Unit Trust Funds Performance, Q1'2021, & Cytonn Weekly #41/2021

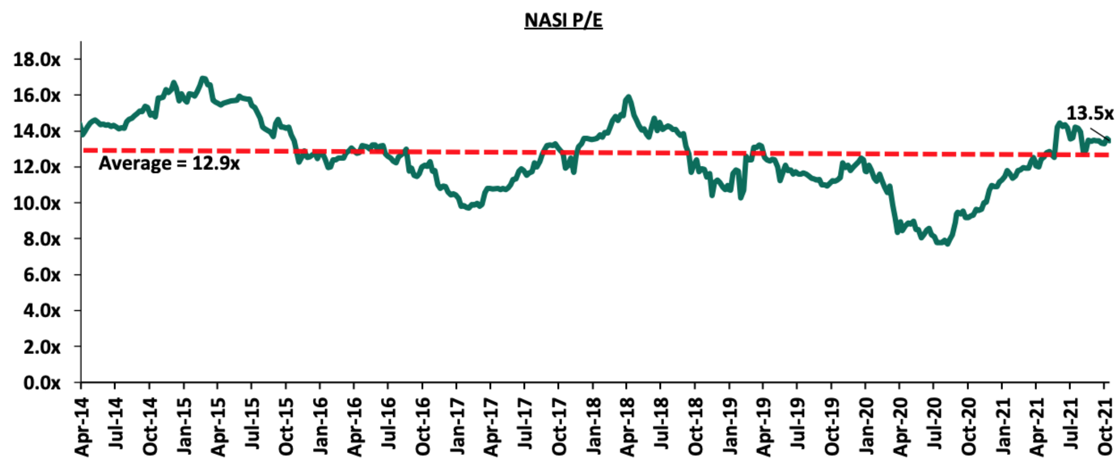
Equities

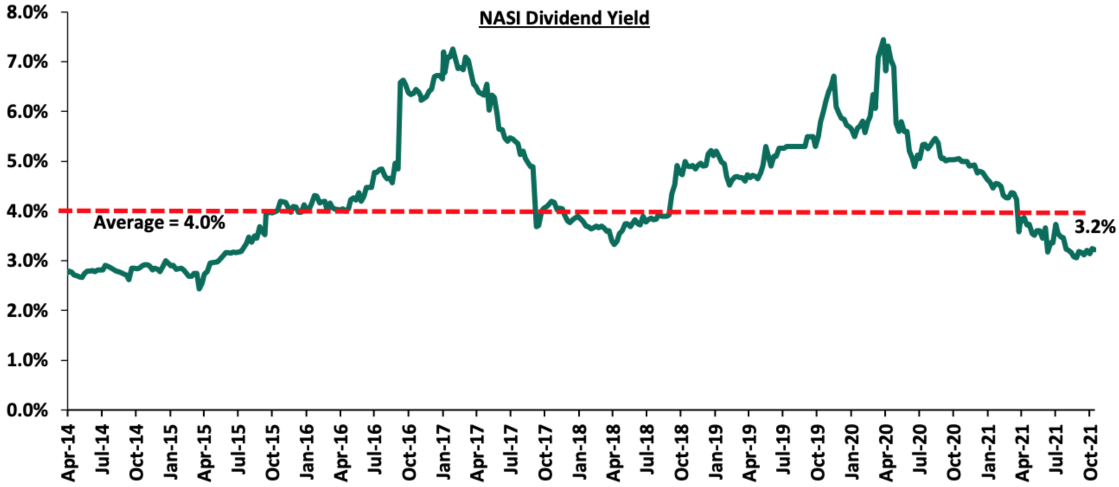
Markets Performance

During the week, the equities market recorded mixed performance, with NASI and NSE 25 gaining by 1.7% and 0.8%, respectively, while NSE 20 declined by 1.1%, taking their YTD performance to gains of 17.6%, 5.2% and 13.4% for NASI, NSE 20 and NSE 25, respectively. The equities market performance was driven by gains recorded by large cap stocks such as Safaricom and NCBA which gained by 3.5% and 2.0%, respectively. The gains were however weighed down by losses recorded by banking stocks such as KCB, Diamond Trust Bank (DTB-K) and ABSA which recorded losses of 2.2%, 1.7% and 1.0%, respectively.

During the week, equities turnover declined by 27.4% to USD 18.9 mn, from USD 26.0 mn recorded the previous week, taking the YTD turnover to USD 973.6 mn. Foreign investors remained net sellers, with a net selling position of USD 0.8 mn, from a net selling position of USD 7.2 mn recorded the previous week, taking the YTD net selling position to USD 26.7 mn.

The market is currently trading at a price to earnings ratio (P/E) of 13.5x, 4.6% above the historical average of 12.9x, and a dividend yield of 3.2%, 0.8% points below the historical average of 4.0%. Key to note, NASI's PEG ratio currently stands at 1.5x, 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, which is currently 62.7% of the market, the market is trading at a P/E ratio of 11.3x and a PEG ratio of 1.3x. The current P/E valuation of 13.5x is 75.7% 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 highlight

I. Sanlam Kenya Credit Ratings

During the week, Fitch Ratings, a global credit rating agency, assigned Sanlam Life Insurance Limited (Sanlam Life), an insurance provider in Kenya, an Insurer Financial Strength (IFS) rating and Issuer Default Rating (IDR) of `B+' and its holding company, Sanlam Kenya Plc, a Long-term Issuer Default Rating (IDR) of `B' with both Rating outlooks being stable. The Insurer financial strength rating on the Fitch Ratings scale ranges from a low of B to a high of AAA. According to Fitch Ratings, the main drivers of Sanlam Kenya's rating were;

i. The company's moderate business profile, attributable to favorable diversification across both life and non-life products which accounted for 59.0% and 41.0% as at end 2020,
ii. Supportive capitalization, and,
iii. Strategic importance of Sanlam Kenya to the parent company, Sanlam Group.

The ratings were also supported by Sanlam Kenya's underlying financial performance, but the performance has been negatively affected in recent years by foreign exchange and investment losses. Sanlam Kenya reported a net loss of Kshs 117.0 mn at the end of 2020, driven by Kshs 214.0 mn of foreign exchange losses on its USD denominated borrowings. In H1'2021, Sanlam Kenya reported a Kshs 298.1 mn loss attributable to one-off forex losses incurred in restructuring USD 27.0 mn loans into a Kshs 3.0 bn loan with a local banking institution. The recent restructuring of Sanlam Kenya's borrowings to local currency to reduce the foreign exchange loss risk and is set to positively impact its future ratings. The positives were however offset by;

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i. The group's high investment risk due to a significantly high exposure of Sanlam Kenya's assets to Kenya's sovereign risk, with sovereign investments-to-shareholders' equity ratio of 1,064.0% at end-2020. However, it is key to note that to date, Kenya is yet to default on its domestic or foreign sovereign securities, and,
ii. A high financial leverage ratio of 69.0% as at end of H1'2021. The high financial leverage points to most of Sanlam Kenya's assets being financed by debt, hence lowering its credit outlook.

However, Sanlam Kenya's debt is guaranteed by the parent, Sanlam group, which has a National Long-Term Rating of 'AA+' with a stable outlook.

Fitch ratings also noted that Sanlam Kenya's future ratings are mainly pegged on the deterioration or improvement in Sanlam Kenya's business volumes and an increase or decrease of Sanlam Kenya's investment risk in sovereign investments. In our view, the IFS and IDR Fitch Ratings and stable outlook are expected to boost confidence on Sanlam Kenya's operations and increase investor confidence as it seeks to strengthen its market position in the insurance sector. Sanlam Kenya is one of the top five insurers in Kenya with a life-insurance market share of 6.0% and a non-life market share of 3.0% as at 2020. We expect Sanlam Kenya to input strategies to lighten investments in sovereign securities and look to other markets as has been the trend in the Kenyan insurance sector which has seen aggressive investment income diversification with insurers looking to mitigate underwriting losses brought about by increased claims and loss ratios.

II. Credit Survey Report June 2021

The Central Bank of Kenya (CBK), recently released the Commercial Banks' Credit Survey Report for the quarter ended June 2021. The quarterly Credit Officer Survey is undertaken by the CBK to identify the potential drivers of credit risk in the banking sector. For the quarter ended 30th June 2021, 38 operating commercial banks and 1 mortgage finance company participated in the Commercial Banks Credit Officer Survey. The report highlights that Profit before Tax (PBT) for the banking sector significantly increased by 133.3% y/y to Kshs 50.5 bn in Q2'2021, from Kshs 21.7 bn in Q2'2020, attributable to a reduction in loan loss provisioning as the economy recovered and business environment improved. On a q/q basis, Profit before Tax increased by 10.1% to Kshs 50.5 bn to June 2021 from Kshs 45.9 bn in March 2021. Other key take-outs from the report include:

i. The banking sector's loan book recorded a 6.9% y/y growth, with gross loans increasing to Kshs 3.1 tn in June 2021, from Kshs 2.9 tn in June 2020. On a q/q basis, the loan book increased by 2.3% from Kshs 3.0 tn in March 2021,
ii. The aggregate balance sheet recorded a 9.1% increase y/y to Kshs 5.7 tn in Q2'2021, from Kshs 5.2 tn in Q2'2020. The expansion in the balance sheet is attributable to an 8.9% growth in deposits to Kshs 4.2 tn in Q2'2021, from Kshs 3.9 tn in Q2'2020, coupled with a 6.9% increase in gross loans to Kshs 3.1 tn in Q1'2021, from Kshs 2.9 tn in Q1'2020. Quarterly, the balance sheet grew by 2.7% to Kshs 5.7 tn in June 2021, from Kshs 5.5 tn in March 2021,
iii. Asset quality in the banking sector deteriorated, with the Gross NPL ratio increasing to 14.0% in Q2'2021, from 13.1% in Q2'2020. Quarterly, however, asset quality improved to 14.0% in June 2021, from 14.6% in March 2021. Some the key sectors driving the y/y asset quality deterioration include Personal and Household, Real Estate, Tourism, and Trade,
iv. The capital adequacy remained favorable with the ratio increasing to 18.9% in June 2021, from 18.5% recorded in June 2020 and 18.8% in March 2021. During the quarter, the sector's total capital increased by 2.1% while the total risk weighted assets recorded a 1.6% increase, bringing the capital adequacy ratio to 18.9%, 4.4% points above the minimum statutory limit of 14.5%,
v. 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 had to provide provisions for both incurred and expected credit losses, and,
vi. Average liquidity in the banking sector increased to 56.8% in June 2021, from 52.8% in June 2020 and 56.3% in March 2021. This was 36.8% points above the minimum statutory ratio of 20.0%.

Due to an improved business environment following the gradual reopening of the economy and increased vaccination rollout, credit risk is expected to decline, evidenced by the commercial banks' reduced loan loss provisioning, as highlighted in our H1'2021 Banking report. The Kenyan Banking sector has showcased robust recovery efforts which have been boosted by an expansion in the loan book and diversification of income which has grown the banks' bottom lines. The strong performance evidenced by the increased profits in the quarter are expected to continue but may face risks such as increased cybersecurity threats emanating from the major shift to digital banking. This adds to the possibility of credit risk elevation due to discovery of new strains leading to reduced economic activity in addition to heightened political activities in the run up to next year's general elections.

Universe of coverage

Company	Price as at 08/10/2021	Price as at 15/10/2021	w/w change	YTD Change	Year Open 2021	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
I&M Group***	21.8	21.5	(1.4%)	(52.1%)	44.9	32.0	10.5%	59.3%	0.6x	Buy
ABSA Bank***	10.3	10.2	(1.0%)	6.6%	9.5	13.8	0.0%	36.0%	1.1x	Buy
Kenya Reinsurance	2.5	2.5	(1.6%)	6.5%	2.3	3.1	8.1%	34.1%	0.3x	Buy
NCBA***	25.3	25.8	2.0%	(3.2%)	26.6	31.0	5.8%	26.2%	0.6x	Buy
KCB Group***	46.1	45.1	(2.2%)	17.4%	38.4	53.4	2.2%	20.6%	1.0x	Buy
Standard Chartered***	129.3	128.3	(0.8%)	(11.2%)	144.5	145.4	8.2%	21.6%	1.0x	Buy
Equity Group***	49.4	49.5	0.3%	36.6%	36.3	57.5	0.0%	16.2%	1.3x	Accumulate
Co-op Bank***	13.2	13.0	(1.1%)	3.6%	12.6	14.1	7.7%	16.2%	0.9x	Accumulate
Stanbic Holdings	86.3	86.0	(0.3%)	1.2%	85.0	96.6	2.0%	14.3%	0.8x	Accumulate
Diamond Trust Bank***	60.5	59.5	(1.7%)	(22.5%)	76.8	67.3	0.0%	13.1%	0.3x	Accumulate
Liberty Holdings	7.8	7.8	(0.3%)	1.0%	7.7	8.4	0.0%	8.0%	0.6x	Hold
Sanlam	11.9	12.0	0.4%	(8.1%)	13.0	12.4	0.0%	3.8%	1.1x	Lighten
Jubilee Holdings	350.0	348.5	(0.4%)	26.4%	275.8	330.9	2.6%	(2.5%)	0.7x	Sell
Britam	8.1	7.6	(5.4%)	9.1%	7.0	6.7	0.0%	(12.3%)	1.4x	Sell
HF Group	3.7	3.7	0.5%	18.2%	3.1	3.1	0.0%	(16.4%)	0.2x	Sell
CIC Group	2.8	2.7	(4.3%)	27.5%	2.1	1.8	0.0%	(33.1%)	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 the 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 1.5x), 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.