Cytonn Monthly - July 2020

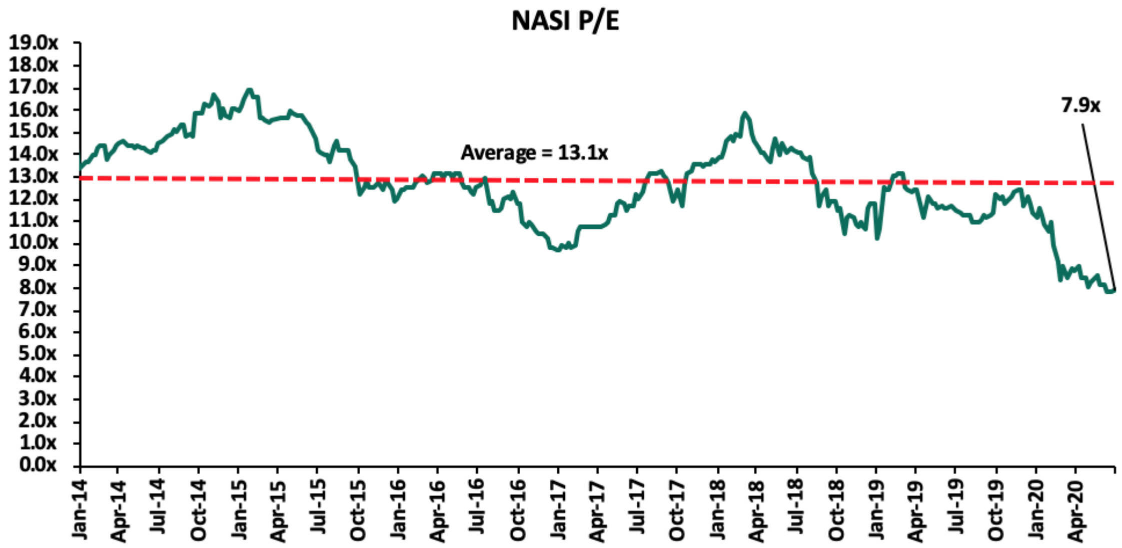
Equities

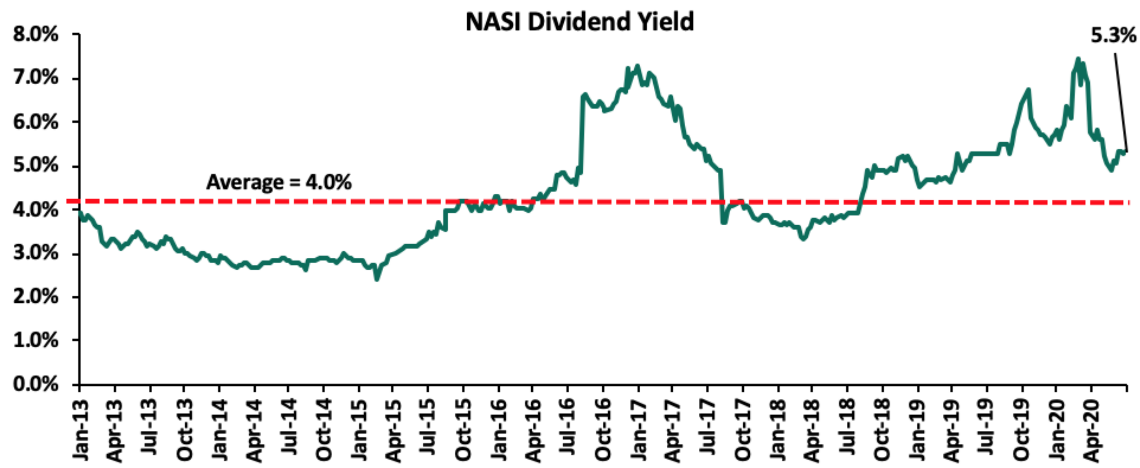
Markets Performance

During the month of July, the equities market was on a downward trajectory, with NASI, NSE 20 and NSE 25 declining by 3.2%, 7.1% and 4.9%, respectively. The equities market performance during the month was driven by large declines recorded by Co-operative bank, ABSA and SCBK of 13.6%, 9.8% and 9.4%, respectively. Similarly, during the week, the equities market was on a downward trend, with NASI, NSE 20 and NSE 25 recording declines of 1.0%, 4.4% and 2.0%, respectively, taking their YTD performance to losses of 19.9%, 32.0%, and 25.4%, for NASI, NSE 20 and NSE 25, respectively. The NASI performance was driven by declines recorded by large-cap stocks, with the highest declines being recorded in EABL, Co-operative bank and NCBA, which lost by 7.7%, 5.8% and 5.3%, respectively. However, the decline was slowed down by gains recorded by other large-cap stocks, with the highest gains being recorded by Safaricom and Equity which both gained by 0.2% and KCB which gained by 0.1%.

Equities turnover increased by 9.0% during the month to USD 125.5 mn, from USD 115.1 mn in June 2020. Foreign investors remained net sellers with a net selling position of USD 49.8 mn, compared to June's net selling position of USD 15.9 mn. During the week, equities turnover declined by 53.8% during the week to USD 14.2 mn, from USD 30.7 mn recorded the previous week, taking the YTD turnover to USD 934.3 mn, with foreign investors turning into net buyers, with a net buying position of USD 0.5 mn, from a net selling position of USD 12.7 mn recorded the previous week, taking the YTD net selling position to USD 265.6 mn.

The market is currently trading at a price to earnings ratio (P/E) of 7.9x, 39.4% below the historical average of 13.1x. The average dividend yield is currently at 5.3%, unchanged from the previous week, and 1.3% points above the historical average of 4.0%. With the market trading at valuations below the historical average, we believe there are pockets of value in the market for investors with higher risk tolerance and are willing to wait out the pandemic. The current P/E valuation of 7.9x is 1.5% above the most recent valuation trough of 7.8x experienced in the second week of July 2020. The charts below indicate the historical P/E and dividend yields of the market.





Monthly Highlights:

- I&M Holdings PLC issued a cautionary statement to its shareholders on its intention to acquire 90.0% share capital of Orient Bank Limited Uganda (OBL). The transaction will see I&M spend more than Kshs 2.0 bn in the acquisition of the Ugandan Bank, whose book value stood at Ushs 114.1 bn (Kshs 3.3 bn) in FY'2019 For more information, please see Cytonn Weekly #30/2020,
- Equity Group disclosed it was seeking to raise up to Kshs 50.0 bn in long-term debt from international financiers in the next three years as it seeks to boost its liquidity and capital positions. This is reflective of the trend by local banks, which are increasingly seeking loans from global financiers such as the International Finance Corporation (IFC) and European Investment Bank. For more information, please see Cytonn Weekly #29/2020, and,
- Mortgage financier HF Group announced it was seeking to raise Kshs 1.0 bn additional tier II capital (a supplementary component of a bank's capital) as part of its measures to inject liquidity into the bank, in a bid to remain compliant with the Central Bank's Capital Adequacy requirements. For more information, please see Cytonn Weekly #28/2020.

Weekly Highlight

During the week, the Monetary Policy Committee (MPC) disclosed that as at June 2020, Kshs 844.4 bn (29.1% of the total banking sector loan book) had been restructured by Kenyan banks in line with the emergency measures announced by the Central Bank to cushion the economy from the impact of COVID-19. Other key highlights from the release include;

1. Of the loans restructured, Kshs 240.0 bn are personal/ household loans were restructured as

income for individuals continue to be strained as a result of depressed revenues to Small and Medium Enterprises (SMEs) and reduced employment income from pay cuts and job losses, occasioned by the pandemic,

2. Kshs 31.4 bn (89.2% of Kshs 35.2 bn) made available by the lowering of the Cash Reserve Ratio (CRR) had been used to support lending especially to the tourism, transport and communication, real estate, trade and manufacturing sectors, and,
3. Private sector credit growth remained subdued recording a growth of 7.6% compared to 8.1% in May 2020. However, the imminent operationalization of the Credit Guarantee Scheme, a program to enable the provision of affordable credit to SMEs in an efficient and structured manner, will de-risk lending by commercial banks and increase credit to the sector currently facing a challenge of accessing credit.

The table below shows the listed banks that have disclosed their restructured loans so far:

Loans Restructured By Listed Banks

#	Bank	Amount Restructured (Kshs Bn)	% of Restructured Loans to Total Loans	y/y change in Loan Loss Provisions
1	Kenya Commercial Bank	120.2	21.7%	149.1%
2	Equity Group	100.0	26.4%	660.4%
3	ABSA Bank Kenya	54.0	26.6%	75.2%
4	NCBA Group	47.3	19.2%	3.1%
5	Diamond Trust Bank	40.7	18.3%	52.0%
6	Standard Chartered Bank of Kenya	22.0	17.5%	3.1%
7	Co-operative Bank of Kenya	15.3	5.5%	79.5%
	Average	**57.1**	**19.3%**	**146.1%**
	Total	**399.5**		

With banks restructuring loans on account of the strained cash flows for businesses as well as disposable income to individuals due to the pandemic, we expect to see a rise in the Non-Performing Loans (NPL) ratio, higher than in Q1'2020, where the Gross NPL ratio stood at 11.3%, from 10.4% recorded in Q1'2019, and much higher than the 5-year average of 8.3%. Loan loss provisions are also set to remain high despite the softer guidance by the Central Bank in provisioning guidelines. The deteriorating asset quality remains a concern as most businesses struggle to keep afloat due to subdued revenues, we believe that they may not be able to meet their repayment requirements further elevating credit risks. As such, we expect bottom-line revenues to be subdued as a result of increased loan loss provisioning coupled with declining yields in Government securities, which the sector has heavily relied on in the past.

Universe of Coverage:

We are currently reviewing our target prices for the Banking and Insurance sector coverage.

We are "Neutral" on equities for investors because, despite the sustained price declines, which have seen the market P/E decline to below its historical average presenting investors with attractive valuations in the market, the economic outlook remains grim.

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