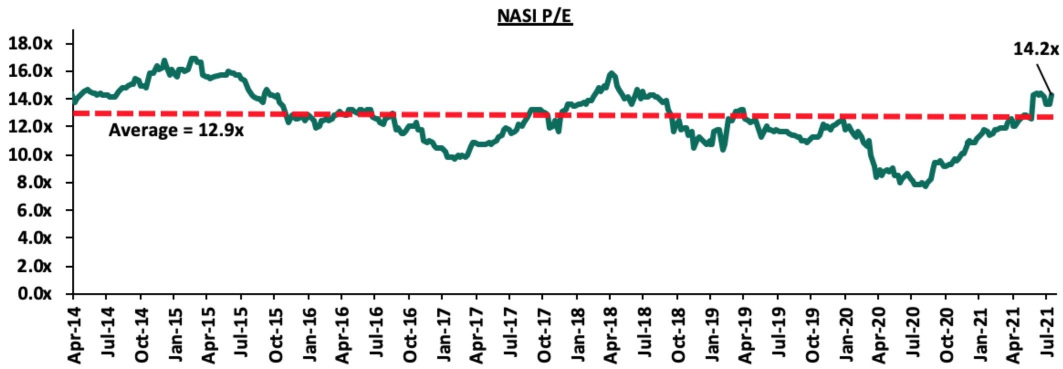
Nairobi Metropolitan Area (NMA) Land Report 2021, & Cytonn Weekly #29/2021

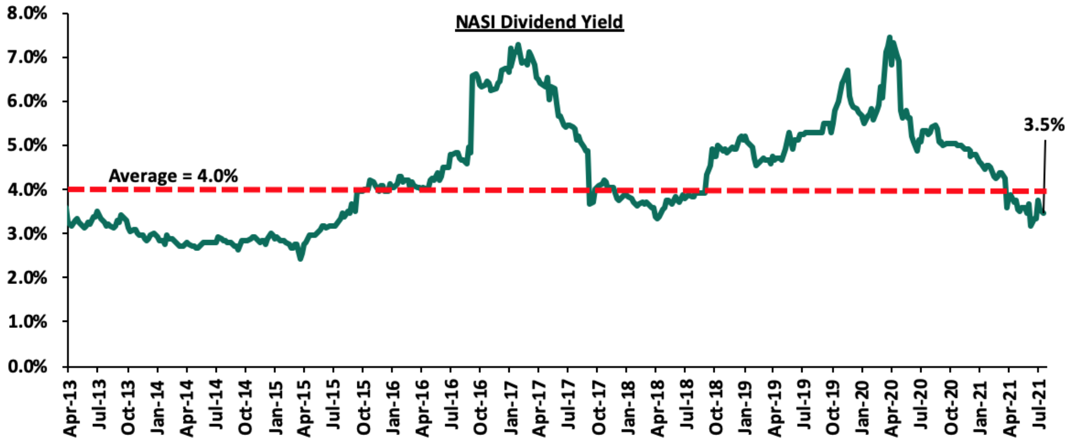
Equities

During the week, the equities market recorded mixed performance, with NASI and NSE 20 gaining by 0.2% and 0.5%, respectively, while NSE 25 declined by 0.2%, taking their YTD performance to gains of 17.7%, 5.8% and 14.2% for NASI, NSE 20 and NSE 25, respectively. The equities market performance was mainly driven by gains recorded by stocks such as BAT Kenya and Bamburi of 4.3% and 2.1%, respectively. The gains were however weighted down by losses recorded by banking stocks such as Co-operative Bank and Diamond Trust Bank Kenya (DTB-K) which declined by 3.0% and 1.9%, respectively.

During the week, equities turnover increased by 0.2% to USD 17.0 mn, from USD 16.9 mn recorded the previous week, taking the YTD turnover to USD 711.4 mn. Foreign investors remained net buyers, with a net buying position of USD 0.4 mn, from a net buying position of USD 1.0 mn recorded the previous week, taking the YTD net selling position to USD 24.8 mn.

The market is currently trading at a price to earnings ratio (P/E) of 14.2x, 9.6% above the historical average of 12.9x, and a dividend yield of 3.5%, 0.5% points below the historical average of 4.0%. Key to note, NASI's PEG ratio currently stands at 1.6x, 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. Excluding Safaricom, the market is trading at a P/E ratio of 12.7x and a PEG ratio of 1.4x. The current P/E valuation of 14.2x is 83.9% 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.





Weekly Highlights:

I. **KCB Group's acquisition of Banque Populaire du Rwanda (BPR)**

During the week, Atlas Mara Limited disclosed that the Rwandese Authorities had approved the sale of Banque Populaire du Rwanda (BPR) to KCB Group, and that the parties are now in the process of finalizing the pre-completion conditions. KCB Group and Atlas Mara Limited had signed a definitive agreement in November 2020 for KCB's acquisition of a 62.1% stake in BPR and a 100.0% stake in Africa Banking Corporation Tanzania Limited (BancABC), subject to shareholder approval and regulatory approval in the respective countries. In May 2021, KCB Group disclosed that it made an offer to the remaining BPR shareholders to raise its acquisition stake in the bank to 100.0% from 62.1% and received shareholders' approval for the acquisitions, with only regulatory approval pending for the finalization of the transactions. Regulatory approval is however still pending with respect to the KCB's acquisition of BancABC from Atlas Mara. For more information on the acquisition, see our Cytonn Weekly #19/2021.

The acquisition will enhance KCB's footprint in the region, which is in line with the group's 'Beyond Banking Strategy' which is aimed at tapping into new growth opportunities regionally. Rwanda presents an ideal growth opportunity for KCB, with only about 36.0% of adults in Rwanda using banking services according to Finscope Rwanda 2020, compared to 41.0% in Kenya. Furthermore, Rwanda's banking sector's asset quality is superior to Kenya's, with an average NPL ratio of 6.2% over the last five years and 4.5% in FY'2020, compared to the average NPL ratio of 14.1% recorded by Kenya's banking sector and 14.8% recorded by KCB Group in FY'2020. Since loans typically constitute the majority of a bank's assets, the superior asset quality in Rwanda can help KCB reduce the level of risk exposure of its loan book to the Kenyan market while increasing profits due to more performing loans. Additionally, according to World Bank data, Rwanda and Tanzania recorded interest rate spreads of 8.7% and 10.0% in 2020, respectively, both higher than Kenya's 5.0% and KCB Group's 7.8% net interest spread over the same period; which means that the acquisitions could help boost the Group's funded income.

Below is a summary of the deals in the last 7 years that have either happened, been announced or expected to be concluded:

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bn)	Transaction Stake	Transaction Value (Kshs bn)	P/Bv Multiple	Date
I&M Holdings PLC	Orient Bank Limited Uganda	3.3	90.0%	3.6	1.1x	April-21

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bn)	Transaction Stake	Transaction Value (Kshs bn)	P/Bv Multiple	Date
KCB Group	Banque Populaire du Rwanda, and, ABC Tanzania	5.3 (Banque Populaire du Rwanda, only. ABC Tanzania financials unknown)	100.0%	6.3	N/D	Nov-20*
Co-operative Bank	Jamii Bora Bank	3.4	90.0%	1	0.3x	Aug-20
Commercial International Bank	Mayfair Bank Limited	1	51.0%	Undisclosed	N/D	May-20*
Access Bank PLC (Nigeria)	Transnational Bank PLC.	1.9	100.0%	1.4	0.7x	Feb-20*
Equity Group **	Banque Commerciale Du Congo	8.9	66.5%	10.3	1.2x	Nov-19*
KCB Group	National Bank of Kenya	7	100.0%	6.6	0.9x	Sep-19
CBA Group	NIC Group	33.5	53%:47%	23	0.7x	Sep-19
Oiko Credit	Credit Bank	3	22.8%	1	1.5x	Aug-19
CBA Group**	Jamii Bora Bank	3.4	100.0%	1.4	0.4x	Jan-19
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	1.0x	Jan-18
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	N/A	Dec-18
SBM Bank Kenya	Chase Bank Ltd	Unknown	75.0%	Undisclosed	N/A	Aug-18
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	0.8x	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	1.6x	Nov-16
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	1.4x	Jun-16
I&M Holdings	Giro Commercial Bank	3	100.0%	5	1.7x	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	2.3x	Mar-15
Centum	K-Rep Bank	2.1	66.0%	2.5	1.8x	Jul-14
GT Bank	Fina Bank Group	3.9	70.0%	8.6	3.2x	Nov-13
Average			**76.7%**		**1.2x**	

*** Announcement Date**
**** Deals that were dropped**

II. Q1’2021 Quarterly Economic Review

During the week, the Central Bank of Kenya (CBK) released the Quarterly Economic Review for the period ending 31st March 2021, highlighting that the banking sector remained stable and resilient in the midst of a pandemic during the period. According to the report, the sector’s total assets increased by 2.0% to Kshs 5.5 tn in March 2021, from Kshs 5.4 tn in December 2020. The increase was mainly attributable to an 8.1% increase in placements coupled with a 5.2% increase in loans and advances in March 2021. Notably, loans and advances accounted for 49.8% of total assets in Q1'2021, which was a 0.5% points increase from 49.3% of total assets in FY'2020.

Other key take-outs from the report include:

i. The banking sector recorded a 94.7% increase in Profit before Tax (PBT) to Kshs 45.9 bn in Q1'2021, from Kshs 23.6 bn in Q4'2020, with the increase in profitability mainly attributable to a 22.8% decline in expenses in Q1'2021. Consequently, the sector's Return on Assets (ROA) recorded a 1.0% points increase to come in at 2.6% in Q1'2021, from 1.6% recorded in Q4'2020, while Return On Equity (ROE) recorded an 8.2% points increase to 22.0% in March 2021, from 13.8% in December 2020,
ii. Lending increased by 0.7% to Kshs 3.04 tn in Q1'2021, from Kshs 3.00 tn in FY'2020, attributable to an increase in loans and advances to Financial Services, Manufacturing, and Personal and Household sectors, which increased by 4.2%, 3.4% and, 1.2%, respectively,
iii. Deposits recorded a 2.8% increase to Kshs 4.1 tn in March 2021, from Kshs 4.0 tn in December 2020, attributable to a 10.1% increase in foreign currency deposits which increased to Kshs 998.4 bn in Q1'2021, from Kshs 907.0 bn in FY'2020, coupled with a 0.6% increase in local currency deposits, which increased to Kshs 3.13 tn in March 2021, from Kshs 3.11 tn in December 2020. Key to note, customer deposits remain the main source of funding for banks, accounting for 74.8% of the sector's total liabilities and shareholders' funds as at Q1'2021, which was a 0.7% points increase from 74.1% of total liabilities and shareholders' funds in FY'2020,
iv. Credit risk remained elevated in the sector, with the gross Non-Performing Loans (NPLs) ratio increasing to 14.6% in Q1'2021, from 14.1% in FY'2020 with Trade, Personal and Household and Manufacturing sectors contributing 22.5%, 16.2% and 15.5% of Gross Non-Performing Loans to the banking sector, respectively. The Real Estate sector registered the highest increase in NPLs by 14.9% in Q1'2021 as a result of the disruptions caused by the COVID-19 pandemic. The sector's NPL coverage ratio increased to 53.1% in Q1'2021, from 51.9% in FY'2020, an indication that the banks continued to increase their provisioning levels to proactively manage risks given the tough economic conditions,
v. The banking sector remained adequately capitalized, with the aggregate Core Capital to Total Risk-Weighted Assets ratio coming in at 16.5% in Q1'2021, a 0.2% points decline from 16.7% recorded in FY'2020 and 6.0% points above the CBK's minimum statutory ratio of 10.5%. Total Capital to Total Risk-Weighted Assets ratio also declined, decreasing by 0.4% points to 18.8% in Q1'2021 from 19.2% in FY'2020, but 4.3% points above the CBK's minimum statutory ratio of 14.5%, and,
vi. The sector remained liquid during the period under review, with the liquidity ratio rising to 56.3% in Q1'2021, from 54.6% in FY'2020. This was 36.3% points above the minimum statutory level of 20.0%. The increase in the banking sector's liquidity is attributable to a 5.7% increase in total liquid assets, which outpaced the 2.0% increase in short term liabilities during the quarter.

The increasing profitability in Q1'2021 indicates that the banking sector remains on the path to recovery in 2021. Although the capital adequacy ratios declined in Q1'2021, they still remain above the minimum statutory ratios and as such, the sector remains sufficiently capitalized while still maintaining adequate liquidity buffers. On the flipside, credit risk remains elevated in the industry, as evidenced by the rising NPL ratio and as such, we expect lending to the private sector to remain constrained in the short-medium term. Key to note, the latest data from CBK indicates that private sector credit growth recorded a 6.8% growth in the 12 months to April 2021, the lowest it has been since October 2019 when the private sector credit growth stood at 6.6%, reflecting the persistent uncertainty in the economy on account of the toll of the COVID-19 pandemic on the business environment. The fact that banks are still reluctant to lend to businesses despite the high liquidity currently in the market also indicates private sector lending is expected to record slow growth in the short-medium term. We however 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:

Below is a summary of our universe of coverage and the recommendations:

Company	Price as at 16/07/2021	Price as at 23/07/2021	w/w change	YTD Change	Year Open 2021	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
I&M Group***	21.5	22.2	3.0%	(50.6%)	44.9	29.8	10.2%	44.7%	**0.3x**	**Buy**
Kenya Reinsurance	2.5	2.5	0.4%	9.1%	2.3	3.1	4.0%	27.0%	**0.3x**	**Buy**
NCBA***	26.0	26.2	0.8%	(1.7%)	26.6	29.5	5.7%	18.5%	**0.7x**	**Accumulate**
Standard Chartered***	129.8	129.5	(0.2%)	(10.4%)	144.5	134.5	8.1%	12.0%	**0.9x**	**Accumulate**
KCB Group***	44.9	44.6	(0.7%)	16.0%	38.4	48.6	2.2%	11.3%	**1.0x**	**Accumulate**
Co-op Bank***	13.5	13.1	(3.0%)	4.4%	12.6	13.8	7.6%	13.0%	**0.9x**	**Accumulate**
ABSA Bank***	10.0	9.9	(1.4%)	3.6%	9.5	10.7	0.0%	8.5%	**1.1x**	**Hold**
Stanbic Holdings	82.8	87.5	5.7%	2.9%	85.0	90.5	4.3%	7.8%	**0.8x**	**Hold**
Diamond Trust Bank***	66.3	65.0	(1.9%)	(15.3%)	76.8	70.0	0.0%	7.7%	**0.3x**	**Hold**
Equity Group***	48.6	47.9	(1.4%)	32.0%	36.3	51.2	0.0%	7.0%	**1.4x**	**Hold**
Sanlam	11.0	11.6	5.5%	(10.8%)	13.0	12.4	0.0%	6.9%	**1.0x**	**Hold**
Jubilee Holdings	385.0	370.0	(3.9%)	34.2%	275.8	330.9	2.4%	(8.1%)	**0.8x**	**Sell**
Britam	7.5	7.7	2.4%	10.0%	7.0	6.7	0.0%	(13.0%)	**1.4x**	**Sell**
HF Group	3.7	3.9	4.1%	22.6%	3.1	3.2	0.0%	(16.9%)	**0.2x**	**Sell**
Liberty Holdings	7.8	9.6	22.6%	24.2%	7.7	8.4	0.0%	(12.1%)	**0.7x**	**Sell**
CIC Group	2.6	2.6	(3.4%)	20.9%	2.1	1.8	0.0%	(29.4%)	**0.9x**	**Sell**

Target Price as per Cytonn Analyst estimates
****Upside/ (Downside) is adjusted for Dividend Yield**
*****For Disclosure, these are stocks in which Cytonn and/or its affiliates are invested in**
Key to note, I&M Holdings YTD share price change is mainly attributable to counter trading ex-bonus issue.

We are "Neutral" on the Equities markets in the short term. With the market currently trading at a premium to its future growth (PEG Ratio at 1.6x), we believe that investors should reposition towards companies with a strong earnings growth and are trading at discounts to their intrinsic value. Additionally, we expect the recent discovery of new strains of COVID-19 coupled with the introduction of strict lockdown measures in major economies to continue dampening the economic outlook.

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