Real Estate Investment Trusts (REITs) in Kenya, & Cytonn Weekly #11/2021

Equities

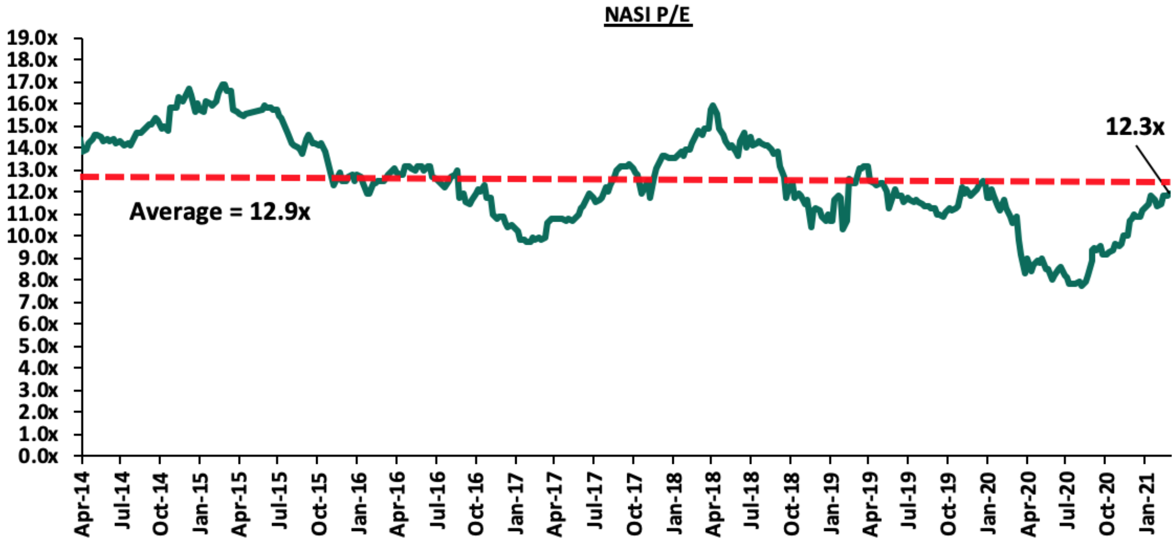
Market Performance:

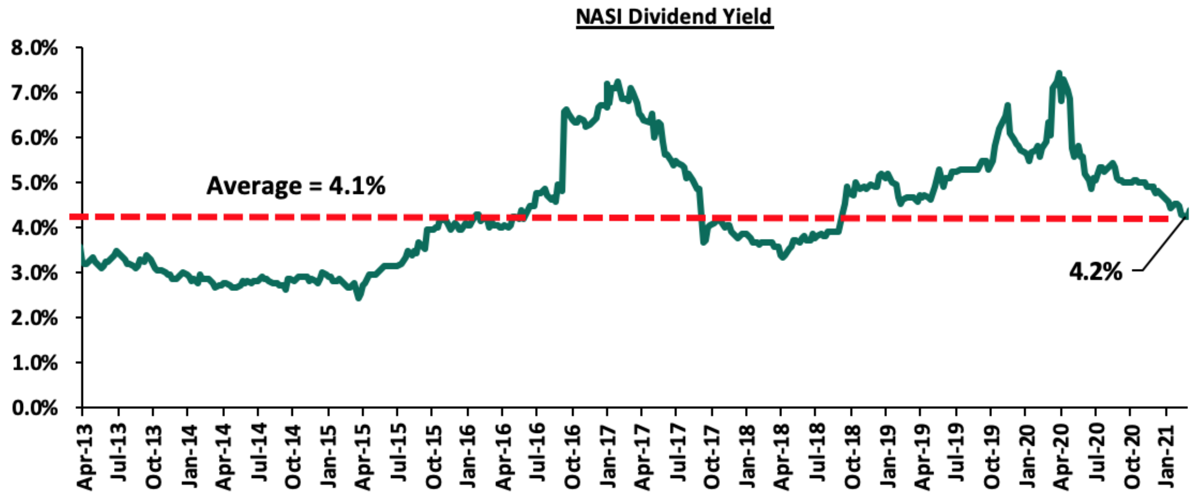
During the week, the equities market was on an upward trajectory, with NASI, NSE 20 and NSE 25 gaining by 3.0%, 0.5% and 2.6%, respectively, taking their YTD performance to gains of 9.8%, 3.3% and 8.8% for NASI, NSE 20 and NSE 25 respectively. The equities market performance was driven by gains recorded by large-cap stocks such as Co-operative Bank, Equity Group, Safaricom and KCB Group, which gained by 7.3%, 4.1%, 4.0% and 3.5%, respectively. The gains were however weighed down by losses recorded by stocks such as EABL, Diamond Trust Bank (DTB-K) and Standard Chartered Bank, which declined by 3.0%, 2.0% and 1.1%, respectively.

Equities turnover declined by 47.8% during the week to USD 15.5 mn, from USD 29.6 mn recorded the previous week, taking the YTD turnover to USD 243.2 mn. Foreign investors turned net buyers, with a net buying position of USD 0.4 mn, from a net selling position of USD 2.9 mn recorded the previous week, taking the YTD net selling position to USD 5.0 mn.

The market is currently trading at a price to earnings ratio (P/E) of 12.3x, 4.9% below the 11-year historical average of 12.9x. The average dividend yield is currently at 4.2%, 0.2% points below last week's dividend yield which came in at 4.4%, and 0.1% 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 12.3x, is 59.5% 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.





Earnings Release:

During the week, KCB Group and Co-operative Bank released their FY'2020 financial results. Below is a summary of their performance;

I. KCB Group

KCB Group FY'2020 Key Highlights

Balance Sheet

Balance Sheet Items	FY'2019 (Kshs bn)	FY'2020 (Kshs bn)	y/y change
Government Securities	164.9	208.8	26.6%
Net Loans and Advances	539.7	595.3	10.3%
Total Assets	898.6	987.8	9.9%
Customer Deposits	686.6	767.2	11.7%
Deposits per Branch	2.0	2.1	6.5%
Total Liabilities	768.8	845.4	10.0%
Shareholders' Funds	129.7	142.4	9.8%

Income Statement

Income Statement Items	FY'2019 (Kshs bn)	FY'2020 (Kshs bn)	y/y change
Net Interest Income	56.1	67.9	21.0%
Net non-Interest Income	28.2	28.5	1.0%
Total Operating income	84.3	96.4	14.3%
Loan Loss provision	(8.9)	(27.5)	209.5%
Total Operating expenses	(47.4)	(70.7)	49.1%
Profit before tax	36.9	25.7	(30.3%)
Profit after tax	25.2	19.6	(22.1%)
Core EPS	7.8	6.1	(22.1%)

Key Ratios

Core Capital/Total Liabilities	18.1%	18.7%	0.6%
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess/Deficit	10.1%	10.7%	0.6%
Core Capital/Total Risk Weighted Assets	17.2%	18.2%	1.0%
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess/Deficit	6.7%	7.7%	1.0%
Total Capital/Total Risk Weighted Assets	19.0%	21.6%	2.6%
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess/Deficit	4.5%	7.1%	2.6%

Key take-outs from the earnings release include;

i. The group's core earnings per share declined by 22.1% to Kshs 6.1, from Kshs 7.8 in FY'2019. The performance is better than our projections of a 35.2% decline to Kshs 5.1. The variance was mainly attributable to the lender having a slower 49.1% growth in Total Operating expenses, compared to our projection of a 54.6% increase,
ii. Net Interest Income grew by 21.0% to Kshs 67.9 bn, from Kshs 56.1 bn in FY'2019, mainly driven by a 64.8% increase in interest income from government securities which increased to Kshs 23.2 bn, from Kshs 14.1 bn in FY'2019, coupled with a 9.8% increase in interest income from loans and advances, which increased to Kshs 64.8 bn from Kshs 59.0 bn in FY'2019. The increase was however weighed down by a 37.3% decline in income from deposits and placements with banking institutions to Kshs 0.8 bn, from Kshs 1.3 bn in FY'2019,
iii. The yield on interest-earning assets increased to 11.1% from 10.9% in FY'2019, attributable to the faster 19.4% growth in interest income, which outpaced the 16.9% growth in average interest earning assets,
iv. Interest expense increased by 14.2% to Kshs 20.8 bn, from Kshs 18.2 bn in FY'2019, following a 15.9% rise in Interest expense on customer deposits to Kshs 18.9 bn, from Kshs 16.3 bn in FY'2019. Interest expense on placements declined marginally by 0.1% to Kshs 1.954 bn from Kshs 1.953 bn in FY'2019. Cost of funds declined marginally by 0.1% points to 2.7% from 2.8% recorded in FY'2019, following a faster 22.3% increase in average interest bearing liabilities that outpaced the 14.2% increase in interest expense,
v. Total operating expenses increased by 49.1% to Kshs 70.7 bn, from Kshs 47.4 bn in FY'2019, largely driven by a 209.5% increase in Loan Loss Provisions (LLP) to Kshs 27.5 bn, from Kshs 8.9 bn in FY'2019, on the back of the subdued operating environment seen during the year. Staff costs increased by 5.1% to Kshs 20.5 bn from Kshs 19.5 bn in FY'2019,
vi. The balance sheet recorded an expansion as total assets grew by 9.9% to Kshs 987.8 bn, from Kshs 898.6 bn in FY'2019. The growth was supported by a 26.6% increase in government securities to Kshs 208.8 bn, from Kshs 164.9 bn in FY'2019, coupled with a 10.3% loan book expansion to Kshs 595.3 bn, from Kshs 539.7 bn in FY'2019. The increased allocation in government securities was mainly on the back of the lender's cautious lending amid the elevated credit risk. Notably, the lender disclosed that they restructured 19.6% of the total loan book amounting to Kshs 106.1 bn. Of the restructured loans, the Real Estate Sector accounted for the highest percentage of restructured loans at 27.6% (Kshs 27.6 bn),
vii. Total liabilities rose by 10.0% to Kshs 845.4 bn, from Kshs 768.8 bn in FY'2019, driven by an 11.7% rise in customer deposits to Kshs 767.2 bn, from Kshs 686.6 bn in FY'2019, with customer deposits from NBK amounting to Kshs 99.2 bn in FY'2020,
viii. Deposits per branch increased by 6.5% to Kshs 2.1 bn from Kshs 2.0 bn in FY'2019, with the

number of branches increasing to 359 as at the end of 2020, from 342 in FY’2019,

ix. Gross non-performing loans increased by 52.4% to Kshs 96.6 bn in FY’2020, from Kshs 63.4 bn in FY’2019. Consequently, the NPL ratio deteriorated to 14.8% in FY’2020, from 11.0% in FY’2019, attributable to the faster 52.4% growth in Non-Performing Loans, which outpaced the 10.3% growth in loans. The rise in non-performing loans was mainly attributable to the poor performance from the Corporate segment, MSME segment, mortgage segment and Check-Off loans recording NPL ratios of 18.6%, 13.9%, 8.7% and 2.6%, respectively,

x. Loan Loss Provisions (LLP) increased by 209.5% y/y to Kshs 27.5 bn in FY’2020, from Kshs 8.9 bn in FY’2019. The NPL coverage on the other hand improved marginally to 59.8% in FY’2020 from 59.5% in FY’2019, as general Loan Loss Provisions increased by 59.9% to Kshs 45.9 bn from Kshs 28.7 bn in FY’2019, attributable to the deterioration of the NPL ratio to 14.8% from 11.0% in FY’2019, and,

xi. KCB Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.2%, 7.7% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 21.6%, exceeding the statutory requirement by 7.1% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 18.4%, while total capital to risk-weighted assets came in at 21.8%.

For a comprehensive analysis, please see our KCB Group FY’2020 Earnings .

?. Co-operative Bank

Co-operative Bank FY’2020 Key Highlights

Balance Sheet

Balance Sheet Items	FY’2019 (Kshs bn)	FY’2020 (Kshs bn)	y/y change
Government Securities	117.80	161.89	37.4%
Net Loans and Advances	266.7	286.6	7.5%
Total Assets	457.0	536.9	17.5%
Customer Deposits	332.8	378.6	13.8%
Deposits per Branch	2.1	2.4	13.8%
Total Liabilities	376.2	444.9	18.3%
Shareholders’ Funds	79.3	90.7	14.4%

Income Statement

Income Statement Items	FY’2019 (Kshs bn)	FY’2020 (Kshs bn)	y/y change
Net Interest Income	31.3	36.3	16.1%
Net non-Interest Income	17.2	17.5	1.9%
Total Operating income	48.5	53.8	11.1%
Loan Loss provision	(2.5)	(8.1)	219.5%
Total Operating expenses	(27.8)	(39.4)	41.7%
Profit before tax	20.7	14.3	(31.0%)
Profit after tax	14.3	10.8	(24.4%)

Ratios	FY’2019	FY’2020	%point change
Core Capital/Total Liabilities	20.2%	19.1%	(1.1%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess/Deficit	12.2%	11.1%	(1.1%)
Core Capital/Total Risk Weighted Assets	16.3%	15.4%	(0.9%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess/Deficit	5.8%	4.9%	(0.9%)
Total Capital/Total Risk Weighted Assets	16.8%	16.9%	0.1%
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess/Deficit	2.3%	2.4%	0.1%

Key take-outs from the earnings release include;

i. The bank’s core earnings per share declined by 24.4% to Kshs 1.6 in FY’2020, from Kshs 2.1 in FY’2019, which was not in-line with our projections of Kshs 1.8, where the earnings for the period came in at Kshs 10.8 bn, slightly lower than our expectations of Kshs 12.4 bn. The variance can be attributed to our expectation of higher earnings of Kshs 13.2 bn, compared to the Kshs 10.8 bn recorded. The performance was driven by a 41.7% increase in total operating expenses to Kshs 39.4 bn in FY’2020, from Kshs 27.8 bn in FY’2019 but was mitigated by the 11.1% increase in total operating income,

ii. Net Interest Income rose by 16.1% to Kshs 36.3 bn in FY’2020, from Kshs 31.3 bn in FY’2019. The growth recorded was as a result of a 30.5% increase in interest income from government securities to Kshs 14.8 bn, from Kshs 11.4 bn in FY’2019, as well as a 5.4% rise in interest income from loans and advances to Kshs 33.5 bn, from Kshs 31.8 bn in FY’2019,

iii. The yield on interest-earning assets, however, declined to 11.4%, from 11.8% in FY’2019 due to the faster 18.1% growth in the average interest-earning assets that outpaced the 11.9% growth in interest income,

iv. Interest expense increased by 1.3% to Kshs 12.5 bn in FY’2020, from Kshs 12.3 bn in FY’2019, largely due to a 2.6% rise in interest expense from customer deposits to Kshs 10.9 bn, from Kshs 10.7 bn. This was however mitigated by a 13.2% decline in other interest expenses to Kshs 1.4 bn, from Kshs 1.6 bn in FY’2019. Consequently, the cost of funds declined to 3.0%, from 3.5% in FY’2019, owing to the faster 18.2% rise in the average interest-bearing liabilities, compared to the 1.3% decline in interest expense,

v. Total operating expenses rose by 41.7% to Kshs 39.4 bn in FY’2020, from Kshs 27.8 bn in FY’2019, largely driven by the 219.5% rise in Loan Loss Provisions (LLP) to Kshs 8.1 bn, from Kshs 2.5 bn in FY’2019, coupled with a 38.7% rise in other operating expenses to Kshs 17.9 bn in FY’2020, from Kshs 12.9 bn in FY’2019. The increased provisioning levels by the lender is mainly as a result of the elevated levels of risk currently in the market. Staff costs also increased by 8.5% to Kshs 13.4 bn, from the Kshs 12.4 bn recorded in 2019,

vi. The balance sheet recorded an expansion as total assets grew by 17.5% to Kshs 537.0 bn in FY’2020 from Kshs 457.0 bn in FY’2019, mainly attributable to the 37.4% growth in government securities to Kshs 161.9 bn from Kshs 117.8 bn, coupled with a 7.5% growth in net loans and advances to Kshs 286.6 bn in FY’2020 from Kshs 266.7 bn in FY’2019. The increase in allocation to government securities shows the bank’s cautious lending strategy considering the elevated credit risk being experienced in the market. Additionally, the bank restructured Kshs 46.0 bn (14.9% of the bank’s loan book) and highlighted that 46.0% of their loan book consisted of personal consumer loans and that they had a total exposure of about 3.0% in the manufacturing, tourism, restaurant and hotel sectors combined, which are among the most affected sectors,

vii. Total liabilities grew by 18.3% to Kshs 444.9 bn, from Kshs 376.2 bn in FY'2019, which was largely attributable to a 74.2% rise in borrowings to Kshs 46.0 bn in FY'2020, from Kshs 26.4 bn in FY'2019, which is attributed to a Kshs 21.6 bn borrowing by Kingdom Bank to support its operations, coupled with the 13.8% rise in customer deposits to Kshs 378.6 bn, from Kshs 332.8 bn in FY'2019. Deposits per branch increased by 13.8% to Kshs 2.4 bn from Kshs 2.1 bn, as the number of branches remained unchanged at 159 branches,

viii. Gross Non-Performing Loans (NPLs) increased by 87.0% to Kshs 59.1 bn in FY'2020, from Kshs 31.6 bn in FY'2019. The NPL ratio deteriorated to 18.7% in FY'2020, from 11.2% in FY'2019 owing to slower growth in gross loans by 11.8% compared to the 87.0% growth in gross non-performing loans. It is important to note that the NPL Ratio is 11.0% higher than the 5-year average of 7.7%,

ix. The NPL coverage ratio deteriorated to 50.3% in FY'2020, from 51.8% in FY'2019, due to the faster 99.6% growth in General Loan Loss Provisions which was outpaced by the 87.0% growth in Gross Non-Performing Loans (NPLs). If the NPL Coverage remained at the 51.8% level recorded in FY'2019, we would have had an additional provisioning of Kshs 0.9 bn, which would have reduced the earnings per share from the reported Kshs 2.1 to Kshs 1.8, and,

x. Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.4%, 4.9% points above the statutory requirement of 10.5%. Also, the total capital to risk-weighted assets ratio came in at 16.9%, exceeding the statutory requirement of 14.5% by 2.4% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 13.9%, while total capital to risk-weighted assets came in at 15.4%,

For a comprehensive analysis, please see our Co-operative Bank FY'2020 Earnings Note .

Asset Quality

The table below is a summary of the asset quality for the companies that have released

Bank	FY'2019 NPL Ratio	FY'2020 NPL Ratio	FY'2019 NPL Coverage	FY'2020 NPL Coverage
Co-operative Bank of Kenya	11.2%	18.7%	51.8%	50.3%
Stanbic Bank	9.6%	11.8%	57.1%	60.6%
KCB Group	11.0%	14.8%	59.5%	59.8%
Mkt Weighted Average	10.5%**	15.7%*	58.8%**	56.8%*

*Market cap weighted as at 19/03/2021
**Market cap weighted as at 09/04/2020

Key take-outs from the table include;

i. Asset quality for the 3 banks that have released their FY'2020 results deteriorated during the period of review, with the weighted average NPL ratio rising by 5.2% points to a market cap weighted average of 15.7% from 10.5% in FY'2019. The deterioration in asset quality was as a result of the coronavirus-induced downturn in the economy which led to an uptick in the non-performing loans,

ii. NPL Coverage for the 3 banks declined to a market cap weighted average of 56.8% in FY'2020 from 58.8% recorded in FY'2019, attributable to Co-operative bank's comparatively low NPL coverage of 50.3% in FY'2020, a decline from an NPL coverage of 51.8% in FY'2019. We expect higher provisional requirements to subdue profitability during the year across the banking sector on account of the tough business environment, and,

iii. Co-operative Bank recorded a decline in their NPL Coverage despite their NPL ratio rising, which could suggest modest provisioning. Given the current economic environment and elevated risk of loans defaults, we expected higher provisioning for the bank. Key to note, If the NPL Coverage remained at the 51.8% level recorded in 2019, the bank would have had an additional provisioning of Kshs 0.9 bn, which would have reduced the earnings per share from the reported Kshs 2.1 to Kshs 1.8,

The table below highlights the performance of the banks that have released so far, showing the performance using several metrics, and the key take-outs of the performance;

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-Funded Income Growth	NFI to Total Operating Income	Growth in Total Fees & Commissions	Deposit Growth	Growth in Government Securities	Loan to Deposit Ratio	Loan Growth	Return on Average Equity	COF***	YIEA***
Stanbic	(18.6%)	(3.4%)	(1.6%)	(4.1%)	4.7%	(8.7%)	44.9%	(18.7%)	15.7%	25.0%	75.5%	2.7%	10.3%	3.0%	7.2%
KCB	(22.1%)	19.4%	14.2%	21.0%	8.5%	1.0%	29.5%	(10.4%)	11.7%	26.6%	77.6%	10.3%	14.4%	2.7%	10.5%
Co-op	(24.4%)	11.9%	1.3%	16.1%	8.5%	1.9%	32.5%	0.7%	13.8%	37.4%	75.7%	7.5%	12.5%	3.0%	11.4%
FY'20 Mkt Weighted Average*	(22.4%)	13.8%	7.8%	16.0%	8.0%	0.0%	32.6%	(7.9%)	12.9%	29.9%	76.7%	8.3%	13.2%	2.8%	10.3%
FY'19Mkt Weighted Average**	8.9%	3.2%	3.4%	3.4%	7.3%	17.4%	37.4%	18.4%	12.7%	19.4%	75.0%	12.8%	18.4%	3.2%	10.4%

*Market cap weighted as at 19/03/2021

**Market cap weighted as at 09/04/2020
*** COF means Cost of Funds; YIEA means Yield on Interest Earning Assets

Key takeaways from the table above include:

i. For the three banks that have released, they have recorded a 22.4% weighted average decline in core Earnings Per Share (EPS), compared to a weighted average growth of 8.9% in FY’2019 for the entire listed banking sector,
ii. The Banks have recorded a weighted average deposit growth of 12.9%, slower than the 12.7% growth recorded in FY’2019,
iii. Interest expense grew at a faster pace, by 7.8%, compared to 3.4% in FY’2019. Cost of funds, however, declined, coming in at a weighted average of 2.8% in FY’2020, from 3.2% in FY’2019, owing to the faster growth in average interest-bearing liabilities, an indication that the listed banks were able to mobilize cheaper deposits,
iv. Average loan growth came in at 8.3%, lower than the 12.8% recorded in FY’2019. The loan growth was also slower than the 29.9% growth in government securities, an indication of the banks preference of investing in Government securities as opposed to lending due to the elevated credit risk occasioned by the pandemic,
v. Interest income grew by 13.8%, compared to a growth of 3.2% recorded in FY’2019. Despite the growth in interest income, the Yield on Interest Earning Assets (YIEA) declined marginally to 10.3% from the 10.4% recorded in FY’2019, an indication of the increased allocation to lower-yielding government securities by the sector. The decline in the YIEA can also be attributed to the reduced lending rates for customers by the sector, in line with the Central Bank Rate cuts. Consequently, the Net Interest Margin (NIM) now stands at 8.0%, 0.7% points higher than the 7.3% recorded in FY’2019 for the whole listed banking sector, and,
vi. Non-Funded Income growth was flat compared to the 17.4% growth recorded in FY’2019. This can be attributable to i) a slower growth in the fees and commission which declined by 7.9% compared to a growth of 18.4% in FY’2019 and ii) the waiver on fees on mobile transactions below Kshs 1,000 coupled with the free bank-mobile money transfer.

Universe of Coverage:

Company	Price at 12/3/2021	Price at 19/3/2021	w/w change	YTD Change	Year Open 2021	Target Price*	Dividend Yield	Upside/ Downside**	Recommendation
Diamond Trust Bank***	75.3	73.8	(2.0%)	(3.9%)	76.8	105.1	3.5%	46.0%	Buy
I&M Holdings***	43.0	43.2	0.5%	(3.7%)	44.9	60.1	6.3%	45.4%	Buy
Kenya Reinsurance	2.6	2.7	1.9%	14.7%	2.3	3.3	4.2%	28.7%	Buy
Sanlam	12.5	11.7	(6.4%)	(10.4%)	13.0	14.0	8.6%	28.8%	Buy
Equity Group***	40.0	41.7	4.1%	14.9%	36.3	43.0	21.6%	24.8%	Buy
Standard Chartered***	134.5	133.0	(1.1%)	(8.0%)	144.5	153.2	9.4%	24.6%	Buy
Britam	7.2	7.3	1.9%	4.6%	7.0	8.6	0.0%	17.5%	Accumulate
NCBA***	24.9	25.0	0.4%	(6.2%)	26.6	25.4	15.2%	17.0%	Accumulate
ABSA Bank***	9.4	9.4	0.2%	(0.8%)	9.5	10.5	2.6%	13.9%	Accumulate
KCB Group***	40.0	41.4	3.5%	7.7%	38.4	46.0	2.4%	13.7%	Accumulate
Co-op Bank***	13.0	13.9	7.3%	10.8%	12.6	14.5	7.2%	11.5%	Accumulate
Liberty Holdings	9.6	8.8	(8.9%)	13.8%	7.7	9.8	0.0%	11.9%	Accumulate
Jubilee Holdings	261.8	285.0	8.9%	3.4%	275.8	313.8	0.0%	10.1%	Accumulate
Stanbic Holdings	83.0	85.3	2.7%	0.3%	85.0	84.9	4.5%	4.0%	Lighten
CIC Group	2.3	2.3	0.0%	8.5%	2.1	2.1	10.9%	2.6%	Lighten
HF Group	3.4	3.4	0.3%	8.9%	3.1	3.0	0.0%	(12.3%)	Sell

*Target Price as per Cytonn Analyst estimates as at Q3'2020. We are currently reviewing our target prices for the Banking Sector coverage
**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. 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.