IMARA
Asset Management

Monthly Market Report

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Market snapshot

November saw some firming after the sharp declines in October. Morocco and Botswana rose 3.0% and 2.6% respectively, while the recovery was more muted in Egypt and Kenya, up 0.5% and 0.7%. Zimbabwe was down 2.0% and Nigeria continues to struggle, falling 5.2% as crude oil prices fell off sharply in the month. Currencies were reasonably stable.

Economic and political overview

Nigeria – External reserves dropped to USD 42bn, down from a peak of USD48bn in June this year. Although reserves remain high, monthly reserves have dropped by an average of USD1.7bn per month since July. At current levels, FX reserves equate to 16 months of import cover, with oil prices dropping close to USD60 per barrel, the reserves will be particularly important as the CBN is likely to defend the Naira headed into elections.

October inflation came in at 11.26%, slightly lower than the 11.28% recorded in September, although food inflation remains elevated at 13.28% y-o-y for October. We were hoping for progress on the minimum wage issue, but for now the recommendation of a wage hike from N18,000 to N30,000 hasn't been followed, with State governors continuing to argue that there is no capacity to pay this, with some states still in arrears. On a positive note, the monthly FAAC distribution to the three tiers of government amounted to N788bn (USD 2.6bn) in November (from October revenues), this was up N89bn from the previous month.

Lastly, the MPC met between the 21st and the 22nd of November, and they decided to keep the MPR unchanged at 14%. The MPC communique makes for interesting reading, the committee notes the positive outlook for domestic output growth evidenced by expanding PMI (both manufacturing and non-manufacturing), both indices up now for 18 consecutive months. However, the underperformance of monetary aggregates remains a concern for the CBN, with broad money (M2) up 6.52% in October 2018 (7.82% annualized), below the provisional benchmark of 10.48 per cent for 2018. Of particular concern was the credit to the private sector, which grew 1.94% (annualized 2.33%), well below the 2018 benchmark of 12.4%. The MPC maintained a GDP growth projection of 1.75% in 2018. In concluding the committee expressed its concern about weak growth expectations and mounting uncertainty in global financial markets, which raises risks to both the economic recovery and inflation outlook.

Egypt – Headline inflation in Egypt rose to 17.7% y-o-y up from 16.0% in September. The CBE MPC met on the 15th of November and decided to keep all policy rates unchanged. The MPC statement mentioned that a key driver of the decision to hold policy rates, was due to the transitory nature of the supply shock related to fresh vegetables. Fresh vegetables contributed 7.6% to the CPI basket (usually contributes between 3-5%) due to a 146% increase in the prices of potatoes and a 43% and 47% for tomatoes and onions respectively. Nonetheless, the CBE reiterated its view that inflation will moderate to single digit levels once the impact of fiscal consolidation measures dissipates.

In a sign of confidence in the macroeconomic conditions in the economy and a further push towards liberalizing the FX policy, the CBE scrapped the repatriation mechanism, it officially ends on the 4th of December. Currently Egypt has USD 44.5bn in reserves (8months import cover) which gives it a comfortable buffer against any further portfolio outflows.

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On a negative note, the Ministry of Finance (MoF) proposed a T-bill withholding tax change, whereby they want to split banking income into two pools and tax them separately: 1) income from treasuries, subject to the 20% withholding tax and 2) income for the rest of the bank, to be taxed at the corporate rate of 22.5%. We had a conference call with the largest private bank in Egypt (Commercial International Bank) and management highlighted that although it is negative, the impact will only be felt in FY20 as the law is not being applied retrospectively. We believe that treasury yields will go up and lending should go up, which partially offsets the negative impact of the proposed law. Commercial International Bank reassured investors on the conference call that the risk profile/asset quality of loans will not be compromised in order to grow lending. We expect some back and forth between the MoF and the Egyptian Banks, but the general view is that cabinet wants to pass the new tax law before year end.

Kenya – We visited Kenya this month and we met the large listed corporates as well as the IMF. In the meeting with the IMF we further discussed the debt sustainability analysis of the country as well as their view that the KES is 17.5% overvalued. Whilst we agree that the KES is overvalued, we are of the opinion that the country will successfully refinance its 2019 Eurobond. Although credit growth remains weak, GDP growth remains high, with a growth projection of 5.5%-6% this year. In 2Q18 they achieved GDP growth of 6.2%. Inflation remains low relative to African peers and whilst we remain concerned about the growing composition of USD commercial loans in the country debt mix, we are confident in the ability of the central bank and policy makers to manage themselves out of the rising debt levels.

A key concern for the IMF was the lack of implementation of reforms needed to reduce the budget deficit as well as a lack of progress on rate cap modification. From our meetings with the Kenyan banks, they still believe that there will be a form of rate cap modification and it is a question of when and not if. The IMF supports rate cap modification, their recommendation is that they remove the floor and delink from CBR and move the ceiling/cap upwards (in a manner that doesn’t constrain ability to price risk), this would enable the banks to start lending again and price risk appropriately.

We have included notes from our Kenya trip on two of our investments at the end of the note. We are particularly excited about the pace and breadth of Fintech growth and innovation.

Morocco – Inflation for October came in at 1.1%, with non-food at 2.0% and food at 0.8%. Inflation for the full year is expected to come in comfortably below the 2.0% level.

Zimbabwe – We visited Zimbabwe this month. We had meetings with several of the large listed companies and we went to the informal market too, to get a feel of activity on the ground. *Summary company notes from the trip are included at the end of the monthly report.* Despite the challenging trading conditions, most of our underlying investments in the country reported robust interim results that saw volumes up significantly. The real test comes now, post the money transfer tax and the negative impact on activity. Shortages have worsened and speculative pricing has kicked in. On a positive note we are hearing that government has stopped issuance of treasuries and in the FY19 budget the Finance Minister reiterated that he remains committed to achieving a sharp reduction in the budget deficit from an estimate of 11.8% this year to 5% in FY19. Given that government is past the election hump and the ruling party controls 2/3rds majority, we hope that they can implement some of the policy reforms necessary to enable this. Cabinet was put in place from September so it is still too early to tell whether this team has been effective or not.

Company updates

IDH (Egypt, Healthcare) 9M 18 trading update: Revenues +25%, driven by tests +4% and rev/test +21%. Ahead of rev guidance of 20%. Walk in performing very strongly with revs + 34% and contract revs +20%. Gross Profit +29% with the biggest contributor being raw materials +9% and only +5% on a per test basis. Management put it down to mix and negotiating more favourable cost rates. Salaries and wages up a significant 32%, driven by necessary increases and incentive costs for increased revenues. Other expenses, mostly utilities up 35% from the July 2017 and 2018 hikes/subsidy removal. They expect the last hike in 2019. EBITDA margin was 39.4%, ex Nigeria the EBITDA margin would have been above guidance of 40% at 41%. EPS +26% aided by interest income growth.

Safaricom (Kenya, Communications) 1H 19 results: Another very solid performance, with an overall view that revenues were slightly light at +7%, but more than offset by lower costs +1%. The cost trends were well flagged by the company and driven by reduced agent commissions as MPESA moves from an in/out transfer service to a multi transactional one. Voice revenue was +1%, MPESA +18%, Mobile data +11% and Fixed data +21%. Mobile data was slightly soft, due to the very aggressive pricing strategy adopted by competitors. Fixed data is driven by the FTTH roll out, with 212k homes and 2k businesses connected. Home penetration is 38% or 79k customers. EPS was +20% on lower D&A and interest.

Delta Zimbabwe (Zimbabwe, Consumer staples) 1H19 results: A very strong set of results. Revenue was up +37% and PAT up 79% on the back of a significant expansion in operating margins from 17.2% to 22.3%. Lager volumes were particularly strong up 54%(peak levels post dollarization), sparkling beverage volumes were up 3% and Sorghum beer volumes were up 2% (Chibuku super up 41%). We were encouraged by the results given the environment. TCCC have been supportive extending credit to Delta despite the USD shortages. Management is pursuing regional expansion opportunities in opaque beer, Zambia is currently doing well and efforts are being made to shift mix towards Chibuku Super, volumes were up 13%.

Econet Wireless (Zimbabwe, Communications) 1H 19 results and corporate action: Excellent set of results with Revenues +70% and EPS +148%. Significantly, Voice now only contributes 31% of revenues and has been overtaken by Smartech at 41%. In addition to being the dominant telco in voice and data, they have firmly established themselves as the dominant platform for non-cash payment. They are also increasingly developing and deploying innovative services to the people and industries that are compelled to interact with and use this platform. Besides the obvious industries like banking and insurance on the platform, government payment and the agriculture sector are huge potential sources of service and hence revenue.

In addition to the above, the Group is also separating its telco and Fintech/Mobile Money businesses (Cassava Smartech), which should create tremendous value for investors. They are also switching from 51% ownership of Liquid Telecom Zimbabwe (a fibre and content company), to c12% ownership of Liquid Telecom International.

However, this has been completely overshadowed by corporate actions which are detrimental to minorities and exhibit poor corporate governance. Action by minorities, including ourselves, both through voting and concerns raised with the Zimbabwe SEC and the company itself, seem likely at this stage to cause management to revise these actions.

Market outlook

Nigeria – The results season confirms a slow recovery and clear path to normalisation of the economy. For the most part, consumer companies are able to shift volume and we expect pricing to improve, especially later in 2018. We maintain a large allocation to banks and the top consumer names in the food and beverages sector, valuations continue to look attractive. Our preferred banks are well positioned to make money from fees. Overall, banks will make less profit from yields as the curve drops in 2018, 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 are seeing 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 removes 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 latest inflation numbers are encouraging and supportive of the BoM monetary policy.

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.

Key company notes from our recent trip to Kenya, Zimbabwe and Zambia

Safaricom

- Overall were comfortable that GDP should grow above 5% for 2018, but concerned about increased taxes.
- Very positive about MPESA regional expansion and global payments.
    - Currently market share is 13% of remittances.

- Partnering with Western Union so that MPESA users can pay money anywhere in the world. Over 500k partner agents globally (parents paying fees for children, sending pocket money, travel money, etc).
  - Also bringing in the QR app via MPESA and enhancing the use cases for enterprise payments.
- 60% (and rising) of airtime top-ups are now via MPESA, there are three salient points worth noting about this:
  - No agent commission.
  - Good for the environment – scratch cards and paper slips are a huge source of litter.
- Moving away from an in-and-out credit/withdraw commission model, to a multi transaction model in between credit and withdrawal. Airtime top up is an example of this.
- On potential FX weakness. 10% of Opex and 35% of capex is USD.
- On Masoko, their online platform:
  - Jack Ma came to Kenya recently and was commending their platform because he felt MPESA is a strong payment platform and that MASOKO can leverage this.
  - Masoko still small have 160k agent pick up points.
  - Issues currently with Logistics taking 5 days to deliver, want a shorter delivery time.
- Using a local partner for warehousing.

Equity Bank

- Experienced margin compression in 3Q, NIMs going from 8.6% to 8.1%, in absolute terms though net interest income is growing but still below 2016 levels , yield curve downward sloping.
  - Cost of funds flat but the yield on earning assets is what is dropping, down 0.3% from last year.
  - They have capacity on the balance sheet that they can deploy at a low cost, the leverage will really kick in once they can utilise the capacity and rate cap gets repealed. Interest rate cap repeal a function of when not if.
- Comfortable with group ROE of 23%, within guidance of 22-25%.
- Loan growth target looking a bit high, had guided 10-15%, looks like it will be closer to 10% or perhaps a little bit lower, next year have the same target pf 10-15% loan growth.
- Deposit growth should also be about 10%.
- There is a shortage of liquidity in the system as a whole and that is why the smaller banks will continue to struggle.
- NPLs above target at 8.7%, but well below the sector, which is sitting at over 12% NPLs (stripping out the Tier 1s it is over 20%).
  - The sectors with the highest NPLs are the SME and manufacturing sectors.
- Mobile loans:
  - There has been pressure on non-bank institutions, but as of now they are unregulated.
  - What they have done is to make sure that both Finserve (via M-key) and Equity Bank (via the Eazy app) have comparable rates, they could price higher on Finserve but they aren’t doing so, if regulation comes in they don’t feel that it will be a negative impact because they are already managing the loans to match the Equity Bank (Eazy app mobile loans).

- Had 1.3m loan customers pre rate cap and now c700k, 93% of loans are going through the mobile phone.
- The loan value so far is KES5.2bn as at the end of October via M-Key.
- Low cost promotions are part of a long term strategy to promote digitisation and retail commerce/increase activations, this will come off eventually as network effects grow.

- Finance director role has been filled now, by an ex-KPMG employee moving from the US.
- Excited about the Jenga platform - Jenga API and Jenga payments (e-commerce), the focus is on rolling out JVs and having an open platform VISA/MPESA/AMEX. Currently have 600 companies on the API (payment gateway, Jenga means to build, basically they are building and allowing coders to build ways to make payments).

Econet – meeting focused on Cassava Smartech, the Fintech business being demerged from Econet.

- Cassava Smartech is focused on Smartech as opposed to just Fintech
  - Ideal is to have a balanced revenue stream spanning (right now): Insurance, Agritech, Healthtech Edutech and not reliant on a particular revenue stream.
  - Launch services that will disrupt themselves, working with teams in Israel, blocktain technology and other payment engines.
  - Overtime have to accept that they will be disrupted and they are incubating products that they feel have high revenue potential.
  - Insurance – premiums are high and country is under covered (8% insurance penetration).
  - Health – USD35 per consult is a prohibitively high cost, working on introducing health tips and checkers, that allow remote diagnosis, much cheaper and wider reach.
  - Education – student teacher ratios too high and remote areas aren't getting access, can bring down costs of education and increase reach.
  - Agritech: working with farmers, assisting in crop husbandry and animal husbandry tips, linking to markets to get better pricing.
  - Vaya: ride hailing service, currently have 1500 riders, riders pay with ecocash.

Delta Breweries

- Chibuku ,sold 3.5m hl, still 1m hl shy of the record of 4.5mhl.
- Lager on the other hand is at peak levels.
- Chibuku has been there since the late 70's, but the product hadn't been innovated, it had a short shelf live and live fermentation, economics weren't good.
- Through empirical observation, cross elasticity of 30% between clear beer consumers and Chibuku consumers (3/10 consumers drink both).
- Chibuku – fulfils two needs: meal replacement and an alcoholic beverage.
- Shelf life of Chibuku Super now 30days, want to get Zambia to the same level in terms of mix between Chibuku and Chibuku Super, Zim now 86% super and 14% standard Chibuku, Zambia 45% super and 55% standard.

- 4% alcohol content in Chibuku Super and it is also carbonated like lager beer, pushing to get packaging to the same standard.
- Volume mix now 58% lager, 21% Sorghum beer and 5% soft drinks.
- Separate transport company that runs all, dynamic distribution and the complexity of the market they do need to do that kind of thing.
- Chibuku Super – addressed many issues that they had with the standard Chibuku
  - Live fermenting presented complications on rough roads – bottles rupture.
  - Super standardised taste and modern pack increased penetration in the modern market/urban market.
- Policy risk and currency risk are the key risk areas, they are also feeding into each other, currency risk high because of policy risk.
- On money transfer tax: they were disappointed they weren't consulted, believe the tax should have been focused on informal market and they should have left tax registered corporates out of it, 2% is so high that if absorbed it takes a significant percentage of the margin, especially from retailers.
- FX USD50m hard currency liabilities, on a cash basis.
- Budget announcement on 22 November.
- Cash balance also includes committed cash and shareholders don't have the ability to take out dividends.

- Because they aren't tapping into parallel market, they are pricing in real USD, which is why they haven't taken any price increases in 5 years in lager.
- Believe that Finance Minister is serious about fiscal consolidation, they haven't printed TBs over the past 2months which is a good sign.