That said, MTN is still awaiting approval.

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The Federal Government is in talks with the World Bank for a soft loan of USD 1.5bn to assist with the country's recovery and cover the 2020 budget deficit. The final decision is expected in October.

Macro releases include (July stats):

- Inflation came in at 12.8% y/y (June: 12.6%).
- FX reserves crept down to USD 35.9bn (June: USD 36.2bn).
- PMI rose to 50.4 (June: 46.4).
- M3 growth was 3.2% y/y (June: 2.1%).

Egypt – Unemployment rose to 9.6% in 2q20 in the wake of the COVID-19 outbreak (1q20: 7.7%). This shows a 2.7m drop in employment numbers, with elevated job losses on the back of the pandemic.

Over 50 000 tourists have visited Egypt's seaside cities since the resumption of international flights, with no COVID-19 cases reported during or after their stays. Travellers from outside the country must have a negative Polymerase Chain Reaction (PCR) test upon arrival as of 1 September. The majority of hotels in Cairo, El-Sokhna and North Coast have since been permitted to operate at the government-mandated 50% capacity. Occupancy rates have been at 30-40% for major Red Sea resorts and the national airline is operating at 45% capacity. Transport services for tourists have resumed, with buses and cars operating at 50% capacity in preparation for museums and other sites opening. The IMF has pegged tourism losses at 2% of GDP.

The banking sector showed an improvement in June, with corporate loan growth +15.9% y/y (May: 13.1%) and retail loan growth flat at +28.3% y/y. Total credit increased, with the Central Bank of Egypt's USD 100bn lending programme for manufacturing, agriculture and construction sectors with subsidised lending rates of 8% contributed to corporate credit growth.

Other macro releases (July stats):

- Inflation slowed to 4.2% y/y (June: 5.6%).
- FX reserves reached USD 38.3 (June: USD 38.2bn).
- PMI rose to 49.6 (June: 44.6).
- M2 growth accelerated to 19.1% (June: 17.5%).
- The fiscal deficit narrowed to 7.8% of GDP in FY19/20, not quite reaching the 7.2% target, but up from 8.2% in FY18/19.

Kenya – Mobile transactions crossed the KES 400bn mark in July (USD 3.7bn), +15.0% m/m growth from June. This is due to a timely combination of the fee waiver, increased use of cashless payments and relaxation of containment measures. Mobile lenders have raised the minimum from USD 5 to USD 20 to reduce micro-defaults. This follows the blocking of some customers for failure to settle Safaricom's Fuliza overdraft loans.

The World Bank has approved a KES 16.2bn (USD 150m) loan for Kenya to upgrade infrastructure and improve access to basic services.

Macro releases (July stats):

- Inflation was 4.4% y/y (June: 4.6%), and has remained at that level in August.
- FX reserves fell to USD 9.34bn, 5.66months of import cover (June: USD 9.72bn). As of 27 August FX reserves declined to USD 8.96bn.
- PMI grew to 54.2 (June: 46.6)
- Diaspora remittances grew +23.7% y/y, up from a -2.3% y/y dip in June. Cumulatively Jan-July is +3.9% higher than the same period in 2019.
- The current account deficit narrowed to 4.7% of GDP (June: 5.0%) on the back of improved exports and inflows, coupled with lower imports.

Mauritius – Tourist arrivals unsurprisingly declined by 60.2% y/y in the first 7 months of 2020. Accommodation and food services are expected to contract by c.70% in 2020 according to Statistics Mauritius.

Macro releases (July stats):

- Inflation came in at 1.5% y/y (June: 1.7%).
- FX reserves grew to USD 7.66bn (June: USD 7.2bn).

Morocco – August saw a resurgence of COVID-19 cases, with warnings of full lockdown as a result. Marrakech experienced a strain of health services and a string of medical staff protests. The EU dropped Morocco from the safe country travel list following reviews in August.

The banking industry continued with stable growth of 5.6% y/y in June (May: 6.5%), as a result of +10.4% debtor account growth and overdrafts, +3.8% equipment loan growth and +1.6% real estate loans and mortgages. Non-performing loans in the sector grew by 11.9% y/y.

Other macro releases included (July stats):

- Inflation was -0.1% y/y (June: -0.7% y/y).
- FX reserves were stable at USD 28.3bn (June: USD 28bn).

Company updates

Fawry (Egypt, IT) 2q20 results: Revenues grew 46.1%, GP by 64.9% as margins expanded by 630bps to 55.1% and PAT by 186% as net interest income and share of associates improved strongly. The underlying KPI's remained strong, with COVID-19 having an overall positive impact on the business model. PoS terminals grew 40% to 167k, Acceptance enabled merchants 49% and number of services provided 30% to 879. Throughput in 2q 20 jumped 46% y/y to USD 1.3bn and interestingly rose by 31% sequentially over the first quarter. Alternate Digital Payments revenue (ADP) grew 29% y/y, but fell from 86% of revs in 2q 19 to 75% in 2q20, a trend which management committed to at the IPO, with Banking Services, Micro finance, Supply chain and Mobile wallet increasing their share. Besides the more obvious and tangible benefits of lockdown, management believe the lasting benefit was that it forced techno/online phobic consumers into alternate payment methods and online shopping habits. It has also emboldened govt/CBE/regulators to continue to throw their weight behind

the move to a cashless economy. In terms of immediate outlook, management indicated that the growth and margin trends have continued in July and August.

EIPICO (Egypt, Healthcare) 1H20 results: Revenue growth decline of -17.0% y/y off a high base in 2019. 2q20 growth -18.2% y/y, while 1q20 -15.9% y/y, as a result of weak local sales and lagging export recovery. Some export markets' land borders were still closed in 2q20 (Saudi, Iraq, Jordan and Sudan) forcing over-land shipping coupled with higher freight fees. Outpatient clinics only reopened on 16 June, and medical facilities saw lower patient traffic so product demand was low. EIPICO revenues tend to be reliant on prescriptions (antibiotics constitute 70% of portfolio) which came under pressure during COVID-19, while chronic drugs fared better. Raw material costs declined -12.8% as a result of initiatives previously mentioned, such as renegotiated API pricing. 2q20 GP margin was flat y/y despite the weak revenue growth, showing the margin enhancing strategies coming through. Operating costs were managed, but the bottom line was hit by a net increase in financing costs. PBT -34.1% y/y. EBITDA marginally declined by 81bps in 1H19 to 27.2% in 1H20. EIPICO has increased reliance on 3rd party distributors, providing over 16m medication packages to the MOH since March to mid-July. Management announced the production of Epifluver in July, the generic equivalent of the antiviral Avigan – approved as a possible treatment for COVID-19. EIPICO currently has 11 products used as part of COVID-19 treatment protocol. Management has adjusted their year-end target for revenues, reducing local sales from +24% growth to +13%.

Nigerian Breweries (Nigeria, Consumer staples) 1H20 results: Revs -10.8% y/y, 2q20 growth -21% y/y due to a decline in volumes. The top line was not a surprise given the already tough macro predating COVID-19. The impact of movement restrictions and bans on public gatherings was apparent in 2q20, in line with our expectations. As anticipated, laga sales largely fell off during the quarter as distributors faced constraints and consumer behaviour shifted. GP margin was squeezed by 320 bps to 38.9%, GP loss of -33.7% in 2q20. Opex was down -6.7% in 1H20 (-23% in 2q20), but this was offset by a net interest expense increase which impacted the bottom line. NB added some debt to its books in 2q20, + 41% q/q. Commercial paper of NGN 25.9bn was issued, its purpose to support short term funding needs. PBT -57% for 1H20, 2q20 PBT decline of -99% y/y. We look to 4q20 for some level of normalisation, and earnings recovery in 2021.

Equity Bank (Kenya, Financials) 1H20 results: PBT -29% y/y despite very positive operational numbers. Interest income +17% y/y and banking income +4% y/y. Management continued with very prudent provisioning (4x the normal level) which more than offset strong banking income growth. The highlight is strong deposit growth of +9% q/q, +12.7% YTD and +19% y/y and shows the strength of the franchise and likely flight to safety. The main feature of the results was the ample liquidity at longer duration rates (The CIB strategy). The NIM stayed flat at 7.5% as longer rates offset lower lending yields which was in line with management's guidance on our June call. Fees on transactions -35% y/y for 2q20 alone and -13% y/y for 1H20 due to inactivity and zero rating of small P2P mobile transactions. Should recover in 2H20. Opex control is good at -3.5% y/y. Overall a satisfactory set of results that matched what we expected and took away from the last management call pre results. Management on the same strategy as pre rates cap. They will stay conservative due to macro, focus on the bond market, liquidity gathering and transaction services via a multi-channel strategy biased towards mobile and agency. Current valuation of 0.9x book accurately discounts 1H20 ROE of 17%. However, our view beyond the immediate crisis places sustainable ROE higher at 23 - 25% which translates to a 2x fair book value.

Guaranty Trust Bank (Nigeria, Financials) 1H20 results: PBT -5% y/y in line with our expectations but far ahead of most analyst's forecasts. The narrative in the market was that banks would post big provisions and so most analysts were inflating provision expectations. Lessons learnt from the past means that oil producers were hedged on at least half of production above USD50/bbl and so a weak crude environment does not necessarily lead to weak cash flows. This point plus a moderate COVID-19 experience in a country used to health challenges leads to a business as usual attitude. Banks have seen this all before and so there is a confidence to trade through this again. GTB impresses operationally. Deposits +17% YTD and 24% y/y. Loans +8% YTD and 25% y/y. Banking income was +7% y/y despite lower margins from low yields in bonds and loans and fees +1% y/y from lower activity levels. The effects of a weaker naira can be seen as their net long position (87% of NAV) translated to revaluation gains. Assets +25% y/y. A full devaluation of the FX market will translate to positive earnings surprises. We are very positive on a post devaluation earnings outlook. Higher yields plus higher asset balances will boost earnings between 60-100%, so the current environment acts more as a brake on its true earnings potential.

Stanbic IBTC (Nigeria, Financials) 1H20 results: PBT +17% y/y was a very good result with 2q20 PBT +32% y/y boosted by extraordinary bond trading gains. Not surprising as their global markets division is a dominant player (almost without peer) in the local and eurobond markets. High volatility in eurobonds (c. 600bps range in April) and sharp yield declines in local paper created a very good environment for their bond desk. In addition, the pensions business is doing well as usual and deposit growth +37% YTD stand out as excellent performances. The latter translated to a lower cost of funding which supported margins where sources of income (bond and loan yields) were under pressure. Overall, banking income +14% y/y. The same read through as GTB on provisions. Where the market expected more provisions, the oil risk is really not there and the economy as a whole is trading through other challenges. Management did say in our June call with them that provisions will be very mild and nowhere near 2016-17 levels. We will upgrade out earnings as the bond performance did surprise us a bit. Moreover, the theme that comes through on our Nigeria banks positions is that they are USD hedged plays with a strong earnings outlook. We are confident those USD hedges and quality of operations are coming through strongly. Our positions are doing well considering the macro and should do even better when the full devaluation of the naira comes through.

Market outlook

The impact of COVID-19 is still being assessed but at this stage it is the main driver of short-term negative macro performance in all our markets. In addition, a lower average oil price in the past 4 months has negatively impacted Nigeria's ability to clear USD FX demand in particular. Overall, we have focused on business models that are either essential or innovative (e.g. Fawry in Egypt) and that can meet our minimum quality criteria. **Nigeria –** Nigeria's outlook remains particularly murky with the twin negatives of COVID-19 and oil. We have revised our previously constructive view on recovery, albeit slow, to negative. The allocation to Nigeria is lower for the time being. Three catalysts will change our view to a more positive stance: 1) full devaluation of the NGN 2) normalisation of the local bond market and 3) Dangote's mega-project fuel refinery coming online. The underlying portfolio companies are very robust in a tough environment. **Egypt/Morocco –** Egypt and Morocco will see some pressure from lower tourism on consumer demand but we expect the overall impact on macro to be relatively muted. In addition, the businesses we have selected are hedged against lower consumer demand. We are therefore comfortable holding larger positions here. **Kenya –** Our view on Kenya is more

negative for 2020 but we have not altered our relatively positive medium term outlook. We expect investments here to remain robust and rebound strongly as the economy recovers. **Mauritius –** Mauritius is very dependent on the timing of large scale tourism recovery. Unless tourism comes back strongly in 2021, the macro and MCB will be under pressure.

Piecing together COVID-19 and Payments mosaic

After a number of engagements with management and analysis of results of portfolio and non-portfolio companies in the Payments and non-cash space, we are starting to develop a clearer picture of the impact of lockdowns. The spending patterns and consumption habits have also given us insight into other sectors of the economy and help with interpreting first half and specifically second quarter results.

Over and above Fawry, Safaricom, HPS and our bank holdings, some of the interesting points have come from Bee and Masary, the number two and three players behind Fawry, as well as Sonatel, the dominant telco and mobile money operator (Orange Money) in Senegal, Mali, Guinea and Sierra Leone.

Going into the pandemic, we had asserted that Covid would be a tailwind to the cash to non-cash theme. Overall this has been the case, but with a number of positives and negatives. In terms of the negatives:

- **Merchant closure/inactivity** - as we saw from Label Vie's market share gains, a number of mom 'n pop stores, market stalls and other merchants in SME and informal sectors were closed, either by law or because the merchant simply could not or did not want to risk working.
- **Non-essential services -** Network International, a Middle East (with some African ops) Payments company, disclosed spending trends within their merchant solutions division (similar to Fawry). For now, the bulk of their operations are in UAE and Jordan, but it remains relevant for our markets.

H1 trends in directly acquired Total Processed Volume (TPV) [1]

Directly acquired TPV, y/y	Jan	Feb	Mar	Apr	May	Jun
Total	5%	3%	-28%	-59%	-46%	-34%
of which Retail	12%	2%	-39%	-75%	-43%	-30%
of which Supermarkets	5%	17%	40%	24%	6%	11%
of which Travel & Entertainment	0%	-11%	-62%	-93%	-85%	-78%
of which Other (Government, Healthcare & Education, Other)	5%	10%	-16%	-51%	-40%	-20%

Positives:

- **Forced first time adoption -** Importantly, this is not just for customers, *but merchants* as well. We believe this was the single most powerful trend. As attractive as a service might be, technophobia, dispersed populations and poor access to technology and hardware are major obstacles. Some companies are saying that this has accelerated their business models by three years and saved huge amounts in promotion and advertising.
- **Increased use of some services** - as we see in the table above.

- **Remittances direct to mobile money wallet or bank account**– remittances from workers abroad is a significant source of FX and income for Africa. Western Union et al, forced to accelerate efforts to send money direct to mobile money wallets as their local outlets shut, as well as being safer for the recipient who can now receive their money without leaving home. Visa and Mastercard partnering with local banks to achieve the same.

Interesting Data Points from the MTN results release

Going through the Nigeria and Group results for more granularity than the summary headlines.

MTN puts out a lot of data in their interim and FY releases. A couple of points I picked up:

- **MTNN – subscribers grew 15.6%**, while Voice revs only grew 2.8%, that means Voice ARPU strongly down. That's not alarming given Covid, what's interesting is how much longer can subscribers grow double digit. Looking at the attached file, cell D598 in green, that's an incredibly low population penetration rate, given dual sims (why a country can be >100%). That's a very low rate, combined with a young population, gives a long runway for just the basic service, albeit at incrementally lower ARPU.
- **MTNN** – Data subs grew by 40% yet Data revs by 58%, that means higher ARPU. Interestingly looking at the MB used per active user, Nigeria and SA are about mid-table. Interestingly Kenya/Safcom is only 1,100 MB per active user per month. Ghanaians clearly love data!
- **MTNN – MoMo subs at 2.2m.** not much vs Safcom at 25m, but it was zero this time last year.
- **Smartphones** – a high absolute number in Nigeria, but still low percentage.
- **Sites** – SA and Nigeria are BIG. Nigeria 4G roll out still some way to go as percentage of 3G sites. Safcom has 4,500 4G sites as a size reference. Looking down the column, Africa generally has some way to go in getting 4G sites up to 2 and 3G levels. That corroborates what Helios Towers said, that 3G sites in Africa only just caught up 2G and that there is still tons of growth in 4 and 5G ahead.
- **Outgoing Minutes of Usage (voice)** – SA way lower than rest of Africa, which I think is because SA uses fixed line at home and office way more than rest of Africa, where most countries don't have a fixed line network.