Kenya's Public Debt, & Cytonn Weekly #52/2020

Equities

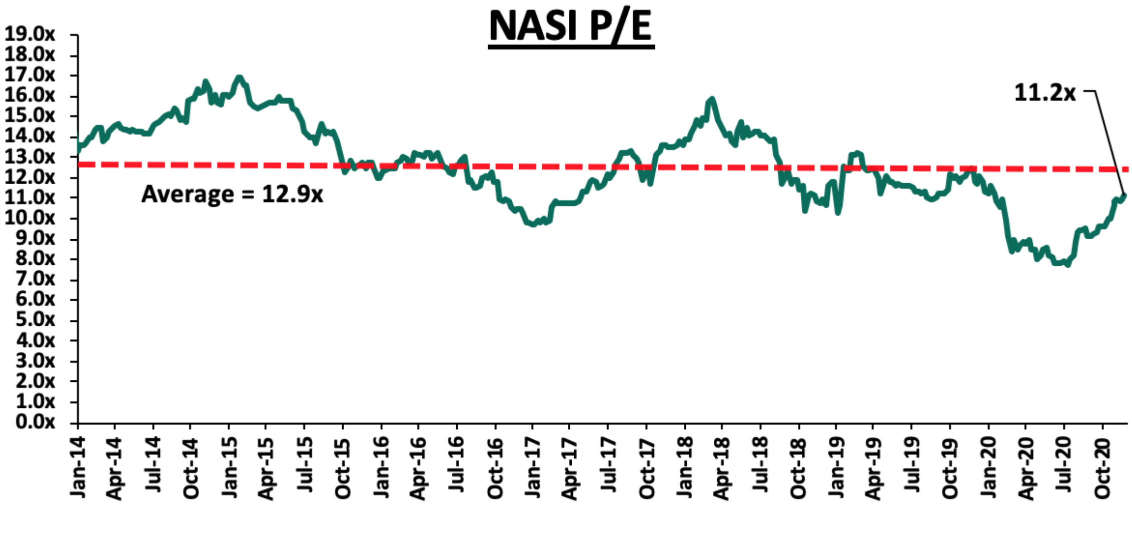
Markets Performance

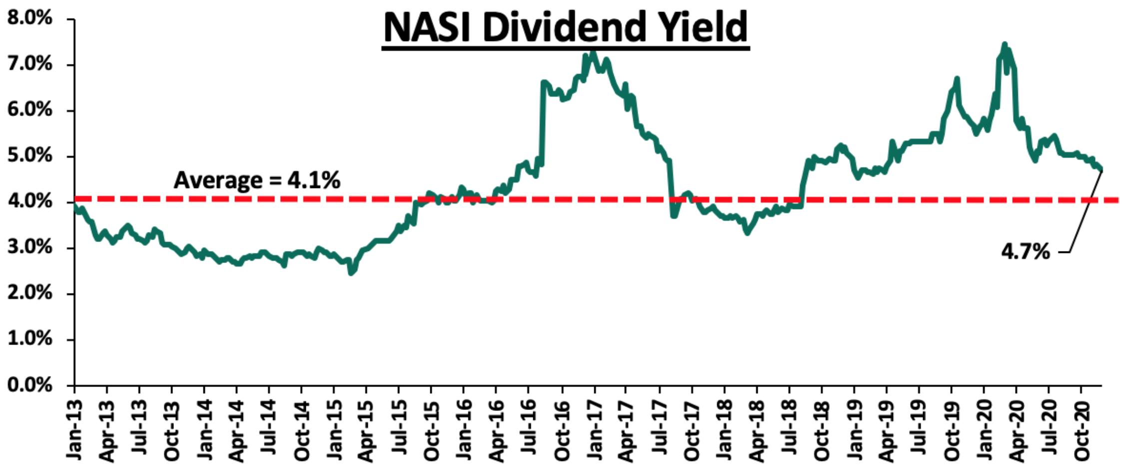
During the week, the equities market was on an upward trajectory, with both NASI and NSE 25 gaining by 1.4%, while NSE 20 gained by 2.4%, taking their YTD performance to losses of 9.8%, 30.7%, and 18.4%, for NASI, NSE 20 and NSE 25, respectively. The equities market performance was driven by gains recorded by large-cap stocks such as Bamburi, Diamond Trust Bank (DTBK) and ABSA of 8.3%, 7.8% and 5.0%, respectively. The gains were however weighed down by losses recorded by other large-cap stocks such as Standard Chartered Bank and BAT of 1.5% and 1.3%, respectively.

Equities turnover declined by 32.9% during the week to USD 12.4 mn, from USD 18.4 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 1.7 mn, from a net selling position of USD 2.3 mn recorded the previous week, taking the YTD net selling position to USD 281.5 mn.

The market is currently trading at a price to earnings ratio (P/E) of 11.2x, 13.6% below the 11-year historical average of 12.9x. The average dividend yield is currently at 4.7%, 0.1% points below the 4.8% recorded the previous week and 0.6% 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 11.2x is 45.2% above the most recent valuation trough of 7.7x experienced in the first week of August 2020. The charts below indicate the market's historical P/E and dividend yield.





Weekly Highlight

During the week, the Central Bank of Kenya (CBK) released the Commercial Banks' Credit Survey Report for Q3'2020, highlighting that 76.0% of the respondents in the mining and Quarry reported that the perceived demand for credit remained unchanged. 45.0% and 44.0% of the respondents in personal/household and trade sectors, respectively, reported increases in credit demand. Additionally, 44.0% and 42.0% of the respondents reported that the demand for credit decreased in the Real estate and Tourism sectors, respectively. Key to note, 50.0% of the banks reported that the COVID-19 pandemic had negatively impacted the demand for credit with the loan book growing by 1.2% in Q3'2020, down from the 2.2% growth recorded in Q2'2020, while 81.0% of the respondents indicated that the demand for credit remained unchanged, after the repeal of interest rate capping law. A total of 38 operating commercial banks and 1 mortgage finance company participated in the Survey. Other Key take-outs from the report include:

i. The balance sheet expanded by 10.4% to Kshs 5.3 tn in Q3'2020, from Kshs 4.8 tn in Q3'2019. This was attributable to increased investment in government securities and foreign currency loans during the period under review, coupled with a 6.4% increase in gross loans to Kshs 2,943.5 bn in Q3'2020, from Kshs 2,766.7 bn in Q3'2019, which was on account of increased advances in the Real Estate, Transport and Communication and personal/household sectors,
ii. Adverse effects from a slowdown in business activities from the COVID-19 pandemic eroded the banks' asset quality, with the NPL ratio rising by 1.2% points to 13.6% in Q3'2020, from 12.4% recorded in Q3'2019,
iii. According to the report, the implementation of IFRS 9 that became effective from January 2018 has negatively impacted the banks' capital adequacy due to the increased provisioning levels required. To mitigate this, the regulator indicates that banks have injected more capital to accommodate the expected increase in credit losses as well as continuously reviewed their business models to incorporate a forward-looking credit risk assessment model, which complies with IFRS 9,
iv. The banking sector remained liquid as evidenced by a 0.5% points increase in the liquidity position to 53.3% in Q3'2020, from 52.8% in Q2'2020. This was 33.3% points above the minimum statutory ratio of 20.0%. The improved liquidity position was attributed to; i) increase in deposit mobilization contributing 57.0%, ii) maturity of government securities contributing 24.0%, iii) capital injection contributing 9.0%, and iv) loan recovery efforts contributing 9.0%. Additionally, the lowering of the Cash Reserve Ratio (CRR) to 4.25%, from 5.25% in March 2020, availed more funds in the sector for onward lending, and,
v. The guidance on loan restructuring given on the onset of the pandemic in March 2020 saw banks give payment holidays to their borrowers who had been adversely affected by the pandemic. As such, most banks reported that they were currently meeting all the loan extension and restructuring costs, putting a strain in their operations as well as their interest income.

Despite the CBK's efforts to cushion the sector against any pandemic related shocks, credit risk remained elevated as demonstrated by the banking industry NPL ratio deteriorating by 0.5% points to 13.6% in Q3' 2020 from 13.1% in Q2'2020. As highlighted in our Q3'2020 Listed Banks Report, we believe that the banking sector remains highly susceptible to these shocks, as evidenced by the depressed earnings and the deterioration in asset quality among the listed banks, with the NPL ratio rising by 2.6% points to 12.4% in Q3'2020, from 9.8% recorded in Q3'2019. However, intensified credit recovery efforts in sectors such as Transport and Communication, Real estate and trade coupled with the banks' adherence to IFRS 9 provisioning requirements will improve the overall quality of the asset portfolio. We expect the banking industry to remain resilient having implemented tightened credit standards on granting of new loans coupled with the proactive monitoring of the current loan book, and the removal of the waiver of fees on bank transfers which will, in turn, boost the Non-funded income.

Universe of Coverage:

Company	Price at 18/12/2020	Price at 24/12/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Kenya Reinsurance	2.3	2.4	4.9%	(22.1%)	3.0	4.0	4.7%	74.2%	**0.3x**	**Buy**
Diamond Trust Bank* **	67.3	72.5	7.8%	(33.5%)	109.0	105.1	3.7%	48.7%	**0.3x**	**Buy**
I&M Holdings* **	45.2	43.4	(4.0%)	(19.6%)	54.0	60.1	5.9%	44.4%	**0.7x**	**Buy**
Sanlam	11.8	13.0	9.7%	(24.7%)	17.2	18.4	0.0%	42.1%	**1.1x**	**Buy**
KCB Group* **	36.8	37.0	0.5%	(31.5%)	54.0	46.0	9.5%	33.8%	**0.9x**	**Buy**
Co-op Bank* **	11.7	11.9	1.7%	(27.2%)	16.4	14.5	8.4%	30.3%	**0.9x**	**Buy**
Equity Group* **	34.6	34.7	0.3%	(35.2%)	53.5	43.0	5.8%	29.9%	**1.0x**	**Buy**
Liberty Holdings	7.4	7.8	6.3%	(24.4%)	10.4	9.8	0.0%	25.3%	**0.6x**	**Buy**
Britam	7.0	7.2	2.3%	(20.2%)	9.0	8.6	3.5%	23.3%	**0.8x**	**Buy**
ABSA Bank* **	9.2	9.6	5.0%	(27.9%)	13.4	10.5	11.4%	20.6%	**1.2x**	**Buy**
Stanbic Holdings	82.0	79.0	(3.7%)	(27.7%)	109.3	84.9	8.9%	16.4%	**0.8x**	**Accumulate**
Standard Chartered* **	147.3	145.0	(1.5%)	(28.4%)	202.5	153.2	8.6%	14.3%	**1.2x**	**Accumulate**
Jubilee Holdings	285.0	283.3	(0.6%)	(19.3%)	351.0	313.8	3.2%	13.9%	**0.7x**	**Accumulate**
NCBA* **	23.5	24.5	4.3%	(33.5%)	36.9	25.4	1.0%	4.7%	**0.6x**	**Lighten**
CIC Group	2.1	2.1	2.9%	(21.3%)	2.7	2.1	0.0%	(0.5%)	**0.8x**	**Sell**
HF Group	3.2	3.2	(2.5%)	(51.1%)	6.5	3.0	0.0%	(5.1%)	**0.1x**	**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 the Equities markets in the short term but "Bullish" in the medium to long term. We expect the recent discovery of a new strain of COVID-19 coupled with the introduction of strict lockdown measures in major economies to continue dampening the economic outlook. However, we believe there exist pockets of value in the market, with a bias on financial services stocks given the resilience exhibited in the sector. The sector is currently trading at historically cheaper valuations and as such, presents attractive opportunities for investors with a high-risk tolerance, willing to wait out the pandemic.