IMARA Asset Management

Monthly Market Report

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Market snapshot

March was a mixed month with a wide disparity in market performances. Egypt was up (+12.7%) and Kenya (+3.2%). South Africa was the top decliner (-5.4%), with Nigeria also posting a weak month (-4.2%). Morocco was flat and Botswana and Zimbabwe were down -1.2%. Most currencies gained versus the dollar, clawing back losses from February.

Economic and political overview

Nigeria – The MPC meeting scheduled for March was pushed out till after Easter holidays due to a delay in the nomination of new members by the Senate. Although inflation has come down, 14.5% y/y in February from 15.1% in January, the MPC did not make any bold moves and kept the policy rate unchanged. The PMI index was 56.7 from 56.3 in February. FX reserves continue their onward march, up USD 3.8bn to USD 46.2bn, the highest since August 2013.

Newsflow has been dominated by bank earnings results. 2017 was a clean-up year, with most banks charging provisions between 3-8% of loan assets and a further 100-200 bps directly against the capital account, to comply with IFRS 9. High net interest margins and trading profits helped to offset provision losses, with the larger Tier1 banks still maintaining ROE's above 15%. The largest NPL, which is 9Mobile (Nigeria's 4th largest mobile provider, previously Etisalat), is nearing resolution stage. It had a syndicated loan of USD1.2bn to 13 Nigerian banks, which became delinquent in April 2017. In March, Teleology (a local investor Group) emerged as the preferred bidder, and most of the banks we spoke to expect to take a 30% haircut as part of the new equity investor coming in.

Notably our key picks, GTB and Stanbic (result commentary below), performed the best with a 34% and 31% ROE's respectively. The tough operating environment over the past three years has shown that the best performing banks are those with the best cost of funds, liquidity management and risk management.

Egypt – Held presidential elections ending 28 March, Sisi winning 97% of the 40% turnout, down from the 47% turnout in 2014. A non-event for the market, as most of Sisi's opponents were sidelined. GDP for the quarter ending December 2017 reported at 5.3% y/y from 5.2% in the previous quarter. The Central Bank of Egypt cut rates at the end of March by 100bps to 16.75%, its second cut for the year. As we expected, inflation was lower again in February to 14.4% y/y from 17.1% in January.

On another front, supporting the broad-based reform program in Egypt, government announced its plans to offer 15-30% stakes in 23 state companies, which should add c.USD4.5bn to state coffers. Tourist arrivals for February 2018 were up +36% y/y to 730,000. Russian arrivals expected back in force from April onwards, so we should see a normalisation to pre-Metrojet levels of 11 million tourists per annum. Despite the positive newsflow, Egypt's PM is still struggling to get above 50, with the Emirates NBD PMI measured at 49.2 from 49.7 in February, which reflects that we are still probably at a very early stage of economic recovery.

Kenya – MPC meeting in March lowered its Central Bank Rate (CBR) by 50 bps to 9.5%, citing stable inflation at 4.5%. Good rains and stable food prices backed up a fairly bullish statement by the governor. Politics surprised positively, as president Kenyatta and his bitter rival from last year's election, Raila Odinga, struck a deal to start a reconciliation process.

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It will include compensation for victims of political violence. The media called it “the handshake that rebooted the Kenyan economy” but we always felt that Kenya would follow market-oriented economic policy once elections were complete. It’s the first time that the NASA opposition recognise Kenyatta as the legitimate president. We had expected NASA to disintegrate as Odinga’s alliance partners defect to Kenyatta. It turns out Odinga outpaced his partners to a deal.

After much criticism by the IMF, Kenya was granted a 6 month extension to its USD1.5bn standby facility to September 2018. Treasury is also busy negotiating a new facility to replace the current one after September. In turn, the IMF demands that the government cut its budget deficit of 8% and to scrap interest rate caps which it says are preventing normal money supply growth. Credit growth is currently 2.5% y/y and sector NPL at 11.5% at end February from 10.7% in December.

Morocco – The central bank (Bank Al Maghrib) in its March meeting kept the policy rate unchanged at 2.25% which reflects the lack of inflationary pressure in the economy. Its forecast for GDP growth is 3.3% in 2018 and muted inflation at 1.5%. The agricultural crop is expected to better in 2018 than 2017, which should put less pressure on the current account as less grain imports are required.

Zimbabwe – We visited Zimbabwe yet again this month, post FY17 results. Management teams are cautiously optimistic in their guidance and an improvement in economic prospects depends on free and fair elections. The positive headlines keep coming in with pledges from the private sector to invest, but all contingent on credible, free and fair elections. On the ground, the queues by the ATMs remain but both the formal and informal sector continues to embrace electronic payment channels. Electronic transactions in the country doubled from 2016 to 2017 to a total of 1bn transactions. The main platform for these payments (by volume) is mobile money which now accounts for 754.7m transactions (74.5% of transactions). By value, mobile money accounts for 18.5% of electronic transactions.

Looking at the banking sector results government crowding out of domestic borrowings is highly evident and most of the growth drivers for banking income is from non interest income. We have covered in detail that the DFIs will likely push for strong fiscal reforms. In the consumer names, the main driver for growth is price, especially when it comes to discretionary consumer goods, we are also starting to see salaries and wages increase again but the good corporates are managing to keep wage growth below top line growth.

Market outlook

Nigeria – The results season confirmed the necessary clean-up by the banks and suggests that liquidity conditions have now normalised. Consumer plays have also found stability in volumes and pricing. Pre-election instability may be the biggest risk factor to a strong recovery but we do expect economic conditions to improve even with election jitters ahead. We maintain a large allocation to banks and the top consumer names in the food and beverages sector. We expect the banks to make less profit from yields as the curve drops in 2018 but higher NGN liquidity and a strong growth in trade facility (LCs) and mobile bank fees will still mean a good growth in earnings. Consumer names we hold has traded through tough consumer conditions to gain more market share and we expect them benefit in a lower competitive environment in 2018.

Egypt – As mentioned in last month's commentary we expected the presidential elections to be a non-event and further rate cuts from the MPC meeting. Both transpired. The economic recovery is continuing as expected and most management teams are positive and expect conditions to improve further.

Kenya - In March, the IMF confirmed an extension to the USD1.5bn standby facility to September 2018. We believe political certainty can now be used to get the government's house in order which should include 1) fiscal restraint and moving closer to the 5% deficit target and 2) removing or modifying interest rate caps. Odinga's jump to affirm Kenyatta's presidency and Kenyatta's majority in parliament provides the political space to do these important reforms. Bank management teams at both Equity Bank and Kenya Commercial Bank, the largest two bank plays in the country, have turned very confident very recently and feel confident that rate caps will be removed before September. We believe current low Price-to-book valuations and a positive shift in money supply that rate cap removals will bring provide a unique asymmetric opportunity. Our biggest change in allocation has been towards Equity Bank to take advantage of this opportunity. We quantify that rates removal will add 2% to Equity Bank's lending yields which in turn boost PBT by 15% and ROE by 3%.

Zimbabwe – We believe that stock selection is of paramount importance and although some businesses will struggle with the cash shortage, particularly corporates that do not have bargaining power with foreign suppliers and therefore are unable to extend credit payment terms. Zimbabwe has the highest chance of a positive outcome in its recent past and a lot depends on credible, free and fair elections. In terms of a bailout package, there will be some pain in the form of fiscal reforms and structural adjustments but in the long term this will be positive for the economy as it will reduce the role of government and free up pools of capital to lend and invest in the private sector. In the near term, the risk of mixed signals and policy risk is high heading into elections in July and August. Most political analysts are expecting an easy win for the incumbent, we believe it may be closer than anticipated, nonetheless, we believe by opening up the elections to the international community, the elections are indeed likely to be free and fair which will add legitimacy to the outcome.