Kenya Real Estate Developers Regulatory Board, & Cytonn Weekly #38/2020

Equities

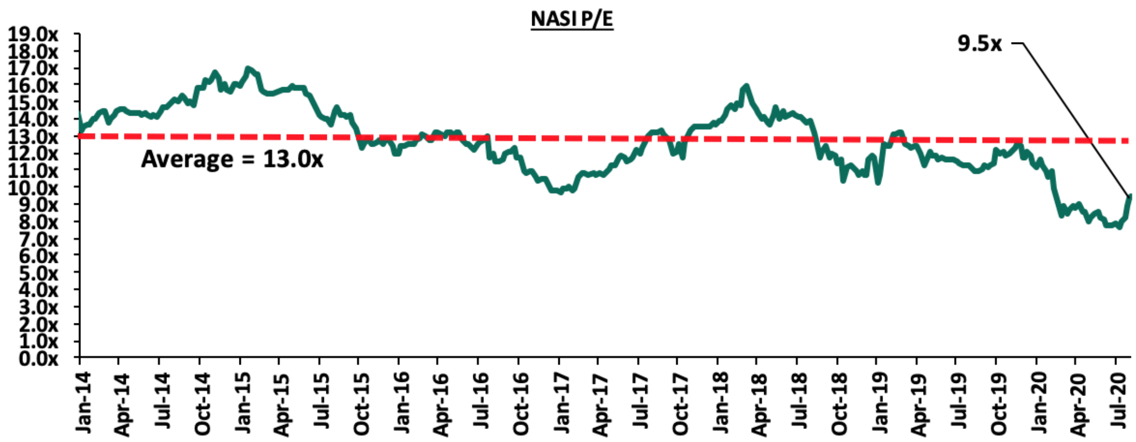
Market Performance

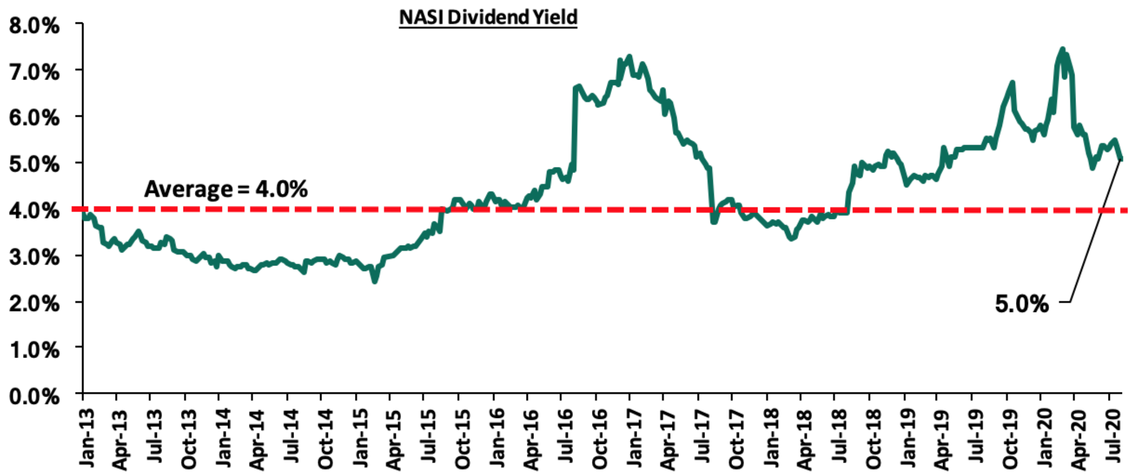
During the week, the equities market was on a downward trajectory, with NSE 20, NASI and NSE 25 all recording losses of 1.5%, 0.7% and 0.5%, respectively, taking their YTD performance to losses of 15.7%, 21.0%, and 30.4%, for NASI, NSE 25 and NSE 20, respectively. The performance was driven by declines recorded by large-cap stocks, with the highest declines being recorded in Diamond Trust Bank (DTB-K), Equity Group, and NCBA Group, which declined by 3.8%, 2.3% and 1.6%, respectively.

Equities turnover increased by 112.2% during the week to USD 47.4 mn, from USD 22.3 mn recorded the previous week, taking the YTD turnover to USD 1.1 bn. Foreign investors remained net buyers during the week, with a net buying position of USD 7.6 mn, from a net buying position of USD 2.0 mn recorded the previous week, taking the YTD net selling position to USD 250.8 mn.

The market is currently trading at a price to earnings ratio (P/E) of 9.5, 26.7% below the 11-year historical average of 13.0x. The average dividend yield is currently at 5.0%, unchanged from the previous week and 1.0% 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 9.5x is 23.8% above the most recent valuation trough of 7.7x experienced in the first week of August 2020. The charts below indicate the historical P/E and dividend yields of the market.





Weekly Highlight

During the week, the Capital Markets Authority (CMA) published guidelines to Collective Investments Schemes on the valuation, performance measurement and reporting. CMA highlighted that given the inconsistencies in the performance measurement and presentation by the fund managers, there was a need for standardization by the Collective Investment Schemes in order to enhance the comparability and consistency of the information presented across the sector. The guidance will be applicable to all approved Collective Investment Schemes and will take effect on 1st January 2021.

The key takeouts from the guidance are;

1. In the establishment of various funds, fund managers shall be guided by the following criteria:
    a. Money Market Funds – The fund shall invest only in interest bearing assets such as Fixed Deposits, Government Securities, Credit Rated Private Comercial Papers / Approved Public Commercial Papers, etc. with a maximum tenor of 13 months,
    b. Equity Fund - The fund shall invest a minimum of 60.0% of the Assets Under Management (AUM) in the equities market. Funds not invested in the equities market shall be invested in cash and cash equivalents,
    c. Balanced Fund - The fund shall maintain a maximum exposure of 60.0% of the AUM in the investments done in the Money Market, Fixed Income and Equities asset classes. Additionally, the maximum exposure in any other asset class shall comply with the limits provided under Regulation 78 of the Capital Markets Regulations, 2001,
    d. Fixed Income Fund - The fund shall invest a minimum of 60.0% of the AUM in fixed income securities, and,
    e. Special Funds – The funds shall invest based on the Fund Managers's investments strategy.
2. Fund Managers shall be required to prepare and submit their performance reports to CMA quarterly and the report shall be submitted within 21 days after the end of each quarter. Additionally, the report shall be made available to the fund managers existing and prospective clients,
3. Fund Managers shall be required to disclose its historical fees for at least the past 2 years,
4. In the determination of the total Assets Under Management (AUM), the fund manager will consider the aggregate fair value of all assets without double counting any assets, actual assets managed by the fund manager including fee-paying and non-fee-paying portfolios and assets outsourced to another fund manager, and,
5. The fund managers portfolios will be valued daily and in accordance with the definition of fair value under International Financial Reporting Standards (IFRS 13). IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price).

We believe this is a commendable move of aligning the market players. As highlighted in our Cytonn Weekly #37/2020, we had highlighted that CMA needed to improve fund managers disclosures by requiring them to publish a periodic report of exactly where their funds are invested. We believe that these new guidelines are a step in the right direction, however, they present various shortcomings. For instance, fund managers are only required to report performance-related information on the general areas of investment for the fund and as such, investors will not be able to specifically identify where their funds are invested. These new guidelines also raise substantive issues with the law such as do these guidelines override the fund managers' trust deed, whether a regulator can determine asset allocation for fund managers etc. Additionally, the guidelines have not dealt with the issue as to what happens with existing investment contracts that run for longer periods of time. We shall have an in-depth analysis of the same in the coming weeks in our topicals.

Universe of Coverage:

Company	Price at 11/09/2020	Price at 18/09/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank***	65.0	62.5	(3.8%)	(42.7%)	109.0	119.4	3.9%	95.0%	0.3x	Buy
Kenya Reinsurance	2.3	2.2	(1.3%)	(26.4%)	3.0	4.0	4.6%	84.0%	0.2x	Buy
Sanlam	12.5	12.3	(1.2%)	(28.5%)	17.2	18.4	0.0%	49.6%	1.2x	Buy
Jubilee Holdings	220.0	220.0	0.0%	(37.3%)	351.0	313.8	3.6%	46.2%	0.5x	Buy
NCBA***	22.6	22.2	(1.6%)	(39.8%)	36.9	30.7	1.0%	39.3%	0.6x	Buy
I&M Holdings***	46.0	45.0	(2.2%)	(16.7%)	54.0	57.8	5.1%	33.6%	0.7x	Buy
KCB Group***	37.9	37.9	0.0%	(29.8%)	54.0	46.4	9.9%	32.4%	0.8x	Buy
Equity Group***	37.0	36.2	(2.3%)	(32.4%)	53.5	44.5	5.9%	29.0%	0.9x	Buy
Standard Chartered***	165.8	164.5	(0.8%)	(18.8%)	202.5	197.2	7.8%	27.7%	1.2x	Buy
Co-op Bank***	11.5	12.0	4.3%	(26.6%)	16.4	14.2	8.4%	26.8%	0.8x	Buy
Liberty Holdings	8.0	8.0	(0.2%)	(22.9%)	10.4	9.8	0.0%	22.8%	0.6x	Buy
Stanbic Holdings	81.0	75.0	(7.4%)	(31.4%)	109.3	84.9	9.0%	22.2%	0.6x	Buy
ABSA Bank***	9.7	9.8	1.0%	(26.3%)	13.4	10.8	12.0%	21.7%	1.2x	Buy
Britam	8.0	7.4	(7.8%)	(18.2%)	9.0	8.6	3.3%	20.2%	0.8x	Buy
CIC Group	2.1	2.2	0.5%	(19.8%)	2.7	2.1	0.0%	(2.3%)	0.7x	Sell
HF Group	4.1	4.4	7.9%	(32.4%)	6.5	4.1	0.0%	(6.2%)	0.2x	Sell

*Target Price as per Cytonn Analyst estimates
**Upside/ (Downside) is adjusted for Dividend Yield
***For Disclosure, these are banks in which Cytonn and/ or its affiliates are invested in

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.