Company Research Report
06 April 2020
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Equity research | Company Report

MALAWI

STOCK	RECOMMENDATION
NBM	BUY
MPICO	BUY
NBS	BUY
PCL	BUY
ICON	NEUTRAL
NICO	HOLD
SBM	HOLD
NITL	NEUTRAL
BHL	NEUTRAL
OML	REDUCE
TNM	BUY
SUNBIRD	HOLD
ILLOVO	REDUCE
FMBCH	REDUCE

Q1 2020 REVIEW - COVID–19 CRISIS

The novel coronavirus pandemic known as Covid-19 could not have been unpredictable. Since 2016, there has been warnings from various quarters that the world was vulnerable to a flu pandemic. As such, the pandemic was not unexpected, however, the current reality differs markedly from earlier projections. The speed of infection, the skyrocketing death toll, and the potential for an economic coma are not only devastating but potentially paralysing.

At the same time, Covid-19 marks the return of a very familiar enemy to humanity. During the course of history, nothing has killed more human beings than disease. Not even natural disasters such as earthquakes, tsumanis, floods, volcanoes or even the European tribal wars such as the two world wars, even including the two atomic bombs.

The so not exhaustive list of pandemics includes the Justinian Plague; Black Death; Smallpox; Spanish Flu and HIV Aids. The HIV pandemic is estimated to have killed as many as 32 million people worldwide and infected around 75 million. Why do diseases kill so many people? This is because the disease-causing agents called pathogens in medicine, self-replicate while natural disasters and wars are confined to a certain geographical area.

Covid-19 encompasses all the positives and negatives of the modern times, starting in a densely populated city of Wuhan in China before spreading to the rest of the interconnected world. It was officially discovered in December 2019, with the first person dying on 9 January 2020 and at the time of writing had spread to over 100 countries in 6 continents. The epicenters are now in Italy, Spain and United States of America.

According to the World Health Organisation (WHO), Covid-19 spreads from one person to the next via *droplets* produced from the respiratory systems of an infected person, often during coughing and/or sneezing. The timeline from exposure to the beginning of symptoms is between two and fourteen days, with an average of five days.

On this note we would advise our investors and clients to familiarize themselves with symptoms and other guidelines produced by the WHO and Ministry of Health. We also advise caution in the light of a lot of fake news doing rounds on the internet and social media platforms. Not everything on the internet is true.

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HEALTH VS ECONOMIC CRISIS

Because of the nature of the mode of transmission, the main response by most countries have been to (a) increase the amount of testing and quarantine of infected persons; (b) institute social distancing through curfews and in some extreme cases a total lockdown of cities and countries; (c) closure of borders and (d) educational campaigns on symptoms and preventative measures.

From another angle, Covid-19 started off as a health crisis but has now quickly mutated into an economic crisis of enormous proportions. The Organisation for Economic Cooperation and Development (OECD) has warned that the virus poses the biggest danger to the world economy since the 2008 global financial crisis.

The most effective measures to **contain** the virus, which are in the main; national lockdowns, social distancing, factory closures and travel restrictions have critically crippled supply chains, curtailed factory output, reduced demand for mineral and agriculture commodities, particularly oil and severely dampened business and consumer confidence. Some commentators have actually opined that *fear* is spreading faster than the virus, hence the precipitous fall in confidence. The pandemic has induced both supply and demand side shocks.

As such, there will be both short term and long-term impacts from the pandemic induced crisis. The short-term impact is likely to arise from the social, emotional and moral impact of illness and death. In the short term, experts anticipate a drop in incomes, a rise in unemployment and a spike in poverty. In the long term, restrictions to social and business activity will lead to business and school closures, increased unemployment which eventually translates into less consumer and corporate spending.

At the same time, unemployed people do not pay taxes; closed businesses do not pay corporate tax, VAT & excise duties and non-traveling tourists do not pay tourism levies in hotels and game parks. All this adds up to lower government revenues in the short and long run.

Investor fears have also meant that volatility has risen in the markets causing oil and stock market prices to tumble with a few historic levels recorded in March 2020. Most of the developed world stock markets have dropped by as much as 35% or in USD terms over USD23 trillion has been wiped off the global stock markets.

However, the Malawi stock market had largely been spared the mayhem.

Before we look at the major Covid-19 themes, we would like to caution that nobody knows how this pandemic will pan out, but lots of people - experts and non-experts - claim to know. Few will be right, by luck or judgement, but many will be wrong.

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We now look at the major themes.

a) Impact on oil demand and prices

China is the biggest consumer and hence source of demand for oil in the world. When the China announced its lockdown, the move significantly reduced demand for the commodity. And when other countries joined by announcing lock downs, demand plummeted by almost 50%. Consequently, with excess supply, the price for Brent crude oil fell from USD61/barrel on Valentine's Day to the current level of around USD30/barrel. It is said that a dispute between major producers; Saudi Arabia and Russia further worsened the price drop. In March 2020, Saudi Arabia abandoned the 2017 OPEC+ output agreement, flooding the market with crude oil. The move was in response to Russia's refusal to effect deeper production cuts to help prop up prices in the face of declining demand.

Source – Thompson Reuters Eikon

The oil price has deep negative ramifications for African oil exporting countries such as Libya, Algeria, Nigeria, Angola and Ghana, most of which work with a budget oil price of USD60/barrel.

On the flip side, the fall in the oil price should have a beneficial impact on the budgets and economies of oil importing African countries including Malawi.

b) Impact on other commodities

Besides oil, China was the biggest importer of African minerals such as copper; chrome, platinum, cobalt; and other rare minerals as well as some agriculture products like coffee, tea, horticulture, floriculture, rubber and cocoa. The drop in prices of metals has affected countries such as Zambia, Zimbabwe, DRC and South Africa. On the other hand, the decline in demand for soft commodities has negatively affected Rwanda, Ghana, Ethiopia, Kenya and Cote d'Ivoire. In the fisheries segment, South Africa lost a sizeable rock lobster and abalone market when China ceased animal imports in January this year. Malawi and Zimbabwe will also be affected as China is the biggest buyer of tobacco leaf.

c) Travel, Tourism & hospitality

At the onset of the crisis, the impact was felt mainly through the decline in number of Chinese tourists which affected airlines and hotels in many countries. Subsequent national lock downs and restrictions on travel and entertainment as part of virus containment measures have collapsed the travel, tourism and other social industries. Other industries negatively impacted as social gatherings are discouraged, are breweries, movies, restaurants, entertainment, betting, sports, casinos, theme parks etc.

d) Manufacturing and trading sector supply chain disruptions

Everyone is agreed that China is the world's factory, a fact which was first underlined when Apple Inc announced in a trading update that the production of gadgets had been impacted negatively by the lock down in Wuhan. Not only is the world reliant on China for raw materials and finished products, many African economies are dependent on China for imports of intermediate goods and finished products such as textiles, industrial chemicals, electronics and household goods. Many SMEs in Africa have been forced to shut down after disruptions to supply chains and their vulnerability induced by their inability to store large stocks, with Kenya being on record as the most affected.

REMEDIAL ACTIONS AND RESPONSES

As mentioned earlier, authorities have responded through the health and preventative measures. Concomitant to these have been the announcement and implementation of some smart and innovative combinations of monetary and fiscal policy measures. The list below is also not exhaustive, but captures the most common ones;

a) Most central banks have resorted to the blunt instrument of cutting interest rates, some timidly and others aggressively.
b) In some countries, central banks have also released liquidity into the banking systems by reducing the statutory reserve and capital adequacy ratios.
c) Some central banks have relaxed the classification guidelines with regards to NPLs and provisioning requirements of affected businesses.
d) Some countries have extended economic support packages mostly to support the SMES either through direct subsidies and/or other relief measures.

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e) Tax regulations have been relaxed with some countries hiking the PAYE exempt amount, and at the same time reducing the VAT and corporate tax rates.

f) Commercial banks across a number of countries have been instructed/and or asked to suspend and extend loan repayments for affected businesses with existing facilities as well as allow for higher borrowing limits. In other words, extend repayment holidays.

We excluded the stimulus packages announced by the USA and most of the Arab world because, these countries generally have the wealth and the measures they announced cannot be implemented in Africa because of affordability issues.

INVESTMENT PORTFOLIO CONSIDERATIONS

Post Covid-19 we will have companies whose revenues will be lower and some whose revenues will be gone. The latter will have expired and would be counted amongst Covid-19 casualties. For the former, some companies will have the capability to reduce variable expenses but will still face some sticky fixed costs items. We expect that most companies will not be able to reduce expenses as fast as the decline in revenues. Thus, margins and profitability will be lower in the short term.

At the same time, revenues for some companies may snap back sooner than others depending on the industry. In this category, most service industries are potential candidates as well as food staples for the so-called V-shaped recovery. Most companies are in for a U-shaped recovery while a few will go for the L-shaped one.

Highly leveraged companies present a complicated case. The more debt a company has, the less likely it is to survive any shocks or tough times. Edcon (Edgars) South Africa is a case in point. The company has already indicated that it may not open its doors post Covid-19 lock down period.

In the post Covid-19 world, companies will face a new consumer whose behaviour would have been reshaped by two main factors; (a) consumers would have adopted short term habits/behaviours that may become permanent; and (b) consumers will emerge from the pandemic in with a new economic reality. This is normally referred to as '*economic scarring*' and normally last longer.

The impact on manufacturing on general has been discussed earlier in terms of supply disruptions. Below we look at the other sectors;

Banking

- Physical supply chains are far less significant for banking entities than for companies in other sectors. However, these manufacturing companies are the recipient of loans and advances. The companies

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will be affected by production and distribution interruptions. One well known adage in banking which will come to the fore is; "*if you owe the bank USD100 and cannot pay back, that's your problem. If you owe the bank USD100 million and cannot pay back, that's the bank's problem.*"

- Credit quality, therefore, may deteriorate quickly, especially in sectors that are hit the hardest. It's not just consumers who will be squeezed but companies as well and a rise in payment delays due to cash-flow constraints arising from a drop in demand for goods and services is anticipated. The hard part for banks would be telling the difference between a routine payment delay and significant deterioration in credit quality.
- Interest rate cuts will affect bank profitability, through contraction of NIMs, which may not be mitigated by an increase in volumes. These, along with a general decrease in business activity, could depress banking profits for some time.
- Banks rely heavily on a network of different but interlocking vendors, more so now in the digital age. Virtually every aspect of modern banking now depends on the availability of third parties, such as the core banking systems, mostly out of India and Singapore; card processing networks, clearing houses and depositories. Some of these could be under pressure from depressed business and banks may be forced to bail them out.
- This is likely to compel banks to take other steps to shore up their capital reserves, first by reducing dividends and possibly raising extra capital.

Real Estate

- In the event of a lock down, commercial tenants may not be able to trade. At the same time, reduced business volumes may affect the ability of tenants to pay rentals, leading to defaults and arrears. Landlords may also face depressed income, especially in shopping malls with turnover linked rentals.
- Some tenants – especially the smaller ones may go under, leaving mall owners and landlords with a lot of voids.
- Rental holidays, discounts and other incentives may have to be instituted in order to retain and nurse back the tenant to full health.
- In a lockdown construction companies may face difficulties in the execution of construction contracts and general delays in construction projects is anticipated.
- Real Estate companies offering hospitality properties such as hotels were the first to be hammered.

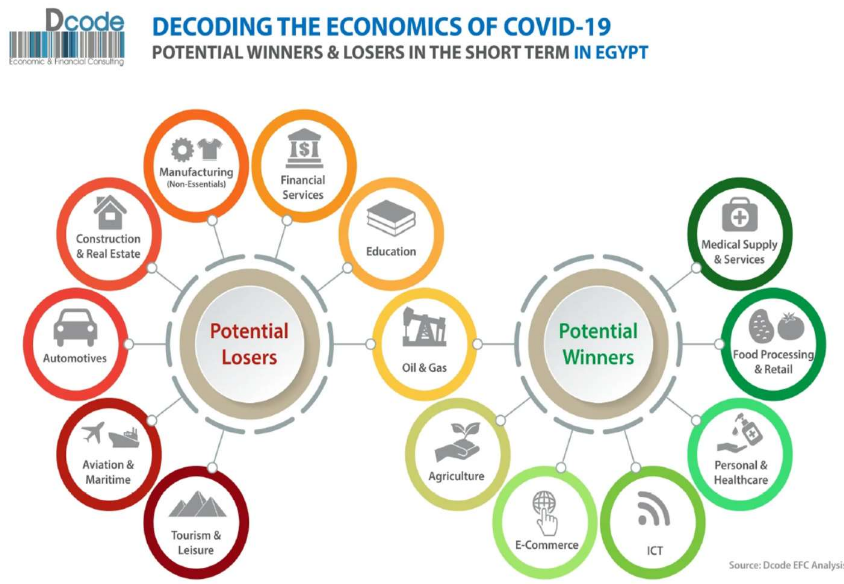
Mobile network companies

- Telecommunications are in theory more or less "recession proof" more like utilities.
- The Covid-19 environment is expected to be much more friendly or even enhance the fortunes mobile network operators in the short term before they succumb to the general economic turndown in the long run. In the first instance, a lockdown and *working from home culture* portends higher growth in data usage and increased minutes of use on voice. On the other hand, corporate data usage will slow down, but will have little impact on revenues as most are structured as monthly fixed contracts. The profile of the customer will have an impact on volumes and revenue growth.
- The other growth area for mobile networks will be mobile money, although most authorities have been encouraging waiver of fees for small amounts. Mobile money was in relative infancy in most of Africa and this would be an opportunity for it to leap forward.
- Most networks have prepaid contracts and hence no build-up of debtors would be expected.
- Networks with local debt should marginally benefit from the softening of interest rates. However, those with foreign currency denominated debt will suffer profit erosion through exchange losses as most currencies have and are expected to depreciate against the USD.

Trade (retail and wholesale)

- Retailers, especially clothing retailers and electronic equipment & gadget traders face a lot of short-term challenges in terms of supply lead times from China.
- Clothing or fashion retail may also experience a lot of inventory build-up and consequently a lot of stock may have to be marked down. The normal seasonality trends of stock holdings have been disrupted.
- In the event of an extended lockdown, clothing retailers may face significant cash flow constrains.
- Grocery purchasing patterns and composition of the basket will be significantly altered and the focus on lower margin basic goods may prevail for an extended period. Spending will most likely congregate around "need" based shelf items and less on discretionary items.
- In this space, we expect groceries to have a V-shaped recovery, on low margins while luxury and discretionary retailers face possibly a U-shaped and L-shaped recovery.

In summary, an organisation called Dcode Economic and Financial Consulting, produced an interesting infographic, when they undertook a research on the impact of Covid-19 on the Egyptian Economy. Although, one might argue that the Malawian economy is different from the Egyptian one, certain aspects can apply to both economies. We attach the infographic below for your attention and further digestion. Please note that the graphic says *potential winners and potential losers*.



Source- Dcode Economic & Financial Consulting

MALAWI STOCK EXCHANGE

The MSE is all but insulated from the world stock markets, mainly because of the minimal activity of institutional foreign investors on the bourse. This means that the MSE has very little “hot money”. As such the MSE, by losing 3.56% in Kwacha and 4.16% in USD was the best performing market in Africa for the first quarter.

Index	USD YTD Change
Malawi - All Share	(4,16%)
Ghana - All share	(6,99%)
Botswana - domestic companies	(12,12%)
Tanzania - All share	(15,44%)
BRVM - Composite	(15.91%)
Morocco - All Share	(20,27%)
Zambia - All share	(22,45%)
Kenya - All Share	(23,39%)
Nigeria - All share	(24,95%)
Uganda - All Share	(30,01%)
Egypt - Top 30	(30,03%)
Mauritius – SEMDEX	(33,26%)
South Africa - JSE All Share	(38,61%)

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As can be expected, those markets with a lot of foreign portfolio investors suffered the worst, with a huge sell off, particularly after 24 February, when Covid-19 hit Italy. The worst affected are South Africa (because of mineral commodities and strong trade links to China); Mauritius (tourism); Egypt (oil price drop, tourism and links to global trade through Suez Canal); Nigeria (oil price drop); Uganda and Kenya (Chinese induced supply interruptions and soft commodity prices). These markets lost a minimum of 20% in USD terms.

Back to the MSE, the best local currency performing stock was new kid on the block; Airtel Malawi which closed at MWK17.50 (*Cedar Capital's fair value was MWK15.52*), up 38% on the IPO price of MWK12.69. The other best performing stocks were MPICO, NITL and NBS Bank.

Source – Thompson Reuters Eikon

Investors have been responding positively to the continued turnaround of NBs Bank. As seen the chart above, the share price has almost doubled since its lows in 2018.

The performance for the first quarter is as in the table below;

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	Dec-19	Mar-20	% Change
AIRTEL	12,69	17,50	37,90%
MPICO	19,53	25,00	28,01%
NITL	80,00	95,00	18,75%
NBS	13,50	16,00	18,52%
NBM	525,00	540,00	2,86%
SUNBIRD	118,00	120,00	1,69%
PCL	1 400,00	1 400,00	0,00%
NICO	48,49	48,49	0,00%
SBM	730,00	730,00	0,00%
OML	2 499,99	2 499,00	(0,04%)
BHL	12,95	12,94	(0,08%)
ICON	10,50	10,49	(0,10%)
TNM	26,00	25,54	(1,77%)
ILLOVO	153,00	94,50	(38,24%)
FMBCH	75,00	40,00	(46,67%)
Malawi All Share	30 252,20	29 176,23	(3,56%)
USD rate (RBM)	736,40	741,00	0,62%

On the other side, FMBCH continued to lose value, down 47%, following the publication of its cautionary statement about the currency woes and the difficult operating environment in Zimbabwe. Illovo Sugar also declined 38% following an uninspiring set of financial results.

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Source – Thompson Reuters Eikon

The financial fortunes of FMBCH have been obscured by the performance of First Capital Bank Zimbabwe, which is a result of an adverse macro-economic environment rather than management deficiencies. The spike in the price to MWK165 in July 2018 was a response to the Zimbabwean foray. The current price of MWK40, reflects a 76% from the peak.

CONCLUSION

Although Malawi has recorded only four cases of the Covid-19, investors would be advised to trade cautiously, while keeping their powder kegs dry for opportunities that will certainly arise. As Winston Churchill once said; "*never waste a good crisis".*

The impact the Covid-19 crisis on the listed companies on the MSE will be different and the structure of the balance sheet will determine whether or not, a company will weather the coming storms.

Investors are also cautioned in advance, that post Covid-19, financial statements may look materially different from what has historically been the norm and some of the investment analysis parameters and accounting ratios we have become accustomed to may have diminished value.

Whilst we have refrained from giving implicit recommendations, we are confident that we have given enough information to consider when making investment decisions.

Stay safe!

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