Nairobi Metropolitan Area Mixed-Use Developments (MUDs) Report-2020 & Cytonn Weekly #51/2020

Equities

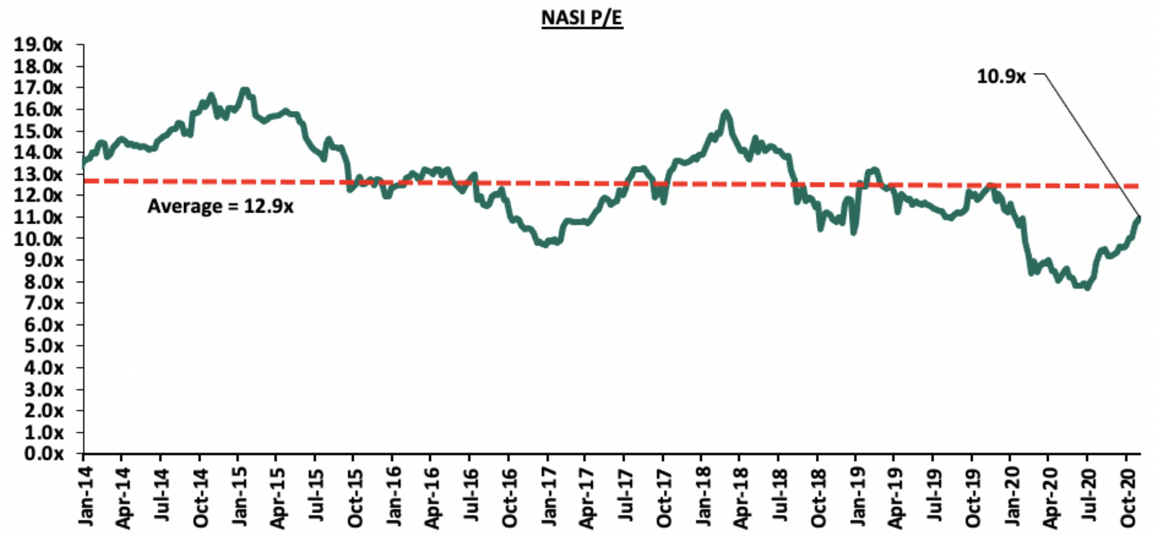
Markets Performance

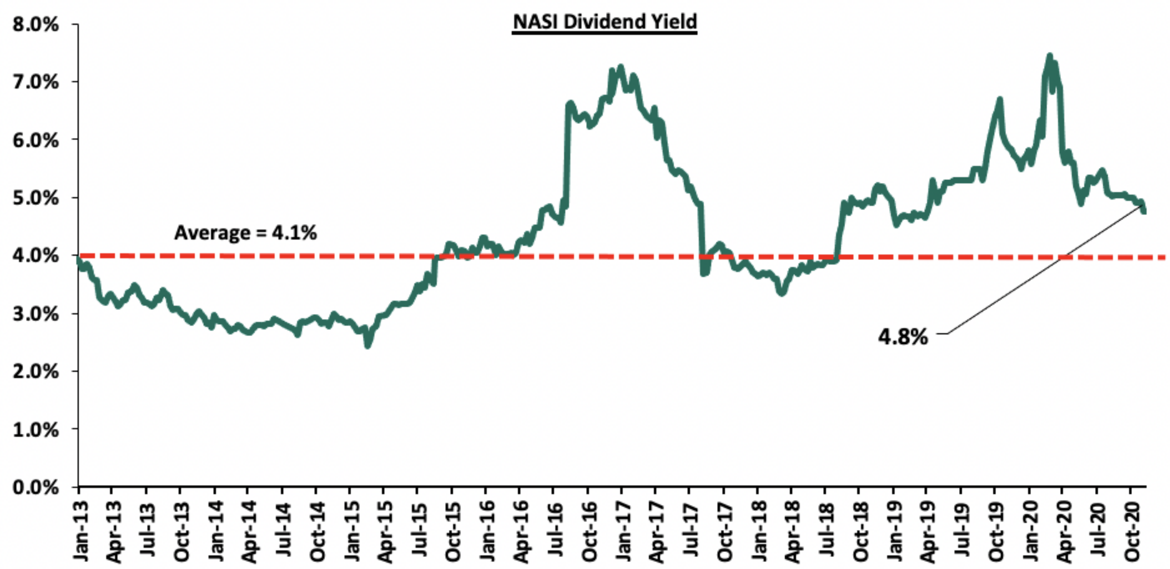
During the week, the equities market was on an upward trajectory, with NASI, NSE 20 and NSE 25 all gaining by 0.6%, 0.2% and 0.1%, respectively, taking their YTD performance to losses of 11.0%, 32.3%, and 19.6%, for NASI, NSE 20 and NSE 25, respectively. The equities market performance was mainly driven by gains recorded by large cap stocks such as Safaricom and NCBA Group of 1.7% and 0.9%, respectively. Other major notable gains were recorded by Stanbic holdings, Kenya Reinsurance and Jubilee Holdings which gained by 9.0%, 6.6% and 5.6%, respectively. The gains were however weighed down by losses recorded by large-cap stocks such as Bamburi, ABSA Bank and DTBK of 10.0%, 4.2% and 2.9%, respectively.

Equities turnover declined by 23.3% during the week to USD 18.4 mn, from USD 24.1 mn recorded the previous week, taking the YTD turnover to USD 1.4 bn. Foreign investors remained net sellers during the week, with a net selling position of USD 2.3 mn, from a net selling position of USD 1.6 mn recorded the previous week, taking the YTD net selling position to USD 279.8 mn.

The market is currently trading at a price to earnings ratio (P/E) of 10.9x, 15.6% below the 11-year historical average of 12.9x. The average dividend yield is currently at 4.8%, unchanged from the previous week, and 0.7% points above the historical average of 4.1%.

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 10.9x is 41.7% 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 Central Bank of Kenya (CBK) released the Bank Supervision Annual Report 2019 highlighting that the sector's gross loans and advances increased by 8.8% to Kshs 2.7 tn in FY'2019, from Kshs 2.5 tn in FY'2018. The highest proportion of the banking industry gross loans and advances were channeled to Trade, Real Estate and Personal/Household sectors, which collectively accounted for 74.5% of the gross loans, a 0.5% point increase from the 74.0% recorded in 2018. Other key take-outs from the report include:

i. The balance sheet expanded with the total net assets growing by 9.1% to Kshs 4.8 tn in FY'2019, from Kshs 4.4 tn in FY'2018. This was mainly attributable to the 9.6% growth in Investments in Government Securities to Kshs 1.3 tn, from Kshs 1.2 tn recorded in FY'2018, coupled with the 7.6% increase in loans and advances to Kshs 2.5 tn, from Kshs 2.3 tn in FY'2018. The outperformance by government securities points to a preference by banks to lend to the government, shying away from lending to the private sector due to the interest rate cap which was repealed in November 2019. The use of alternative channels such as agency banking and mobile phones platforms led to an 8.3% growth in customer deposits to 3.6 tn in FY'2019 from 3.3 tn in FY'2018,
ii. Interest Income increased by 1.5% to Kshs 391.6 bn, from Kshs 386.0 bn in FY'2018 attributable to the 60.4% increase in interest income from deposits and placements to Kshs 8.5 bn, from Kshs

5.3 bn in FY’2018. Interest income from government securities grew by 2.5% to Kshs 121.6 bn, from Kshs 118.7 bn recorded in FY’2018. However, the gains were weighed-down by a 9.4% decline in other interest income which declined to Kshs 1.2 bn in FY’2019 from Kshs 1.3 bn in FY’2018 and interest income from Loans and advances which declined by 0.1% to Kshs 260.3 bn, from Kshs 260.7 bn over the same period,

iii. Non-Funded Income (NFI) increased by 15.6% to Kshs 140.0 bn, from Kshs 121.1 bn in FY’2018. The increase was mainly driven by the 33.7% increase in Fees and commissions from loans to Kshs 33.8 bn from Kshs 25.3 bn in FY’2018, coupled with an 8.7% increase in other fees and commissions to 52.1 bn in FY’2019 from Kshs 47.9 bn in FY’2018. Forex trading income also grew by 9.7% to Kshs 30.8 bn in FY’2019, from Kshs 28.1 bn recorded in FY’2018. Consequently, the revenue mix for the banking sector shifted to 65:35 funded to non-funded income, from 68:32, owing to the faster growth in NFI compared to Net Interest Income (NII) pointing towards continued revenue diversification in the banking sector,
iv. The pre-tax profit for the sector increased by 4.2% to Kshs 159.1 bn, from Kshs 152.7 bn in FY’2018. The growth in profitability in 2019 is attributed to a higher increase in total income by 6.6% to Kshs 573.3 bn in FY’2019, from Kshs 513.5 bn in FY’2018, which outpaced the 4.8% increase in total expenses to Kshs 378.2, from Kshs 360.8 recorded in FY’2018. The sector recorded a 4.2% increase in the profit after tax to Kshs 105.7 bn in FY’2019 from Kshs 110.1bn in FY’2018,
v. Gross non-performing loans (NPLs) rose by 6.3% to Kshs 335.9 bn in FY‘2019, from Kshs 316.7 bn in FY‘2018. The NPL ratio declined by 0.2% points to 12.5%, from 12.7% recorded in FY’2018, following the faster 8.2% growth in gross loans to Kshs 2.7 tn in FY’2019, from Kshs 2.5 tn recorded in FY’2018, that outpaced the 6.3% increase in NPLs,
vi. NPL coverage for the sector declined by 0.4% points to 56.0% in FY’2019, from 56.4% owing to the faster 29.3% increase in general loan loss provisions which outpaced the 6.3% increase in gross NPLs. Key to note, in the risk classification of the loans and advances, Kshs 2.1 tn of the sectors loan book were classified as loss in FY’2019, a 10.9% increase from the Kshs 1.9 tn recorded in FY’2018, and,
vii. During the period of review, the sector also saw several consolidation efforts, which were necessitated by factors such as: regional expansion and industry market share growth. Some of the major consolidations included: KCB acquiring 100.0% shareholding in National Bank of Kenya (NBK), even though NBK will continue operating individually, CBA Bank merged with NIC Bank to form NCBA Bank which became the third largest bank by assets, at Kshs 464.9 bn, controlling a combined asset market share of 9.7%, and, Access Bank from Nigeria acquired 100.0% ownership in Transnational Bank.

From the Financial Stability Report – October 2020, CBK expects the banking sector to remain stable and resilient despite the negative effects of the COVID-19 pandemic on the sector’s assets quality and overall performance. The regulator also expects the industry to utilize its sufficient capital buffers to withstand COVID-19 pandemic related shocks. Given the uncertainty of the tenor of the pandemic, we believe that the banking sector will continue to be negatively affected as evidenced by the depressed earnings and the deteriorating asset quality seen in Q3’2020. As highlighted in our Q3’2020 Banking Report, the listed banking sector recorded a weighted decline in its core earnings per share of 32.4%, compared to a weighted growth of 8.7% recorded in Q3’2019 with the asset quality deteriorating, with the gross NPL ratio rising by 2.6% points to 12.4% from 9.8% in Q3’2019. However, despite all these effects, we support CBKs outlook and we believe that banking sector will remain resilient due to the proactive monitoring of the loan book coupled with the measures taken by the Central Bank to support the sector, as highlighted in our Cytonn Weekly #50/2020.

Following the approval granted by the Capital Markets Authority (CMA), the Nairobi Securities Exchange (NSE) launched the Unquoted Securities Platform (USP), a market infrastructure that will facilitate the trading, clearing and settlement of securities of unlisted companies. For trading purposes, an investor will be required to open and maintain a USP securities trading account, identified by a unique trade identification code, generated by the platform. An investor shall then trade their USP securities by placing a buy or sale order through their USP securities dealer.

Some of the offerings that the platform will provide to issuer companies include:

i. Offering issuers an opportunity to access the capital markets for long term funding through private placements whilst enjoying flexibility in listing requirements and obligations,
ii. Enabling unquoted companies that have a register of shareholders to enjoy price discovery and increase liquidity of their shares, and,
iii. The platform will also increase transparency and accessibility to information for investors given that prices will be published daily.

The move is in line with the objectives of the CMA's 10-year strategic plan Capital Market Master Plan (2014-2023) of developing a deeper and more liquid domestic equities market through increased listings. We are of the view that the platform will help unlisted firms, mostly SMEs, with an opportunity to raise capital necessary for growth and enhance their future listing prospects on the respective segments at the Exchange.

Universe of Coverage:

Company	Price at 11/12/2020	Price at 18/12/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Kenya Reinsurance	2.1	2.3	6.6%	(25.7%)	3.0	4.0	4.9%	82.7%	**0.2x**	**Buy**
Diamond Trust Bank* **	69.3	67.3	(2.9%)	(38.3%)	109.0	105.1	3.9%	60.2%	**0.3x**	**Buy**
Sanlam	12.7	11.8	(6.7%)	(31.4%)	17.2	18.4	0.0%	55.9%	**1.2x**	**Buy**
Liberty Holdings	7.5	7.4	(1.9%)	(28.9%)	10.4	9.8	0.0%	33.2%	**0.6x**	**Buy**
I&M Holdings* **	46.0	45.2	(1.7%)	(16.3%)	54.0	60.1	5.5%	38.5%	**0.7x**	**Buy**
KCB Group* **	37.0	36.8	(0.5%)	(31.9%)	54.0	46.0	9.5%	34.5%	**0.8x**	**Buy**
Co-op Bank* **	11.7	11.7	0.0%	(28.4%)	16.4	14.5	8.5%	32.5%	**0.8x**	**Buy**
Equity Group* **	35.0	34.6	(1.3%)	(35.4%)	53.5	43.0	5.7%	30.2%	**0.8x**	**Buy**
ABSA Bank* **	9.6	9.2	(4.2%)	(31.4%)	13.4	10.5	11.5%	26.1%	**1.1x**	**Buy**
Britam	7.2	7.0	(2.5%)	(22.0%)	9.0	8.6	3.5%	26.0%	**0.8x**	**Buy**
Stanbic Holdings	75.3	82.0	9.0%	(24.9%)	109.3	84.9	9.4%	12.9%	**0.7x**	**Accumulate**
Jubilee Holdings	270.0	285.0	5.6%	(18.8%)	351.0	313.8	3.3%	13.4%	**0.5x**	**Accumulate**
Standard Chartered* **	150.0	147.3	(1.8%)	(27.3%)	202.5	153.2	8.3%	12.4%	**1.2x**	**Accumulate**
NCBA* **	23.3	23.5	0.9%	(36.2%)	36.9	25.4	1.1%	9.2%	**0.6x**	**Hold**
CIC Group	2.1	2.1	(0.5%)	(23.5%)	2.7	2.1	0.0%	2.4%	**0.7x**	**Lighten**
HF Group	3.1	3.2	5.2%	(49.8%)	6.5	3.0	0.0%	(7.4%)	**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 "bullish" on the equities market, given the current low valuations, compared to historical averages, presenting pockets of value especially in the financial sector for investors with a higher risk tolerance and are willing to wait out the pandemic.