Monthly Market Report

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Market snapshot

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

Sep Performance (%)	LCY	USD
MSCI World	1.9	1.9
MSCI EM	1.7	1.7
Nigeria	0.4	0.8
Botswana	0.9	1.0
Mauritius	-1.6	-0.9
Zambia	-0.7	-1.3
Kenya	-1.4	-1.7
Egypt	-3.9	-2.3
Morocco	-1.3	-2.2
Tunisia	-3.1	-3.1
BRVM	-7.0	-7.7

September was a mostly negative month, with most local markets declining. While Nigeria was the only market to post an increase, subsequent market moves suggest this might have been some quarter end window dressing.

Economic and political overview

Nigeria – GDP growth slackened to 1.9% in 2Q19 due to a slowdown in non-oil activity. The non-oil economy grew +1.6%, down from +2.5% in 1Q19. Growth continues to be caught in a tug-of-war between a structural demand for USD and a Central Bank hell bent on protecting reserves and the currency. The structural demand comes from import reliance and an inherent desire of firms and individuals to dollarize. A bright spot on the horizon is the launch of the Dangote oil refinery in 1H 2020, which significantly and permanently, reduces import demand and relieves numerical and psychological pressure on the FX market.

As we have mentioned before, the various interventions by the CBN in the meantime, are like squeezing a soft balloon with your hand; pressure applied to one area simply results in a bulge somewhere else. The latest attempt has been for the CBN to further raise the minimum LDR for banks from 60% to 65%, by the end of December.

Other macro releases:

- Inflation dropped to 11.02% y/y in August from 11.08% y/y in July. The decline was primarily due to food items, even with food import restrictions, minimum wage disputes and border closures. The CBN Governor took the opportunity to rule out the possibility of interest rate cuts until inflation drops to at least 9%.
- PMI in August up to 56.4 from 54.6 in July.
- FX reserves fell to USD 43.67bn, a USD 1.23bn decline from July.
- Budget deficit of NGN 1.15trn recorded in 7 months ending in July.

Egypt – September 20 marked the start of anti-Sisi protests in Egypt. Demonstrators took to the streets in Cairo and other cities, following a series of online videos accusing the government of corruption. The market reacted negatively as participants are all too aware of the recent past and the lack of trickle down at this stage of the economic reform plan.

Despite protests fizzling out and the market's strong bounce back, these events cannot be taken lightly. While Egypt's IMF sponsored plan has been a poster child for EM economic reform, it is nevertheless a long hard road and a multi stage process. The risks were always, and remain, public discontent at the initial economic hardship that people have to bear. If the hardship is too severe or too protracted, this discontent can derail the entire process. We view the government's successful crackdown and the CBE's continued rate cuts as crucial in moving Egypt into the growth stage of the recovery, where increased employment and a stable inflation increase real disposable incomes.

A side development, but important for the recovery story, is that new gas discoveries are now on line and have:

- contributed to FX reserves by shifting Egypt back to net exporter from net importer,
- allowed the government to decrease the cost of gas to industry by just over 20%.

The second point being critical as the 2014-2016 shift from gas to imported coal and other, was a cost and a drag to industry, as well as a drain on FX reserves.

Macro releases included:

- Inflation continued to decelerate to 7.5% y/y (0.7% m/m). Prices were contained, with food & beverages only up +6.9% y/y. This was aided by a -0.9% m/m decline in the clothing & footwear segment and offset by +2.1% m/m increase in health prices.
- On 26 September, the CBE cut policy rates by 100bps.
- FX reserves have increased by USD 53m to USD 44.97bn in August, compared to USD 44.92bn in July. This is more than 8 months of import cover.
- The Markit Egypt PMI fell to 49.4 in August from 50.3 in July, revealing low growth in domestic activity. National accounts data indicates that domestic demand is growing slower than overall GDP growth.

Kenya – GDP for 2Q19 was 5.6%, consistent with 1Q19 but down from 6.4% posted in 1Q18. There were positive performances from several sectors but overall growth was curbed by slowdown in agriculture, manufacturing and transport. Agriculture (36.5% of GDP) and manufacturing (7.7% of GDP) were hampered by the delay of rainfall. Transport (7.8% of GDP) was impacted by fuel price increases.

Mobile Money update

The recent 2Q19 release from the Communications Authority, showed mostly positive developments across the board. On a positive note for financial inclusion, Kenyans moved KES 23.96bn digitally per day in 2Q19. Mobile money is increasingly the preferred route for transactions as opposed to cash. During the quarter, 103 mobile money transactions were carried out per second, up from 92 transfers in 2Q18. The data indicates that of these transactions, 72.8% were payments for commodities and utilities (electricity and water). Mobile money transaction value grew 13.5% y/y to KES 2.18trn, with e-commerce transactions accounting for 89.5% of all mobile cash transfers.

The important aspect of the statistics above is that none of this happens without platform development, innovation and collaboration. The increase in utility payment is due to installation of prepaid smart meters on KPLC's (Kenyan electricity distributor) side and Safaricom fully integrating MPESA into KPLC's systems, such that payment and settlement are real time. The extreme alternative to this is people wasting hours queuing to pay at municipalities.

The next exciting stage of development is already underway, with not only payment and settlement being real time, but activation as well, enabled by sim cards in smart meters for individuals or NbIoT in networks of meters for larger organizations.

Parliament has increased excise duty on cigarettes, wines and spirits by +5.15% from the original Finance Bill 2019. This is now awaiting presidential approval.

Macro releases included:

- Inflation decelerated to 5.0% y/y in August, down from 6.27% y/y in July. This was driven by a decrease in food & non-alcoholic drinks (-1.89%).
- The CBK retained its benchmark lending rate of 9.0% on September 24. Private sector growth reached 6.3% despite rate cap constraints and has shown positive acceleration in the past 12 months. However this is still below the CBK's target of 12-15%. Although lending has increased, a large proportion of SMEs are still locked out, facing tight restrictions from local banks.
- PMI declined to 52.9 in August from 54.1 in July. Activity was affected by cash flow problems, partly arising from a backlog of government department bills.
- Remittances stood at USD 224m, +4.0% y/y in July down from +11.0% y/y in June. The 31.7% m/m drop has come only a month after the country recorded an all-time high in remittances as citizens rushed to beat the tax amnesty deadline. Kenyan remittances have risen to become the biggest source of foreign exchange, ahead of tourism, tea, coffee and horticultural exports.

Morocco – Inflation rose to 0.8% y/y in August, up from 0.3% y/y in July, and the highest recorded since December 2018. This was driven by overall price increases, particularly in alcoholic beverages & tobacco prices (+15.1%). The only decrease was in food & non-alcoholic beverages (-0.2%).

Tourist arrivals were up +6.6% y/y at the end of June, due to the positive performance of French and Spanish markets (+9.0%) as well as German tourist arrivals (+8.0%). Overnight stays grew +5.0%.

Statistics released by the Moroccan central bank, Bank Al Maghrib, show increased lending in the banking sector. Real estate loans have increased +3.0% while consumer loans have also trended upwards +4.7%.

Company updates

IDH (Egypt, Healthcare) 1H19 results update: Strong operational and FCF performance with a muted EPS performance. Revenues grew 22.5%, EBIT 24.8%, EPS 3.5% and FCF 54.1%. The operational numbers were distorted by the 100 Million

Healthy Lives Campaign, run in conjunction with the government, which boosted patients, but diluted margins. Ex Campaign or underlying revenues grew by 17.2%, of which +5.2% from tests and 12.0% from rev/test, driven by pricing and mix. COGS/test only grew by 5.0% due to scale and purchasing power, which drove the rise in EBIT. At an EPS level, a number of one-offs, as well as the introduction of the 0.25% health levy, offset the growth from operations. Al Borg Radiology has had a very strong start and at the end of the half year was already EBITDA positive. While Nigeria has had a slower start than expected, management remain confident in the prospects there and we are comfortable that they are not over-committing. An interesting development is that the company now has a massive database of 13m clients in Egypt, which they plan to better serve and cross-sell to, using data analytics. To conclude, we remain confident that the levers for growth and shareholder returns are firmly in place, despite the muted earnings in the first half.

Fawry (Egypt, IT) 1H19 results update: Decent results, topline growth in line with expectations but bottom line was down due to non-recurring expenses. We do not have historical quarterlies, but it is clear that the growth momentum in topline and operating profit was sustained. 2Q19 revenues were up 37% y/y and 1H19 revenues up 36% y/y to EGP 373.3m, throughput grew by 51% y/y to EGP 22.4bn and transactions rose 46% y/y to 386m. Other operational KPIs showed strong growth, with monthly active users rising from 18.6m in June 18 to 23.0m in June 19, number of POSs rose from 87,800 to 110,400 and contracted banks increased to 33 from 25. Segmentally, the largest segment remains alternative digital payments (adp) which grew 30% y/y and contributed 86% to revenues (down from 90% contribution in 1H18). The other segments grew faster than adp, with banking services (mobile wallets, omnichannel acceptance) showing the highest growth, up 167% y/y in 1H19, the dilution in contribution of adp and the diversification of the revenue stream is a key part of Fawry's growth strategy. Overall, EBITDA grew faster than topline, up 42.9% y/y driven mainly by gross margin expansion, EBITDA margin grew from 23% in 1H18 to 24,1% in 1H19. Reported net profit for 1H19 was down 7% y/y, stripping out non-recurring items, normalised net profit was up 33%. We understand the source of the bulk on non-recurring expenses, however we need to get more colour on the share of losses of investments in startups of EGP 8.7m, there isn't enough information on this in the English press release. The valuation looks high at current levels on an intrinsic basis, but on a relative basis less so, at 24% of the range. Given the strong growth prospects of the company, the EV multiples should unwind rapidly as the company meets its growth targets.

EIPICO (Egypt, Healthcare) 1H19 results update: Decent results, topline growth in line with expectations but further margin contraction dampened bottom line. 1H19 revenue was up 21.5% y/y and PAT up 2.2%. Local sales up 29.7% and export sales down 5.2%. EBIT margins shrunk to 23.9% in 1H19 down from 30% in 1H18, deepening a trend we saw in 1Q19. The main driver of margin contraction is the increase in COGS (due to raw material costs) which continue to grow faster than topline, up 42% y/y (a trend we saw throughout 2018). One of the main reasons for the sharp increase in COGS is glass prices. We noted in the FY18 results that EIPICO lost market share, with the pharmaceutical sector growing 25% y/y by value whilst EIPICO grew 18%. In 1H19 we believe that EIPICO continued regaining lost market share with local sales up 29.7% y/y. We expect continued strong growth in the sector and the company, with most of the growth being volume driven. There were no further updates on the Biosimilar plant.

Label Vie (Morocco, Consumer staples) 1H19 results: Strong top line performance, weighted toward lower margin formats. Revenue growth came in +12.4%, impressive given inflation of 0.4% and non-agricultural GDP growth of 3.6%.

LFL revenue stats were Overall 7.0%, of which supermarket 3.5%, hypermarket 4.0%, Atacadao 13.0% and fuel stations +22.0%. This was ahead of guidance of Overall 6%. Headline format revenue breakout was supermarket 12%, hypermarket 9% and Atacadao 13%. Lower margins in Atacadao (wholesale cash n carry), filling stations as well as lowering fruit and vegetable prices in lower income (sector C) areas, meant GP only grew 10%. Higher opex growth of 11.5%, meant that EBIT only grew by 5.3%. This is not alarming, however we will need to monitor this trend as our investment case is based on positive operating leverage from increased scale. In terms of store roll-out they are on track with 6 of the 12 new supermarkets guided to for 2019 being operational at half year, with the hypermarket and Atacadao additions due to be complete before year end, taking total store count to 105 and Sqm to over 200k. EPS came in at MAD 59.8, up 20.7% or 6.5% on an underlying basis.

HPS (Morocco, IT) 1H19 results update: Revenues came in +17.0% and EBIT +21.8%, however one-offs and the new 2.5% solidarity tax in Morocco saw EPS down 5.0%. On the positive side Group recurring revenues were +23.3% and the flagship Solutions division (73% of revs) grew its revenues by 21.7%, with upselling to its existing client base +60.1%. The Services division (17% of revs) put in a solid performance of +8.9%. The negatives at the earnings level were a FX loss vs a gain last year, a pick-up in non-deductible expenses, the introduction of the new social solidarity tax in Morocco and a MAD 2m drop in income from associates. In terms of growth, two areas of concern will require further monitoring. Firstly, the Processing division (10% of revs), a major driver of future growth had flat revenues. This should resolve itself as three new contracts were won in Africa, over and above the SocGen win and a first time contract win in the Middle East. Secondly, at a Group level the backlog, which is contracted revenues not yet delivered, declined 11.6% owing to a push in deployment of existing services over new sales.

MCB (Mauritius, Financials) FY19 results: An excellent set of results with PBT +26% y/y which beat out +20% forecast. A very strong 4q19 to June result driven by 60% y/y growth in loan fees and +25%y/y for FX fees. Overall all the drivers of growth which are higher loans and loan related fees remain in place for FY20. Management expects a strong performance in commodity (oil trading) space. Not as strong as FY19 but still growing at 15%. An important competitive factor is MCB's credit rating. It was recently upgraded to Baa2 from Baa3, which reaffirms it as the highest rated bank in Africa and the preferred trade line confirmation bank. Overall loans expected to grow at 10% as Mauritian rupee loan growth expected at 6% - Mauritius corporate opportunities modest. Net interest margins improved 0.22% to 3.69% driven by Mauritian t-bills climbing 1% from 3 to 4%. The margin is expected to remain stable in FY20. From a risk perspective commodity trading exposure is mainly Nigeria, Ghana and Egypt – a risk it managed successfully in 2015 oil price shock. NPL ratio improved to 4.1% from 4.5% and CoR stable at 59 bps, flat y/y. Overall, valuation remains attractive at 1.2x book and 5% dividend yield for FY20.

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.