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) –

Oct Performance (%)	LCY	USD
Kenya	9.7	10.3
MSCI EM	4.1	4.1
Egypt	2.1	3.0
MSCI World	2.5	2.5
BRVM	-0.4	1.8
Botswana	0.9	1.6
Tunisia	-0.9	0.8
Morocco	-0.7	0.6
Mauritius	-0.4	-1.5
Zambia	-1.5	-2.5
Nigeria	-4.6	-4.9

A month of diverging performances, with Kenya in the lead (+10.3%) following the rate cap removal announcement. Strong performances from Egypt (+3.0%) and Morocco (+0.6%), offset by Nigeria (-4.9%).

Economic and political overview

Nigeria – The Central Bank of Nigeria (CBN) collected NGN 499.1bn of c.USD1.4bn of deposits from banks unable to meet 60% LDR at end September. It is unlikely to really impact GTB or Stanbic. GTB was at 58% end September and Stanbic above the regulated level at 62.8%. The main culprit banks are the legacy Tier1s in FBN, UBA and Zenith Bank, which have historically very low LDR's.

E-payment channels continue to signify strong growth opportunities. 2Q19 saw 711.3m transaction volumes (+27.6% q/q) valued at NGN 40.5trn or c.USD 110bn (+19.0% q/q) recorded.

The federal government decided to increase the value added tax rate (VAT) to 7.5%, a 250bps increase from the current rate. They defended this decision by expanding the VAT exemption list so small businesses would not feel a negative impact. 85% of VAT collected is disbursed to the states.

Macro releases this month:

- Inflation crept up to 11.2% y/y, after falling to 11% in August. Food prices +13.5% y/y following controversial border closures.
- PMI rose to 57.1 in September up from 56.4 in August.
- September banking sector credit to the private sector +2.6% q/q to NGN 25.5tn (USD 70bn).
- FX reserves USD 41.9bn in September, down from USD 43.6bn in August.

Egypt – GDP growth +5.6% y/y in 3Q19. Net exports a big boost as oil import contraction reflects local natural gas production ramp-up. Furthermore, private investment also picked up. The budget deficit declined to 5.3% of GDP, versus 6.2% in 3Q18. The country continues to indicate early stage recovery as the EGP strengthened following September rate cuts.

A draft banking law was approved by cabinet in a move to adapt the legislative environment to global trends. It is aimed at raising bank performance as well as strengthening the governance and independence of the Central Bank of Egypt (CBE). Two key highlights include 1) Increasing banks' minimum paid-in-capital by 10x to EGP 5bn, up from the current EGP 500m and 2) Redirecting 1% of annual profits to the banking sector support fund. 28 banks will not need to increase their capital based on the stipulation. Banks will be given a 1-3 year grace period to comply. CIB is one of only two listed banks that meet the proposed minimum capital.

Macro releases included:

- Inflation dropped to 4.8% y/y in September from 7.5% y/y in August. Food and beverages (40% of the basket) were the largest driver of the lower inflation rate, down by 0.3% y/y (1.8% m/m).
- Net FX reserves reached USD 45.1bn in September inching up from USD 45.0bn in August.
- Markit Egypt PMI crept up to 49.5 in September from 49.4 in August, in contrast to strong GDP growth noted in 3Q19.

During the month, we held a call with an economist from one of the larger investment banks in Egypt. We believe the outlook for consumer disposable income, FDI and capex lending is very positive in Egypt. Our detailed notes are included at the end of this report.

Kenya – President Kenyatta repealed the rate cap, a move which was subsequently passed in Parliament. He rejected the Finance Bill to retain the cap, and the National Assembly failed to garner the two-thirds majority required to override him. This is good news for private sector lending growth, and ultimately a positive move for the banking sector. Market activity surged in response to the rate cap news, the rally starting in mid-October.

Our view: Three years on and president Kenyatta finally brought Kenyan finance policy to its senses. Strengthened by his second term position, no need for re-election, he used his presidential powers to refuse acceptance of the Finance Bill, which included continued rate caps. MP's then had a choice to either oppose his stance, which would have required a two thirds majority or pass an acceptable modification with a simple majority. Unable to attain the former, they chose the latter. MP's managed to keep rate caps on existing loans but any new loans would not be subject to rate caps.

We feel relief that a major policy error can finally be put to bed. We always felt that it would come to an end due to its unintended consequence of low credit growth but nevertheless it was a painful period of low finance opportunity for the important SME sector. Now instead of being forced to take inadequate credit from the microfinance sector at 70% per annum we expect new life to breathe into the SME sector with finance at 20-25% interest rate.

Banks are understandably cautious in their public guidance noting a measured approach to lending and that initial impact will be limited, but the truth is they are being modest about their margin and growth prospects. It is a very big change. In the case of our exposure in Equity Bank the average duration of the Kenyan shilling book is 3.5 years, so expect c.30% to reprice at uncapped rates annually. We expect a 0.9% increase in NIM for 2020 and again in 2021 based on the following assumptions:

Approximately 50% of Group loans affected as:

- 65% of Kenyan book typically higher priced SME loans.
- Kenya is c. 75% of Group loan assets.
- 6% re-pricing from current cap levels.
- Our formula for re-pricing: 50% x 30% refinanced in 12 months x 6%.

That means NIM rises from current 7.5% level to 8.4% at end 2020 and 9.3% at end 2021. Historically, Equity's NIM was in the 10-11% range pre rate caps. The positive margin impact is clear to see. Importantly, the asymmetric opportunity we added to our investment thesis in 2018 is now back in play. And is based on the valuation impact of 1) a higher medium-term ROE – the impact is likely to be a 3% shift in our assumption to 27% for Group ROE and 2) a lower perceived country discount rate. We have updated our fair value for Equity Bank from 57/share to 70/share which assumes a 2.4x book multiple as fair. Importantly, the second factor also has important spill-over effect for Safaricom, EABL and the overall Kenya investment case. Our September trip to Nairobi highlighted that Kenya needed credit growth to support SME vibrancy and ultimately consumer demand.

In other news from Kenya, a 21% increase in manufacturing excise duties has been proposed and could see Kenyan manufacturers feeling the pressure. Consumers will likely feel the pinch with the additional costs pushed onwards.

Safaricom appointed their new CEO, Mr Peter Ndegwa, who is taking over from interim CEO Michael Joseph. The appointment is effective 1 April 2020. Ndegwa is a former Diageo MD, Guinness and EABL senior executive. Most importantly, he is a Kenyan national which is a key political angle for the company which straddles government, regulators and consumers.

Macro releases this month included:

- Inflation reduced to 3.8% y/y in September from 5.0% y/y in August, indicating low underlying inflation pressures.
- FX reserves dipped to USD 8.9bn in September, the lowest level since May.
- PMI climbed back to 54.1, echoing July's levels after the dip to 52.9 in August.

Morocco – Bank Al Maghrib maintained its key interest rate at 2.25% and reduced the monetary reserve rate to 2.0% from 4.0%. The monetary reserve ratio is a specified percentage of the average amount of customers deposits held by a commercial bank in a specified period, and more importantly, that cannot be used for lending. The reduction frees up cash for credit extension and is an important tool for monetary easing. By contrast, the CRR, as it is called in Nigeria is 22.5%.

Inflation fell to 0.3% y/y in September, down from 0.8% y/y in August.

Company updates

CIB (Egypt, Financials) reported strong 3Q19 numbers with PBT +26% y/y. In line with our target. EGP loan growth in line with guidance at 20% y/y but on headline level loan growth looks weak at 4.1% YTD. The answer is a technicality – some USD loan paydown and lower translation value from EGP appreciation. The main driver of earnings growth still much lower provisions this year with CoR at 1.05% YTD vs. 2.66% in 2018 which reflect a much better risk backdrop. Interest income flat y/y as margins have come off with lower treasury yields. NIMs now 6.12% vs. 7.16% in Sep 2018. Fees did recover somewhat after a weak 1H19, up 7% y/y.

Stanbic IBTC (Nigeria, Financials) 3Q19 PBT +24% y/y. Strong quarter with 28% loan growth to meet the CBN requirement of 65% loan to funding by December 2019. Management notes that they are in a good position at 62.8% at end September. It was also mentioned that while lending opportunities are limited by the current level of GDP growth, there are opportunities in oil/gas and telco capex and the usual FMCG working capital requirements. Retail and small business lending is an ongoing strategy but ticket size is smaller. Interestingly, they also reduced their higher cost funding to less than 30%, usually about 45% of funding base. Other highlights were the growth of Wealth business AuM by 13% y/y which more than offsets the 2nd wave of fee cuts (Pension managers are regulated to cut their fees by 10% starting July 2019. The final regulated cut of 10% will be July 2020). Now trading very discounted at 1.2x 2020 PBV vs. a 5 year average of 1.9x. DY is 7% and ROE 31.7%. Reported FY19 earnings will be flat dealing with high FY19 base where PBT was boosted by provision writebacks. Excluding provisions, the earnings runrate is about 10% y/y.

GTB (Nigeria, Financials) 3Q19 PBT flat y/y. A slightly weaker quarter after a strong 1H19. Loan growth was +8.3% q/q (9.4% YTD) achieving an LDR of 58%. The substantial reallocation of resources had a short-term liquidity impact which is negative margins. 3Q19 NIM declined by 0.47% to 6.95%. However, we expect a boost to margins in 2020 - higher asset yield from more lending and lower cost of funds as they reduce time deposits in their mix. As with Stanbic, trading at a very discounted level of 1.1x 2020 PBV vs. 5 year average of 2x. DY is 11.5% and ROE 36.8%.

Edita (Egypt, Consumer staples) 3Q19 results update: A solid set of results with revenues +7% and EPS +20%, with recurring EPS +15% adjusting for FX and provisions. At an overall level, number of packs sold rose 5% and avg price per pack was up 2%. On a product basis, Cake revenues declined by 2%, while Croissant was +19%, Rusks 21% and Wafer 11%. EBITDA grew only 6% as impressive production cost savings were offset by higher SG&A, particularly marketing to support Croissant and Wafer segments. There is a positive outlook through to the end of the year as 4Q is seasonally a very strong quarter, while a stronger EGP, reduced interest rates and increased consumer disposable income provide further tailwinds.

HPS (Morocco, IT) 1H19 results update: Revenues came in +17.0% and EBIT +21.8%, however one-offs and the new 2.5% solidarity tax in Morocco saw EPS down 5.0%. On the positive side Group recurring revenues were +23.3% and the flagship Solutions division (73% of revs) grew its revenues by 21.7%, with upselling to its existing client base +60.1%. The Services division (17% of revs) put in a solid performance of +8.9%. The negatives at the earnings level were a FX loss vs a gain last year, a pick-up in non-deductible expenses, the introduction of the new social solidarity tax in Morocco and a MAD 2m drop in income from associates. In terms of growth, two areas of concern will require further monitoring. Firstly, the Processing division (10% of revs), a major driver of future growth had flat revenues. This should resolve itself as three new contracts were won in Africa, over and above the SocGen win and a first time contract win in the Middle East. Secondly, at a Group level the backlog, which is contracted revenues not yet delivered, declined 11.6% owing to a push in deployment of existing services over new sales.

Sonatel (BRVM, Communications Services) 3Q19 results update: An improved set of results, with most line items showing an uptick from the H1 numbers. Revenues +8.4% (7.0%), EBITDA + 4.8% (1.2%) and PAT +1.6% (-10.0%), with H1 numbers in parentheses. Operating FCF (EBITDA less capex) for the full nine months was down 10% on a 23% rise in capex, mostly related to accelerated 4G deployment. The underlying subscriber trends remain strong, with a total of 32.5m subscribers, with 11.5m data and 6.3m Orange Money subscribers, both +15% y/y.

MTN Nigeria (Nigeria, Telecommunication services) 9M19 trading update: A strong set of results, despite IFRS16, with revenues +12.1%, EBITDA +39.3% and PAT +29.0%. On an IAS 17 basis, EBITDA was +15.8% and PAT +36.6%. In the third quarter, active subscribers grew only 0.1m to 61.6m, with data subscribers growing 1.6m to 22.3m. The relatively low data penetration will drive future growth, as will the rapidly growing (+44%) number of Smartphones, which still represent only 41.7% of the data subscriber base. Unsurprisingly total data traffic grew by 69% y/y (25% users and 44% usage) and comfortably offset a per unit pricing decline of 34%, giving an overall data revenue growth of 35% y/y. Following the award of the Super Agent license, the company has registered 66k agents and plans to get this to 100k by year-end to drive its cash-in-cash-out (CiCo) money transfer service.

Dangote Cement (Nigeria, Materials) 3Q19 results update: Group revenue came in +4.5%, EBITDA -6.6% and EPS -22.2%. The key drivers of poorer profitability are a 20% increase in selling and distribution expenses and an FX loss recorded in the quarter. FCF declined by 10% for the nine months to September, however remains robust at 22% of revenue. The Nigerian business demonstrated the challenges of the sluggish economy and low spending power. While revenues grew strongly by 10% (vols +9%, prices +1%) and mkt share increased from 64% to 66%, EBITDA declined as the company had to pay for this growth by hiking up marketing and distribution expenses. What was encouraging, is that the company was able to achieve this growth, despite a 5% volume loss from land border closure and seasonally heavy rains. In conjunction with these results the company announced Board approval for a share consolidation and share buyback programme.

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 rate cuts 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 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.

Egypt Economics - Call with local economist - Liquidity release, disposable income and capex lending increase

During the month we organized a call with an economist from one of the larger investment banks in Egypt. The call centered around potential release of CBE absorbed liquidity, consumer disposable income/wage increases and timing of a capex/FDI driven expansion.

- In an effort to mop up liquidity, CBE offered attractive rates to banks to place money on deposit with them. Rates are currently 14% net of taxes.
- Those deposits now amount to EGP 670bn or 12% of GDP. This was approx. 1% pre 2015.
- CI believe that EGP 560bn of this could be released back over the next two years. Specifically that EGP 250bn could be released before June 2020, without disrupting the inflation target and FX rate.
- The mechanism would be simply lowering rates on these deposits.
- Could also stimulate liquidity by lowering the amount that has to be covered by local banks in government paper auctions. Do not believe this would risk deficit financing as already covered by EU bond and other.
- Other methods of releasing money are lowering CD rates from government banks. This is quite a slow transmission mechanism as of the 250bp rate cuts, CD rates have only dropped by 100bps. Also some have longer maturities such as 18 months.
- Believe increased liquidity in banks will be directed first toward WC financing (to cope with increased demand) and then capex financing as cu's start increasing. Avg cu is 60-70%, but we asked what is a more granular split of cu's i.e. are some industries 85% and others 55%, didn't get a clear answer.

What was key for us is that for all this liquidity to be released and find a "proper" home, consumption and hence real wages have to increase. Also CD's should come down to promote other forms of saving/investment i.e. real estate.

In terms of real wage increases and the capex phase.

Real wages in decline for the past four years.

- Civil servants, of which there are 6-8m, are entitled to a 10% increase. Got this plus a bonus in July, which is typically effective date of increase.
- Meetings with a number of large private sector companies, indicate a 10-15% increase. Private sector increases are typically calendar Q1. Also mentioned that a number of increases and/or promotions have been on hold, so could be released.
- We also asked, despite Egypt not being an indebted society at an individual level, does the Egyptian consumer need to first repair balance sheet before consumption. The answer was not really, as balance sheets are healthy, with a lot of money locked up in CD's.

In conclusion, we believe the outlook for consumer disposable income, FDI and capex lending is very positive in Egypt.