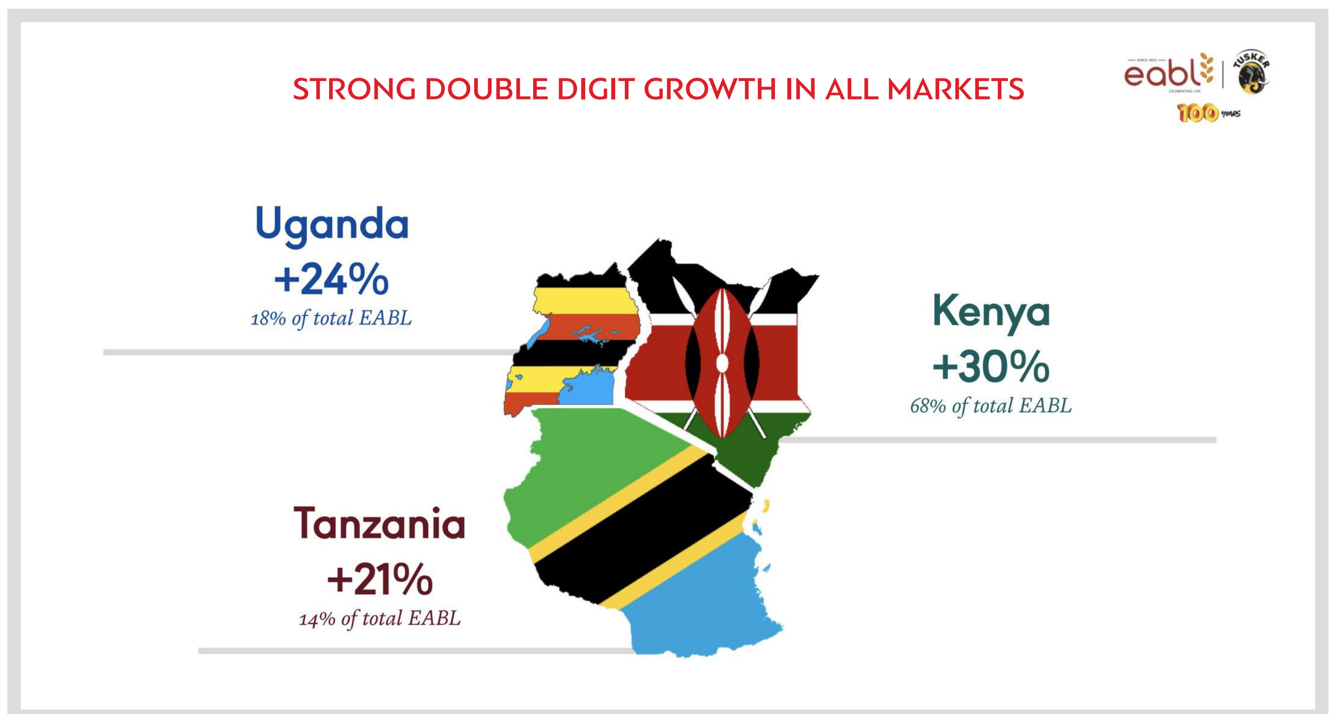
AFRICA FINTECH OVERVIEW

We recently concluded our semi-annual Strategic Asset Allocation meeting, which is the culmination of six months of country, sector and company research. The objective is to test our assumptions, screen our companies and finalize our desired portfolio for the coming six months. As we head out of an extremely tough year and into a much more promising 2023, it is timely to remind investors what we are looking for and how we look for it.

Our first assumption is that the megatrends of economic formalization, urbanization and financial inclusion will drive consumption, and more importantly robust consumption in Africa. 2022 could not have been a harder test and yet this assertion came through with flying colours, where, across the board real Gross Domestic Product (GDP) grew and companies were able to deliver strong revenue growth. While cynics might want to argue growth was likely inflation driven, strong volume growth proves otherwise. Corroborating evidence will come to light in Fintech in the pages that follow, but it's important to demonstrate strong consumption that our Fintech platforms harness. We could fill this page and the next with examples, but none are as striking as the chart below, which is an extract from our November 2022 monthly report.

Take a look at what's bubbling in East Africa

One of our key assertions is that the African consumer market is buoyant and will remain robust, despite geo or macro political events. One could be forgiven for assuming that with what is happening globally, this might be called into question. However, as the graphic below demonstrates, this view would be at odds with the merry-makers and bar-goers who are customers of Diageo's East Africa Breweries (EABL). Underlying those strong revenue growth numbers, is volume growth of 22%. Stop and ponder that for a while, think about where else in the world is delivering that sort of beverage consumption growth, in this economic climate.



It is not at all surprising then that Diageo, EABL's parent, is trying to buy an additional 15% stake in the business for a substantial premium to the hopelessly low valuation of 7.3x and 4.2x forward PE and EV/EBITDA, that it trades at on the Nairobi Stock Exchange.

You might well say, what does any of this have to do with Fintech. As you will know from your own lives, more of this consumption is being transacted on Fintech platforms AND more often. **Additionally, low but rapidly increasing FINANCIAL INCLUSION, turbo charges this trend.**

WHY FINTECH?

This is a good point to lead us into why Fintech? The low penetration of financial services means Fintech is a leveraged play on the above as it captures both increased consumption as well as increased users and use cases. Or put simpler **more people, using it more often to buy more stuff**.

Even to a cynic it must be obvious that Africa abounds with opportunity, but its critical to select and position systematically, methodically, and repetitively. This is also a good place to lead into what we like in Africa, why we like it and how we find it or to use industry parlance, our Investment Philosophy and Process.

Philosophy

- We believe that businesses geared to these trends will perform very strongly.
- We believe Relentless emphasis on quality mitigates risk.
- We believe Rigorous research is critical to identify and monitor these businesses.
- We believe A high conviction, long term investment style captures this opportunity in Africa.

Process

We execute our beliefs using an in-house developed research system called **QVG**, whose objective is to help us find corporate champions, companies that are masters of circumstance. These are companies with sustainable barriers to entry, dominant market position, quality management and strong governance. We travel the extra mile, literally, to better understand a business. **Engaging companies is and always has been a big part of our job**.

The **Q** in QVG stands for **Quality**. We developed a 5 factor, Likert scoring system that enables us to consistently and repeatedly score companies across sectors and geographies each quarter....and importantly over time. So while each score gives a snapshot, we have a movie going back 15 years or more that allows us to form a clear view of a company's quality.

For **V** or **Value**, we use a number of metrics to determine fair value and look to buy our companies at the best price.

For **G** or **Growth**, we favour businesses that demonstrate consistent and sustainable growth.

Ok, that's all good and well, but what have we learned over the last 15 years, what has our system told us and importantly, how does that benefit an investor looking at Africa. Our key learning is that Africa has large populations, however low incomes, so volume and market share is key. Companies that tend to do well in our QVG system, are those that are able to access the whole income pyramid.

- Thereby generating small, but high volume, repeatable purchases.
- Secondly by leveraging scaleable technology, large distribution networks and brand loyalty.
- Thirdly by offering additional products, for extra revenue but little or no marginal cost.

Nowhere are these characteristics demonstrated more clearly than Fintech. In Africa, we see Fintech manifesting itself in three sectors, which make up the bucket from which we select our portfolio.

- Pureplay Fintechs - software, payments platforms.
- MoMo Telcos - mobile phone companies with strong Mobile Money offerings.
- Innovative Banks - agency and increasingly mobile banking pioneers.

FINDINGS FROM SAA

What better time to test our assertions above than the year and pandemic we have just been through. So how did our thesis and companies fare?

2022 was a tough year and caps off a tough period since 2019

Taken in context of the bullet points to follow, the performances in the table below (which show growth from 2019 to 2022) certainly show growth and robustness. Without stating the obvious it was an extremely tough period. The following happened, coinciding happening simultaneously, with emphasis on the past tense:

1. Covid pandemic and lockdowns.
2. Russo Ukraine war sending soft commodities and oil soaring.
3. Sharply rising US interest rates.
4. Morocco suffered its worst drought in decades.
5. Kenyan pre-elections.
6. Nigerian pre-elections.
7. Moroccan pre-elections.
8. Spike in yields in Morocco with local fund allocation crisis.

% Change from 2019 - 2022		
Company	**EPS**	**Revenues**
Sonatel	45.8	15.0
MTI	-33.3	-22.1
Fawry	81.1	164.9
NI	341.8	31.5
Equity	106.0	79.6
Safcom	11.5	19.0
HPS	83.9	50.5
GT	8.1	21.5
MTNN	82.2	68.4
MTN	139.1	36.7
Purple Group	448.2	178.2

QVG - Quality at historically cheap valuations in a tough macro

Our December 2022 SAA reflects our views after new data points from 1H22 and 3q22 results. After discussions, our overall view is that the majority of our watchlist and portfolio companies:

- deliver solid growth despite macro challenges,
- maintain quality metrics, both on our internal scorecard and ESG, and
- are priced at substantial discounts to fair value.

Outlook

Importantly, the Outlook is very promising. When considering Outlook, you have to stop and consider where you are now and what you have been through. A tough period and incredibly tough series of events have all been digested already, they are in the rear view mirror and either cannot or are highly unlikely to recur in the next four years.

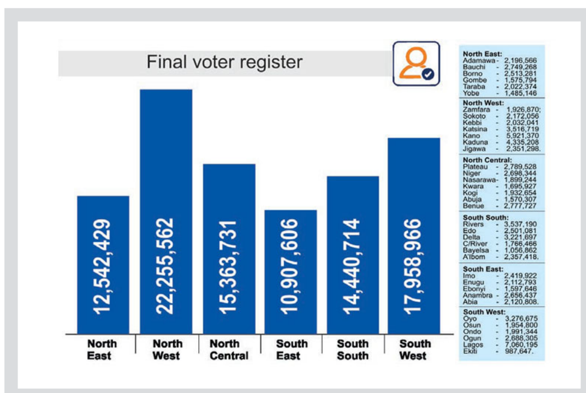
ECONOMIC AND POLITICAL OVERVIEW FOR THE MONTH

Nigeria

Moody's downgraded Nigeria's FX and local currency issuer rating to Caa1 with a stable outlook (Prev: B3). The previous rating had been a downgrade in late 2022; two downgrades in 3 months. Reasons include fiscal deterioration, insufficient access to external funding, constricted oil production and low capital flows. The fuel subsidy also weighs heavily, as it is a major contributor to the government's adverse fiscal position. S&P also revised Nigeria's outlook to Negative (Prev: Stable), but affirmed its B- sovereign credit rating citing similar reasons.

The World Bank noted that the -40% decline in oil production was due to insecurity, production costs, theft and indiscipline. The non-oil economy will have to bolster growth, and the World Bank sees GDP for 2022 reaching 3.1% and easing to 2.9% in 2023. The United Nations is aligned with this, estimating 2023 GDP at 3.0%. The IMF has a more optimistic view for 2023, pencilling in GDP growth at 3.2% following 3.0% in 2022.

The Central Bank of Nigeria's (CBN) Monetary Policy Committee (MPC) hiked rates by 100bps to 17.5%, wary of pre-election expenditure on top of elevated inflation. The latter moderated this month, for the first time since Nov-2021.
Presidential elections are to be held on 25 February, with no clear front runner but several high-profile contenders. The pre-election process has gone as expected, although on the ground there is a shift to social media and digital ad campaigns compared to previous elections. The Independent National Electoral Commission (INEC) has warned, however, that ongoing insecurity may threaten the election process. The INEC published the final list of registered voters:



Macro releases included (December stats):

- Inflation moderated to 21.3% y/y (Nov: 21.5%).
- FX reserves remained largely flat at USD 37.1bn.
- PMI inched up to 54.6 (Nov: 54.3), and dropped to 53.5 in January.
- M3 growth was +17.3% y/y (Nov: +21.6%).
- Private sector credit growth was +19.7% y/y (Nov: +17.5%).
- AUM for the pension industry grew +11.7% y/y to NGN 15.0trn, which is c.USD 32.6bn (Nov: NGN 14.8trn).
- Mobile subscriptions grew +13.9% y/y to 222.2m in 2022.

21.3% y/y	US$ 37.1bn	54.6	17.3%
Inflation Rate	FX Reserves	PMI	M3 Growth

Egypt

S&P affirmed Egypt's rating at B with a stable outlook. External financing from the IMF and GCC is supportive, as well as sufficient momentum in the FX market. Moody's downgraded Egypt to B3 (Prev: B2) with a Stable outlook (Prev: Negative). The outlook for Egypt has been moderated by the IMF, revising its GDP estimate for 2023 to 4% (Prev: 4.4%). The World Bank estimates 2023 GDP at 4.5% (Prev: 4.8%). On the ground, growth indicators look strong, with tourism, IT, agriculture, retail and logistics sector statistics all pointing in the right direction. The government projects GDP growth at c.4.8%-5%.

The government cleared the importation backlog at the end of January. The goods clearance has returned to normal, with restoration of usual inventory levels. The total value of goods released since 1 December totals c.USD 16.2bn, which should assist in normalising pricing of goods. Additionally, the government has launched a subsidised loan programme for businesses in the industry and agricultural sectors, as well as approving an increase in the local wheat procurement price as an incentive for increasing local harvests.

Macro releases (December stats):

- Inflation accelerated to +21.3% y/y (Nov: 18.7%).
- FX reserves reached USD 34.0bn (Nov: USD 33.5bn).
- PMI rose to 47.2 (Nov: 45.4); this dipped to 45.5 in January.
- M2 growth was +27.1% y/y (Nov: +27.5%).
- The trade deficit narrowed to USD 2.4bn in November (Oct: USD 2.9bn).
- The Central Bank of Egypt's (CBE) Monetary Policy Committee (MPC) maintained the lending rate at 17.25%.

21.3% y/y	US$ 34.0bn	47.2	27.1%
Inflation Rate	FX Reserves	PMI	M2 Growth

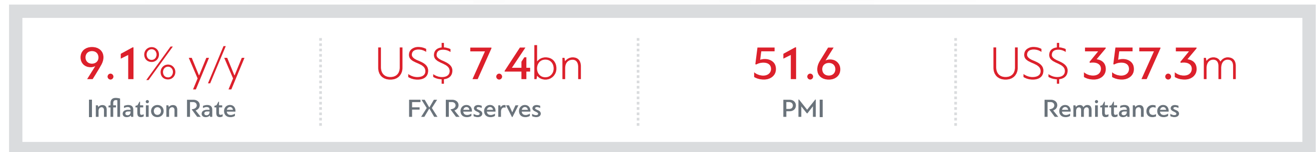
Kenya

The government forecasts GDP growth reaching 6.1% in 2023, and 5.6% estimated for 2022. The assertion is that 2023 will be a stronger year, in direct contrast to the developed world. The country is still buoyant due to post-pandemic recovery, as well as having a well-diversified economy. However, growth will be impacted by the drought, high inflation and interest rates. The World Bank estimates +5.0% GDP growth for both 2022 and 2023. The IMF's projections have set Kenya as the 5th largest economy in Sub-Saharan Africa this year.

Consumers continue to be under pressure. The government has put through several excise taxes on SIM cards, mobile phones and alcoholic beverages which will hit the already-constrained consumer. In addition, electricity price increases of up to 78% are proposed from April as the power subsidy that buffers lower-income homes is reduced.

Macro releases included (December stats):

- Inflation decelerated slightly to 9.1% y/y (Nov: 9.5%).
- FX reserves were USD 7.4bn (Nov: USD 7.1bn). The Central Bank of Kenya (CBK) had to dip into reserves to honour debt repayments, so reserves slid down to USD 7.0bn as at end-January.
- PMI rose to 51.6 (Nov: 50.9).
- Remittances saw a slight uptick, growing 1.9% y/y to USD 357.3m (Nov: USD 345.4m). This brings total remittances for 2022 to USD 4.0bn, up +8.3% y/y (2021: USD 3.7bn, up +20.2%).
- The trade deficit widened by -20.4% in November.



Mauritius

The Bank of Mauritius (BOM) introduced a new monetary policy framework. It effectively outlines changes such as the adoption of a flexible inflation target, with a range of 2-5%. The Key Repo Rate will be replaced with the Key Rate as the policy rate – starting at the current level of 4.5%. The BOM has indicated that MP instruments are under review to manage liquidity. Additionally, the BOM raised commercial banks' FX reserve ratio from 6% to 9%, to be maintained monthly as opposed to daily.

Tourism arrivals rose 4.5x in 2022 compared to 2021, noting the soft base. This slightly undershot the government's target of 1m tourists for the year. Arrivals in 2021 declined -42% y/y as borders only opened from October that year.

Macro releases included (December stats):

- Inflation was 12.2% y/y (Nov: 12.1%).
- FX reserves were USD 7.8bn, which is 16.1m of import cover (Nov: USD 6.7bn).

Morocco

Morocco is officially the world's leading exporter of canned sardines in 2022, with ongoing efforts to protect and maintain marine ecosystems bearing fruit. The fisheries industry earned USD 2.7bn in export revenue in 2022, a volume increase of +13% y/y and +16% y/y in value. Volume growth was strong within this sector: Canned sardines recorded +9% y/y growth, frozen sardines grew +43% y/y and fishmeal and oil up +36% y/y.

The IMF commended Morocco's response to global shocks in 2022; the strong stance allowed the country to retain stability. Additionally, the IMF is in support of Bank Al-Maghrib's decision to tighten its monetary policy in response to inflation as well as affirming the government's 2023 state budget. 2022's GDP growth is estimated to have hit +1.3% due to the drought and global macro conditions effect on the economy. The IMF has pencilled in GDP growth for Morocco at 3.0% in 2023, due to a rebound in the agricultural sector.

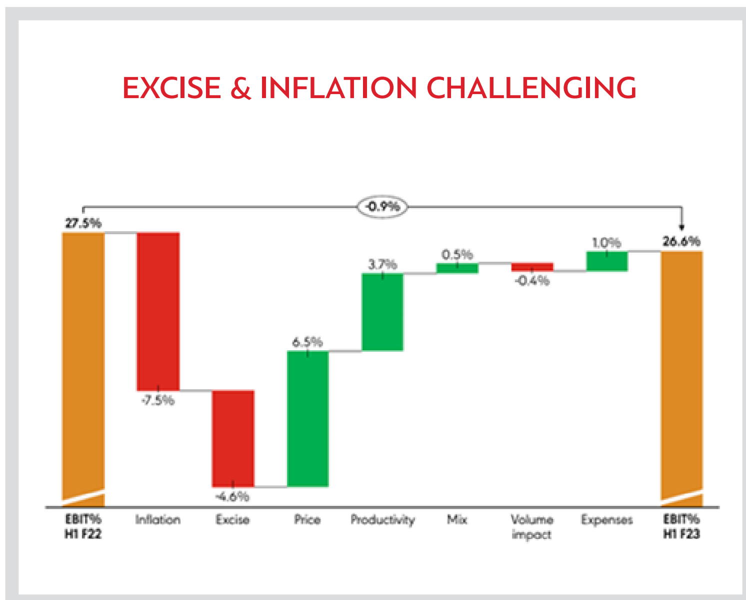
Macro releases (December stats):

- Inflation remained flat at 8.3% y/y.
- FX reserves slipped to USD 31.3bn (Nov: USD 32.0bn).
- Tourism receipts grew +112% above that of 2019 pre-pandemic. However, in absolute terms, tourist arrivals are at 10.9m, below 2019's total of 12.9m arrivals.
- In 2022 the trade balance reached -22% of GDP according to the government, and is expected to narrow to -20% of GDP in 2023.

COMPANY UPDATES

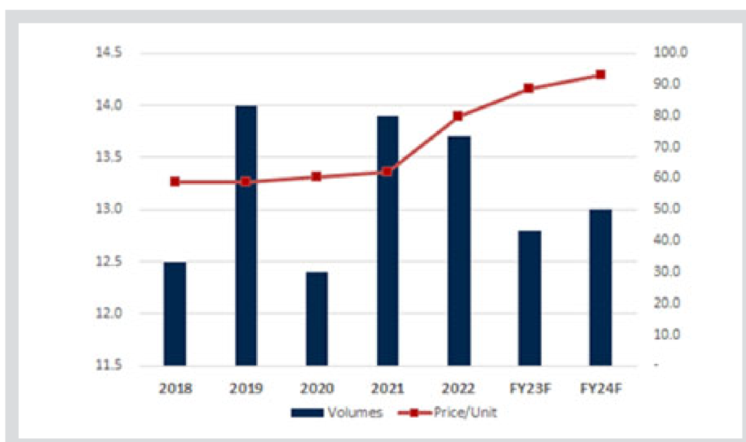
KEY TO BRACKETS: (COUNTRY, INDUSTRY, WEIGHTING)

EABL (Kenya, Consumer staples) 1H23 results: Revenues grew a muted +4.3% y/y, undershooting expectations set at the last management call in December. The group pushed prices by +8% y/y to deal with anticipated cost growth, but this only partially offset the increases. Major headwinds included excise duty and inflation. The latter hit grain, fuel and other inputs which affected margins. Kenya's excise duties were +17% y/y in Beer and +28% y/y in Spirits. As a result, the Kenyan market (64% of revs) was down -1% y/y, while Uganda (20% of revs) and Tanzania (16% of revs) toplines grew +19% y/y and 11% y/y respectively. Premium grew a strong +13% y/y, followed by spirits +4% y/y. Beer grew a muted +2% y/y and new frontiers lagged -2% y/y. COGS offset topline growth up +8.0% y/y. GP margin was squeezed by 184bps to 46.4%. Opex was flat, while interest expenses grew +8.0% y/y. PBT and PAT growth were flat y/y. Kenya's excise increase took 5ppts off bottom line y/y. Net debt grew +27% h/h, so the group is still highly geared. Management sees the remainder of 2023 as recovery, expecting inflationary pressures to ease in 2H23. Dividend declared of KES 3.75 per share, similar to 1H22.



Unpacking expectations for topline

This was the first major price Increase in Senator Keg since 2q14, so volumes would inevitably take a dip. However, consumer wallets are under pressure all round, so price elasticity is even more fragile. In 2014 excise was +100%, prices were doubled which led to a 75% volume decline in beer. This time around, excise was +17% and volumes fell from +22% growth to +2%; essentially a bigger hit on volumes for a smaller increase. Looking ahead, 2H23 will still harbour the impact of ongoing elevated inflation for all inputs. Up until now, EABL has been effectively insulated from many headwinds apart from the pandemic – weathering FX issues, moderate inflation and drought. However, for the next couple of years, topline will be affected by many raw input increases plus escalating fuel costs. We expect margins to be hit for FY23, bringing topline growth down from +27% y/y in (June) FY22 to 4% y/y in FY23F.



Long and wide runway for growth

The illicit market constitutes c.50% of the total market in Kenya which is a huge potential growth opportunity. Added to this, Uganda's informal illicit brewers make up 60% of alcohol consumption – more space for growth.

MARKET OUTLOOK

Africa is expected to outperform the rest of the world with an improved outlook in 2023. We continue to allocate to high quality businesses; those that score highly on our internally developed, Likert Q-scoring system, both currently and over time. We have two additional quantitative overlays, valuation and growth. We also have two qualitative overlays being management and ESG. What is particularly exciting is that we have a number of businesses across Africa that fit these criteria. The key transformational trends of financial inclusion, urbanisation and economic formalisation underpin a robust African consumer story that is taking shape regardless of global volatility. We allocate to the best companies in the sectors that tap into this transformation. At the moment, we have a bias towards financial inclusion and fintech themes as they do particularly well on our growth metrics.

Nigeria – An election year signals muted growth; but the mass youth registrations are a positive sign. Adjusted economic reforms are more likely given new leadership. However, fuel subsidy reform delays show institutional weakness. We still wait for a signal from the CBN for a free flow and float of the Naira which is for us the real trigger for economic recovery. The road to full recovery will take committed policy change and will be bumpy. The communications, fintech and banking sectors are growing strongly, yet high quality companies exploiting these, are at all time low valuation multiples.

Egypt – The outlook for Egypt remains positive with continued accumulation of FX reserves and the CBE's sound monetary policies keeping the bond carry trade alive. The tourism outlook has improved, wheat prices have halved, and strong remittance growth continues. With the bulk of household consumption in cash, the investment opportunity for us in fintech is immense in this 100m population country and it will also drive economic formalisation and increased government revenue through widening of the tax net.

Morocco – Morocco's key economic drivers are mining, agriculture and tourism. Agricultural production is promising, with good rains since November supportive of growth. Tourism is rebounding with positive indicators for 2023. In terms of outlook, it remains a stable, mid-growth country with excellent opportunities in retail, manufacturing and fintech.

Mauritius – Tourism rebounded and growth prospects are positive.

Kenya – Peaceful elections and a new, business-friendly President bode well for the country in the foreseeable future. Continued recovery in tourism, lower soft commodity import prices and a rebound in food exports should provide tailwinds. Corporate expansion into neighbouring countries such as the DRC and Ethiopia, provide significant opportunities for Kenya. Safaricom and Equity Group are the two main drivers. IMF and World Bank support will also allow the country to maintain a strong growth trajectory.