Monthly Market Report

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Region: Africa ex South Africa
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Market snapshot

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

Jan Performance (%)	LCY	USD
Egypt	8.4	9.8
MSCI EM	8.7	8.7
Kenya	7.1	8.4
MSCI World	7.7	7.7
Zambia	8.2	7.6
Botswana	0.3	4.6
Tunisia	-0.1	0.7
Mauritius	-0.3	-0.1
Morocco	-0.1	-0.1
Nigeria	-2.8	-2.4
BRVM	-3.3	-3.3

On the back of softening global outlook (China, Germany, US) the Fed's more dovish stance is noticeable. Traditionally, our markets are positively geared to a weaker USD, and again we can see the positive effect of any USD retreat. As expected, the most responsive currency was the ZAR, up almost 8% vs the EUR and USD. The EGP and KES recorded minor gains.

From an individual market perspective, Egypt 9.8% and Kenya 8.5%, with the only major decliner being Nigeria down 2.4%. Our portfolio, had strong gains in Kenya and Egypt - performance was mainly driven by mining and property sectors while we focus on consumer/retail themes which had relatively poor performances in the month.

Economic and political overview

Nigeria – Overall not much has changed and the market is in a holding pattern with some selling pressure. To be expected as all eyes on the presidential election on the 16th of February. Interestingly over 70 candidates but only 2 realistic ones with the incumbent Buhari seen as the favourite.

Inflation again remained the same, at 11.4% y/y (Nov: 11.3%, Oct: 11.3%) so MPC expected to stay put as inflation is above target.

PenCom, the pensions regulator, recently announced a Micro Pension scheme to address the SME and vast informal sector. The scheme aims to ultimately capture 20m new members of the roughly 60m addressable market and would increase total pension assets from just under USD25bn to close to USD35bn. This bodes well for long term financing and the capital markets.

Egypt – Overall positive reinforcement of several macro items. Tourism, gas, remittances, subsidy reforms all seem on track. As expected by the CBE, headline inflation in Egypt dropped to 12% y/y (Nov: 15.7%). Fruit and vegetables prices dropped 21% m/m as expected.

Reform progress is tangible. Minister of Petroleum mentioned that the fuel subsidy reduced by 15% in 2018 to EGP43bn. In April we expect another round of subsidy removals. The lower oil price offsets inflation pressure somewhat in our opinion. After April, we do expect more talk of a cut if the inflation outlook supports it. The Minister of Finance said that real GDP growth to June 2019 expected at 6.5% from 5.3% previously.

Remittances +5.7% to USD23.3bn.

Unemployment dipped to 8.9% in 4Q 18 from 10.0% in 3Q 18.

The EGP appreciated slightly on the back of recent good macro news (clearance of FX window, GDP updates and reform progress) plus a renewed foreign demand for T-Bills.

Gas production expected at 8bn cf in 2019 from 4.5bn cf in 2016. Local demand is 6.5-7bn, which leaves 1-1.5bn of export potential. This is significant as it would take them very close to peak exports in mid-2000's of 2bn cf.

Kenya – Reviewing 4th quarter data it is likely that a pick-up in remittances and an acceleration in credit in October stimulated greater household spending. Moreover, PMI readings for Q4 indicate private sector activity remained resilient. IHS Markit Stanbic PMI was 53.6 in December vs. 53.1 in November.

On the negative side, slower corporate earnings prompted the Kenya Revenue Authority to reduce its revenue target for the current fiscal year by 5.0%. Also negative, a hotel and office complex in the capital came under attack from Al-Shabaab militants on the 15th of January. Unlike Egypt, where terrorism is embedded in political opposition, we do not agree with a narrative painted in the media that this may be negative for FDI or tourism. Kenya's stated foreign policy is a strong alliance to the US and therefore it will sporadically experience attacks from outside Kenya with no long lasting economic impact.

Central Bank of Kenya MPC held the monetary rate at 9% as inflation remained within target and is expected to decelerate. The MPC said economic growth is expected to remain strong in 2019. IMF sees economy expanding 6%. National Treasury estimates 6.1%.

Remittances +39% y/y for 2018 to USD 2.7bn. The exact amount to come back from the Amnesty program is not known, but at June 2018, USD130m or 7% of the incremental growth had come from India.

Current account data just released show the tangible effect of the above, with Kenya's FY18 CAD improving, with a fall to 4.9% from FY17's 6.3%, as food trade, remittances and tourism improve.

Morocco – Unemployment rate dropped to 9.8% in 2018, from 10.2% in 2017. The Moroccan economy created 112,000 jobs last year, including 21,000 in rural areas, up from 86,000 jobs in 2017. Services created 65,000 jobs, while construction and manufacturing created 15,000 and 13,000 jobs, respectively. Bank Al Maghrib released its latest banking statistics for the end of December 2018, showing loan growth of 3.2% driven mainly by real estate loans which were up 3.6% (mortgage loans up 5.6%).

Company updates

CIB (Egypt, Financials) FY18 results: Strong PBT +30% y/y. Both a yield and volume story. On the volume side, deposits +16% (FCY+4% and LCY +20%) and loans +20% while on the margin side, NIM expanded from 4.4% in FY17 to 5.5% in FY18, a 25% margin increase. The yield side reflects another leg up in T-bill yields during the year and more higher priced loans in the asset mix. Overall net interest income +45% y/y while fees/trading a relatively pedestrian +10% y/y. Opex and provisions did spike up. On provisions side CoR was 2.9% from 2% in 2017. Management prefers a large provision buffer when earnings are good but with an NPL of 4% and coverage of 270%, we do expect CoR to decline. Management guides to +25% y/y earnings growth in 2019 based on the same themes (growing LCY deposits, some lending pick-up) and we suspect a slower CoR may bolster y/y earnings.

EABL (Kenya, Consumer Staples), 1H 19 results update: A good set of results from EABL, albeit off a low base. 1H19 net sales (NSV) +13% y/y, driven mainly by a recovery in Senator volumes, a strong performance in Tanzania (Serengeti Lite) and mainstream spirits. Overall NSV +12% y/y in Kenya, +12% in Uganda and +26% in Tanzania. A positive mix effect from Senator Keg (lower cost) and productivity savings resulted in COGS/Case dropping 5% y/y partially offsetting the 16% growth in selling and distribution expenses as the company continued its aggressive investments in brands. Operating profits +23% y/y and EPS up +25% y/y. Commercializing Kisumu brewery will be the core focus for 2H19.

Market outlook

Nigeria – Results confirm a slow recovery and a path to normalisation of the economy. For the most part, consumer companies are able to shift volume and we expect pricing to improve on the back of consumer income recovery. We maintain a large allocation to banks and the top consumer names in the food and beverages sector. Valuations are deeply discounted and attractive. Our preferred banks are well positioned to make money from fees. Overall, banks will make less profit from yields as the curve drops, but higher NGN liquidity, strong growth in trade facilities (LCs) and mobile bank fees will still mean good growth in earnings. Consumer names we hold have traded through tough consumer conditions to gain market share, the announcement of an expansionary budget points to increased liquidity pre-elections, which could be a nice kicker to 2H18. In the same breath, pre-election instability remains the biggest risk factor to a strong recovery.

Egypt – The economic recovery is continuing as expected and most management teams are positive and expect conditions to improve further. We see volumes recover as wages catch-up to inflation and this is further supported by corporates restocking as demand picks up. Upside risk to inflation from subsidy removal and rising oil prices, but there is enough positive momentum to maintain the growth trajectory.

Kenya – The political decision not to remove interest rate caps remove the opportunity for an asymmetric trade on the banking shares and reduces economic momentum. Despite, a less optimistic outlook, we remain invested on the payments and fintech theme which we play through telco and banking.

Mauritius – The country continues its moderate recovery and we are happy to see the BoM continuing to mop up excess liquidity, which is pushing up money market yields. The 1q19 to September MCB numbers reflect this, showing NIM expansion and loan growth acceleration.

Morocco – Our outlook remains unchanged, we continue to search for attractively priced growth investment opportunities with our existing investments showing moderate growth and attractive dividend yields**.**

Zimbabwe – We have always taken a long term view to Zimbabwe, preferring to look through the political noise and focusing on identifying corporate champions that can generate shareholder wealth no matter the environment. OMIR allows us to get both liquidity and a reasonable valuation as we wait. Bottom up, the 1H18 corporate results are very strong and the companies in our portfolio have survived hyperinflation before and they have highly capable management teams. Key to Zimbabwe's economic recovery is a fresh capital injection and debt forgiveness/restructuring, we believe that announcements signalling progress in this regard will be catalytic for our investments in the country.

Valuation commentary

Overall, we invest in two types of investment cases. One, fairly priced businesses which have a very strong business model coupled with superior returns to the market and competitors and two, where businesses have superior returns and deep discounts to fair value, often driven by near-term pessimism. The former will provide superior returns and the latter outsized returns. Pessimism and poor market sentiment has generally driven more investment cases into the latter category. In general, forward multiples are at low levels and several cases at deep discounts to what we think is fair. Nigeria and Kenya in particular are at very attractive levels which provide more opportunity for outsized returns. From our recent strategic review, we reaffirmed Equity Bank and Nigerian Breweries in our Top 5 ranked opportunities based on outsized return potential and valuation.

- Equity Bank, trades at 1.3x forward 2019 book, where the 5yr average is 2.2x and our PB method yields a fair value of 2.1x. Underpinned by ROE of 24% near its 5yr average of 26%.
- Nigerian Breweries trading at 6.9x 2019 EV/EBITDA with 5yr average at 12x and our fair value at 10x. We expect a move back to 25% ROIC in 2019 from current 22% vs. 5yr average 25%.

Safaricom, Stanbic IBTC and CIB complete our Top5, themselves having periods of discounts we have not seen before. Strong recent performances closing some of the discount to fair value.