Cytonn Q1’2021 Markets Review

Equities

Market Performance:

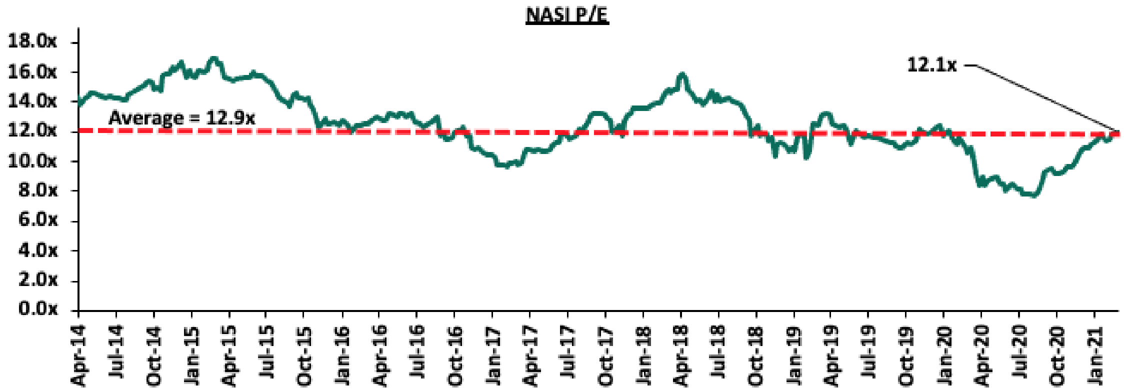
During Q1’2021, the equities market recorded a mixed performance, with NASI and NSE 25 gaining by 4.3% and 3.4%, respectively, while NSE 20 declined by 1.2%, taking their YTD performance as at the end of March to gains of 4.3% and 3.4% for NASI and NSE 25, respectively, while NSE 20 declined by 1.2%. The equities market performance during the quarter was driven by gains recorded by large caps such as BAT Kenya, KCB Group, Safaricom, and Co-operative Bank of 31.6%, 8.4%, 5.8% and 5.6%, respectively. The gains were however weighed down by losses recorded by stocks such as Diamond Trust Bank (DTB-K), ABSA Bank and NCBA Group of 16.3%, 8.7% and 6.0%, respectively.

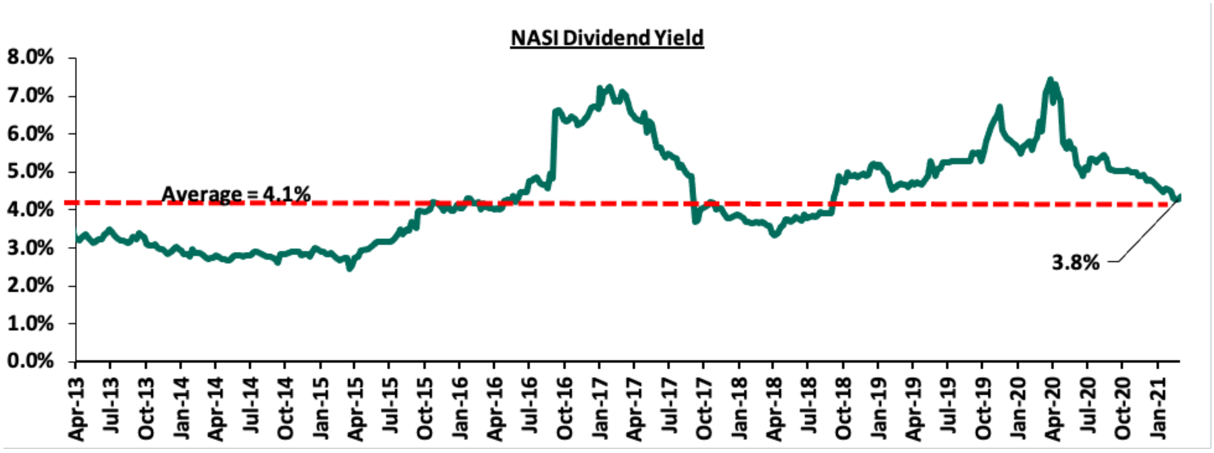
Equities turnover increased by 15.2% during the quarter to USD 288.5 mn, from USD 250.5 mn in Q4’2020. Foreign investors remained net sellers during the quarter with a net selling position of USD 8.9 mn, from a net selling position of USD 24.5 recorded in Q4’2020.

During the week, the equities market was on a downward trajectory with NASI, NSE 20 and NSE 25 losing by 3.5%, 2.0% and 2.9%, respectively, driven by losses recorded by large-cap stocks such as Cooperative Bank, EABL and Equity Group of 12.1%, 5.8%, and 4.8%, respectively. The losses were however mitigated by gains recorded by NCBA Group, which gained by 9.7%.

During the week, equities turnover increased by 32.1% to USD 29.0 mn from USD 21.9 mn recorded the previous week, taking the YTD turnover to USD 294.2 mn. During the week, foreign investors turned net sellers, with a net selling position of USD 9.1 mn, from a net buying position of USD 4.4 mn recorded the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 12.1x, 6.7% below the historical average of 12.9x, and a dividend yield of 3.8%, 0.3% points below the historical average of 4.1%. Key to note, NASI’s PEG ratio currently stands at 1.4x, an indication that the market is trading at a premium to its future earnings growth. Basically, a PEG ratio greater than 1.0x indicates the market may be overvalued while a PEG ratio less than 1.0x indicates that the market is undervalued. As such, with the market trading at a premium to its future earnings growth, despite the low valuations currently in the market, we believe that investors should reposition towards companies with a strong earnings growth and are trading at discounts to their intrinsic value. The current P/E valuation of 12.1x is 56.5% above the most recent trough valuation 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.





There have been a couple of companies that have released during the quarter and among them are the banking stocks. One of the key features for the banks has been the worsening Asset quality. The table below explains the changes in the asset qualities of the various banks.

Asset Quality

Below is a summary of the asset quality for the listed banks

Bank	FY'2019 NPL Ratio	FY'2020 NPL Ratio	FY'2019 NPL Coverage	FY'2020 NPL Coverage	% point change in NPL ratio	% point change in NPL coverage
ABSA Bank Kenya	6.6%	7.7%	77.0%	71.1%	1.1%	(5.9%)
Diamond Trust Bank	7.7%	10.4%	42.9%	44.6%	2.7%	1.7%
Equity Group	9.5%	11.5%	47.5%	62.4%	2.0%	14.9%
I&M Holdings	11.3%	11.6%	59.1%	66.8%	0.3%	7.7%
Stanbic Bank	9.6%	11.8%	57.1%	60.6%	2.2%	3.5%
NCBA Group	12.6%	14.7%	55.9%	60.9%	2.1%	5.0%
KCB	11.1%	14.8%	59.5%	59.8%	3.7%	0.3%
Standard Chartered Bank	13.9%	16.0%	78.7%	80.6%	2.1%	1.9%
Co-operative Bank	11.2%	18.7%	51.8%	50.3%	7.5%	(1.5%)
HF Group	27.7%	24.6%	47.8%	63.4%	(3.1%)	15.6%
Mkt Weighted Average	**10.5%****	**12.8%***	**57.6%****	**60.8%***	**2.3%**	**3.2%**

*Market cap weighted as at 1/04/2021
**Market cap weighted as at 09/04/2020

Key take-outs from the table include;

i. Asset quality for the listed banks deteriorated during the period of review, with the weighted average NPL ratio rising by 2.3% points to a market cap weighted average of 12.8%, 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. Notably, for Diamond Trust Bank (DTB-K), and NCBA, the NPL ratio is at the highest it has been for more than a decade,
ii. NPL Coverage for the listed banking sector increased to a market cap weighted average of 60.8% in FY'2020, from 57.6% recorded in FY'2019, as the banks increased their provisioning levels to proactively manage risks given the tough economic conditions occasioned by the pandemic. This was in line with our expectations of higher provisioning levels which would subdue profitability in

FY’2020 across the banking sector on account of the tough business environment, and,

iii. ABSA and 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 banks. Key to note, if Cooperative Bank’s 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, while if ABSA’s NPL coverage remained at the 77.0%, level recorded in 2019, the bank would have had an additional provisioning of Kshs 1.5 bn, which would have reduced the earnings per share from the reported Kshs 0.8 to Kshs 0.5.

The table below highlights the performance of the listed banking sector, 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
Equity	(10.9%)	23.5%	26.3%	22.6%	7.6%	25.1%	41.1%	6.9%	53.5%	26.8%	64.5%	30.4%	16.5%
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%
I&M	(21.9%)	2.5%	5.1%	0.6%	5.4%	4.3%	35.6%	4.4%	14.3%	88.6%	71.3%	6.9%	13.2%
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%
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%
SCBK	(33.9%)	(6.1%)	(20.4%)	(1.8%)	6.8%	(10.2%)	30.2%	(12.0%)	12.3%	0.2%	47.4%	(5.6%)	11.0%
NCBA	(41.7%)	73.4%	54.0%	91.1%	5.8%	3.1%	45.1%	19.2%	11.4%	12.8%	59.0%	(0.3%)	6.6%
ABSA	(44.2%)	1.3%	2.7%	0.9%	7.1%	5.2%	32.3%	(9.9%)	6.7%	2.5%	82.3%	7.2%	15.1%
DTB-K	(51.5%)	(5.4%)	(8.0%)	(3.4%)	5.0%	6.1%	25.3%	(7.8%)	6.4%	12.0%	70.0%	4.8%	5.8%
HF Group	(1443.7%)	(17.4%)	(23.8%)	(5.2%)	4.2%	(63.0%)	21.8%	(38.0%)	6.8%	54.4%	92.6%	(4.0%)	(23.3%)
FY'20 Mkt Weighted Average*	**(24.4%)**	**16.4%**	**12.4%**	**18.6%**	**7.3%**	**6.5%**	**35.3%**	**(2.1%)**	**22.4%**	**26.6%**	**69.8%**	**11.8%**	**13.2%**
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%**

***Market cap weighted as at 1/04/2021**
****Market cap weighted as at 09/04/2020**

Key takeaways from the table above include:

i. The listed banking sector recorded a 24.4% weighted average decline in core Earnings Per Share (EPS), compared to a weighted average growth of 8.9% in FY’2019, attributable to the increased Non performing loans and loan loss provisions due to the unfavorable economic environment as a result of the pandemic which impacted individuals and businesses’ ability to service loans. This was evidenced by the deterioration in asset quality, with the weighted average NPL ratio increasing to 12.8% from 10.5% in FY’2019,

ii. The Banks have recorded a weighted average deposit growth of 22.4%, faster than the 12.7% growth recorded in FY’2019,

iii. Interest expense grew at a faster pace, by 12.4%, compared to a 3.4% growth in FY’2019 while cost of funds declined, coming in at a weighted average of 3.1% 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 11.8%, lower than the 12.8% growth recorded in FY’2019. The loan growth was also slower than the 26.6% 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. The faster growth in government securities could also be attributed to cautious lending by banks in a bid to reduce the cost of risk as well as mitigate further deterioration of the asset quality,

v. Interest income grew by 16.4%, 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 to 10.1%, from the 10.4% recorded in FY’2019, an indication of the increased allocation to lower-yielding government securities by the sector during the period. 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. The Net Interest Margin (NIM) remained flat at 7.3%, similar to what was recorded in FY'2019 for the whole listed banking sector, and,

vi. Non-Funded Income growth increased by 6.5% 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 2.1% 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. However, with the expiry of the waiver on bank charges on 2nd March 2021, we expect NFI growth to recover in the medium-long term due to the increased adoption of digital channels. According to Central Bank Annual Report 2019/2020, 67.0% of banking transactions were conducted on mobile phones after the onset of the pandemic, compared to 55.0% of transactions before the pandemic. Moreover, more than 1.6 mn additional customers are now using mobile-money channels compared to the period before the pandemic began.

For the various earnings notes of the various companies, click these links:

i. Stanbic Holdings FY'2020 Earnings Note;
ii. KCB Group FY'2020 Earnings Note;
iii. Cooperative Bank FY'2020 Earnings Note;
iv. ABSA Bank Kenya FY'2020 Earnings Note;
v. Diamond Trust Bank Kenya (DTB-K) FY'2020 Earnings Note;
vi. Standard Chartered Bank Kenya FY'2020 Earnings Note;
vii. Equity Group FY'2020 Earnings Note;
viii. I&M Holdings FY'2020 Earnings Note;
ix. NCBA Group FY'2020 Earnings Note;
x. HF Group FY'2020 Earnings Note;

Quarterly Highlights:

During the quarter;

i. The Insurance Regulatory Authority (IRA), released the Q3'2020 Insurance Industry Reporthighlighting that the industry's gross premiums rose by 2.6% to Kshs 179.4 bn, from Kshs 174.9 bn recorded in Q3'2019, with the general insurance business contributing to 58.6% of the industry's premium income, a 1.6% points decline from the 60.2% contribution witnessed in Q3'2019. The regulator noted that the COVID-19 pandemic had impacted the insurance sector mainly through reduced returns from the capital markets and a rise in insurance claims in the long term insurance business class. For more information see our Cytonn Weekly #03/2021,

ii. The Central Bank of Kenya (CBK), released the Commercial Banks' Credit Survey Report for the quarter ended December 2020. According to the report, the banking sector's loan book recorded a 7.1% y/y growth compared to 8.8% the prior year, with gross loans increasing to Kshs 3.0 tn in December 2020, from Kshs 2.8 tn recorded in December 2019 while 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. For more information, please see Cytonn Weekly #05/2021,

iii. Liberty Holdings Limited (Liberty), a financial services and property holding company announced plans to buy an additional 84.2 mn shares in Liberty Kenya Holdings Plc (LK), which represents 15.8% of the company. The deal entails a private sale of 49.5 mn ordinary shares from the Kimberlite Frontier Africa Master Fund (KFAMF), representing 9.2% of Liberty Kenya's issued share capital and a further 34.6 mn ordinary shares from Coronation Africa Frontiers which owns 6.5% of the company's stock. The planned acquisition will increase the company's stake to 73.5% (393.6 mn ordinary shares) from the current 57.7% (309.3 mn ordinary shares), retaining Liberty's status as the biggest shareholder of the insurer. The total cost of this transaction is Kshs 926.6 mn, with Liberty Holdings Limited buying each share at Kshs 11.0 while Liberty Kenya Holdings is currently trading at Kshs 8.1 indicating an undervaluation of 35.8%. For more information, please see Cytonn Weekly#09/2021, and,

iv. The Central Bank of Kenya (CBK) announced that the emergency measures on restructuring of loans for bank borrowers put in place in March 2020, expired on 2nd March 2021. The emergency measures were meant to cushion the borrowers from the adverse effects of the pandemic which would affect their ability to service loans such as the reduction in disposable income. According to the Central Bank, the measures were highly effective, giving borrowers restructuring options which included moratorium on principle or interest and waivers on interest fees. Cumulatively, as at the end of February 2021, loans amounting to Kshs 1.7 tn were restructured, accounting for 57.0% of the banking sector's gross loans as at February 2021. Following the resumption of payments by most borrowers, outstanding restructured loans as at end of February stood at Kshs 569.3 bn, which was 19.0% of the sector's total gross loans, a sign that the economy is on a recovery path. For more information, please see Cytonn Weekly#12/2021.

Universe of Coverage:

Company	Price at 26/3/2021	Price at 1/4/2021	w/w change	q/q change	YTD Change	Year Open 2021	Target Price*	Dividend Yield	Upside/ Downside**	Recommendation
Diamond Trust Bank* **	66.5	68.0	2.3%	(16.3%)	(11.4%)	76.8	105.1	0.0%	54.6%	**Buy**
Kenya Reinsurance	2.6	2.5	(2.7%)	5.2%	9.5%	2.3	3.3	4.3%	34.8%	**Buy**
Co-op Bank* **	13.6	12.0	(12.1%)	5.6%	(4.8%)	12.6	14.5	8.4%	29.7%	**Buy**
Sanlam	12.0	11.0	(8.3%)	(16.6%)	(15.4%)	13.0	14.0	0.0%	27.3%	**Buy**
I&M Holdings* **	43.2	49.0	13.6%	11.1%	9.3%	44.9	60.1	4.6%	27.2%	**Buy**
Britam	7.1	7.0	(1.4%)	(3.3%)	0.0%	7.0	8.6	0.0%	22.9%	**Buy**
Liberty Holdings	8.2	8.2	0.0%	7.0%	6.5%	7.7	9.8	0.0%	19.5%	**Accumulate**
ABSA Bank* **	8.9	8.8	(0.7%)	(8.7%)	(7.6%)	9.5	10.5	0.0%	19.3%	**Accumulate**
Standard Chartered* **	145.0	142.0	(2.1%)	(1.7%)	(1.7%)	144.5	153.2	7.4%	15.3%	**Accumulate**
KCB Group* **	41.1	41.1	0.0%	8.4%	7.0%	38.4	46.0	2.4%	14.4%	**Accumulate**
Jubilee Holdings	267.8	278.5	4.0%	(4.8%)	1.0%	275.8	313.8	0.0%	12.7%	**Accumulate**
Equity Group* **	41.0	39.1	(4.8%)	3.8%	7.7%	36.3	43.0	0.0%	10.1%	**Accumulate**
Stanbic Holdings	83.5	83.3	(0.3%)	(4.4%)	(2.1%)	85.0	84.9	4.6%	6.5%	**Hold**
NCBA* **	23.1	25.4	9.7%	(6.0%)	(4.7%)	26.6	25.4	5.9%	6.1%	**Hold**
CIC Group	2.3	2.2	(2.2%)	(2.3%)	4.3%	2.1	2.1	0.0%	(4.5%)	**Sell**
HF Group	4.6	3.8	(17.5%)	20.8%	20.4%	3.1	3.0	0.0%	(20.6%)	**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 stocks 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. 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.