Databank Leadership

Databank Research

First quarter review and outlook for Q2-2019

Ghana poised for broad-based growth

April-2019

GHANA QUARTERLY STRATEGY REPORT

Contents

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Ghana | Quarterly Report

April-2019

Q1-2019 ECONOMIC AND FIXED INCOME REVIEW

Growth prospects remain bullish on the back of steady recovery in bank lending, but currency pressures experienced in Q1-2019 pose upside risk to the inflation outlook

Review of Growth Indicators

The pace of economic activity remains modest despite a slight softening in the first quarter of 2019. The Bank of Ghana's Composite Index of Economic Activity registered a real growth of 3.2% in Jan-2019 (vs. 3.6% a year earlier). Key indicators of economic activity in first quarter 2019 include: growth in domestic VAT collection, industrial consumption of electricity, higher port activity and imports.

Commercial banks resumed expansion of private sector credit portfolio on the back of higher capital base and lower non-performing loans ratio. The Bank of Ghana eased the monetary stance in Jan-2019, a decision we view as the authorities' pro-growth stance in 2019.

Growth Outlook for 2019

We maintain a bullish outlook for Ghana's real GDP growth, both in the short-to-medium term with 2019 growth projected at 7.3% ±50bps (IMF: 8.8%, World Bank: 7.6%, GOG: 7.6%)

The 2019 growth poles include the following:

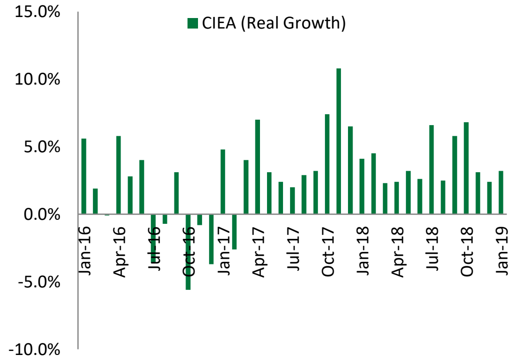
- Government issued a $3 billion Eurobond in Mar-2019 with $2 billion earmarked to support planned public expenditure for 2019. The government plans to front-load infrastructure spending in 2019 ahead of the 2020 elections (through the Sinohydro infrastructure deal and CAPEX execution in the 2019 budget). This should support growth in construction, transport & haulage, manufacturing and agriculture sectors with a multiplier effect on other allied sectors of the economy.
- Renewed risk-appetite by commercial banks also bodes well for the 2019 growth prospects while the re-opening of the Obuasi mine in Jan-2019 should add further momentum to growth.

Although the recent power supply challenges and the lagged impact of currency pressures could pose a downside risk, the government's ongoing reforms at the country's ports brighten the prospects for growth on the back of efficiency gains.

Review of Exchange Rate Performance

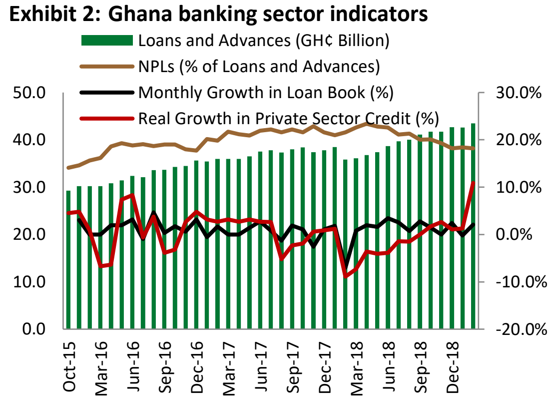
The Ghana Cedi endured intense depreciation pressure in the first quarter of 2019 which dragged the local currency to a loss of 8.02% and 13.73% on the interbank and forex bureau markets respectively by mid-March. The depreciation pressures were stoked by seasonal FX

Exhibit 1: Development in real sector indicators



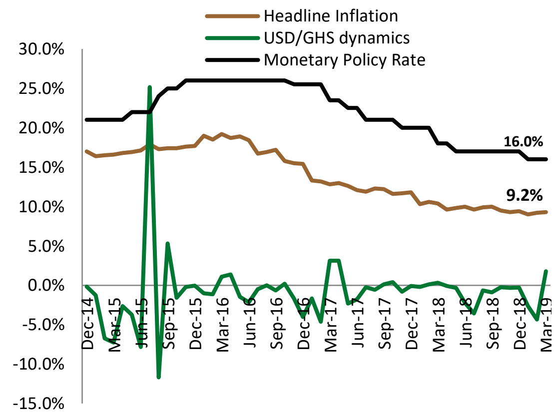
Source: Databank Research, Bank of Ghana

Exhibit 2: Ghana banking sector indicators



Source: Databank Research, Bank of Ghana

Exhibit 3: Exchange & Inflation rate dynamics



Source: Databank Research, Bank of Ghana, GSS

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demand, power sector companies who sought to repatriate accumulated capacity charges. Coupon and principal redemption by non-resident portfolio investors who reacted negatively to the cut in the policy rate ahead of completing the IMF program also exerted a strain on the Cedi.

The Bank of Ghana was unable to aggressively support the supply side due to reserves constraints (3.2 months of import cover in Feb-2019 vs. 3.5 months minimum target for 2019). The heightened uncertainty triggered speculative pressures which pushed the Ghana Cedi to record lows before the $3 billion Eurobond inflow prompted a sharp correction which partly trimmed the Cedi's losses. In line with Ghana's economic fundamentals, the Bank of Ghana's index of real effective exchange rate suggests a cedi depreciation of between 3% – 5% rather than the sharper-than-expected depreciation observed in Q1-2019.

Exchange Rate Outlook for 2019

We believe the Eurobond-induced correction in the exchange rate has significantly reduced the speculative pressures, allowing the Cedi's value to be broadly determined by the economic fundamentals.

The main sources of depreciation risks in Q2-2019 will include upcoming coupon payments on government outstanding bonds (Eurobonds and GHS-denominated debts held by non-resident investors) as well as potential dividend repatriations. We however remain confident that the $9.9 billion (equivalent to 5.0 months of import cover) provides enough buffer for the supply side of the market.

The flow of Ghana's export revenue exhibits seasonality with a higher inflow during the second half of the year compared to the first half inflows. In addition to the strong reserves, we believe the expected improvement in export flows in 2H-2019 will combine with COCOBOD's syndicated loan in Q3-2019 to sustain the Cedi's stability for the rest of the year. While we remain mindful of the overall depreciation bias on account of the persistent current account deficit, we believe the narrowing current account deficit would ensure a range-bound depreciation.

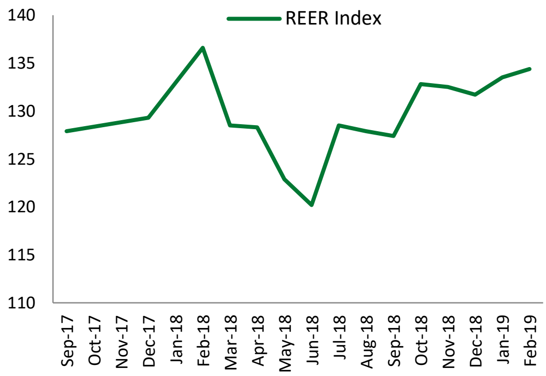
Fixed Income Market Review

The sharp depreciation of the Ghana Cedi in Q1-2019 imposed a further dent on investor confidence following the risk-off across Emerging Markets and Developing Economies (EMDEs) in 2018.

The Treasury yield curve for GHS-denominated securities consequently tilted upward at the mid segment to back-end as investors priced-in the heightened exchange rate risks (see Exhibit 5). However, the sharp correction in the exchange rate helped a reversal of the curve to end Q1-2019 below the year-start level, indicating a moderation in yields at the mid to back-end of the curve.

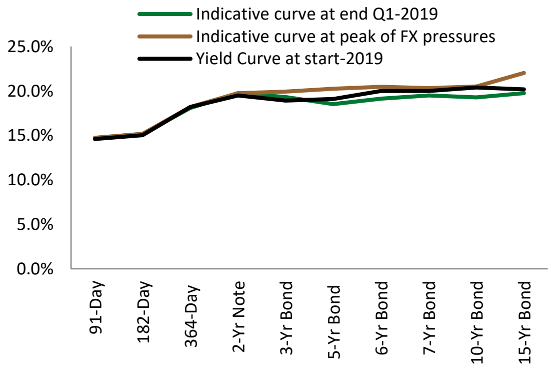
The low participation of non-resident investors in government issuances since 2018 has significantly weakened the domestic market's capacity to absorb all Treasury bond offers. The demand for punitive yields by resident investors amidst the bond market selloff resulted in increased issuances at the front to mid-segment of the curve.

Exhibit 4: Ghana real effective exchange rate



Source: Bank of Ghana

Exhibit 5: Treasury yield curve dynamics in Q1-2019



Source: Databank Research, Bank of Ghana, CSD

Exhibit 6: Treasury debt issuance calendar 2nd Quarter

Q2-2019 Treasury Debt Issuance Calendar (GH¢ Million)				
Tenor	**April-2019**	**May-2019**	**June-2019**	**TOTAL**
91-Day Bill	1,400	1,400	1,500	**4,300**
182-Day Bill	900	950	1,050	**2,900**
364-Day Bill	250	250	250	**750**
2-Year Note	600	-	-	**600**
3-Year Bond	-	800	-	**800**
5-Year Bond	1,000	-	-	**1,000**
6-Year Bond	-	500	-	**500**
7-Year Bond	-	-	-	**-**
10-Year Bond	-	-	800	**800**
15-Year Bond	-	-	450	**450**
TOTAL	**4,150**	**3,900**	**4,050**	**12,100**

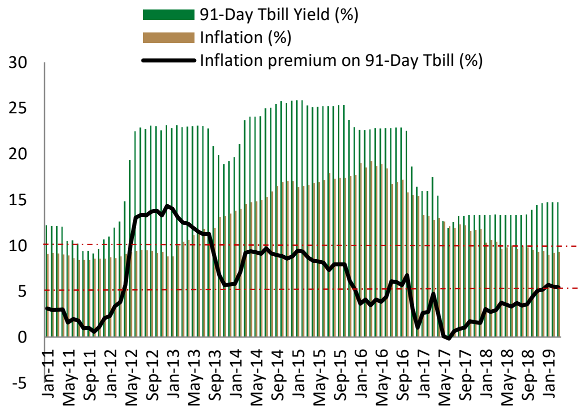
Source: Databank Research, Central Securities Depository

Outlook for The Fixed Income Market

The government has published the Q2-2019 Treasury debt issuance calendar, indicating plans to resume longer tenor issuances with 10-year and 15-year tenors planned for June-2019. The borrowing target of GH¢12.10 billion for Q2-2019 includes 95.3% as rollover of existing debt (vs. 90.2% in Q1-2019) and 4.7% new debt in Q2-2019.

We view the slight moderation in yields as an indication of improving prospect for the government to attract long term investors on the back of the stable outlook for exchange rate. We believe the $1 billion (earmarked from the Eurobond) for liability management will support government's capacity to manage yield expectations of investors at issuances.

Exhibit 7: Historical inflation premium for 91-day



Source: Databank Research, Bank of Ghana, GSS

Outlook for Yields in 2019

We expect a marginal upside risk to the inflation outlook as headline inflation edged higher for two consecutive months in Q1-2019 largely driven by the sharper-than-expected currency pressures experienced in Q1-2019. We however expect this upside risk to be offset by the reduction in benchmark values for import duty computations (Vehicle: -30%, other imports: -50%). The anticipated reduction of electricity tariffs in July-2019, will also exert a downward pressure on headline inflation in the near-term.

While we expect short-term yields to remain broadly stable at current levels, pending a moderation in the upside risks to inflation, we perceive improving prospects of a sustained decline in yields in the near-term. In our view, the prevailing inflation-adjusted yields of 4% – 5% for T-bills are on the higher side when compared with historical averages recorded during periods of single digit inflation (see Exhibit 7). ***Against this backdrop of higher-than-average real interest rates on T-bills, we anticipate a cumulative decline of between 100bps to 150bps for short-term yields by FY-2019.***

Q1-2019 STOCK MARKET REVIEW

Bearish Sentiments steer affairs in Q1-2019

Trading on the Ghana Stock Exchange (GSE) remained listless as the market maintained its bearish run in Q1-2019 occasioned by weak investor sentiments that resulted from heightened currency pressures, uncertainties about Ghana's exit from the IMF ECF program and foreign investor sell-offs in the market. The benchmark Ghana Stock Exchange Composite Index (GSE-CI) closed the quarter losing 4.58% (Q1-2018: +30.51%) and down 27.10% y/y to 2,454.51 points. The market traded a total of ~19.40 million shares during the quarter – a 46.12% slump compared with Q1-2018. Market turnover stood at GH39.48 million (-61.16% y/y), headlined by trades in Fan Milk (30.85%), MTN Ghana (12.25%) and Guinness Ghana Breweries (10.50%) which together accounted for more than half of market turnover for the quarter.

The market witnessed 9 gainers and 13 decliners out of a total of 32 counters that traded during the quarter. The top performers included TOTAL (Oil Marketing; +49.71%) and SOGEGH (Banking; +20.00%) following good earnings numbers reported for FY-2018. Ayrton Drug Manufacturing (AYRTN, Pharmaceutical) closed the quarter with a 14.29% gain amidst the ongoing merger transaction involving Starwin Products (Pharmaceutical; SPL) and Dannex Limited. Bringing up the rear, SIC (Insurance, -21.05%), and BOPP -18.47% emerged among the worst laggards following disappointing results reported for FY-2018 while GOIL (Oil Marketing, -19.55%) continued to decline despite its strong growth prospects.

Market News and Corporate Actions

The GSE took off **Aluworks Ltd (ALW)** from its Watch List, effective January 14, 2019, after ALW provided the GSE with detailed plans on the recovery strategy of the company. In Dec-2017, the GSE placed the company on their "watch list" on concerns of a deteriorating financial situation.

In a similar a fashion, the GSE removed **Cocoa Processing Company Ltd (CPC)** off the Exchange's Watch List after the company (CPC) held an Annual General Meeting (AGM) for the first time since 2015 and presented all financial accounts that were in arrears (FY-2015 to 9M-2018). CPC also issued a press release in the first week of the year to update the investor community on their operations. A suspension in the trading of shares of the company was also lifted with effect from January 14, 2019.

Pioneer Kitchenware Ltd (PKL) was compulsorily de-listed from the main market of the GSE at the end of trading on January 14, 2019. The GSE, going by its listing Rules, took the decision after the company failed to complete its restructuring and resume production.

The **Agricultural Development Bank (ADB)** announced a Renounceable Rights Offer of 48,949,580 ordinary shares of no-par value at GH¢4.76 to raise GH¢233 million in a bid to shore up its new minimum capital requirement of GH¢400 million. The offer was made in a ratio of 1:4.7176 shares. During the offer, 18 applications were received from qualifying shareholders, subscribing for a total of 30,798,261 shares out of the total amount on offer. The Renounceable Rights Offer raised

Exhibit 8: Quarterly stock market statistics

GSE MARKET STATISTICS SUMMARY		
	Q1-2019	**Q1-2018**
DSI-20 Index	111.25	169.93
GSE-CI Level	2,454.51	3,366.85
YTD Return DSI-20 (GH¢)	-5.45%	31.10%
YTD Return DSI-20 (US$)	-10.35%	31.44%
YTD Return GSE-CI (GH¢)	-4.58%	30.51%
YTD Return GSE-CI (US$)	-9.52%	30.85%
Market Cap (GH¢ m)	59,750.01	64,375.88
Aggregate Volume Traded	19,396,650	36,000,373
Aggregate Value Traded (GH¢)	39,482,353.88	101,642,175.23

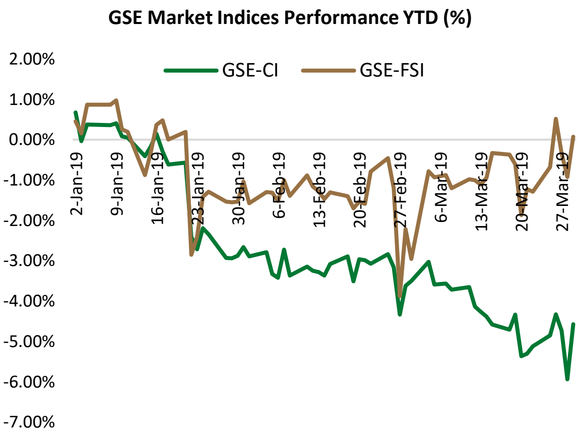
Source: Databank Research, Ghana Stock Exchange

Exhibit 9: Performance of listed stocks in Q1-2019

GSE TOP PERFORMERS		GSE WORST DECLINERS	
Counter	**Q1-2019 Change (%)**	**Counter**	**Q1-2019 Change (%)**
Total Petroleum	+49.71%	SIC Insurance Co.	-21.05%
Société Générale Gh.	+20.00%	Ghana Oil Co. Ltd	-19.55%
Ayrton Drug Manufacturing	+14.29%	Benso Oil Palm Plantation	-18.47%
Access Bank Gh.	+12.68%	GCB Bank Ltd	-13.04%
Aluworks Ltd	+12.50%	MTN Ghana Ltd.	-11.39%

Source: Databank Research, Ghana Stock Exchange

Exhibit 10: Ghana Stock market trend in Q1-2019



Source: Databank Research, Ghana Stock Exchange

~GH¢146.60 million representing a subscription rate of 62.92% and exceeding the minimum offer amount of GH¢125 million.

GSE Outlook

Market Expected to Recover to Positive Territory

Despite the poor performance of the stock market in Q1-2019, our outlook appears favorable as we expect the stock market indices to recover from the negative territory in Q2-2019. We maintain our forecast for GSE-CI at 18%±500bps for FY-2019. Key drivers for the stock market recovery are: (1) Stronger earnings expectation – We expect stronger earnings expectation for Q1-2019 in the banking, OMC, FMCG and telecommunication sectors to stimulate demand for stocks. (2) Increased foreign investor participation - we expect the recovery and stable outlook of the Ghanaian currency supported by improving economic conditions to boost investor confidence in the stock market and create more demand for stocks.

From a valuation perspective, the banking, OMC, FMCG and telecommunication sectors are highly attractive with some key listed companies in the sectors trading at attractive metrics. Further details of the various sectors are given below.

Increased Capitalization Tipped to Drive Earnings Growth

Our outlook for the banking sector is positive as we expect the banking stocks to see further growth in earnings. Increased capitalization leading to aggressive but cautious expansion of loan book will contribute to earnings growth. We believe the stronger supervision through the new directives and regulations by the Bank of Ghana will boost investor sentiments toward the banking sector and enhance the recovery of banking stocks.

From valuation perspective, the banking sector is attractively priced, currently trading at a P/BV multiple of 1.52x as compared to 2.29x for Q1-2018. Cal Bank and GCB Bank are our preferred stocks in the banking sector. We expect Cal Bank to see further growth in earnings to be driven by the agency banking module. We tip the agency banking to propel deposit mobilization, lower cost of funds and increase non-funded income. Given GCB Bank's aggressive expansion of loan book and expansion of corresponding banking relationship into other West African countries (Sierra Leone and Liberia) in October 2018 is projected to drive earnings.

A Strong Economy to Spur Growth in FMCG and OMC

We remain upbeat on the prospects of FMCG and OMCs stocks going forward. Ghana's improved macro-economic environment with real GDP growth for 2019 projected at 7.3% by Databank and 8.8% by the IMF buoyed by a relatively stable cedi, stable power supply and lower inflation should ease cost pressures and set the stage for healthy growth in the consumer sector. We expect the recent reduction in benchmark import values (50% for general goods and 30% for cars) to reduce import taxes on raw material and benefit profitability of the FMCG sector.

Fan Milk is expected to see a rebound of earnings growth this year as its newly introduced premium products continues to gain traction in the market. The company has introduced premium products at relatively higher prices with diverse flavors (chocolate, citrus, strawberry, vanilla, mango passion and banana) in a bid to capture a bigger share of consumers' wallets, both the lower and upper ends of the market. We foresee a continued recovery of Guinness Ghana Breweries as the company's earnings turned the corner for its half year period ended Dec-2018 after four consecutive years of decline in earnings.

We expect the oil marketing companies to benefit from increased activity in Ghana's upstream oil and gas sector on account of increased supply of marine gas oil to vessels and oil rigs. The dominant indigenous OMC, Ghana Oil Company (GOIL), is expected to continue its strong earnings growth supported by its expansion into bitumen and lubricant blending business. In November 2018, GOIL formed a strategic partnership with a global oil giant, ExxonMobil, where GOIL owns 5% interest in the Deep Water Cape Thee Points (DWCTP) oil block in the Western Region through its newly established subsidiary, GOIL Offshore Ltd. GOIL's entry into the upstream petroleum business will augment its already strong growth prospects in the long term.

We remain positive about earnings outlook for Total Petroleum underpinned by the company's aggressive product renovation, advertising and quality strategies to enhance customer experience along with the imminent recovery of the mining sector.

4G to Boost Earnings in Telco Sector

We expect growth in Ghana's telecom industry to remain strong spearheaded by data and mobile money services. MTN Ghana, as the leading provider of 4G data and mobile money services remains favourably positioned to be the principal beneficiary of the industry's growth. In Q1-2019, MTN introduced a faster and more efficient 4G Plus service in a move to consolidate its leading position following the launch of 4G data services by Vodafone Ghana. We expect this to positively impact data revenues and consequently boost earnings as 4G data services continue to gain traction.

We anticipate further engagement between Vodafone Ghana and the telecom regulators – National Communication Authority (NCA) on a potential listing of its shares on the Ghana Stock Exchange following the acquisition and launching of its 4G services in Q1-2019. In Nov-2018, the NCA slapped a fine of ~GH¢34m on MTN and other telecoms operators for poor services to consumers. While this fine is relatively small and may not significantly impact on the sector's profitability, we believe continued fines for poor services may occasion improved services by operators and give consumers good value for money.

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