Cytonn 2021 Markets Outlook

Equities Outlook

In 2020, the Kenyan equities market was on a downward trajectory, with NASI, NSE 25 and NSE 20 declining by 8.6%, 16.7% and 29.6%, respectively. Large-cap decliners in 2020 included Bamburi, Equity Group, Diamond Trust Bank, KCB Group and Standard Chartered which declined by 52.7%, 31.7%, 31.2%, 29.4%, and 28.8%, respectively. Key to note, Safaricom recorded gains of 8.7% YTD, attributable to the continued demand from investors as the firm is expected to see a faster recovery in the post-COVID environment. Additionally, the directive by the Central Bank of Kenya on the reinstatement of the fees on mobile transfers saw the stock price rally in the last week of December 2020. Notably, Safaricom continues to benefit from working from home environment and increased digitization trends.

Following the poor performance in the equities market in 2020, the market valuation declined below the historical average with NASI closing the year at a price to earnings ratio (P/E) of 11.3x, 12.9% below the 11-year historical average of 12.9x, and a dividend yield of 4.6%, 0.5% points above the historical average of 4.1%. Equity turnover on the other hand declined by 5.9% to USD 1.4 bn, from USD 1.5 bn in FY'2019. Foreign investors turned net sellers, with a net outflow of USD 280.9 mn, compared to net inflows of USD 10.7 mn recorded in FY'2019. The year also saw 15 companies issuing profit warnings, a rise from 10 companies in 2019, attributable to the tough macro-economic environment amid the COVID-19 pandemic. Key to note, Companies are required to issue profit warnings if they project a more than 25.0% decline in profits year-on-year. For more information, see our Cytonn Annual Markets Review - 2020.

Kenyan 2021 Equities Outlook

In 2021, we project the following positive factors to affect the direction of the Kenyan equities market:

i. Gradual recovery in Corporate Earnings: We expect a gradual upward recovery in earnings growth in 2021, supported by a relatively stable business-operating environment, coupled with the low base coming from 2020. However, despite this, we expect Safaricom and the banking stocks, which currently comprise above 60.0% of the Nairobi All Share Index (NASI), to register modest growth in their earnings in 2021 due to; (i) expected lower provisioning by banks, (ii) Increased lending as the economy rebounds, (iii) growth in Safaricom earnings from the M-PESA revenue line following the expiry of the waiver on M-PESA transaction fees, and (iv) increased use of digital platforms by banks;
ii. Attractive valuations: Following the poor performance in the equities market in 2020, the market valuations declined to below historical average with NASI closing the year at a price to earnings ratio (P/E) of 11.3x, 12.9% below the 11-year historical average of 12.9x, and a dividend yield of 4.6%, 0.5% points above the historical average of 4.1%. Given these low valuations, we expect investors to take advantage of this and buy into the market;
iii. Capital Markets Investor Sentiment: We expect the equities market to register increased foreign inflows in 2021, mainly supported by the fact that Kenya and specifically, Safaricom, has an increased weighting in the MSCI Emerging Markets Index, as capital flows go back to Emerging

and Frontier markets. Kenya is projected to be one of the key beneficiaries as the economy recovers and as the ease of doing business remains attractive. Key to note, Kenya ranked position 56 globally and 4th in Sub-Saharan Africa in the 2020 Ease of Doing Business report;

iv. Diversification of Capital Markets and New Listings: We expect several activities to be undertaken by NSE in 2021 including; increasing the number of Single Stock Futures traded on the derivatives market. Currently, the bourse offers 6 Single Stock Futures namely Safaricom Plc, Kenya Commercial Bank Group Plc, Equity Group Holdings Plc, East African Breweries Ltd, ABSA Bank Kenya and British American Tobacco Plc. In 2020, the Derivatives Market recorded an 83.6% growth in turnover to Kshs 38.0 mn, from Kshs 20.7 mn recorded in 2019 while the trading volume increased by 118.0% to 1,247, from the 572 recorded in 2019.It is our view that these initiatives would result in; (i) increased liquidity in the market by increasing the volume of securities available for trading, and (ii) improved depth in the capital market by increasing product offerings at the exchange, consequently attracting investors;

v. Monetary Policy Direction: We expect monetary policy to remain stable in 2021 as the Central Bank continues to support the economy amid the COVID-19 pandemic. As such, we expect the accommodative monetary policy stance to lead to increased capital inflows into the Equities markets as investors take on additional risks in search of higher returns as the bond yields fall, and as such, bolster the equities markets in the medium term. Further, we expect low rates to lead to increased economic activities and higher earnings for firms.

Below, we summarize the metrics used in coming up with our 2021 Equities Outlook;

Equities Market Indicators	Outlook for 2021	Current View
Macro-Economic Environment	• We expect a gradual recovery in the economy given the continued partial reopening of the economy. However, we believe that the country’s promptness/ability to acquire and distribute the COVID-19 vaccine will pose a risk to the recovery of the economy. • We are projecting GDP growth for 2021 to come in at 3.9% – 4.1%, lower than the 5-year historical average of 5.7%	Neutral
Corporate Earnings Growth	• We expect a gradual upward recovery in earnings growth for the year 2021, supported by a relatively stable business-operating environment, coupled with the low base coming from 2020, and, • Given that the major attributor for the decline in earnings in the Banking sector was increased provisioning levels as banks covered for downgraded facilities, we expect to see a gradual decline in the provisioning levels in the banking sector in 2021, as the business environment improves. We expect Safaricom to register an improvement in its earnings growth in 2021 attributable to, (i) increased M-PESA revenue following the expiry of the waiver of M-PESA transaction fees, (ii) increased demand for Fiber to the Home (FTTH) as more people work from home, and, (iii) the potential entry in the Ethiopian Market	Neutral
Valuations	• With the market currently trading at a P/E of 11.8x, and expected earnings growth of 8.9%, the market is currently trading at a Forward P/E of 10.6x, representing a potential upside of 22.0% compared to historical levels	Positive
Investor Sentiment and Security	• Increased Foreign participation is expected in stocks such as Safaricom, which have shown resilient performance amidst the pandemic. Additionally, we expect investors to register strong interest in stocks that are likely to register quick recovery and robust earnings growth post COVID-19 on the back of their strong fundamentals, • Kenya remains more attractive compared to other frontier markets boosted by stronger historical economic growth compared to other economies in the region such as Nigeria and Ghana, and as such, attracting investors seeking the high growth in a frontier market, • On the downside, however, given the anticipation of a decline in dividends following the declined earnings in 2020 and the profit warnings issues by most firms, we expect capital flight from equity investors whose focus is on the dividend play, and, • Additionally, given that 2022 will be an election year, the 2022 General Election, and as the political tension builds up towards the tail end of 2021, we expect to see increased capital flight towards the tail end of 2021 as investors shift from the volatile Equities market and towards the safer havens such as the Fixed Income Securities.	Neutral

Out of the four metrics that we track, three have a “neutral” outlook while one has a “positive” outlook. Compared to 2020, we have maintained our positive outlook on the valuations of the market. As such in consideration of the above, we have a ‘’NEUTRAL” outlook on the Kenyan Equities market *in the short term. However, we maintain our bias towards a "BULLISH" equities markets in the medium to long term, with the expectations of a gradual recovery in corporate earnings, the cheaper valuations currently in the market, and the improving investor sentiment.*

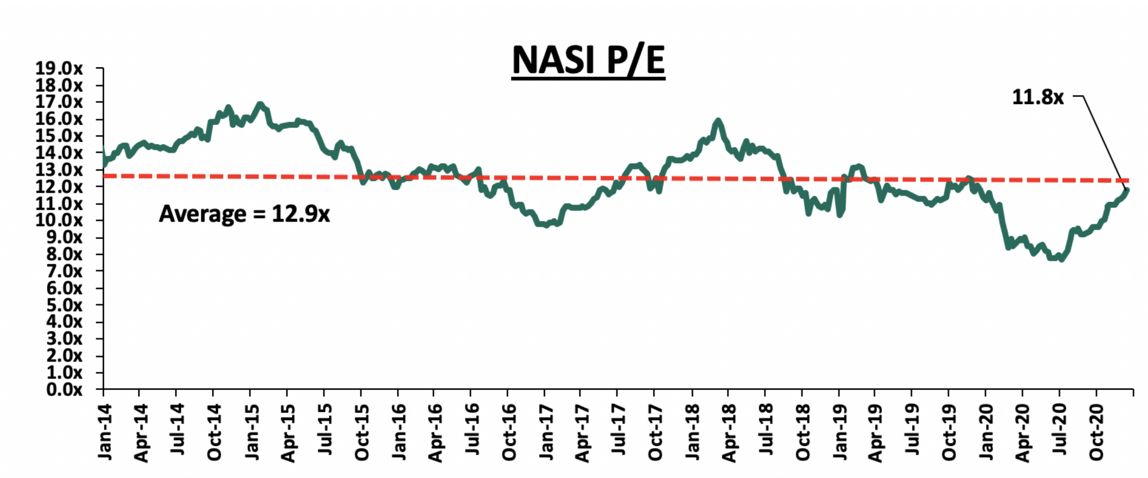
Weekly Market Performance

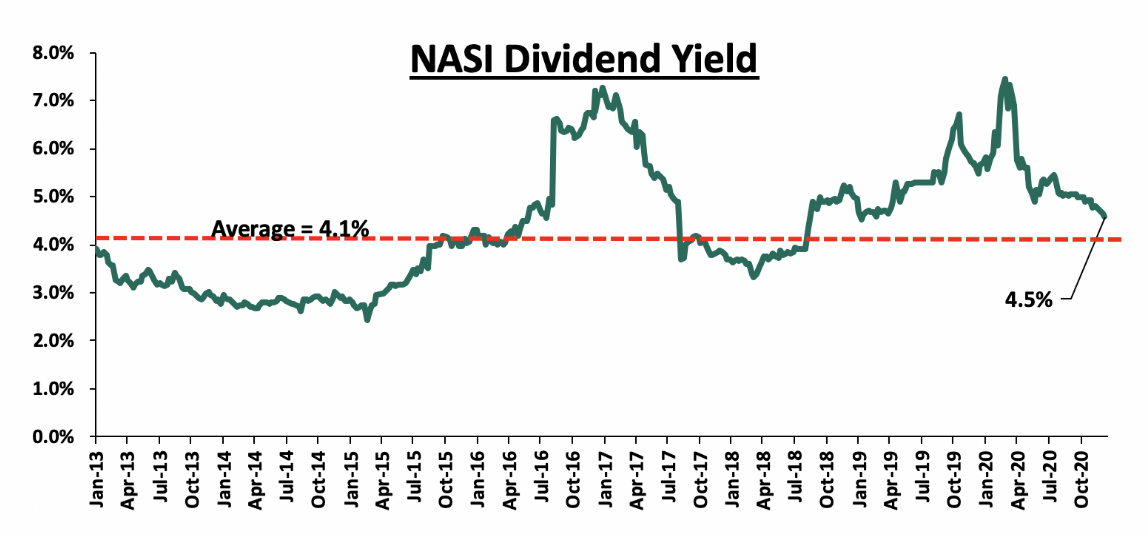
During the week, the equities market was on an upward trajectory with NASI, NSE 25 and NSE 20 recording gains of 2.6%, 1.3% and 1.2%, respectively, taking their YTD performance to gains of 4.0%, 2.5% and 2.3% for the NASI, NSE 20 and NSE 25, respectively. The equities market performance was driven by gains recorded by large-cap stocks such as Bamburi, Safaricom and Equity Group of 15.1%, 4.4%, and 2.5%, respectively. The gains were however weighted down by losses recorded by other large-cap stocks such as KCB, EABL and Co-operative Bank of 3.7%, 2.4% and 0.8%, respectively.

Equities turnover increased by 30.4% during the week to USD 19.0 mn, from USD 14.6 mn the previous week, taking the YTD turnover to USD 33.6 mn. Foreign investors turned net buyers during the week, with a net buying position of USD 6.6 mn, from a net selling position of USD 1.9 mn recorded the previous week, taking the YTD net buying position to USD 4.7 mn.

The market is currently trading at a price to earnings ratio (P/E) of 11.8x, 8.7% below the 11-year historical average of 12.9x. The average dividend yield is currently at 4.5%, 0.1% points below what was recorded the previous week and 0.4% 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 11.8x is 53.2% 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.





Universe of Coverage

Banks	Price at 08/01/2020	Price at 15/01/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank***	77.5	77.0	(0.6%)	0.3%	76.8	105.1	3.5%	40.0%	0.3x	Buy
I&M Holdings***	46.0	45.9	(0.3%)	2.2%	44.9	60.1	5.6%	36.6%	0.7x	Buy
KCB Group***	38.3	36.9	(3.7%)	(3.9%)	38.4	46.0	9.5%	34.1%	1.0x	Buy
Kenya Reinsurance	2.5	2.6	6.5%	14.3%	2.3	3.3	4.2%	29.2%	0.3x	Buy
Sanlam	12.0	13.2	10.0%	1.5%	13.0	16.4	0.0%	24.2%	1.1x	Buy
Liberty Holdings	7.9	8.0	1.3%	3.9%	7.7	9.8	0.0%	22.5%	0.6x	Buy
ABSA Bank***	9.5	9.5	0.2%	(0.2%)	9.5	10.5	11.6%	22.1%	1.2x	Buy
Equity Group***	36.0	36.9	2.5%	1.8%	36.3	43.0	5.4%	22.0%	1.1x	Buy
Co-op Bank***	13.0	12.9	(0.8%)	2.8%	12.6	14.5	7.8%	20.2%	1.0x	Buy
Britam	7.4	7.5	0.5%	6.6%	7.0	8.6	3.4%	18.6%	0.8x	Accumulate
Standard Chartered***	140.0	139.8	(0.2%)	(3.3%)	144.5	153.2	8.9%	18.6%	1.1x	Accumulate
Stanbic Holdings	80.3	80.5	0.3%	(5.3%)	85.0	84.9	8.8%	14.2%	0.8x	Accumulate
Jubilee Holdings	291.5	290.0	(0.5%)	5.2%	275.8	313.8	3.1%	11.3%	0.7x	Accumulate
NCBA***	25.6	25.5	(0.4%)	(4.1%)	26.6	25.4	1.0%	0.6%	0.7x	Lighten
CIC Group	2.1	2.2	2.4%	1.9%	2.1	2.1	0.0%	(2.3%)	0.8x	Sell
HF Group	3.4	3.6	7.7%	15.9%	3.1	3.0	0.0%	(17.6%)	0.1x	Sell

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

We are “Neutral” on the Equities markets in the short 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 maintain our bias towards a “Bullish” equities markets in the medium to long term. 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.