IMARA Asset Management

Monthly Market Report

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Region:	**Africa ex South Africa**
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Market snapshot

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

Nov Performance (%)	LCY	USD
Nigeria	2.4	2.7
MSCI World	2.6	2.6
Morocco	2.9	2.5
Botswana	-0.4	0.8
MSCI EM	-0.2	-0.2
Kenya	-1.0	-0.3
Tunisia	-0.6	-1.2
Mauritius	0.4	-1.3
BRVM	-0.1	-1.3
Egypt	-4.9	-4.8
Zambia	-1.7	-10.6

November was another month of divergence. Nigeria (+2.7%) and Morocco (+2.5%) showed positive performances while Kenya (-0.3%), Mauritius (-1.3%) and Egypt (-4.8%) were down.

Economic and political overview

Nigeria – The GDP report was slightly positive compared to Nigeria's recent experience. The economy grew by 2.3% in 3Q19. The 2Q estimate was also revised up to 2.1% from 1.9% previously because of better oil sector production numbers. The agricultural sector grew +2.3% y/y despite some heavy rains in the harvest season.

Capital inflows (portfolio flows and FDI) remained positive at USD 5.4bn in 3Q19, +88% y/y. The majority of capital flows going for relative attractive NGN yields. But the recent decision by the CBN to bar all non-bank entities, including local pension funds, from the OMO window has caused a shift in investment patterns. We noticed a rush for the FGN bond market driving yields lower and then as yields shifted too low we noticed equities finding bids. Many of the bigger Nigerian shares have seen some buying, GTB's performance this month being a case in point.

Moody's ratings agency affirmed Nigeria's B2 rating but downgraded its outlook from stable to negative. Slow growth, low revenues and declining FX reserves are reasons cited.

Macro release this month (Oct stats):

- Inflation rose to 11.6% (Sep: 11.2%). 17-month high, driven by a rise in food inflation increases as a result of border closures.
- CBN Policy rate unchanged at 13.5%
- FX reserves declined to USD 40.5bn (Sep: USD 41.9bn).
- PMI flat at 56.9

Egypt – The Central Bank of Egypt MPC made its third consecutive cut of 100bps. This follows decelerating inflation m/m. The CBE governor, Tarek Amer, was re-appointed for his second 4-year term this month signalling positive sentiment. He was at the helm during the currency crisis, and has overseen implementation of the IMF-backed reform programme.

Fitch affirmed Egypt's long-term FX rating at B+ with a stable outlook, citing macroeconomic improvements. The ratings agency recognised the government's fiscal policy advancements, noting that they have met their FY19 targets. Fitch noted that political risks and governance concerns weighed in on the rating.

Macro releases this month (Oct stats):

- Inflation 3.1% (Sep: 4.8%). The main driver continues to be food & beverages -6.3% y/y on account of lower fish prices.
- Net FX reserves USD 45.3bn (Sep: USD 45.1bn)
- PMI flat m/m at 49.2. Firms expanded and added to staff but buying and output levels fell.

Kenya – Moody's held Kenya's sovereign debt rating at B2 with a stable outlook. Its comment remains the same as before – concern regarding high fiscal debt (62.0% of GDP) and low revenue collection balanced with praise for the country's diversified economy, strong financial markets which provide some resilience to external shocks.

The Central Bank of Kenya (CBK) MPC cut rates by 50bps to 8.5%. Inflation is within target range and they expect this to continue. Furthermore the MPC believes that monetary policy will now more precisely translate into real growth following the rate cap repeal.

Macro releases this month (Oct stats):

- Inflation 4.95% (Sep: 3.83%). An increase in food & beverages and tobacco & narcotics drove the upturn.
- PMI 53.1 (Sep: 54.1)

Morocco – Tourist arrivals increased by +6.4% y/y, steered by French (+8%), Spanish (+6%) and German (+7%) visitors. Overnight stays grew +5% y/y, with the highest growth in 4 and 5-star accommodation (+8%). American and Italian tourist numbers grew strongly, although they only account for 6% of total visitors.

The local banking industry grew by +5.1% y/y to end 3Q19. Real estate loans led growth +3.4%, as well as an increase in consumer loans (+4.5% increase in mortgages). Investment loans grew +3.2% y/y.

Inflation still very low. October CPI 0.7% (Sept: 0.3%).

Company updates

Equity Bank (Kenya, Financials) produced a good set of 3Q19 results, PBT +13% y/y. The highlight was loans +8.7% q/q and 16.7% YTD already ahead of FY19 guidance. As in 1H19 and FY18 feedback, the decline in bond yields, and the profit taking, has opened up liquidity and a risk margin for a shift to writing more loans. The removal of rate caps opens up even more opportunity for credit growth in 2020/21. Management indicates they are very liquid and ready to grow loans strongly. Non-funded income growth +14% reflect a strong performance on mobile money (EazzyApp transactions +91% y/y, overall STK/App +18%), merchants (+35% y/y) and agency (+14% y/y) offsetting stagnant ATM/branch volumes. Post the call we are likely to adjust the uptick in margin by less than our initial take. As before we expect 30% of the book to re-price in the next 12 months but a lower 4% uptick (instead of 6%). Management indicated they will use a gradual approach, first lending to best risk pricing above the current cap level – so expect credit demand being filled at the 16-18% level rather than the highest priced loans at 19-22% level. Politically and strategically is seems the prudent approach to follow. At the same time we think credit growth will be faster than we had assumed before, 20% growth looks probable for FY20 instead of a more pedestrian 10-15%. We conclude a substantial uptick in PBT growth of c.21% for FY20 and ROE shifting up by 1.3% in FY20. We expect medium-term Group ROE to pick up by 2% stabilising at 26%. This implies a FV book multiple of 2.3x or 74/share, 51% upside from current 49/share. The big message for Kenya Inc – expect a large monetary stimulus that should show results in 12-18 months from now on the consumer demand side.

Nestle Nigeria (Nigeria, Consumer staples) 3Q19 results update: In a difficult environment, resilient results from Nestle with topline up 2.4% y/y for 3Q19 and operating profits down 3.4% y/y. In terms of segmental performance, Food revenue was down -0.9% y/y whilst Beverage revenue was up 8.3% y/y. GP margins shrunk 153bps to 43.5%. OPEX growth at 1.9% y/y was below revenue growth. Overall EBIT margins shrunk to 23.9% in 3Q19 from 25.4% in 3Q18. Nestle Nigeria's listed peers have reported much lower operating margins in this environment which points to the defensive nature of the business. We were surprised by the food segment performance, as we expected to see a slight positive impact from Maggi signature, an extension of the Maggi Brand. The strategy of having a narrow SKU with a concentrated core portfolio seems to be the right one at the moment.

Nigerian Breweries (Nigeria Breweries, Consumer staples) 3Q19 results: 3Q19 net sales were up 2% y/y and gross sales before excise duties were up 2.7%. The numbers confirm that the sector is back to growth, albeit low single digit volume growth. We expect low single digit growth for the rest of the year. Our meeting this month with ABInbev subsidiary, International Breweries confirmed the same. The sector is in growth however the key issue remains pricing. ABInbev is playing the patient game, waiting for the market leader, Nigeria Breweries (NB) to raise price. To this effect, NB announced price increases effective at the end of November, however these price increases affect distributors and they aren't price increases of the recommended retail price (RRP). The increases are marginal but we believe it is the first step in getting the sector to shift up price points. What we are waiting for is significant movement in RRPs across the board. For now it remains a matter of smart pricing, managing mix and consolidating market share. GP margins improved from 28.5% in 3Q18 to 37.4% in 3Q19. OPEX growth remained sticky downwards at 6.3% y/y, although it is below inflation, it is still above sales growth, squeezing margins. We expect OPEX growth to remain high due to intensive competition and promotional activities. The third quarter is usually the poorest quarter due to seasonal heavy rains. Overall the company reported a small operating profit (EBIT margin 0.5%) in 3Q19 compared to an operating loss in 3Q18. EBITDA margin improved to 13% in 3Q19 from 5% in 3Q18.

Label Vie (Morocco, Consumer staples) 3Q19 KPI's: Revenue trends mostly positive in 3Q, with overall revenue accelerating to +17% from 14% in the first half. As with the first half, the strongest trend came in from Atacadao (wholesale format) 27%, with supermarket 14% and Hypermarket 7%. The company opened two new stores in the quarter, bringing total openings for the year to nine and total stores to 101. Guidance of 16 stores for the year looks a bit stretched at this stage. Like-for-like figures were not provided. As with the first half, we do not expect this strong revenue trend to fully pass through to profits, as the Atacadao format is lower margin. The company looks well positioned for the full year as they go into their strongest quarter seasonally and we have revised our forecasts upwards. At a FY19 EV/EBITDA of 12.2x, the company is trading above its historical range. With strong growth and an expanding RoIC however, we expect the upward re-rating to continue and see substantial upside in the share. We remind readers of the continuing boost to margins from volume driven supplier rebates.

EIPICO (Egypt, Healthcare) 3Q19 results update: Good results, in line with expectations. Revenue was up 25% y/y and HEPS was up 19% y/y for 3Q19. Local sales were up 28% y/y and export sales were up 15% y/y. Some cost efficiencies dampened the impact of gross margin contraction resulting in EBIT margins remaining flat at 18.9% for 3Q19. We expect continued strong growth in the sector and the company, with most of the growth being volume driven (a key part of their strategy), they have sufficient room for growth with capacity utilization currently at c60%. We believe that going forward, normalised margins will be lower than historic margins as they move to more 3rd party distribution, however the benefit will come in the form of higher volumes. Although they have taken on more debt, their capital structure remains healthy, with a low net debt to equity ratio of 8%. We are not concerned about the higher level of debt, as we expect competition to intensify as the industry continues to grow, distributor credit terms (receivables) will likely lengthen and balance sheets are likely to gear up due to the easing cycle in Egypt.

Fawry (Egypt, IT) 3Q19 results update: Good results, with topline growth in line with expectations and bottom line better than expected. Revenue grew 44% y/y and operating profits were up 153% y/y. ADP revenue grew 31% y/y and contribution to topline dropped to 84% from 89%, a deliberate part of their strategy to diversify away from ADP. The number of POS terminals grew to 125k from 89k in 3Q18. Yet again, the main driver for growth was Banking services, driven by mobile wallets (mobile wallet transactions doubled to 10.1mn), banking services contribution to topline has now grown to 7% (from 3.5% in September 18). The main positive surprise was gross profit margins expanding to 51.2% in 3Q19 from 47.5% in 3Q18. OPEX growth lagged topline, up 26% y/y, which resulted in operating profit margins expanding to 19.1% from 10.8% in 3Q18. They are growing so fast that the big risks lie in their execution and their ability to grow incremental returns from new initiatives/CAPEX/POS expansion.

IDH (Egypt, Healthcare) 3Q19 results update: Continued strong revenue (+15%) and cash flow performance (+21%), with EPS (+4%) dampened by higher depreciation, lower interest income and IFRS16. The third quarter was the first quarter that allowed for like for like comparison, ex the 100 million Healthy Lives campaign, which boosted tests, but diluted margins. In the Contract segment (60% of revs) revs grew 11%, comprised of Patients +4%, Tests/Patient -1% and Rev/Test +8%. In the Walk-in segment (40% of revs) revs grew 21%, Patients +13%, Tests/Patient +2% and Rev/Test

+5%. With healthcare spend on the rise in Egypt and new initiatives like Al Borg Scan gaining traction, the business is well positioned for a positive close in 2019 and continued growth in 2020.

Mauritius Commercial Bank (Mauritius, Financials) 1Q20 to September PBT +19% y/y. A very healthy set of results that continues the momentum of FY19. We expect this to continue as management sees a healthy pipeline of trade finance credit opportunities. Guidance remains at 15% growth for this line of business and the overall book to grow by 10%. 1q20 Loan growth was 1.9%, slightly behind but on track. Fees including credit related fees up strongly at 12.6% y/y. Positive jaws as opex up 5.7% y/y which drives ROE higher – now 18.5% from 18% at FY19 and 14% in FY18. Clearly a very healthy state to be in and good momentum coming through.

Attijariwafa (Morocco, Financials) 3Q19 PBT +3% y/y. Driven by stable growth in fees and interest income, both approximately 4% y/y. NPL and provisions continue at its low trend, 0.13% for the quarter, 0.39% YTD. After a good 2018 loan performance, 2019 YTD loans of -2% is disappointing.

Unilever Nigeria (Nigeria, Consumer staples) 3Q19 results update: Following on from a disappointing set of numbers from Unilever in 1H19, 3Q19 was the weakest quarter. Revenue dropped -62.9% y/y for 3Q19 and -28.6% y/y for 9M19. In May this year, we felt that management did a poor job of explaining the 1Q19 revenue miss and we feel justified in our call given that 9M19 numbers showed an even steeper decline in topline y/y than the drop in 1Q19 revenue of -20.8% y/y. The company reported an operating loss for the quarter and they will not be hosting a conference call. The revenue decline was attributed to a decision by management to tighten its credit terms to its trade partners and reduce trade receivables. Whilst this is understandable given the lack of credit extension from the banks and the squeezed disposable incomes, we are surprised by the magnitude of the decline. The decision gave us pause as we assessed our other consumer names in Nigeria and they didn't seem to have such a steep exposure to trade receivables as a percentage of sales as Unilever.

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 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.