IMARA
Asset Management

Edition: November 2020
Region: Africa ex South Africa
Issued by: Imara Asset Management Limited

Author: Rainer Orth, Tony Schroenn, April Mthupha

Imara Asset Management 2020 Update - Transcript

Good afternoon everyone, thank you for taking the time to dial into the call. The onset of Covid-19 and the resulting lockdowns, have made this an extremely tough year, however it has given us and our investors a chance to test our key assertions.

Just to recap, we have asserted that Africa has a number of powerful, transformational trends such as the cash to non-cash fintech revolution, digitalization, fastest urbanization rates globally and the move from the informal to the formal economy. These trends are driving strong growth in the sectors that tap into them. We also asserted the best way to profit as investors, is to select the corporate champions in these sectors that have a long and wide runway for growth and importantly have the quality to stay the course and entrench their competitive advantage.

Now that we have results to September, as well as updated company guidance for the remainder of 2020 and 2021, we can confidently say that while Covid was an extreme test, that yielded mixed results, our assertions and our investment process are firmly intact. We have seen the following outcomes:

1. Strong operational and financial performance. Typically fintech.
2. Strong operating, but weaker financial KPI's. Typically banks and telcos.
3. Weak operational and financial performance. Typically healthcare, alcoholic beverages, tourism, entertainment.

This has led us to the important observation and necessary distinction going forward, between Covid and lockdown. At the start of the pandemic, the words were used interchangeably, now it has become clear that some companies are impacted by Covid and/or lockdowns. For example lockdowns disrupted healthcare and parts of fintech, but Covid has provided a long term boost.

As an overriding observation, the negatives have been one-offs, while the positives, point to recurring strength. In the slides that follow, we detail the numbers and statistics that back up our assertions. With that I will ask you to turn to Slide 4.

This talks to our cash to non-cash transformational trend, which has been clearly demonstrated and reinforced by Safaricom's MPESA, the company we refer to in this slide. The top chart shows how lockdown put a lid on merchant acquisition in March to June, but with a Jack in the Box jump after that. The bottom table shows how the existing customer base boosted activity despite this.

Staying with Safaricom, but moving onto Data consumption on the next slide, you can clearly see how this product steamrolled through the entire event, talking strongly to our digitalization transformational trend. Note, Safaricom is a March year end company, so Q4 is January to March and HY is the 6 months from the end of March to September. Without sounding dramatic, I will say strap yourselves in as you have seen nothing yet in this theme, as 4G and later 5G are rolled out, there will be years of strong growth to come in Data consumption.

Moving on to Slide 6, Fawry, our Payments fintech pick in Egypt, showing similar trends to Safaricom MPESA, where you can see the negative temporary effect of lockdown, but the positive impact of Covid. I would like to clarify the key growth

SCLAIMER This document provides general commentary on market activity and industry trends and does not constitute investment advice, nor does it constitute a recommendation for any particular investment. The economic and market information presented, and views expressed herein, are as at the date hereof and are subject to change at any time. While all material is deemed to be reliable, accuracy and completeness cannot be guaranteed, and any opinions stated should not be relied upon. This document is issued by Imara Asset Management Limited, which is licensed by the British Virgin Islands Financial Services Commission. This document may not be reproduced, transferred, or distributed without prior written permission from Imara Asset Management Limited.

vectors here. So, lockdowns slow merchant acquisition and activity, that is because merchants struggle to physically receive their PoS devices and their points of sale, be it a stall or shop, are shut during lockdown. However what Covid has done i.e. lack of mobility and cash physically transmitting the disease, is forced first time adoption by customers and forced merchants onto platforms. Fawry estimates that this phenomenon, has pushed parts of its business plan forward by 5 years. Their financial results this year have been spectacular and the share price has quadrupled.

At this point I will hand over to Rainer Orth, our Financials sector specialist.

Thank you Tony. Turning to slide 7. As Tony mentioned, the banks showed very strong operational numbers through the COVID-19 crisis and that helped push deposits up 34% y/y. The statistics show big strides made in customer numbers, mobile money, and network size. On the slide we measure a basket of 10 core banks where growth is ahead of the universe of African banks and as you can see on the slide, fast growth is evident for this core group: customers +23%, # MM transactions +29%, value of MM transactions +38% and Points of sale +22%.

Now, investments made in digital technology in the past 5 years meant that banks could keep growing through COVID-19 and customers found a greater need to transact remotely. While Kenya are the MM champions for several years now, Nigeria has also arrived in the MM space in the past 12 months. For example, one of the basket of 10 banks, Guaranty Trust Bank in Nigeria grew its customer numbers from 13m to 19m, an almost 50% growth in a mere 12 months which shows the power of extending to a digital to build your customer base.

Moving to slide 8, beyond adding customers and size, the growth in digital is a better growth as it is lower cost than legacy channels such as ATM and branch. On this slide, we show the transaction channels for Equity Bank in Kenya, a core holding for our portfolio to explain this point.

While branches, ATM and merchants saw a decline in the # and value in transactions, partly driven by COVID-19, we saw an acceleration in MM and specifically a greater share of MM transactions done on app rather than the older sim-based USSD / STK, text prompt technology. As you can see # of app transactions went up to 339m from 237m for the corresponding quarter in 2019, an increase of 43% y/y and the value of app transactions went up 50% to USD 6bn. We expect this trend to accelerate further.

Now what is the business model impact from moving more to digital? For Equity Bank and other banks the impact is twofold:

1. On the income side MM channels tend to suck up more liquidity faster as we can see in the faster deposit growth in the last 12 months. Equity bank grew its deposits by 26% in the past year vs. an industry in the mid-teens. The increased float of liquidity from MM allows for more earnings growth as liquidity gets reinvested in treasuries and loans.

2. On the cost side, MM channels are low cost and variable versus higher branch and ATM fixed costs. A branch transaction cost is typically about USD 1 per transaction vs. 3-5 US cents per mobile transaction. So clearly there is huge cost efficiency play coming through. We can already see this in Equity Bank's Kenya sub where CTI ratio has declined from 50% to below 40% in the last 3 years.

Now Equity Bank has an added growth opportunity which we are very excited about. It acquired a second bank in the DR Congo in August to add to existing small footprint there and it also received approval to do agency banking. The opportunity

is remarkable. There are 2m accounts in a population of 90m in DRC and Equity bank now has a 28% market share. We expect to see an investment in digital (both through MM and agency) that will lead to exceptional growth of the bank in the coming years.

Now I will hand over to April to take us through healthcare and retail.

Thank you, Rainer. Looking at healthcare on Slide 9: Egypt's pharma industry showed resilience throughout the pandemic, demonstrating that the worst is over after 2q20 with a return to positive growth in the third quarter. On the ground, our core pharmaceutical production companies are experiencing a positive trajectory but the distribution companies continue to face challenges, with some channels affected by ongoing movement restrictions. These restrictions may persist if there is a second wave.

Slide 10 looks at Integrated Diagnostics Holdings, one of our core portfolio companies focused on producing accurate and timely diagnostics services. The number of tests performed predictably fell in the first half of the year, due to movement restrictions and consumer caution. In 3Q20 numbers showed a strong bounce back, with topline and bottomline beating that of 3Q19 and showing a resumption of activity on the ground.

Slide 11 shows an overview of a basket of core healthcare companies, tracking their top and bottomline metrics over time. As mentioned 2Q20 was the most difficult quarter, and 3Q20 revealed a return to normalcy in Egypt. All companies in our universe have seen increasing demand across the board as economies open up, and this is expected to continue into next year.

Slide 12 looks at the retail sector – and we used South African examples to show the mixed results. Food retail was unsurprisingly strong y/y, as people stocked up on essential goods and services. Even though food demand slowed as economies opened up, this segment has proven resilient in all our markets with robust operating financial metrics. Apparel experienced mixed results. This quarter saw consumers downtrading from high quality expensive brands to the more affordable clothing, which companies like MRP tapped into.

Online revenues continued to grow strongly y/y, but still contribute a relatively minor portion to overall revenues compared to foot traffic in stores. Companies have noted that there appears to be sticky demand, with increasing basket sizes online and dual consumers who buy both in store and online.

An update on ESG on slide 13: we achieved AAA for the UN PRI assessment for 2020, an upgrade from last year. Major changes included 1) deeper integration of ESG into our investment decision-making, by expanding our database and increasing the number of one-on-one engagements with companies 2) incorporating the SASB materiality framework as a lens through which to calibrate progress, further embedding ESG related issues. ESG has enhanced our bottoms-up approach, further informing the risk/return trade-off of investments. Notably we found overall communication with companies improved this year, forced by the pandemic, and we hope that the upfront engagement will continue. We think the increased focus on ESG, with more sustainability reports and impact assessments being made public, is a positive sign of the integration of this aspect within our universe. I will now hand back over to Rainer for a macro and valuation outlook.

Quick reflection on macro on slide 15-16. What we saw is an overall sharp decline in economic activity in April to early June with steady m/m recovery through the third quarter as evidenced by a recovery in PMI as the first wave of COVID started

subsiding in August. We are now seeing a slight increase in numbers but most of our main markets still open with minimal restrictions. Deeper analysis shows the main losers of the crisis are tourism and hospitality. So while the GDP number show -5 to -10, it really is minus 70-80% on the tourism and hospitality front with most other sectors stay resilient and as we noted telco, payments, banks, pharma and retail particularly robust.

Slide 17, is a very interesting slide, where it shows that the overall Africa equity rating is still at the bottom close to GFC levels in 2008/9 and the oil price crisis levels in 2015/16. And while the portfolio recovered from the big shock into end March, valuations keep getting cheaper as the companies in the portfolio grow operations and earnings. And that will remain our focus to target these exciting themes which should see multiple years of growth ahead. Valuation will sort itself out at some point as and when EM, frontier and Africa gets more capital flows. We estimate current valuations are between 60 and 100% below historic average multiples. In many cases what we see as fair value is higher than the historic average multiple.

So valuation and earnings growth makes us really excited about the prospects for high returns. To conclude, we believe our portfolio is very well positioned for a recovery or an extended second wave. Despite having had a very strong performance in the third quarter, we believe the Fund is very attractively priced and at an attractive entry point.

With that I will hand the call back to you Harry for Q and A.