Kenya Mortgage Refinance Company (KMRC) Recap, & Cytonn Weekly #45/2020

Equities

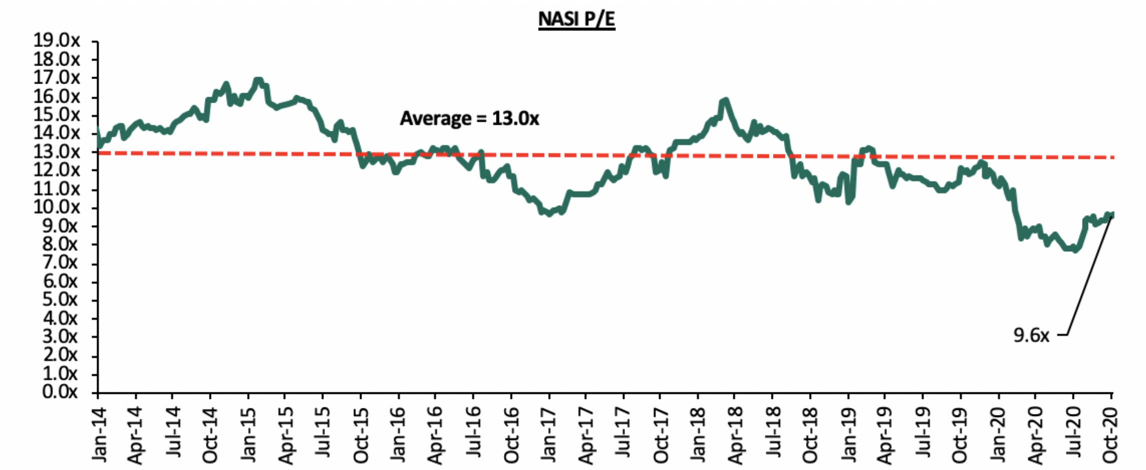
Market Performance

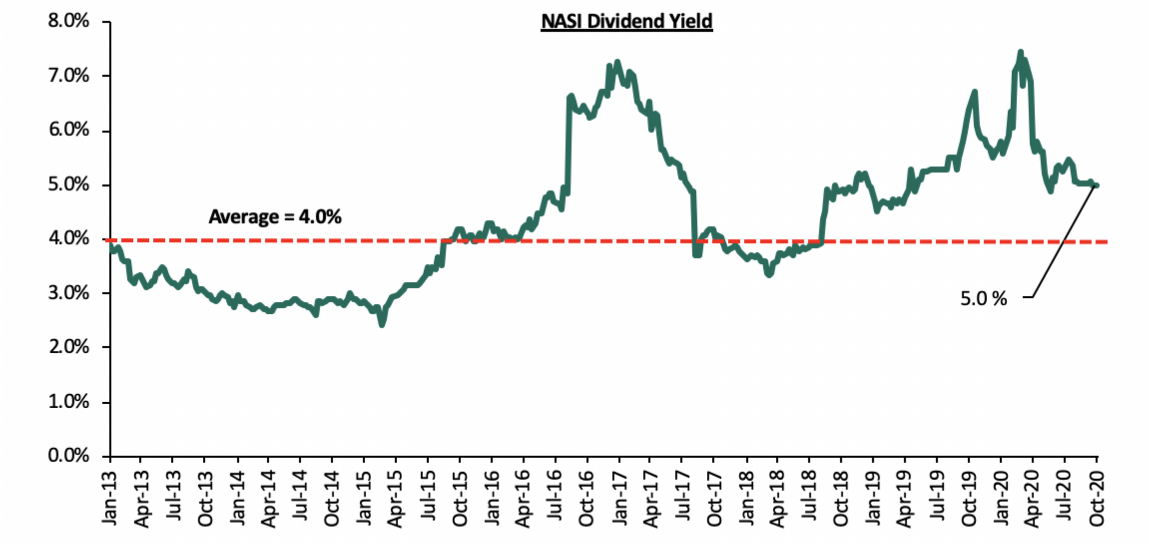
During the week, the equities market recorded mixed performance with both NASI and NSE 25 gaining by 0.9%, while NSE 20 shed 0.8%, taking their YTD performance to losses of 15.1%, 22.0%, and 33.3%, for NASI, NSE 25 and NSE 20, respectively. The NASI performance was driven by gains recorded by large-cap stocks, with the highest gains being recorded in Equity Group, Bamburi, Co-operative Bank and BAT of 3.2%, 2.9%, 2.7% and 2.3%, respectively. The gains were however weighed down by losses recorded by banking stocks such as NCBA Group and KCB Group, which declined by 3.1% and 1.2% respectively.

Equities turnover increased by 86.6% during the week to USD 28.8 mn, from USD 15.4 mn recorded the previous week, taking the YTD turnover to USD 1.2 bn. Foreign investors remained net sellers during the week, with a net selling position of USD 11.1 mn, from a net selling position of USD 3.7 mn recorded the previous week, taking the YTD net selling position to USD 278.0 mn.

The market is currently trading at a price to earnings ratio (P/E) of 9.6x, 25.6% 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 9.6x is 25.3% 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) approved the registration of ABSA Unit Trust Funds, which will be offered by ABSA Asset Management Limited (formerly Barclays Credit Limited). ABSA Asset Management Limited is a fully owned subsidiary of Absa Bank Kenya PLC. The fund will offer the following Collective Investment Schemes (CIS); ABSA Shilling Fund, ABSA Dollar Fund, ABSA Fixed Income Fund, ABSA Equity Fund, and, ABSA Balanced Fund. As at Q2'2020, there were 23 approved Collective Investment Schemes made up of 93 funds in Kenya. Out of the 23 however, only 19 were active while 4 were inactive. According to the recently published data by the Regulator, the top five Fund Managers control 81.7% of the market leaving approximately 18.3% of the market to the other 14 active fund managers. As such, we are of the view that given that Absa Unit Trust Fund is a subsidiary of ABSA Bank Kenya, the fund will be able to leverage on the Bank's brand recognition to acquire a piece of the market share.

The consent granted to ABSA Asset Managers for the registration of the fund, follows a similar move by the regulator where African Diaspora Asset Managers (ADAMS) was granted a Fund Manager's license towards the tail end of Q3'2020, as highlighted in our Cytonn Weekly #37/2020. In our view, these actions by CMA will work towards opening up Kenya's capital markets. However, there is still a lot of work to do to make our capital markets functional. According to World Bank data, in well-functioning economies, businesses rely on banks for just 40.0% of their funding with the larger percentage of 60.0% coming from Capital Markets. However, in Kenya businesses rely on banks for a staggering 99.0% of their funding, with less than 1.0% coming from Capital Markets. This makes funding difficult to access, and when accessed, it's exceedingly expensive. Lack of capital is the primary reason why the housing agenda has not taken off. To stimulate capital markets, CMA needs to engage market participants to remove the myriad of obstacles that impede market growth. Specifically;

i. Remove conflicts of interest in the governance of capital markets and create a governance structure that is more responsive to market participants so that the market can grow,
ii. Removed conflicts in the governance of fund structures so that funds can be innovative and grow,
iii. Reduce the minimum investments for real estate finance vehicles – the minimum of Kshs. 5 million per investor for the formation of a development REIT is too high for a country where the median income is just Kshs. 50,000, hence the minimum investment is 100 times higher than the median income, no wonder there is not a single Development REIT formed so far, making it hard to finance real estate initiatives such as the President's housing agenda,
iv. Make it easy for funds to on-board clients by allowing them to have as many banking partners as they so wish, the current requirement that funds must choose just one bank as their custodian is unnecessarily restrictive,
v. Allow for the formation of sector funds; the current regulations only support diversification. In this

day and age, sector funds such as a technology fund, a financial services fund or a real estate fund are key to stimulating specific areas of the economy,

vi. Improve fund transparency to provide investors with more information – each Unit Trust Fund should be required to publish their portfolio holdings on a quarterly basis, and,

vii. Fairness in application of regulations; CMA needs to be seen to be consistent and fair in their interpretation and application of regulations to market participants. In a recent ruling, the High Court found an instance where CMA was dispensing a sanction that is not in even provided for in law.

Capital Markets are essential to funding businesses, which in turn create jobs, growth economy and uplift the standards of living. We believe that the above reforms would open our capital markets, stimulate fund formation and ultimately provide financing for businesses as an alternative to bank funding.

Universe of Coverage:

Company	Price at 30/10/2020	Price at 06/11/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Kenya Reinsurance	2.3	2.0	(10.2%)	(33.3%)	3.0	4.0	5.4%	103.5%	0.2x	Buy
Diamond Trust Bank***	61.3	61.0	(0.4%)	(44.0%)	109.0	119.4	4.4%	100.2%	0.3x	Buy
Sanlam	12.3	12.8	3.7%	(25.9%)	17.2	18.4	0.0%	44.3%	1.2x	Buy
NCBA***	22.7	22.0	(3.1%)	(40.4%)	36.9	30.7	1.1%	41.0%	0.6x	Buy
KCB Group***	36.1	35.6	(1.2%)	(34.1%)	54.0	46.4	9.8%	40.2%	0.8x	Buy
I&M Holdings***	44.0	43.2	(1.8%)	(20.0%)	54.0	57.8	5.9%	39.7%	0.7x	Buy
Standard Chartered***	158.3	157.0	(0.8%)	(22.5%)	202.5	197.2	8.0%	33.6%	1.2x	Buy
Equity Group***	33.9	35.0	3.2%	(34.6%)	53.5	44.5	5.7%	32.9%	0.9x	Buy
Co-op Bank***	11.3	11.6	2.7%	(29.1%)	16.4	14.2	8.6%	31.0%	0.8x	Buy
Liberty Holdings	7.6	7.5	(1.1%)	(27.5%)	10.4	9.8	0.0%	30.7%	0.6x	Buy
ABSA Bank***	9.4	9.5	0.6%	(28.8%)	13.4	10.8	11.6%	25.3%	1.2x	Buy
Jubilee Holdings	269.5	269.0	(0.2%)	(23.4%)	351.0	313.8	3.3%	20.0%	0.5x	Accumulate
Britam	7.4	7.5	1.6%	(16.7%)	9.0	8.6	3.3%	18.0%	0.8x	Accumulate
Stanbic Holdings	77.0	80.0	3.9%	(26.8%)	109.3	84.9	8.8%	14.9%	0.6x	Accumulate
HF Group	3.7	3.7	(1.1%)	(42.9%)	6.5	4.1	0.0%	11.1%	0.2x	Accumulate
CIC Group	2.3	2.2	(3.1%)	(18.7%)	2.7	2.1	0.0%	(3.7%)	0.7x	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.