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) –

Feb Performance (%)	LCY	USD
Tunisia	1.3	0.2
Botswana	0.7	-1.8
Morocco	-2.2	-2.3
Zambia	0.0	-3.9
Mauritius	-1.6	-5.1
BRVM	-4.4	-5.1
MSCI EM	-5.3	-5.3
Egypt	-6.5	-5.5
MSCI World	-8.6	-8.6
Kenya	-8.3	-9.1
Nigeria	-9.1	-9.5

Markets plummeted as Africa saw the first few cases of coronavirus hit its shores amidst the global panic this month. Egypt and Nigeria were directly affected. Negative performances from Morocco -1.6%, Egypt -5.0%, Kenya -8.4% and Nigeria -8.8%.

Economic and political overview

Nigeria – 4Q19 GDP came in at 2.55%, up from 2.28% in 3Q19. This was buoyed by oil economy growth +6.4% y/y and the non-oil economy +2.3% y/y. The IMF cut Nigeria's GDP forecast to 2% for 2020 (down from 2.5%), citing weak trade terms and capital flight.

The first case of coronavirus in sub-Saharan Africa was reported in Nigeria. The patient returned from Milan and is being treated in Lagos.

Macro releases included (January stats):

- Inflation inched up to 12.13% (Dec: 11.98%), border closures adversely affecting food prices.
- PMI fell marginally to 55.9, with soft private sector expansion (Dec: 56.8).
- FX reserves dropped to USD 38.01bn (Dec: USD 38.6bn), reflecting capital outflows. This has declined further in February by USD 1.71bn, reaching USD 36.3bn – a 4.5% m/m drop and the largest since March 2019.
- Pension industry assets grew +17.6% y/y in November 2019 and 1.8% m/m.

Egypt – The Egyptian economy is a strong growth story, with GDP growth coming in at 5.6% for 1H19/20. Inflation is well-contained, allowing the Central Bank of Egypt (CBE) to retain policy rates this month. On the fiscal side, the country recorded a primary surplus of 0.5% of GDP for 1H19/20, a +0.4% improvement y/y. Unemployment dropped to 8% in 4Q19, the fluctuation indicating seasonality of contract workers.

Tourism surged in 4Q19 (+30% y/y) with the lift of the travel ban from the UK to South Sinai. Tourists from the UK constitute 35% of the visitors in that region.

Macro releases (January stats):

- Inflation 7.17% y/y (Dec: 7.1%) with many sub-indices increasing by more than 10% y/y.
- M2 growth accelerated to 13.7% (Dec: 13.3%).
- PMI fell to 46.0 (Dec: 48.2), reflecting subdued private spending. PMI in February ticked upwards to 47.1.
- FX Reserves reached USD 45.46bn (Dec: 45.42bn). Latest CBE statistics show end-February reserves at USD 45.51bn.

Kenya – Kenya's electricity access rate is 70% and the country has diversified sources of electricity generation. Main power producers are pushing green energy, incorporating geothermal, hydro and wind. 78% of power is now produced from fossil fuel alternatives, 48% from geothermal and 30% from hydro. Geothermal is particularly interesting as it is a natural endowment and a competitive advantage for Kenya. Kenya has developed expertise in the area and is now consulting to regional peers.

The United Nations cited concerns about locust invasions in East Africa. So far, the impact on Kenyan farmlands has been negligible as the infestation has been primarily in the semi-arid north. Infestations vary with weather patterns, which are expected to change in the next 2 months. Weather warnings of more rainfall and higher temperatures make the exact impact on Kenyan agriculture unclear. Moody's warns of a ratings threat as a result.

Macro releases (January stats):

- Inflation flat at 5.78% (Dec: 5.82%), subsequently rising to 6.37% in February.
- PMI fell to 49.7 (Dec: 53.3) falling below the 50-mark for the first time since April 2019, showing deterioration in private sector business conditions.
- FX Reserves fell marginally to USD 8.5bn (Dec: USD 8.76bn).
- M3 data from November 2019 showed 5.9% growth (Oct: 7.5%).

Morocco – Inflation came in at 1.3% (Dec: 1.2%), driven by both food (+1.3% y/y) and non-food (+1.4% y/y) prices.

Tourist arrivals grew 5.2% y/y at the end of 2019, propelled by a wave of French (+6%), Spanish (+6%) and German (+5%) visitors. Overnight stays grew +5%, with occupancy ratios averaging 48% (2018: 46%).

Morocco recorded its first case of coronavirus, transmitted to a local visiting from Italy.

Company updates

Mauritius Commercial Bank (Mauritius, Financials) 1H20 PBT +23% y/y ahead of even our strong expectations. FX dealing and bond profits +50% y/y caused non-funded income +19.5% y/y. This high growth line offset a relatively slow fees line of +2% y/y. Loan growth disappointed, up only 1.7% YTD. This after management talked a big game on trade and structured finance book where they expect 15% growth for the year and overall loan growth target of 10%.

Letshego (Botswana, Financials) FY19 PAT +35% y/y a good result bringing ROE back to an acceptable level of 16%. It is a better performance after a combination of goodwill and credit loss impairments marred FY18. It was also our first opportunity to discuss the way forward with new CEO Andrew Akai (ex-Stanchart Zambia CEO). We think he has a healthy balance between targeting growth (10% for Group, with more reliance on mobile and USSD technology) and profitability (maintain 16% for 2020 and 20% for 2021). Our preference is for making more synergistic sense of country silos, which we feel undermine overall tax and cost efficiency. On the positive side, they have long been one of the better operators and they have a much more conservative provisioning policy - 105% coverage vs. 50-70% previously.

Guaranty Trust Bank (Nigeria, Financials) FY19 PBT +7% y/y a very good result in line with our expectation and ahead of management guidance. The results followed the script we expected which was very good fee growth of 18% offsetting a declining yield curve. The bank managed to still produce 4% net interest income mostly through deposit cheapening. Positive jaws of 6% banking income vs. 3% opex is very nice to see in a tough inflationary environment. Final dividend of NGN 2.50 (FY19 total dividend: NGN 2.80) places it on a high 12% dividend yield. ROE 37% and 1x 2020 book value.

Nestle Nigeria (Nigeria, Consumer staples) FY19 results update: Nestle managed to report resilient results, in line with expectations. Topline up 6.7% y/y for FY19 and operating profits up 18.8% y/y. In terms of segmental performance, Food revenue was up 4.7% y/y whilst Beverage revenue was up 10% y/y. EBITDA margins expanded by 96bps to 28% for FY 19. The seasoning market remains extremely competitive and Nestle is struggling to get both volume as well as price increases, they have fared better in the beverage segment with top line growth in line with inflation. Overall PAT was up 6.2% y/y in FY19, with operating profit growth failing to fall to bottom line due to a higher effective tax of 35.8% compared to 28% in FY18. According to management the higher tax rate was due to new regulation that only allows royalty deducted for tax to be a maximum of 5% of profit (in FY19 Royalty was 15% of PBT, FY18 17% of PBT). We expect similar, low growth in FY20 due to muted consumer demand and heightened competition in seasoning which will make it challenging to pass on price increases, the 2.5% increase in the VAT rate will also have an impact in the near term. Despite these headwinds Nestle remains the best consumer company in Nigeria showing a demonstrable record of resilience during difficult macroenvironments.

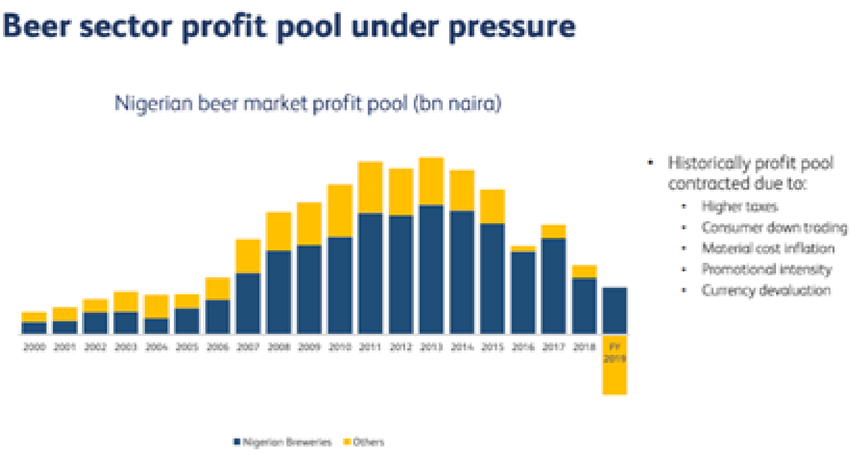
Safaricom (Kenya, Communications) Safaricom's DigiFarm wins global mobile award. Safaricom's DigiFarm platform has won the Best Mobile Innovation for Emerging Markets in this year's Global Mobile Awards (GLOMO).

https://www.the-star.co.ke/business/kenya/2020-02-26-safaricoms-digifarm-wins-global-mobile-award/

Our take. We believe this is really interesting as it:

1. Fits with our view that Safaricom is best placed and has proven exceptionally strong at building services and ecosystems that leverage its strong brand and network, to generate high marginal profit revenue streams and create increased loyalty.
2. Fits with our view that providing high utility, low cost, repeatable revenue generating services to consumers in the massive lower half of the pyramid, creates wealth for shareholders and citizens alike.

Nigerian Breweries (Nigeria Breweries, Consumer Staples) FY19 results:** FY19 net sales were down 0.4% y/y and operating profits were down 4.6% y/y. Operating profit margins contracted by 48bps to 10.9% from 11.4% in FY18. Higher interest expenses led to PAT dropping by 17% y/y for FY19, below our expectations. The beer sector profit pool has been under pressure since 2013 but Nigerian Breweries has managed to remain profitable throughout. The chart below illustrates this. We listened to the conference call and management indicated that they will continue with price increases, having implemented the first one in February 2020. Other highlights from the call included their improved mix as Heineken posted double digit growth, improving sales mix as well as higher local sourcing with 67% of raw materials being locally sourced. Nigeria Breweries is twice the size of its nearest competitor International Breweries (IB) with an estimated 56% market share. We feel this gives it an edge due to economies of scale and a lower cost per hectoliter, which is why it has remained profitable during this intense price competition. IB has announced that they will raise prices in March 2020 which will be positive for the industry profit pool. The environment remains challenging but we were encouraged by the conference call as well as the relative outperformance of NB compared to the other brewers in Nigeria.



EIPICO (Egypt, Healthcare) FY19 results: Topline results in line with expectations, net sales up 21% y/y for FY19 but bottom line disappointed with PAT down 5% y/y. Over the year we saw pressure on bottom line with strong topline growth failing to trickle down to bottom line due to higher raw material costs (which outpaced sales growth) and higher interest costs. Gross profit margins declined by 740bps to 36.7% for FY19. Operating income grew 2% y/y but higher interest costs pushed bottom line down 5% y/y. We have seen strong local sales throughout the year, with local sales growing by 28% y/y for FY19, export sales however contracted by 2% y/y. We expect sales growth to follow a similar trend this year with export sales under pressure and local sales growing double digits. We obtained insight that 40-45% of EIPICOs imports come from China, so this may be an issue in terms of supply chain disruptions, EIPICO does keep 6-8 months cover but it is an area to watch. We will be engaging in dialogue with management on the issue.

Market outlook

Nigeria – Results confirm anaemic growth, with little or no volume uptick. Any revenue growth is well below inflation. Attempts to raise prices have been rejected by customers and undermined by competition which, combined with excise duties (alcoholic beverages), have resulted in significant margin erosion. An exception is telco, where increased penetration and rapid data uptake are driving strong growth. After a very strong 2018, banks have done well to produce flat earnings. They made a lot of money off yields in 2017-2018 and have seen margins come down from this source in 2019. We like our picks in the sector going forward because of its strong fee growth strategy in trade, mobile banking and wealth management. Overall, the macro outlook is extremely opaque, where the desired objectives of the government's tight monetary policy, higher FX reserves and lower inflation, are not being achieved. Positive catalysts are a higher oil price and the completion of the Dangote refinery, albeit substantially delayed.

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. With the upside risk to inflation from subsidy removal digested, we expect further rate cuts and liquidity injections to drive the next phase of economic growth, which will be capex and consumer driven.

Kenya – The decision to remove interest rate caps reintroduces the opportunity for an asymmetric trade on Kenya bank shares and economic momentum. This decision coupled with the CBK's MPC to lower rates a strong signal for monetary stimulus to commence. We expect lending to accelerate in 2020 which will breathe new life into the consumer and SMEs. 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 – The non-agricultural, and less volatile part of the economy has performed well. We expect fiscal and monetary stimulus to continue this trend into 2020. The challenge remains to find attractively priced growth investment opportunities, which we see possibly developing in Payments/Fintech and local consumer goods production. Our recent addition, Label Vie (supermarket, hypermarket, cash 'n carry), 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.

Sefalana Management Call - 13 February 2020, Mohamed Osman CFO

<u>Overview</u>

- The Botswana stock exchange, economy and political apparatus has been in the typical pre-election stasis leading up to the December 2019 elections.
- Manifests itself in lower govt spending, frozen tendering and even elements of corruption starting to creep in to the vacuum, all undermining confidence.
- They have been able to produce very good results despite this. See below.
- The election of President Masisi has been taken very well by the business community and he is viewed as a competent technocrat.
- Sefalana participate in govt tenders in their milk, sorghum and maize cereal manufacturing businesses. They can already see an improvement in process and accountability.
- There has also been increased like for like and seasonally adjusted footfall across most of their stores.
- Inflation is expected to be 2.5% (range 3-6%) and GDP growth 2.5-3.5%.
- Their core business is FMCG in Botswana, which they execute across a retail (supermarkets, mini marts) and wholesale (cash n carry) platform.
    - Currently have 60 stores in total, which they believe can grow at a rate of 4-5 annually.
    - Believe they can achieve revenue growth of nominal GDP.
    - FCF enhanced by positive working capital:
        - Most suppliers in just under 30 days to make sure they get discounts.
        - Retail stores are all cash and only offer credit (less than 30 days) to 30% of sales in Wholesale.
        - Overall credit sales are 15% of retail and wholesale combined.
    - In a number of areas they are the only store for miles, so have worked very hard at building a strong brand and trust in the local communities.
    - Source 70% of their imports from abroad, mostly South Africa.
    - Have an online shopping service, but it is still very small.
    - In November 2019, opened their 3,200 sqm flagship Sefalana Shopper store (“The Big One”). This store offers a wide range of up-market products, a significant Hot Foods counter, one of the largest Butcheries, a Bakery and a Pharmacy. Feedback to date has been very positive and they are making record level sales already.
- In terms of manufacturing:
    - Milk - convert fresh milk into UHT, part of which goes to govt feeding schemes and part into their own household brand. They purchased a milk processing plant out of liquidation a number of years back, so the Invested Capital base is light.
    - Cereals - Sorghum and Maize, mostly go to govt tenders for various feeding schemes.
- Their largest regional store offering is Namibia.
- As a group they are net cash.

- Overall the competitive advantage is Botswana is a vast, sparsely populated country. Their competitive advantage lies in developing a strong, trusted brand nationwide, from which they can benefit from distribution and economies of scale. It is also just too small a market to justify a larger global player taking seriously. Food self-sufficiency is seasonal, so Sefalana's stores and supply to govt feeding schemes perform an important role in society.

Recent results - for the 6 months to 31 October 2019

- Revenues +11.3%, Gross Profit +20.1% and PAT +13.4%, slightly dampened by higher taxes.
- Generate a reasonably strong RoIC of 18% or 1.3x WACC on operating assets, however RoE is low due to a high cash balance and a number of non-core assets, mostly real estate.
- Declared an interim DPs of 10t, which I forecast to be a full year total of 45p or 5.5% yield.
- I have copied in an extract from their results commentary which is encouraging: *"During the period, we have noted positive signs of recovery in the market, as consumer spending and confidence appears to be improving. Our customers are visiting our stores more often and basket sizes are increasing. We are also noting a greater level of sophistication with our customer base, as they now look for a greater range and a one-stop-shopping experience. We are pleased to have identified this and been able to provide our valued customers with what they want".*
- Our forecast for the year ended April 2020 is EPS of 85-90t, which put them on a forward PE of 10x. It scores between 13 and 15 on our Q-scoring system, with future results looking set to be closer to the top end.