IMARA Asset Management

Monthly Market Report

Edition:	**January 2020**
Region:	**Africa ex South Africa**
Issued by:	**Imara Asset Management Limited**
Author:	**Craig Bandason, Rainer Orth, Tony Schroenn**

Market snapshot

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

Jan Performance (%)	LCY	USD
Nigeria	7.5	7.7
Morocco	3.0	2.5
Egypt	-0.3	1.3
Mauritius	1.6	0.7
Tunisia	-0.6	-0.2
MSCI World	-0.7	-0.7
Kenya	-2.6	-1.5
Botswana	0.7	-2.5
Zambia	-0.3	-3.6
MSCI EM	-4.7	-4.7
BRVM	-4.1	-5.3

The year started with a month of diverging performances. After a strong start, emerging markets plummeted as the unfolding coronavirus spread and China's unprecedented response takes centre stage. Nigeria (+7.7%), Morocco (+2.5%), Egypt (+1.3%) and Mauritius (+0.7%) performed strongly, offset by Kenya (-1.5%). We visited Egypt and Morocco last week and left with a positive view on both.

Economic and political overview

Nigeria – In a surprise move, the CBN increased the Capital Reserve Ratio (CRR) for banks from 22.5% to 27.5%. While this would typically signal slower loan growth, it seems to be contrary to the CBN's minimum LDR requirements, which supports loan growth. We think the truth is less controversial. Most banks are substantially above the 22.5% requirement so it codifies what is already in place. On the positive side, more evidence came through that minimum wage payments have started to trickle in for civil servants, including arrears accrued from May 2019. The increase was +67% at the lowest pay grades, while anecdotal evidence indicates that federal workers at a higher pay grade above the minimum received an increase of 15%.

Macro releases included:

- Inflation crept up to 11.98% y/y in December (Nov: 11.85%), driven by +14.7% y/y growth in food prices and +9.3% y/y growth in non-food prices.
- PMI fell marginally from 57.7 in Nov to 56.8 in December.
- FX reserves continued to decline, falling to USD 38.6bn in December (Nov: USD 39.8bn). The CBN Governor recently insisted that current FX management will continue with no adjustments.
- The current account deficit narrowed to 2.3% in 3Q19 from 3.3% of GDP in 2Q19, as trade showed stronger performance.

DISCLAIMER 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.

Egypt – We visited Cairo last week and could sense the growing confidence from management teams. We met with CIB on their FY19 results day and their confidence could not be higher after a great 4Q19 number. Also, after much wait, and rate cuts, several multinationals are signing capex loans albeit mostly for replacement rather than new capacity. **CIB** expects a substantial pipeline of EGP 9-11bn (c.USD 600-720m) in 1H20. A particular focus of the trip was the fast growing fintech space. We met interesting start-up companies such as Halan (3-wheeler ride hailing and nano-loans), however the key area for us was to understand the payment segment where **Fawry** and its main competitors Masary and Bee (both partly owned by listed MTIE) dominate. The key takeaway is that both will benefit from high growth in an underpenetrated market. For **IDH**, there were a few mixed highlights around the fringes, but the core Egyptian business remains very strong. Management is guiding to a "softer" 2020, with Group revenue growth of 20% and slightly higher EBITDA margins of 42%. We visited **Rameda** (recent Pharma IPO) impressive production and warehousing facility. We like management, their product and active ingredient pipeline but remain cautious as its trades on a substantial premium. We also expect some near-term earnings disappointment. The government's recent announcement to double healthcare expenditure bodes well for the country and the sector. *We have included company notes below.*

Moody's maintained Egypt's sovereign debt rating at B2 and stable outlook. Continuing with the theme of improved confidence, the Finance Ministry and Central Bank have not accepted an offer for further financial assistance from the IMF, stating that going forward it should be limited to technical and advisory assistance.

In another vote of confidence for Egypt, STC of Saudi Arabia, made an offer to buy Vodafone Group's 55% stake in Vodafone Egypt (VFE), for USD 2.4bn and a 50% premium above most analyst's valuations. Over and above the vote of confidence, Telecom Egypt owns 45% of VFE, which if it were to sell, would bring just under USD 2bn into Egypt. This would likely be routed to the govt (80%) and the free float (20%) via a special dividend.

Macro releases (December stats):

- Inflation rose to 7.1% (Nov: 3.6%) on the back of higher food prices. This increase reflects the unfavourable base effect from shock reversal of fresh vegetable prices in 2018. Core inflation came in at 2.4%, compared to 2.1% in November.
- PMI rose to 48.2 (Nov: 47.9) showing the private sector's lagging recovery.
- FX reserves continued to grow steadily, reaching USD 45.4bn (Nov: USD 45.3bn).
- M2 growth was 13.3% (Nov: 13.2%)

Kenya – The Central Bank of Kenya's (CBK) Monetary Policy Committee (MPC) made its second consecutive rate cut, bringing the lending rate to 8.25%. The aim is to stimulate business activity and encourage growth, given that inflation continues to fall within the target range. Lagged data shows 3Q19 GDP at 5.1%, a decline from 6.4% in 3Q18 and 5.6% in 2Q19.

The banking sector has remained largely stable y/y. Liquidity for commercial banks stood at 49.7% in Dec, while the ratio of non-performing loans (NPLs) to gross loans declined to 12.0%. Banks have progressed loan recovery efforts, resulting in reduced NPLs in trade, real estate, financial services, manufacturing and household sectors.

Macro releases included (December stats):

- Inflation inched up to 5.82% (Nov: 5.56%).
- PMI was flat at 53.3 (Nov: 53.2).
- FX reserves reached USD 8.5bn, equivalent to 5.2 months of import cover.
- Private sector credit grew by 7.1% to the end of 2019.
- Diaspora remittances reached USD 250.3m. 2019 remittances grew +3.7% y/y for the year, a significant drop from +38.5% y/y growth in 2018, and the slowest since 2015.
- The current account deficit narrowed to 4.6% of GDP in 2019 from 5.0% in 2018. This is the lowest level for a decade.

Morocco – We also visited Casablanca last week. We were again struck by the orderliness and sophistication of the market, the quality of management teams and growth opportunities that still exist. Three opportunities stand out:

- **HPS** (banking software and switching specialist) will grow even faster than expected as it lands several new large mandates. *More detailed report to follow.*
- **Label Vie** grew faster than 2019 budget and optimistic again for 2020. Significant potential upside from real estate subsidiary IPO. *See notes below.*
- **Mutandis** (local brand detergent, seafood, packaging and fruit juice) still expect to grow its route to market to 50-70k stores from 35k, and in the process taking market share from sleepy multinational brands. *More detailed report to follow.*

Morocco's industrial capability is impressive as we have seen in auto and phosphate. The scope for large scale industrial investments in transhipment (global logistics hubs) such as the Tanger-Med project is also an interesting source of new growth. We met with Marsa Maroc, the largest local port handling operator, who plans to complete a USD 196.2m capex in the 1.5m container capacity of Tanger-Med Container terminal 3 (TC3) in 2020. Overall, the Tanger-Med plan is for capacity of 9 million containers and is already an industrial hub for 900 companies.

The macro releases are mainly in line:

- 2019 year-end figures for the banking sector show +5.3% y/y growth.
- Inflation quickened to 1.2% in December (Nov: 0.4%), the highest since December 2018. The increase is mainly due to alcoholic beverages & tobacco (+15.1% y/y).

The government announced the introduction of affordable funding for SMEs in 2020. Annual support of MAD 2bn (USD 207.3m) has been earmarked over the next 3 years in order to accommodate an interest rate of c.100bps below the benchmark.

Overall, we think Morocco is heading in a positive direction. There have been a number of corporate fiscal penalties, asymmetric tax audits in 2018 and a rate increase from 30% to 32.5%, however you get the distinct impression that the proceeds of these as well as recent privatizations, are being and will continue to be, put to productive use. This view is reinforced by the presence of three ex-businessmen technocrats in the key roles of Finance, Planning and Agriculture.

Often these individuals are opportunists masquerading as patriots, however there is a strong feeling on the ground that this is not so.

Company updates

East Africa Breweries Limited (Kenya, Consumer staples) 1H20 results: Results in line with expectations. We saw consistent growth in all 3 markets as well as all 8 categories. Volumes were up 5% y/y, net sales up 10% y/y and operating profits up 9% y/y. Gross margin expansion +1.5% driven by volumes, price mix and productivity savings (procurement, local sourcing, process loss reduction, lower distribution costs). Operating profits grew +9% y/y, behind topline due to investment in additional headcount in sales as well as their investment behind their brands. Looking at the categories, the investment in margin accretive brands is starting to pay off with strong growth in reserve and premium spirits up 13% y/y and 14% y/y respectively. On the 1H20 investor call, management highlighted the growth opportunities in the East Africa region, with a median age of 19 and 1m consumers being added to the LDA population each year, we expect them to invest in capacity expansion projects in Uganda and Tanzania.

Commercial International Bank (Egypt, Financials) FY19 PBT +29% y/y capped a very strong year. 4Q19 loan was +8% q/q and reflects a new appetite for credit after several rate cuts. Management guides to a strong capex pipeline of EGP 9-11bn (USD 600-720m) in 1H20. That is already 10% of the loan book. Loan growth guidance for 2020 is at 20%. As a result we also expect credit related fee growth. Capex attracts a letter of credit which is charged at 1.25% per quarter. A capex programme usually runs 5 quarters, so represents 6.25% fee potential on face value. Although yields are coming down, cost of funds is also cheapening which means NIMs will be slightly lower. Stable NIMs, strong fees and loans plus stable CoR means 2020 will be another good year. Overall we expect 20-25% earnings growth in 2020. CIB is indeed the gift that keeps on giving.

Stanbic IBTC (Nigeria, Financials) unaudited FY19 PBT +3% y/y was a good result when compared to the high base set by 2018 boosted by provision write-backs and high yields. These were only an unaudited release and expect a more thorough feedback once the audited results are released.

Market outlook

Nigeria – Results 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. 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 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's MPC to lower rates 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.

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's MPC to lower rates 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. 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.

IMARA
Asset Management

Egypt and Morocco – Company notes from recent visit

Commercial International Bank (COMI)

- 350 bp cut has led to credit demand.
- 4Q19 9% on $ q/q and 6% EGP q/q.
- 1Q20 and 1H20 will see more capex loans, commitment from companies mainly multinationals.
- Pipeline: EGP 9-11bn for 1H20.
- Edita/JUFO/Domty B segment not strong customer and only area of concern but a wage issue, will lap.
- Capex is a focus on replacement capex, early part of investment cycle, have more legs.
- Biggest issue for Egypt investment case in Middle East politics, specifically Saudi/Iran relationship, Israel is irrelevant.
- Egypt strategic role is last large standing army of 1m + soldiers.
- NFI fees will go up as capex require LC, charged at 1.25% per quarter, typically capex last 5 quarters of LC funding.
- 2020 loan growth: 25-30% EGP, 10-15% USD = Total of 15-20%.
- NIM may be slightly down in 2020, NFI will be strong.
- Pre profit share target is EGP 14.2 bn (19: 11.8bn).
- CASA is improving a lot from 42% to 51% - recent deposit acquisition 62% CASA - to continue due to payroll targets.

Integrated Diagnostics Holding (IDH)

- Core Egypt business remains robust and growth story very much intact, with a few small developments around the fringes.
- Guiding to 20% Group revenue growth and 42% EBITDA margins.
- Al Borg Scan (Imaging) - performing well and the first branch is profitable at branch level. New branch opening imminently.
- Jordan - 7% of revenues:
    - Prices regulated, historically low margins in the low 20's.
    - Initiatives on the cost side have raised margins to 36% in 2019.
- Sudan - 1.5% of revenues, current political and economic situation has EBITDA slightly negative. IDH (and other Egypt co's we met) are long term positive on the country as a source of growth for Egyptian corporates.
- Nigeria - original plan was to invest $10.5m max in the country. Have found the environment extremely difficult and have now decided to cap investment at $4m and turn the current footprint profitable. Believe long term potential is huge, but not willing to throw money at the problem.
- 2020 outlook:
    - 20% rev guidance is 10-13% pricing and 5-10% volume.
    - Margin expanding slightly to 42% on efficiencies, economies of scale.

- Salaries and wages up between 10 and 15% depending on category, increases mostly passed in Q1. Do not believe there will be a disconnect between these increases and revenues, such that margins take an initial hit.
    - Base capex is 6% of revenues, with Al Borg 2nd lab being over and above at approx EGP25m.
- Data analytics - in its infancy, but hired a specialist. Believe their database of 30m customers is hugely valuable.
- Dividends - do not plan on building cash balance so any earnings/FCF will be paid out.

Label Vie

We visited Label Vie mgmt at their main dry goods warehouse and distribution centre between Casablanca and Rabat.

Management indicated that the long awaited listing of its deconsolidated real estate arm, Aradei, via a REIT, should take place either 4Q20 or early 2021. The significance of this is that should the listing take place, it should value the business around MAD 4bn, and LBV's 58% stake at MAD2.3bn, substantially higher than the carrying value of MAD 1.2bn. A lingering concern of ours has always been LBV's relatively high level of debt for a retailer (MAD 1.5bn). Ownership of a more liquid, tradable asset, gives LBV optionality to reduce debt and/or pay a special dividend, depending on what portion they maintain or sell.

In terms of operations:

- Mgmt expects double digit revenue growth for 2019, noting a pick up in 4Q19. Noted that 4Q18 had been quite soft, which bodes well for y/y growth.
- We noted that while revenue growth in 1H19 had been very strong, operating profit growth has been less impressive. For this two factors were given:
    - Atacadao format (largescale, wholesale, B2B) is lower margin. This sector has been growing revenue the fastest like for like, but margins lower. This effect should at least partially lap in 2020.
    - Atacadao has also had to invest heavily on marketing and brand recognition, as it is not a known brand like Carrefour. This will also reduce and lap in going forward.
    - Store roll-out costs in the supermarket division.
- The success of Atacadao appears to be as a preliminary step in the modernization of retail. It also augments the traditional segment, which while not growing as fast, still represents the bulk of retail in the country.
- Atacadao is also 5-10% cheaper than Marjane, the largest competitor, driving market share gains and volumes.
- There is a big focus on costs, streamlining and efficiency. Atacadao has 6k SKU's, as a reference LBV's hypermarkets have 33k SKU's and supermarket 25k SKU's.
- In terms of expansion, mgmt plans for another 30,000 sqm in 2020, which will be equally split across the three formats. This implies 10-12 new supermarkets.
- The new Gourmet, super high end format, only has 2 stores. The margins are high, but so is the capex and outlay effort, meaning progress is likely to be slow.
- Management is confident of the outlook in 2020 and is guiding towards another double digit revenue growth year.

Fawry

- Underlying metrics remain strong and momentum from September results continues.
    - At IPO had 105k PoS, then 125k end September and closed 2019 with just short of 150k. Believe this can get to 180k-200k in 2020.
    - 2019 revenue growth in mid 40's.
    - GP growth in high 50's.
    - EBITDA Margin high 20's.
    - Operating profit should roughly triple.
- Still believe that there is significant scope for horizontal and vertical growth of their offerings, or as we say a long AND wide runway for growth. Horizontal growth is for example more PoS's, vertical is more services over a PoS.
- One of the key services offered to consumers is funding of prepaid electricity meters over their various channels.
    - Believe the system integration work done with the govt utility creates a significant barrier to entry.
    - Currently 6-7m such meters in Egypt and believe this should grow to 35m in the next 5-7 years.
- 22 of 28 banks use Fawry technology and infrastructure, to offer their customers access to Fawry services. Believe that the banks are unlikely to repeat this investment with Fawry competitors.
- Fawry consumer app - bulk of Fawry development and success has been on the merchant side, the next initiative/challenge is to develop the consumer side. They have a consumer app, but as yet only has 120k customers.
- Costs - main costs are:
    - PoS costs
    - Back office processing
    - R&D
- Capex - ongoing and expansion comfortably covered by FCF.
- DPS - no dividend policy yet.
- Key assets:
    - Self developed technology
    - Brand
    - Data

MTIE - Consumer conglomerate, with investments in Fintech/Payments/Microfinance

Ebtikar (Masary and Bee) similar to Fawry.

- Combined have similar PoS's as Fawry, at 123k end Sep.
- They do 3m transactions, worth EGP 42m per day.
- They believe that even combined with Fawry, they represent a tiny part of the market and that the growth potential for all providers is massive.
- They are more consumer focused, where for now Fawry is more merchant focused. 35m Egyptians use Bee and Masary, whereas 22m use Fawry.
- Bee has its own wallet with 300k customers, whereas Fawry is on a banks wallet.

- They claim to also be present in the utility bill payment market.
- They plan to leverage the Group's countrywide distribution and customer network and see tremendous synergies with the car and consumer electronics businesses. 90% geographic footprint, 95% popn reach, 34 distn hubs, 40k points of sale.
- MTIE owns 49.9% of Ebtikar, which owns 60% of Bee, so effective 30%. Balance held by mgmt and founders.
- MTIE owns 10.6% direct in Masary and Ebtikar owns 69.8%, so effective 45%.
- Ebtikar also owns Tamweel (car finance and leasing) and Vitas (Microfinance).
- Ebtikar is associate accounted and has recently turned profitable.

Cars

- Have exclusive franchises for Jaguar, Bentley, Land Rover and Mazerati.
- Importantly, these are duty free (EU treaty), so are outcompeting the Asian brands.
- Doubled volumes in 2019 and plan to reach 11,000 cars in 2020.
- 20% gross margin business.
- Have an in-house car finance offer.
- Launching a used car department.
- As with most car businesses, benefit mostly from spare parts.

Electronics

- They have 2 of the 4 Samsung agencies and 1 of the 2 Huawei agencies in Egypt, so semi exclusive.
- Also have exclusive on Bosch, which is also duty free from EU.
- Warehousing, logistics and delivery are all in-house, so they have a massive distribution network across Egypt.
- GM in Samsung is 6%, Huawei 8% and Bosch 15%.
- Mobile phone handset growing very fast. 4yr handset upgrade cycle vs EU of 2yrs. Heard varying stats, but roughly Smartphone penetration is 40% of handsets. Increased adoption should help contract the upgrade cycle.

Telco - they manage 85 phone shops/retail outlets for Vodafone Egypt. MTI has 27k points of sale that sell scratch cards and offer electronic top up and represent 50% of Vodafone's distribution.

Rameda (recent pharma IPO and partial competitor to Eipico)

- Nov/December launched 8 new molecules, 9th application require more bioequivalence testing.
- 4Q19 earnings will be much better with EBITDA between 95 and 98m.
- 2020 guidance is to be in line with prospectus.
- Based on assumption of 12-15 new product launches in 2020 and some more toll manufacturing.
- CU at 34%, 5 years of growth potential.
- IPO costs will be adjusted to equity not P&L.
- ESOP plan will add some dilution 2-3%.
- Overall site visit was very positive and impressive. Noted cleanliness and newness of factory.
- Care taken to A, B purity level segments was also insightful and impressive.