IMARA
Asset Management

## Monthly Market Report

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## Market snapshot

Another tough month for African markets, with Mauritius being the only market up in September at +1.3%. The key decliner was Kenya (-10.8%), off the back of no rate cap repeal and a cocktail of taxes and excises on banks and telco on Presidential assent of the Finance Bill. Egypt and Nigeria did not fare much better, down 8.6% and 6.7% respectively. With the exception of the Zambian Kwacha, which depreciated 16% in the month, currencies were broadly stable vs the USD.

## Economic and political overview

**Nigeria –** Internet connection continues to surge in Nigeria and almost 1m new internet subscriptions were recorded in August alone, following on from 0.9m in July and similar amounts in previous months. The connection rate was 14% higher than August 2017 and the total number of internet subscriptions in the country now stands at 104m. MTN Nigeria took the largest share of this.

The opposition PDP presidential candidate has finally emerged. Atiku Abubakar, former Vice President 1999-2007, will stand against the incumbent in the upcoming elections in February next year. Competition was stiff and included a number notable politicians, however he managed to win by a wide margin. It is encouraging that he will be running on a constructive economic manifesto and one which will not be too dissimilar to his opponent. One difference is that he is said to be a proponent of floating the Naira, however this was not included in his main objectives.

One of the metrics we track is the monthly FAAC distribution, which the federal allocation of funds across the three tiers of government. The upward trend continues and we note that allocations have almost tripled from the lows of 2016 (see chart at end of report). Transmission from FAAC distributions to consumer disposable income has been frustratingly slow in 2018 however, as consumers appear to have opted for personal balance sheet repair over consumption.

**Egypt –** Official figures show Egypt's current account deficit for the fiscal year to June 2018, decreased 59% to USD6bn or 2.4% of GDP. While the trade deficit widened to USD37bn from USD35bn, considerable gains in the services (98% to USD11bn) and remittances (21% to USD26.4bn) drove the sharp narrowing of the deficit. Overall balance of payments recorded a surplus of USD 13bn.

Keeping with the above theme, the government recently announced that Egypt has imported its "last" shipment of LNG. This has been achieved with the Zohr field producing 2bcf/day, so there should be ample room for exports and/or increased local demand when the field gets to its 3bcf/day target in the second half of this year.

*We travelled to Egypt during the month and met with a number of corporates as well as the deputy finance minister, our notes are included at the end of the report.*

**Kenya –** The controversial Finance Bill was finally passed and is now the Finance Act of 2018. Conscious of IMF pressure and the need to reduce the fiscal deficit, the Presidential assent added some additional taxes and duties. VAT on fuel was raised from zero to 8% and excise tax on mobile money and ATM transfer was raised from 10% to 20%. Excise on voice and data was raised from 10% to 15%. The excise is clearly negative, but we don't believe these new charges in any way derail the cash to non-cash move. It is clearly disappointing when contrasted to Morocco, where, in order to promote non-cash transactions, the govt introduced a 0.8% levy on cash transactions.

On the positive side, tea farmers have earned a record gross payment of KES 86bn, off the back of a bumper harvest in the past season, marking the third year of improved earnings. Kenya's tea earnings are up 9.4% compared to last season, which is significant given the industry is one of the largest employers in the country and tea accounts for 25% of export revenues.

**Morocco** – Morocco's GDP is estimated to have grown 2.8% in 3Q18, from 2.4% in the previous quarter, according to government sources. They cited improvements in agricultural output and non-agricultural sectors alike as the reasons. Agricultural output, which accounts for 14.5% of GDP, is estimated to have grown 3.1% during the quarter. The country had an exceptional cereals harvest this year, totalling 10.3mn tons. Non-agricultural output likely grew 2.8% in 3Q18, driven mainly by expansion in industrial activity and mining. Fourth quarter growth is forecasted at 2.9%, while agricultural output is expected to remain flat. The government expects 3.6% growth this year and 3.2% next year.

**Zimbabwe –** In our previous monthly commentary we mentioned our excitement at the appointment of Dr. Mthuli Ncube as the new Minister of Finance. Since then he has been engaging with business leaders and giving interviews discussing his ideas on turning the fortunes of the country around. On the 1st of October, following the Monetary Policy Statement announcement, Dr. Ncube stepped up to give his views and economic plan centered around fiscal consolidation, improved revenue collection, limited issuance of T bills, re-engagement with multilateral creditors and privatization of state owned enterprises. On paper the plan makes sense, but the politically sensitive environment will make it extremely difficult to execute. We will be doing a separate Zimbabwe investment note later in the week because there is a lot to cover, but the key highlights for us from his announcements are:

GDP growth projection of 6.3%, up from 4.5%, driven mainly by agriculture and mining. It was interesting to note that he had a different growth projection to the RBZ governor, who increased his growth projection to 5% up from 4.5%.

Acknowledgement of the severity of the fiscal deficit and the problem with the nature of its financing.

We have written about this extensively, T-bill issuance and monetary financing (RBZ overdraft) of the deficit has been the main source of funding for the government. This has crowded out "good" credit, perpetuated a recurrent fiscal expenditure problem and worst of all resulted in the creation of electronic dollars in the system.

Privatization of state owned enterprises: Announced plans to privatize 9 SOE's as well as thorough checks on the viability, profitability and balance sheet strength of these entities. Something that is long overdue.

External debt: With external debt sitting at USD7.4bn at the end of Aug 2018 and the country running twin deficits, with very low FDI and portfolio flows, the country has a severe currency problem. Whilst he didn't elaborate on progress in discussions with multilaterals, he did highlight how crucial re-engagement is, given his background in this area we hope to see more progress. We do not see a recovery without a fresh capital injection and debt forgiveness/restructuring.

The money transfer tax (transaction tax): Dr. Ncube announced a transaction tax of 2% on all electronic transactions up from a flat tax of 5 cents. This idea has been around for a while and we have seen across the continent that it is an effective source of fiscal revenues, particularly when it comes to mobile money, which is a rapid growth segment. 95% of retail transactions are electronic in Zimbabwe, the highest in the region, with usage being accelerated by the cash shortage. Whilst we believe it was a good idea, especially when it comes to capturing the informal sector, 2% was too aggressive and too soon for the consumer. Such a sharp tax has negative consequences for inflation as well real disposable incomes. Last week Friday, 4 days after his initial speech, Dr. Ncube gave further detail on the transaction tax, exempting transactions below USD10, as well as a number of other transactions including but not limited to intra company transfers, purchase and sale of investment securities and salaries.

Separation of FCA accounts for Nostro and RTGS funds: Although this a monetary policy issue, it was a major highlight for us, ring-fencing Nostro FCAs is a first step to official devaluation. Despite the assurances from the Reserve Bank that two categories will remain at parity, the reality is that they have never been at parity. The rates on the parallel market and the Old Mutual implied rate (OMIR), have been indicative of this, at the time of writing, we have seen a sharp devaluation to 3.62 electronic dollars (units of local currency USD) to 1 USD. Meanwhile on the market the OMIR has devalued to 3.74 units of local currency to 1 USD.

Money supply growth: Money supply growth was 40.8% for June 18, although it is lower than the 50% growth we saw in November 2017, it is still extremely high and reflects the growth in domestic credit to the government. The money supply growth number makes a mockery on claims that RTGS FCAs are on parity with USD FCA's.

## Market outlook

**Nigeria –** The results season confirms a 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 remove 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 3Q18 MCB numbers reflect this, showing NIM expansion and loan growth of 9% y/y. **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 -** Fiscal expenditure is always sticky downwards and hard to reduce significantly in a short space of time. Fiscal revenue collection via the transaction tax is a transparent, simple and significant potential source of financing. With 95% of retail transactions being electronic and informal it is a very effective way to raise revenues for government. However, 2% is too high and will likely have a significant inflationary impact on the economy if implemented in its current form. We expect this rate to be revised significantly due to the civil unrest and the negative reaction from the business community. The separation of Nostro FCAs and RTGS FCAs is necessary and quite possibly the first step in official devaluation. We have already priced our Zimbabwean positions at the OMIR, which closely tracks the parallel market rate. We expect equities to continue to rally as an inflation hedge and a safe haven for local investors, which should dampen the negative impact of rising OMIR. Long term, we look forward to seeing the government implement some of the initiatives they are working on. 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 despite 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.

**Egypt meeting notes – 16-18 September**

We were impressed with the level of infrastructure gains being made in the short period since our last visit.

- Metrorail due in 6 month time, will take 2m commuters off the roads.
- Add to that 100k civil servants moving to New Cairo premises in February 2019, will further de-congest the city.
- Zohr field and gas production reaching new highs, now self-sufficient in electricity production.

Terrorism is the key risk. Another Metrojet will dent tourism and sentiment. What is still under pressure is the consumer. While inelastic items have stayed flat post-devaluation, weak discretionary item spending vs. 2015 levels (i.e. 130k cars vs 200k peak in 2015). Our overall take is that Egypt as a whole is progressing to a higher level of development, through infrastructure and efficiency gains as well as policy certainty. However, prices of more discretionary goods remain high for an under pressure consumer. Therefore we believe our current allocation, toward consumer staples and healthcare, remains valid.

**Ministry of Finance** - meeting underscored how well they have done to reform the Treasury. They have big plans on tax collection/evasion initiatives, specifically digitisation, which should lift their low tax base as % of GDP, although we believe this will take some time. According to the ministry, it will take another year to complete planned subsidy reforms, which in turn means another year of consumer spending pressure and an inflation rate in the 10-15% range.

**Commercial International Bank** – excellent business model to monetise banking penetration. Primary driver of 20% CAGR earnings is deposit growth, which is still continuing strongly.

**Integrated Diagnostics Holdings** – core pathology business in Egypt to grow at 10-20% CAGR for the foreseeable future. New ventures, Nigeria and radiology, look promising but are still in the investment phase.

**Eipico** – very stable, high quality business geared to pharmaceutical growth. Cheap valuation (vs. global peers and profit profile). Illiquidity probably a discount for now.

**Cleopatra Hospitals** – Overall good theme of topline growth driven by pricing power, patient growth and mix shift to higher revenue patients (more sophisticated procedures). Most GP margin gains probably been had although management saying they can do more. M&A acquiring new beds/hospitals has disappointed and likely they will issue new capital when projects come along. A very exciting theme and growth potential if you can handle investment risk/capex overhang.

**Obourland** – Core white cheese market slowing to 5% + CPI on the top line. High investment risk as they enter Juice, and Milk production simultaneously.

**Oriental Weavers** – probably sorted out their dependence on Ikea (2014). Ikea is now a smaller contributor plus new European wholesaler, strong US housing market and stable Egyptian market. It's noticeable how large their export subsidy arrears have grown and remains a key event for stock rating.

**FAAC Distribution chart - Nigeria**