IMARA Asset Management

Monthly Market Report

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Region:	**Africa ex South Africa**
Issued by:	**Imara Asset Management Limited**
Author:	**Craig Bandason, Rainer Orth, Tony Schroenn**

Market snapshot

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

April Performance (%)	LCY	USD
MSCI World	3.4	3.4
Morocco	2.6	2.8
Egypt	1.2	2.3
MSCI EM	2.0	2.0
Tunisia	0.3	1.2
BRVM	1.3	0.6
Botswana	-0.3	0.0
Kenya	-0.2	-0.7
Mauritius	-1.1	-0.7
Nigeria	-6.1	-6.0
Zambia	-2.5	-7.3

April was a mostly positive month with Morocco and Egypt performing strongly up 2.8% and 2.3%, while Nigeria fell back strongly at -6.0%.
Notably, the EGP appreciated vs the Euro and USD.

Economic and political overview

Nigeria – Gross official reserves increased by USD2.1bn in March to USD44.4bn. This is reassuring and the main drivers have been:

- Oil revenue, driven by price and volumes as production has stabilized due to reduction in vandalism of oil assets.
- Trades of foreign portfolio investors (FPI's) have also contributed to the pick-up. Since 23 February (i.e. post the presidential election) the investors and exporters' FX window (NAFEX) has recorded inflows of over US$5.0bn, with FPI's accounting for 73% of the total.

Reserves at end-March covered more than 13 months' merchandise imports, a healthy buffer.

Nigeria's inflation rate has decelerated to 11.25% for the third consecutive month in March 2019, to reach its lowest level in six months. A lower figure is encouraging, as it gives the government some degree of flexibility in executing the minimum wage and pursuing their infrastructure improvement plans.

Egypt – Moody's upgraded Egypt's long term foreign and local currency rating by one notch to B2, while at the same time changed the outlook to stable from positive. The rating agency justified the upgrade to the "fiscal" improvement seen in addition to a strong nominal GDP growth. They said that a marked improvement in debt affordability or an improvement in non-hydrocarbon exports would warrant further upgrades. Despite this, they acknowledged that Egypt's fiscal metrics remain "very" weak compared to similarly rated sovereigns.

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This is a trend we see across Africa, where taxes (excl commodity extractive) are weak and are attributable to a large, mostly untaxed informal sector. We believe our key trends of increased formalization and financial inclusion are key drivers to fiscal improvement and access to cheaper funding.

Headline inflation fell to 14.2% y-o-y in March from 14.2% in February, while core inflation fell to 8.9% from 9.2%.

Kenya – Kenya's annual headline inflation rose to 6.58% in April, from 4.35% in March, mainly on account of rising food inflation and pump prices of petrol and diesel. Food inflation was mostly driven by a rise in the price of maize flour, with millers raised prices of the former following reports of a potential drought given the delayed long rains. These pressures are likely to persist, however we expect late and sporadic rainfall rather than a full blown drought. It is also worth noting that increased economic diversification and low bank exposure (our picks) to agriculture should mitigate risks.

Morocco – Morocco's budget deficit in 1Q19 was down 63% Y-o-Y to MAD3.6bn, according to the General Treasury. Receipts rose by 11.8% to MAD63.5bn, led by an 8.6% increase in tax receipts, which reached MAD59.6bn. We expect this trend to continue in Q2 19 as we have noted in corporate results that a number of companies have made settlements with the tax authorities for the 2018 fiscal year, as well as corporate taxes rising from 30% to 33.5%.

Zimbabwe – We traveled to Zimbabwe this month. We were positively surprised by the level of retail activity in the stores, despite the domestic hyperinflation. In addition to the usual corporate visits we spent some time visiting the trade in order to understand consumer activity at the point of contact. What we have spent a lot of time trying to understand is the fair value of a Zimbabwean dollar. An exercise we did this month was to compare the price of a basket of goods in Zimbabwe and the same basket in South Africa (converted to USD at the prevailing USD/ZAR rate). A basket consisting of 1l cooking oil, 1kg rice, 1kg salt, 1kg mealie meal, 1kg sugar, 1kg oats, a pack of tea and a can of baked beans will cost you RTGS$80, the same basket costs you USD18,50 in South Africa. Taking RGTS$80 and dividing by USD18,50 you get an implied RTGS$/USD exchange rate of RTGS$4,33: USD1. The Old Mutual Implied Rate (OMIR) is RTGS$6,21: USD1, Parallel Rate RTGS$5,20:USD1, Interbank FX RTGS$3,18:USD1. Currently we are valuing all Zimbabwe positions at OMIR, the most conservative rate. If we start seeing tangible liquidity in the interbank market we would shift our approach but at the moment the Old mutual mechanism remains the only way to get USD liquidity.

On a company level, from our meetings with management, everyone is trying to get their heads around price elasticity. The magic number seems to be RTGS$4:USD1, if you price your product at this rate or below, you are still getting volume growth. If you go above this number you are losing volume. RTGS$ haven't full adjusted across the economy but are starting to go up in the private sector, so a smart pricing strategy is essential. The premium end/higher income end, tends to be less price elastic because of access to USD income streams or savings. This price volume trade-off seems to be playing out differently within our companies but net-net we should still see topline growth, with the better players growing in line with inflation. Opex is likely to increase sharply as labour costs, electricity and council rates have remained stable but it is likely that these will go up as well. Hard currency payables (USD payables mainly) remain a significant issue to the manufacturing sector and we expect some currency losses to come from these liabilities when companies account for the RTGS$:USD1 exchange rate.

Company updates

Guaranty Trust Bank (Nigeria, Financials) 1Q19 PBT +8% y/y was a good set of results. Highlights are 1) deposits +6.6% YTD vs. 12% expectation for 2019, therefore well on track 2) fees and commission +28.5% y/y, and 3) no credit provisioning. This all helped to offset lower margins from loans and fixed income. NIM is now 16% lower at 7.3% vs. March 2018 NIM of 8.7%, to be expected as the yield curve moves lower. Loan growth +1.8% shows a return to lending after a 14% contraction of the loan book in 2018. The valuation, 1.6x book and 8.7% dividend yield, is very discounted and attractive given its ROE of 36%.

Stanbic IBTC (Nigeria, Financials) 1Q19 PBT -11% y/y. Results satisfactory considering high base of 2018 (1q18 was boosted by a substantial provision write-back). Excluding provisioning noise, PBT was +3% y/y. NIM is stable at 6.5% which is impressive in a declining yield environment, mainly by reducing term deposit funding. Low cost deposits is now 65% of funding base versus 58% in March 2018. ROE recorded at 32.5% and trading at 1.8x book.

Nigerian Breweries (Nigeria, Consumer Staples) 1Q19 results update: A decent set of numbers from Nigerian Breweries (NB). Topline beat our expectations and EPS was in line. Commentary from Heineken parent mentioned that volumes grew mid-single digits and that volumes last year were affected by destocking. 1Q19 gross sales were up 3.33% but net sales were up 0.4%, reflecting the higher excise duty. GP margins were good at 42.1% which is closer to normalized levels and OPEX growth remained lower than inflation. We are encouraged by NBs cost cutting initiatives and smart pricing strategy but we feel that the industry will only return to profit once competition raises prices in not just mainstream and premium but in the value segment as well. The environment remains challenging and one of their main competitors increased prices in the mainstream segment only to reverse the decision, which shows that the consumer remains under pressure. The beer industry has now had 7 quarters of relatively flat prices with both NB and other players reversing price increases. Overall EPS was down 21% y-o-y to NGN1.00.

Unilever Nigeria (Nigeria, Consumer Staples), 1Q19 results update: A disappointing set of numbers from Unilever. 1Q19 revenue was down 21% y/y, Food revenue was down 13% y/y and HPC revenue was down 27% y/y. From pricing surveys we see that pricing was flat so the assumption is that the decline in revenues was volume driven. At the moment we haven't received any news of a supply disruption, so it seems that there is a distributor issue, or an inventory build up issue at a distributor level. Trade receivables have been growing and the quarterly miss is concerning. 1Q19 has been a difficult quarter for most of the Nigerian private sector and consumer disposable income remains weak. Elections we held in February and there were several delays to voting and this may have been a factor. Costs were cut and opex was down 24% y/y but EBIT margins still contracted to 6.7% for 1Q19 compared to 13.7% in 1Q18. We will obtain more colour from management on the 8th of May 2019 on their results call and we will be revising our forecasts for the year accordingly.

Nestle Nigeria (Nigeria, Consumer Staples), 1Q19 results update: Good results from Nestle Nigeria with topline slightly behind expectations but operating profits in line. Nestle's 1Q19 revenues were up 5% y/y, with the beverage segment up 4% y/y and the food segment up 6%y/y. COGS were down 5.4% y/y, mainly due to lower prices for Cocoa, Sugar and Wheat. Opex however was up 10.6%, with marketing expenses up 15.5% y/y. Stripping out the impairments from the base, operating margins expanded by 110 bps to 26.9%. Overall EPS was up 49% y/y (including the impairments in the base).

Nestle launched an extension of the Maggi brand (seasoning/bouillon) - Maggi Signature in the South-South region. Sales of Maggi are highly concentrated in the North of the country and Nestle has been expanding its brand offering in the south in order to both defend and grow market share in the region.

HPS (Morocco, IT) FY18 results update: HPS reported a strong set of results, with the second half being particularly strong. Revenues were +18.3% and operating leverage brought EBIT up 22.7%, despite a 20.3% increase in R&D. EPS rose 29.8% on higher interest from a building capex net cash balance. DPS was increased 25% to MAD 50. Encouragingly, looking out to 2019, the Backlog grew 50% on new contract wins and increased demands from existing customers. The expansion into Asia with the opening of a Singapore office is getting some traction with contract wins in Indonesia and Cambodia.

Maroc Telecom (Morocco, Communications) Q1 19 results update: A mixed set of results, with revenues down 0.5% and EPS flat. The dynamic seen last year of stronger domestic Moroccan performance, offset by weak Francophone West Africa performance, continued in the quarter. The higher corporate tax rate in Morocco also weighed. The key growth area, mobile data in Morocco, continues to perform strongly, with subscribers +12.9%, however outside of this it is difficult to see where meaningful growth will come from, given the absence of mobile money.

Equity Bank (Kenya, Financials) announcement on potential acquisition: Equity Bank announced an agreed term sheet with London listed Atlas Mara to buy selected assets in Rwanda, Zambia, Mozambique and Tanzania. Subject to a final due diligence and approval, the deal will be funded by a swap of newly issued shares equal to 6.7% of existing shares or USD105m. The acquisition will add USD470m or 16% to Equity's loan book. We think the Rwanda acquisition is particularly interesting. Equity would acquire a majority 62% stake in the sizable Banque Populaire du Rwanda. A review of the numbers show a 7% ROE bank with poor cost efficiencies and a sizable loan book of USD190m with an acceptable 7% NPL ratio. We think Equity can generate value by merging BPR with its existing Rwanda operation, upscaling and using technology to increase efficiencies. As with Rwanda, its Tanzania subsidiary can move to a larger platform challenging larger players. We also like the fact that the deal is not too large and should not detract management from its core Kenya strategy. Pre-deal, Kenya is approximately 85% of Group.

Delta Zimbabwe (Zimbabwe, Consumer Staples) 4Q19/FY19 (March Y.E) trading update: Decent numbers from Delta in line with expectations. Lager beer volume declined by 3% y/y for 4Q19 and up 31% y/y for FY19. Demand has dropped due to the increase in RTGS$ wholesale and retail prices. Sorghum beer volume (Zimbabwe standalone) declined by 2% y/y for 4Q19 and up 5% for the full year (Chibuku Super contributed 85% of volume). Natbrew (Zambia) recorded a volume decline of 24% y/y for 4Q19 but flat on FY19 y/y. Demand has dropped following some price increases and down trading to subsistence offerings. The sparkling beverage business continued to struggle due to non-availability of imported raw materials and it was virtually closed for the quarter. Volume declined by 89% compared to the prior year 4Q19 and down 44% for FY19. Operations have started again and they are working on solutions with The Coca-Cola Company to restore the business. Overall group revenue will reflect an increase of 33% for 4Q19 and 26% for FY19. The local currency (RTGS$) has been adopted as the functional currency and they will use the Interbank FX rate RTGS$:USD1. The FY19 numbers will be distorted by the change of currency, Delta maintained stable pricing for the nine months and only partially rebased

prices in the fourth quarter. The full impact of the introduction of the inter-bank exchange rates on the Group's financial position is still being assessed, FY19 results will be out on the 16th of May.

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, with the new minimum wage adjustments, we should see this happen in 2H19. 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. Since we are past the election hump we hope to see more expansionary monetary policy and credit creation to stimulate growth and spur the economy out of this early recovery phase.

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. The earlier than expected 1Q19 cut in rates should further support growth for 2019.

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. However, low inflation and a multi-year investment in infrastructure have created a platform for strong real GDP growth. On a bottom up basis, we remain very optimistic on the payments and fintech growth theme which we play through telco and banking.

Mauritius – Our investment in Mauritius, MCB, is doing extremely well, with very strong momentum in trade finance. MCB continues to grow earnings above GDP and expand NIMs, increasing the ROE further above the cost of capital and creating scope for further rerating.

Morocco – We continue to search for attractively priced growth investment opportunities with our existing investments showing moderate growth and attractive dividend yields. We recently added Label Vie (supermarket, hypermarket, cash n carry), which we believe is well positioned to benefit from low formalized retail penetration in the country.

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. 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.