IMARA Asset Management

Monthly Market Report

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Market snapshot

Markets (MSCI indices in USD/currencies vs the USD) –

Dec Perf (%)	MTD LCY	YTD LCY	MTD USD	YTD USD
MSCI World	2.9	25.2	2.9	25.2
Egypt	0.8	7.1	1.3	19.5
Kenya	5.4	18.5	6.6	19.1
MSCI EM	7.2	15.4	7.2	15.4
Morocco	3.0	7.1	4.1	6.8
Tunisia	2.5	-2.1	2.8	5.3
Botswana	-0.1	-4.6	2.2	-3.4
Mauritius	2.4	-1.9	3.5	-7.6
BRVM	12.4	-7.5	14.6	-9.4
Nigeria	-0.6	-14.6	-1.5	-14.9
Zambia	0.1	-18.7	3.9	-31.4

December saw a positive month, with most markets ticking up in local currency. However, a strong showing by the USD trimmed translated performances, as the US and China appear to be moving toward a trade war resolution.

Overall the performance for 2019 was positive, with diverging attributions. On the upside, our positive stance on Kenya was rewarded. We expect more from this allocation in 2020 as positive sentiment flows into the market from a combination of more credit and consumer spending.

If you strip out the performance of CIB, the Egypt market performance was less stellar, especially on some consumer names. Our core picks, IDH and EIPICO managed to produce reasonable results, albeit slightly behind our high expectations. Still, their performances were ahead of more discretionary consumer names which struggled with pricing power. Subsidy removal did place a lid on consumer spending even though inflation came down. We believe that 2020 will be better as the economy moves past recovery to real growth.

On the negative side, Nigerian Breweries struggled in a weak consumer environment as a lack of pricing power and flat volumes translated to poor results. Still, despite the headwinds of poor growth and business sentiment in this market, we are very satisfied with the quality of business models and valuation levels of our holdings.

A further negative contribution came from illiquid holdings in Botswana and Zambia. We think it reflects a liquidity premium (illiquidity discount) which is more glaring in a frontier risk-off phase.

Economic and political overview

Nigeria – The Government passed the 2020 budget before year-end, with an assumed oil price of USD57 per barrel and oil output of 2.18mn bpd. The oil price assumption is conservative and the production is in line with current levels. The budget implies a fiscal deficit of 1.5%. Both the Federal Government (FG) and the Central Bank (CBN) have been in the

spotlight this year, with policy inconsistency a major theme. On one end some policies have been aimed at stimulating growth such as the increase in the minimum wage and the increase in the loan-to-deposit ratio (LDR). On the other end, shutting borders, excise duty and VAT increases, a restrictive CRR and the over-regulation of banks has stifled activity. The challenge of high unemployment and stagnant economic output persists. However, December is earmarked as the first month of minimum wage implementation by the FG, with a deadline of 31 December issued by the Labour Congress to all 36 states.

Lending to the real sector has jumped +7.7% q/q since the LDR directive was instituted in June, an increase of NGN 1.1trn (USD 3.03bn). In addition to this, the CBN has issued licenses to 15 mobile money operators as part of its focus on financial inclusion. Guidelines governing services have been released, and include a plan to roll out 500,000 agents in 2020.

The new year will see the impact of VAT increases, excise duties and continued wrangling for payments of the minimum wage. Positive sentiment remains on the ground, with the PMI consistently above 50 and the promise of imminent projects that will significantly impact the economy such as the Dangote Refinery.

Macro data releases (Nov stats):

- Inflation 11.85% (Oct: 11.61%) driven by food inflation linked to border closures.
- FX reserves declined to USD 39.8bn (Oct: USD 40.5bn) due to portfolio outflows.
- PMI quickened to 57.7, an improvement from 56.9 last month on the back of new orders.
- E-payment transactions totaled 800m valued at NGN 43trn (USD 118.6bn) in 3Q19. Penetration now stands at 62% of the population (c.200m).

Egypt – The strong economic policy reform in the country has laid the platform for sustainable growth, most of these reforms we have covered in detail in previous notes (devaluation, subsidy reduction, bankruptcy laws). In line with this, December kicked off with an announcement of 3 initiatives to bolster economic development. Funding is budgeted at EGP 150bn (USD 9.3bn), to be distributed as follows:

- EGP 100bn (USD 6.2bn) directed towards the industrial sector at a subsidised interest rate of 10%. The focus is on industries that reduce importation, although all entities with a turnover of EGP 1bn are eligible. 96k companies are expected to benefit.
- Accumulated interest on troubled factories will be waived, assisting over 5k companies facing financial constraints to restart operations. Accumulated interest stands at EGP 31bn (USD 1.93bn), while principal debt is EGP 6bn (USD 374m). If firms pay 50% of principal, they can access new funding. This will increase capacity utilisation which has been stagnant over the past two years.
- EGP 50bn (USD 3.1bn) targeted at aspirant homeowners at an interest rate of 10% (20 year funding). This is a major boost for pressured middle-income consumers.

Macro data released:

- Inflation crept up to 3.6% y/y in Nov (Oct: 3.1%) due to an increase in non-food inflation (0.2% y/y).
- End-Nov FX reserves USD 45.3bn (Oct: USD 45.2bn).

- PMI fell to 47.9 in Nov (Oct: 49.2)
- Government spending on fuel subsidies fell by 69% y/y in 1Q19/20 in accordance with the IMF-backed reform programme.
- Loan growth +11% y/y in October. Corporate loan growth slowed slightly due to the strengthening of the EGP, but retail loan growth continued to recover at 27% y/y.

Kenya – Post rate cap removal, 2020 promises to be a stimulative environment for local businesses. Banks are currently still offering loans at 13%, with only a few lenders who have raised their interest rates. This will be interesting to monitor, as banks disclose 1Q20 product fees.

Equity Bank was named "Bank of the Year" by the Financial Times, making it the top regional financier for the second consecutive year.

Macro releases (Nov stats):

- Inflation rose to 5.56% (Oct: 4.95%), mainly driven by increases in food and non-alcoholic beverages.
- PMI remained flat at 53.2.
- Foreign capital inflows into the Telco sector rose +70.8% (USD 659.03m) between 2016 and 2018.

Morocco – 2020 promises a continuation of the stable backdrop for growth. The unemployment rate was 9.4% in 3Q19 (9.3% in 3Q18). Although more jobs were created in services and construction, agriculture and handicraft industries lost positions. The impact of the agricultural job losses was felt mainly in rural areas with the rural unemployment rate rising to 4.5% (3.9% in 3Q18). In urban areas, unemployment fell to 12.7% (13.1% in 3Q18). Youth aged 15-24 constituted the largest proportion of the unemployed (26.7%).

Loan growth crept up to 6.1% in October, as real estate loans continued to increase +3.3% y/y and consumer loans were on the rise +4.6% y/y.

Company updates

Safaricom (Kenya, Communications) 1H20 results update: A good set of results, albeit with a lighter than usual top line. Revenues came in +5.8%, with EBITDA +10.1% and EPS +12.9%, as depreciation charges flatten out. Within this, Voice revs were -1.4%, SMS -11.1%, MPESA +18.2%, Mobile Data +4.0% and Fixed +18.4%. The company kept its full year guidance for EBIT of KES 93-97bn, however we believe this will be comfortably beaten. As expected with a diversifying business, there were a number of moving parts in these results and reassuringly the negatives are logically explained and/or will reverse.

- Voice – down 1.4% as subscriber growth of 7% to 25m, was outweighed by ARPU decline of 9%. This trend is expected as data increasingly cannabalizes voice.
- MPESA withdrawals – only grew by 9.2%, this is a well flagged trend and part of the business model. MPESA v1 was only an in-out transfer system, with revenues earned from withdrawal fees. However, these fees attract agents commission. An ever growing suite of apps and services now encourages chargeable transactions in addition to withdrawals. These transactions do not carry agent fees and are higher margin. In 1H20 chargeable transactions per customer per month rose 17.5% from 9.3 to 10.9, which contributes to Group EBITDA margins rising. The attached slide 14, shows how the composition of MPESA revenues has changed since 1H17.
- Gaming revenues – down 15.5% on the ban, these are unlikely to return but will be rolled out of the base.
- Data – revenues only grew 4% y/y, which reflects the price war which ensued toward the end of the comparative 1H19. As the annotation shows in slide 16, a further recovery in 2H20 (growth and seasonal), should yield a high comparative growth rate. We are comfortable that data will resume high teens growth beyond 2019. The slide also shows the robust demand drivers in data notably:
    - Avg use per user +43.6% y/y.
    - Customers +14.8% y/y.
    - 4G devices +70.8% y/y to 4.5m, with 4G sites +51% and coverage now at 63%.

On the positive side, MPESA ex issues above, grew strongly.

Fixed service, while relatively small is growing fast, as Safaricom fills the void left by the absence of a nationwide fixed line operator. FTTH homes passed rose 42% to 300k and customers +44% to 115k. Importantly, there is a substantial uplift in ARPU from a mobile customer at c.USD 6.5 to an FTTH customer at c.USD 40. FTTB, even higher ARPU, is also showing substantial growth as the attached slide 17 shows.

To conclude the company is well positioned for a strong second half and close out of the full year to 31 March 2020. We expect stronger revenue growth and continued cost efficiencies to outweigh the growth in capex and depreciation, driving increased shareholder returns. The share is trading at 8.7x FY19 EV/EBITDA and 17.4x FY19 PE, the mid-point of its range.

Market outlook

Nigeria – The results for the first nine months non-financial sector confirm anaemic growth, with little or no volume uptick. Any revenue growth is well below inflation. Attempts to raise prices have been rejected by customers and undermined by competition, which combined with excise duties (alcoholic beverages), have resulted in significant margin erosion. An exception is Telco, where increased penetration and rapid data uptake are driving strong growth. After a very strong 2018, banks have done well to produce flat earnings this year. They made a lot of money off yields in 2017-2018 and have seen margins come down from this source in 2019. We like our picks in the sector going forward because of its strong fee growth strategy in trade, mobile banking and wealth management. Overall, the macro outlook is extremely opaque, where the desired objectives of the government's tight monetary policy, higher FX reserves and lower inflation, are not being achieved. Positive catalysts are a higher oil price and the completion of the Dangote refinery, albeit substantially delayed.

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 (wage growth may exceed inflation in 2020) and this is further supported by corporates restocking as demand picks up. With the upside risk to inflation from subsidy removal digested, we expect further rate cuts and liquidity injections to drive the next phase of economic growth, which will be capex and consumer driven.

Kenya – The decision to remove interest rate caps reintroduces the opportunity for an asymmetric trade on Kenya bank shares and economic momentum. This decision coupled with the CBK MPC to lower rate by 50bps is a strong signal for monetary stimulus to commence. We expect lending to accelerate in 2020 which will breathe new life into the consumer and SMEs. 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 – The non-agricultural, and less volatile part of the economy has performed well, up 3.8% so far in 2019, while inflation has remained comfortably under 1%. We expect fiscal and monetary stimulus to continue this trend into 2020. The challenge remains to find attractively priced growth investment opportunities, which we see possibly developing in Payments/Fintech and local consumer goods production. Our recent addition, Label Vie (supermarket, hypermarket, cash 'n carry), 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.