Mobile Payments, & Cytonn Weekly #05/2021

Equities

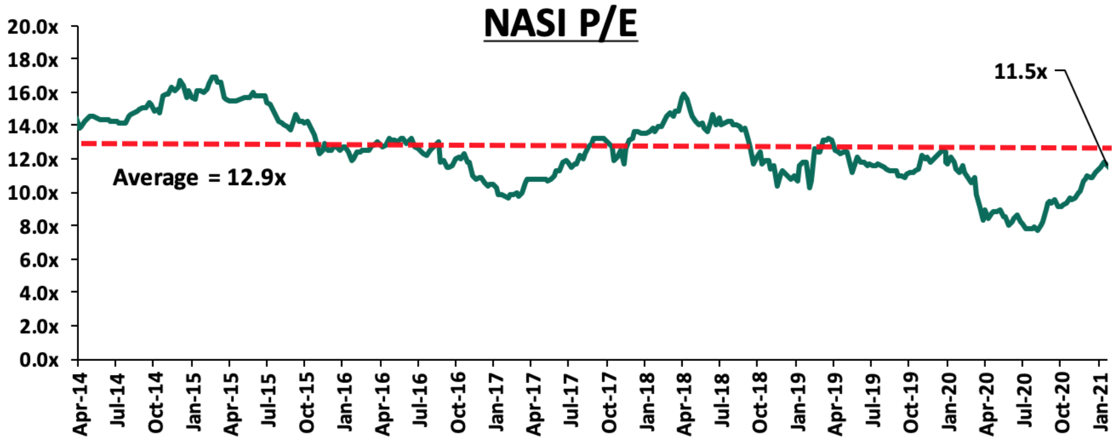
Market Performance:

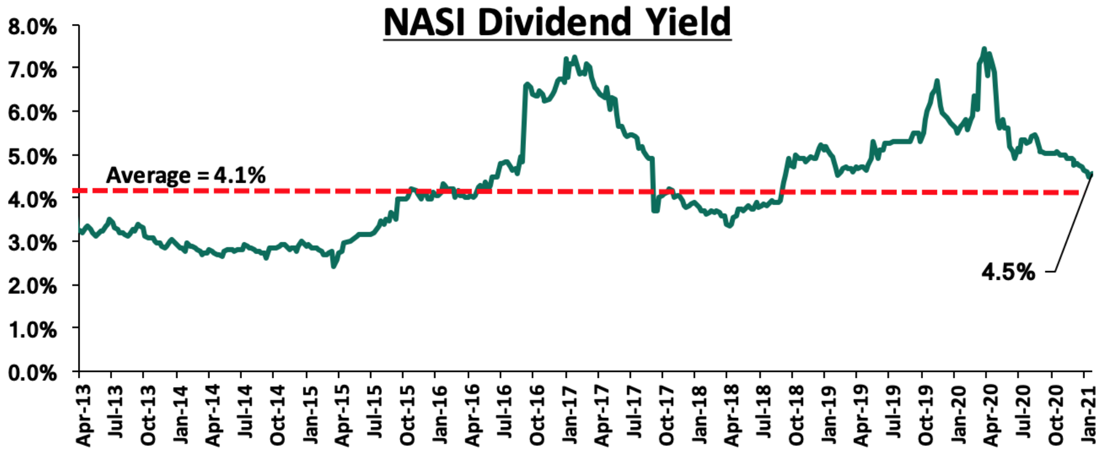
During the week, the equities market recorded mixed performance, with NASI and NSE 25 gaining by 1.0% and 1.3% respectively, while NSE 20 declined by 0.8%, taking their YTD performance to gains of 3.3% and 2.0% for NASI and NSE 25 respectively, and a loss of 0.3% for NSE 20. The equities market performance was driven by gains recorded by large-cap stocks such as EABL, BAT, KCB Group and Equity Group of 10.4%, 3.6%, 3.3% and 2.1%, respectively. The gains were however weighed down by losses recorded by banking stocks such as Diamond Trust Bank (DTB-K), Co-operative Bank and Standard Chartered Bank which declined by 9.9%, 3.2% and 1.1%, respectively.

Equities turnover rose by 24.4% during the week to USD 28.5 mn, from USD 22.9 mn recorded the previous week, taking the YTD turnover to USD 109.0 mn. Foreign investors turned net sellers, with a net selling position of USD 4.5 mn, from a net buying position of USD 0.7 mn recorded the previous week, taking the YTD net buying position to USD 1.2 mn.

The market is currently trading at a price to earnings ratio (P/E) of 11.5x, 11.0% below the 11-year historical average of 12.9x. The average dividend yield is currently at 4.5%, unchanged from 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 that there are pockets of value in the market for investors with a higher risk tolerance. The current P/E valuation of 11.5x is 49.4% 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 the quarter ended December 2020. The quarterly Credit Officer Survey is undertaken by the CBK to identify the potential drivers of credit risk in the banking sector. The survey is collected from senior credit officers of banks, requiring them to indicate their banks' perception or actual position in the quarter and the subsequent quarter in terms of demand for credit, credit standards, interest rates, asset quality, credit recovery efforts, deployment of liquidity and impact of implementing new standards. For the quarter ended December 31st 2020, 38 operating commercial banks and 1 mortgage finance company participated in the Commercial Banks Credit Officer Survey. The key take-outs from the report include:

i. The banking sector's loan book recorded a 7.1% y/y growth, with gross loans increasing to Kshs 3.0 tn in December 2020, from Kshs 2.8 tn in December 2019. Profit Before Tax (PBT) for the banking sector declined by 21.9% y/y to Kshs 112.8 bn in FY'2020, from Kshs 159.1 bn in FY'2019, attributable to the adverse effects of the pandemic with the banks recording increased operational costs as they had to bear all loan extension and loan restructuring costs and also due to an increase in the loan loss provisions. On a q/q basis, PBT declined by 19.2% to Kshs 23.6 bn Q4'2020, from Kshs 29.2 bn recorded in Q3'2020, attributable to a faster growth in expenses across the sector, which increased by 10.4%, compared to the 4.4% increase in income,
ii. The aggregate balance sheet recorded a 12.5% increase y/y to Kshs 5.4 tn in FY'2020, from Kshs 4.8 tn in FY'2019. Quarterly, the balance sheet grew by 1.9% to Kshs 5.4 tn in December 2020, from Kshs 5.3 tn in September 2020. The 12.5% y/y growth in the balance sheet is attributable to an 11.1% increase in deposits to Kshs 4.0 tn in December 2020, from Kshs 3.6 tn in December 2019 as a result of increased use of alternative digital channels for deposit mobilization in the sector, coupled with a 7.1% increase in gross loans to Kshs 3.0 tn in December 2020, from Kshs 2.8 tn in December 2019,
iii. Asset quality in the banking sector deteriorated, with the Gross NPL ratio rising by 2.1% points y/y to 14.1% in December 2020, from 12.0% in December 2019 and this followed a further deterioration in the fourth quarter where the NPL ratio rose by 0.5% points from the 13.6% recorded in September 2020. The deterioration in asset quality is due to the adverse effects of the COVID-19 pandemic such as cash flow constraints and job losses on economic output. NPLs increased during the quarter in Personal and Household by 55.0%, Tourism, 53.0%; Real Estate, 53.0%; Transport and Communication, 47.0%; Trade, 45.0%; and Building and Construction, 41.0%,
iv. The perceived demand for credit remained unchanged in seven economic sectors namely; Agriculture, Mining and Quarrying, Building and Construction, Financial Services, Energy and Water, Tourism, Restaurant and Hotels and Transport and Communication. The perceived demand for credit increased in Trade and Personal and Household sectors and decreased in the Real

Estate Sector due to subdued business activities during the period in the sector,

v. The banking sector remained adequately capitalized, with the capital adequacy ratio increasing by 0.4% points y/y to 19.2%, from 18.8% recorded in December 2019. Quarterly, capital adequacy increased by 1.0% points to 19.2% in December 2020, from 18.2% in September 2020. This was as a result of a 6.4% increase in total capital, which increased at a higher rate compared to total risk weighted assets, which recorded a 1.3% increase. The banking sector's capital adequacy ratio reported in December 2020 was 4.7% points above the minimum statutory limit of 14.5%,

vi. IFRS 9 implementation had an adverse effect on the banking sector's capital adequacy as a result of increased provisioning due to the challenging business environment. Commercial banks have therefore injected additional capital to accommodate the expected increase in credit losses,

vii. In the quarter ended December 2020, 90.0% of respondents indicated that the demand for credit remained unchanged after the repeal of capping of interest rate which was a 1.0% points decline from 91.0% respondent in December, and,

viii. Average liquidity in the banking sector increased by 4.9% points y/y to 54.6% in December 2020, from 49.7% in December 2019. The average liquidity of 54.6% was also a 1.3% points increase from 53.3% recorded in September 2020. This was 34.6% above the minimum statutory ratio of 20.0%. Interbank lending also increased q/q, with 64.0% of commercial banks reporting an increase in their interbank lending activities during the quarter. The improved liquidity position in December 2020 was as a result of increased deposits which contributed 46.0%, maturity of government securities which contributed 21.0%, loan recovery which contributed 21.0% and capital injection contributing 5.0%.

The reduced profitability in the banking sector has led to six listed banks issuing profit warnings during the period. Notably, the Central Bank governor highlighted that the NPL ratio would increase to 17.0% in the near term, if the economy fails to rebound as expected coupled with commercial banks restructuring 54.2% of the loan book as at December 2020. In our view, we believe that the Central Bank should support the sector in the recovery period in its capacity as the lender of last resort and provide additional funding to the sector while closely monitoring the NPL growth across the industry. We expect commercial banks to utilize their improved liquidity for lending to the private sector in the first quarter of 2021. This will in turn boost the sector's funded income, which declined in 2020 as a result of loan restructuring due to the subdued business environment. We expect the banking sector to remain resilient boosted by the CBK's efforts to improve their liquidity positions by maintaining the Cash Reserve Ratio at 4.25%, proactive monitoring of the loan book by commercial banks and improved capital adequacy across the sector.

Universe of Coverage:

Banks	Price at 29/01/2021	Price at 05/02/2021	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank***	76.0	68.5	(9.9%)	(10.7%)	76.8	105.1	3.9%	57.4%	0.3x	Buy
I&M Holdings***	47.0	44.2	(6.1%)	(1.6%)	44.9	60.1	5.8%	41.9%	0.7x	Buy
Kenya Reinsurance	2.5	2.4	(1.6%)	5.2%	2.3	3.3	4.5%	40.3%	0.3x	Buy
Sanlam	13.0	11.8	(9.6%)	(9.6%)	13.0	16.4	0.0%	39.6%	1.1x	Buy
KCB Group***	35.9	37.1	3.3%	(3.5%)	38.4	46.0	9.4%	33.6%	1.0x	Buy
Co-op Bank***	12.6	12.2	(3.2%)	(2.8%)	12.6	14.5	8.2%	27.0%	1.0x	Buy
ABSA Bank***	9.3	9.3	(0.6%)	(2.7%)	9.5	10.5	11.9%	25.3%	1.2x	Buy
Liberty Holdings	7.5	7.9	5.3%	2.6%	7.7	9.8	0.0%	24.1%	0.6x	Buy