

Market snapshot

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

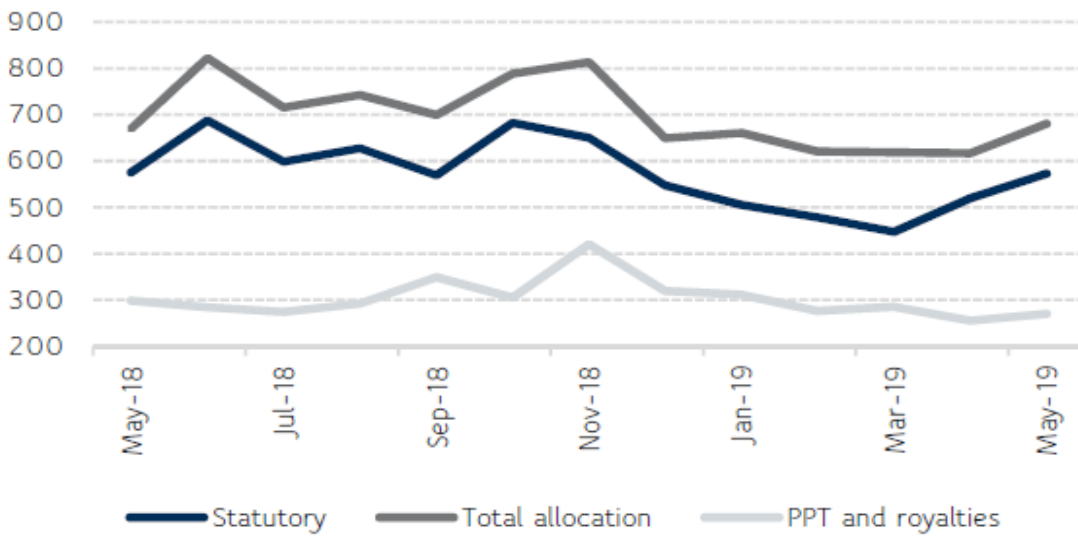
June Performance (%)	LCY	USD
Zimbabwe	8.8	8.8
MSCI World	6.5	6.5
MSCI EM	5.7	5.7
Tunisia	1.5	5.5
Morocco	2.6	3.9
Egypt	2.4	2.9
Botswana	-1.6	-0.1
Mauritius	-0.2	0.2
BRVM	-3.1	-1.3
Kenya	-0.2	-1.3
Nigeria	-3.5	-3.7

June was a positive month (+1.4%) based on strong performances from Morocco (+2.1%) offset by Nigeria (-5.4%). Nigerian Breweries (+6.6%) did very well to offset the drag of Nigeria and particular our holdings in Nestle and Stanbic IBTC which both declined by 6%. FX was a negative contributor as the Naira, Egyptian pound and Kenyan shilling all weakened against the USD.

Economic and political overview

Nigeria – Moody’s visited Nigeria in June. It kept its Nigeria rating at B2 with a stable outlook. It is noted that Nigeria has a relatively low debt ratio and low liquidity risk. Also, the outlook for the oil sector is improving. Stability in the Niger Delta, the absence of cash call arrears in Joint Venture operations for over two years and expected progress with the Petroleum Industry Bill have contributed to its improved outlook. Its highlighted poor education and housing as the most disappointing structural weakness that prevents a demographic dividend longer term. Forecasts 2019 GDP at 2.3% and 2020 at 2.8%. We were happy to notice a pick-up in government allocations. Budget (FAAC) allocations in May which is paid out in June, recovered strongly after it noticeably slowed down during the Feb-April election period.

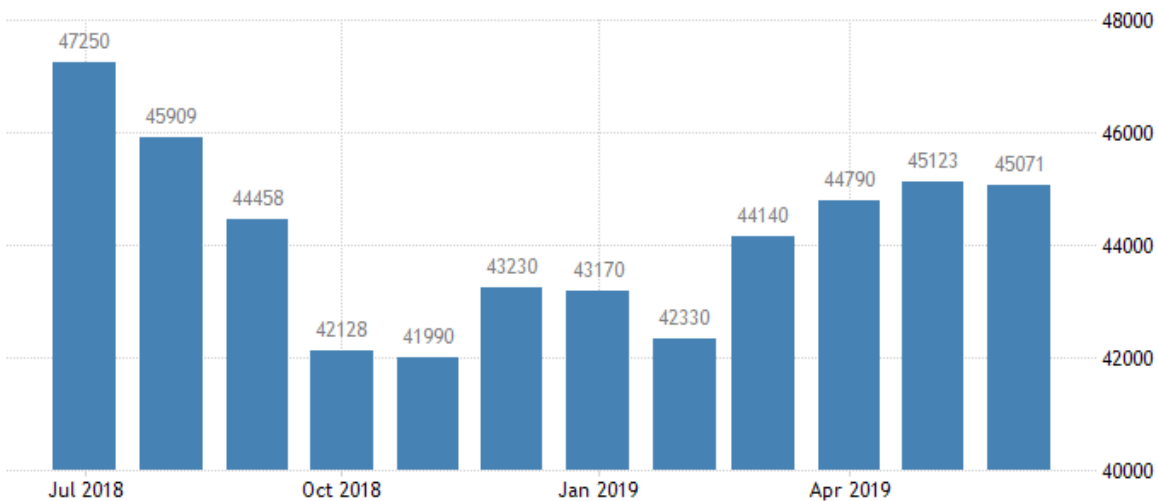
Revenue allocations (gross) by the FAAC (N bn)



Source: OAGF, CBN, FBNQuest

A rumour circulated the market that the CBN may float the exchange rate. Governor Emeziele crushed the rumour stating that the bank would continue to defend the naira using foreign exchange reserves stating that the policy is to protect purchasing power of the poor in the country.

It is noticeable that the demand for FGN bonds has picked up. Capital importation, most of which goes to the bond market has also picked up strongly and supports the recovery in FX reserves to USD 45bn. Net capital inflow for 1Q19 was USD 8.2bn or +309% q/q of which USD 7bn was portfolio flows. 92% of portfolio flows were into the bond and money markets. FDI was USD 530m.



SOURCE: TRADINGECONOMICS.COM | CENTRAL BANK OF NIGERIA

PMI came in at 52.9 in May down from 55.

Egypt – Headline inflation accelerated to 14.1% y/y in May from 13% y/y in April. Core inflation fell to 7.8% y/y from 8.1% y/y. There are no underlying inflation pressures in the economy although energy reforms will push regulated prices up in July. The Emirates NBD Egypt PMI dipped from 50.8 in April to 48.2 in May and then recovered in June to 49.2. We had a call with Ahmed Kouchouk, Vice Minister of Finance for Fiscal Policies and he noted that they are very happy to report meeting their primary fiscal deficit target of 3.5%. It was at a 7% level in June 2017. He also noted that debt to GDP ratio is now at 91% from 108% in June 2017.

Kenya – 1Q19 GDP +5.6% y/y. Split into agriculture 5.3%, manufacturing 4.2%, and services 5.8% y/y. Stanbic Bank Kenya PMI rose to 51.3 in May from 49.3 in April. Kenya budget: Fiscal deficit projected at 5.6% of GDP (6.8% last year). The 'Big Four' plan is a key priority for the government and allocated an equivalent of 14.6% of the budget spend. Big Four aims to spend on food security, job creation in manufacturing hubs, universal healthcare and affordable housing. Key proposals within the budget include 1) increasing excise duty on alcohol and tobacco by 15%, which impacts EABL and BAT; 2) repealing interest rate caps 3) increasing capital gains tax on property to 12.5% from 5% currently; and 4) imposing 10% excise on amounts staked on betting.

Morocco – Bank Al-Maghrib left its benchmark interest rate unchanged at 2.25% saying current borrowing costs were consistent with medium-term inflation and growth outlook. Rates have been on hold since March 2016. We delved into 1Q19 macro data which showed a strong performance in the external sector. Exports of EUR 7.9bn +4.2% y/y. Main contributions y/y:

- Phosphate EUR 1bn was +20%
- Auto industry EUR 2bn +1.7%
- Agriculture EUR 1.8bn +3.6%

Zimbabwe – June was an eventful month in Zimbabwe. The finance minister announced SI 142, which marked the end of the multi-currency system and the official return of the Zimbabwe dollar (ZWL). The Reserve Bank of Zimbabwe (RBZ) followed this up with a circular announcing several monetary support measures for the Zimbabwe dollar. The key monetary support measures announced by the RBZ were 1) overnight lending rate hiked to 50% from 15% 2) 50% of surrendered FX from exporters to go to interbank mkt 3) purchase to funge/disposal cycle for dual listed shares 90 days and 4) RBZ taking over USD 1.2bn of FX creditors (at 1:1 ZWL/USD). We spent most of the month contacting brokers, corporates we are invested in and policy makers within the finance ministry, some of the highlights from our conversations below

- Most of the corporates we talked to have submitted their FX creditor list to RBZ, however they are unsure where the RBZ will source the FX to pay these creditors and there is a lack of clarity on which FX payables will get priority.
- As much as it is illegal to invoice in USD (or any other foreign currency) most companies are still likely to index pricing to their source of FX (a mix of parallel rate and interbank rate).
- Old Mutual mechanism has now turned into a T+90 trade: Since the announcement the OMIR has dropped from ZWL 11.2/USD to ZWL 9.1/USD (89.1% discount).
- Liquidity in the market has dried up.
- Banks have hiked lending rates following the RBZ circular, average lending rates 28%.

- Government has been running a surplus for the past 8 months.
- Money supply ZWL 10bn in deposits, of that ZWL 10bn, ZWL 4bn in loans, ZWL 3bn treasury bills, ZWL 1bn in OMO and ZWL 2bn is reserve money.
- Only ZWL 2bn in reserve money chasing USD 400-500m worth of imports monthly.
- Policy consistent with IMF SMP, contractionary macroeconomic policy, expect Real GDP to drop but inflation to also come down.

In our view for the reforms to be a success the country needs an FX injection/bailout package. Without it, the country will re-dollarise again. We are encouraged by the policy coordination between the finance ministry and the reserve bank. The challenge now is avoiding the printing press and sticking to the reforms. We also would have liked to see a more liberal foreign currency system, with exporters being allowed to sell all their proceeds on the interbank system. This would take market share away from the parallel market and establish the interbank window as the main window for foreign currency, shoring up confidence as well as improving transparency. The second half of the year will be difficult with the prevailing contractionary economic policy, the key thing we are keeping an eye on is FX payables and FX liabilities on the balance sheets of our companies.

Company updates

Safaricom (Kenya, Telco) update regarding CEO's passing on 1 July. Company announced the passing of CEO Bob Collymore after an 18 month battle with leukemia. The Board announced that Michael Joseph, a director and previous CEO was appointed as the interim CEO until a permanent replacement is appointed.

EIPICO (Egypt, Healthcare) call with new MD: We had a conference call with the new MD for EIPICO. It is early days but the new MD seems ambitious and determined to shift to a more aggressive growth strategy. The target is to become a Top 3 pharmaceuticals player in Egypt over the next 5 years. Their current market share is 3.5%. Part of that strategy is to outsource distribution. Third party distributors were responsible for 15% of sales historically and currently they are now at 50% of sales with a target of 85% over the next couple of years. The other leg is to register new products, they have a pipeline of 65 new products and 8 of those will be launched over the next 6 months.

In addition, we received an update on the Medical Union Pharmaceutical (MUP) acquisition and the Biosimilar plant. FY19 capex of EGP1bn will be split between the Biosimilar plant and MUP.

MUP Transaction:

- EIPICO acquired 10% of MUP for EGP 220m, pending regulatory approvals.
- MUP Revenues EGP 2.4bn FY18, expected to be EGP 2.8bn for FY19.
- MUP generated a net profit of EGP300m in FY18 with a targeted net profit of EGP 360m in FY19e.
- They plan to buy 10% more equity.

Capex will be funded by both debt and internal cash flow

- Project construction of the Biosimilar plant will take 2 years but the company will start applying for product licenses ahead of that.

Overall we came away from the call excited about the growth prospects of the company. A key aspect of the strategy that we will keep an eye on is the increased appetite for leverage. The company is currently net cash and has paid out generous dividends in the past. We expect the company to increase gearing and management guided for a higher absolute dividend but potentially lower payout.

Market outlook

Nigeria – Results confirm a slow recovery and a path to normalisation of the economy. For the most part, consumer companies are able to shift volume and we expect pricing to improve on the back of consumer income recovery, with the new minimum wage adjustments, we should see this happen in 2H19. We maintain a large allocation to banks and the top consumer names in the food and beverages sector. Valuations are deeply discounted and attractive. Our preferred banks are well positioned to make money from fees. Overall, banks will make less profit from yields as the curve drops, but higher NGN liquidity, strong growth in trade facilities (LCs) and mobile bank fees will still mean good growth in earnings. Since we are past the election hump we hope to see more expansionary monetary policy and credit creation to stimulate growth and spur the economy out of this early recovery phase.

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. Upside risk to inflation from subsidy removal and rising oil prices, but there is enough positive momentum to maintain the growth trajectory. The earlier than expected 1Q19 cut in rates should further support growth for 2019.

Kenya – The political decision not to remove interest rate caps removes the opportunity for an asymmetric trade on the banking shares and reduces economic momentum. However, 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 – We continue to search for attractively priced growth investment opportunities with our existing investments showing moderate growth and attractive dividend yields. We recently added Label Vie (supermarket, hypermarket, cash n carry), which we believe 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.

Strategic review of Telco allocations

The recent IPO of Airtel Africa gives us a timeous opportunity to reflect on our investment thesis and allocations in the African telco sector. Around the time Safaricom generated excess cash flow to reward shareholders with a special dividend, Airtel shareholders had to pay in USD 1.3bn just to cover losses from ongoing operations. Simply put, we prefer companies that give money to shareholders rather than the other way around. Staying with Kenya, Safaricom's annual capex is USD 350m, compared to Airtel Kenya, which spends USD 30m.

Our three key demand drivers in the African telco sector are new subscribers, rapidly rising data demand and the cash to non-cash migration. We look for the best platform to capture these, whose key characteristics are:

- Breadth - country coverage by base stations and transit network.
- Depth - Licenses (preferably up to 4G), spectrum (narrow through to wide band), base station density and fibre.
- Software - analytics, applications.

A superior platform, plus strong management drive deployment of the best products, which can be own developed i.e. MPESA or where the platform is selected as partner of choice i.e. PayPal, BuuPass choosing Safaricom. These lead to multiple revenue streams, mostly at low marginal cost and include:

- Voice - resilient as new subscriber growth (breadth) and bundling, offset price decline and cannabalization.
- Data - strong subscriber growth (breadth) and volume growth>price decline (depth).
- Mobile money transfers
- Mobile wallet
- Micro credit
- Internet of Things

There is also scope for cost savings, where mobile top up in particular, is reducing agent commission costs and expensive, environmentally unfriendly scratch cards.

Revenue growth and cost savings lead to increased free cash flow, which facilitates further investment and reinforcement of scale and competitive advantage over the number two and three players. As such we see the key risks as government or regulatory intervention.

Ranking the main telco's in Africa using the above framework:

Safaricom - Excellent platform, best products, most revenue streams, high cost savings. Potential regional expansion opportunities. MPESA number one brand in East Africa and Safaricom number one in Kenya. 65%+ market share. High and rising RoIC justifies premium valuation of 16x and 8x forward PE and EV/EBITDA.

MTN Ghana - As above, only MNO with 4G and high 77% market share likely to remain that way due to govt requirements. Valuation is attractive at 9.7x and 4.7x forward PE and EV/EBITDA with rising RoIC, however local cost of capital very high and stock exchange illiquid. Prefer to play through MTN Group.

Sonatel - The holding company for Orange in Senegal, Mali, Guinea Conakry, Bissau and Sierra Leone. Market leader in each market with 55%+ market share. Orange Money growing rapidly and likely to accelerate as move closer to the MPESA model. Reverting to growth after voice loss stabilization and fiscal levies peaking and even reversing. Most attractive valuation in the sector with a Euro linked dividend yield of 11%, PE 8.7x and EV/EBITDA 4.1x with rising RoIC.

MTN Nigeria - Mobile money opportunity uncertain, but highest growth potential from new subscriber acquisition in a substantially underpenetrated country. 50% overall market share. In terms of "breadth", 20m Nigerians and counting, only have access to MTN, while the chart below clearly demonstrates their spectrum advantage over Airtel's largest African asset. Attractively valued at 13.1x and 4.7x forward PE and EV/EBITDA with rising RoIC, however we believe best played through MTN Group as the sale of MTN Group shares on the Nigerian Stock Exchange is an overhang.

Frequency							
3,500MHz	1x30					2x30	
2,600MHz	2x30						
2,100MHz	2x10	2x10	2x10	2x10			
1,800MHz	2x15	2x15	2x15	2x15	2x15		
900MHz	2x5	2x5	2x5	2x5	2x5	2x10	
800MHz	2x10					2x10	2x10

Maroc Telecom - excellent network breadth and depth, however products (mobile money) uncertain and a substantially more competitive market with low 40's voice and high 40's data share. High valuation at 18.4x and 7.5x forward PE and EV/EBITDA with RoIC slightly up. Reasonably high leverage, low growth and an already 100% payout ratio do not give much scope for increased shareholder remuneration.

Airtel Africa - this is a highly indebted, holding of Tier 2 assets across Africa. Telco's, particularly in Africa, require heavy AND continued investment and are scale businesses. Failure to invest in sufficient network at the outset, leads to the exact opposite of the positive reinforcing cycle we refer to in Safaricom above. Over ambitious price/volume wars to reclaim market share, simply serve to undermine quality and reduce brand equity as lower cash flows thwart necessary reinvestment in network, spectrum, licenses and products. If you overlay this model with USD debt that needs to be serviced by these local cash flows, you have a toxic cocktail. Post earlier bail-outs and the IPO, the company has an improved balance sheet, however net debt/EBITDA is still 2x. A forward PE of 8.8x and EV/EBITDA of 5x at the lower end of the range, are not relatively cheap and in no way compensate investors for the risks. We find it particularly concerning that the company intends paying dividends prior to fully deleveraging.