Kenya Retirement Benefits Schemes FY'2021 Performance, & Cytonn Weekly #10/2022

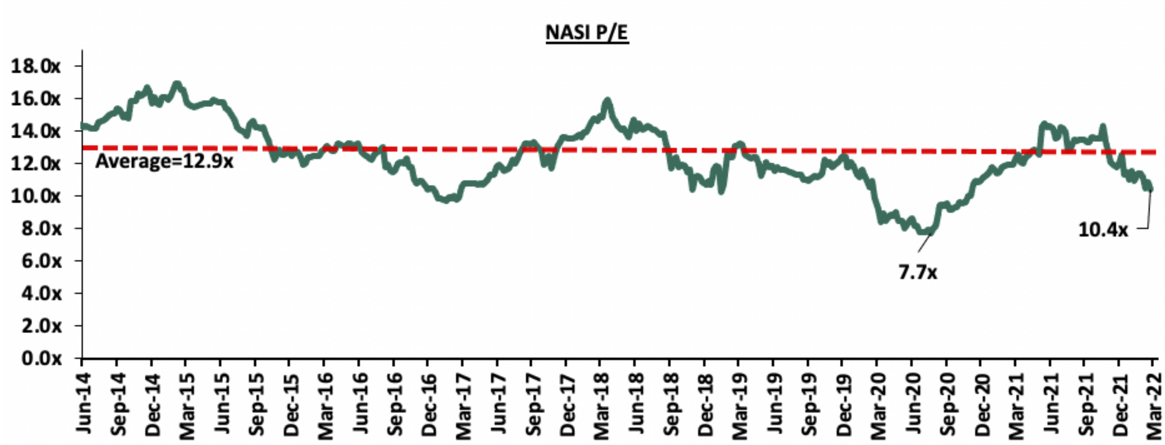
Equities

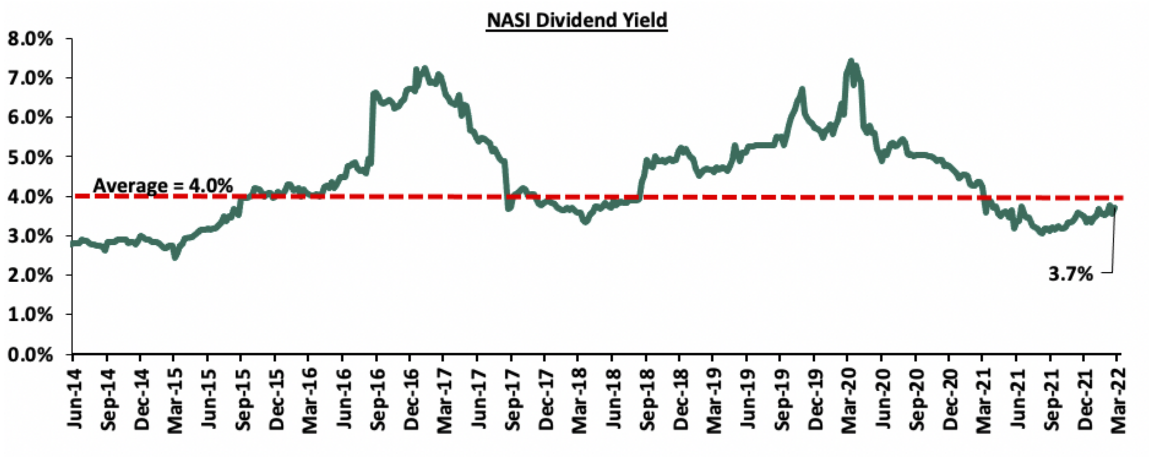
Markets Performance

During the week, the equities market was on a downward trajectory, with NASI, NSE 20 and NSE 25 declining by 3.4%, 1.8% and 2.4%, respectively, taking their YTD performance to losses of 4.8%, 2.6% and 3.8% for NASI, NSE 20 and NSE 25, respectively. The equities market performance was driven by losses recorded by large cap stocks such as Safaricom, EABL, KCB and Equity Group of 5.3%, 2.4%, 1.4% and 1.0%, respectively. The losses were however mitigated by gains recorded by other large cap stocks such as ABSA of 1.3%.

During the week, equities turnover increased by 5.1% to USD 21.4 mn, from USD 20.4 mn recorded the previous week, taking the YTD turnover to USD 197.6 mn. Foreign investors remained net sellers, with a net selling position of USD 3.8 mn, from a net selling position of USD 3.0 mn recorded the previous week, taking the YTD net selling position to USD 9.2 mn.

The market is currently trading at a price to earnings ratio (P/E) of 10.4x, 19.2% below the historical average of 12.9x, and a dividend yield of 3.7%, 0.3% points below the historical average of 4.0%. Key to note, NASI's PEG ratio currently stands at 1.3x, an indication that the market is trading at a premium to its future earnings growth. 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. The current P/E valuation of 10.4x is 35.5% 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:





Weekly highlight:

CBK Credit Survey Report – Q4'2021

During the week, the Central Bank of Kenya (CBK), released the Commercial Banks' Credit Survey Report for the quarter ended December 2021. The quarterly Credit Officer Survey is undertaken by the CBK to identify the potential drivers of credit risk in the banking sector. During the quarter, 38 operating commercial banks and 1 mortgage finance company participated in the Commercial Banks Credit Officer Survey. The report highlights that the banking sector's loan book recorded an 8.3% y/y growth, with gross loans increasing to Kshs 3.25 tn in December 2021, from Kshs 3.00 tn in December 2020. On a q/q basis, the loan book increased by 1.7% from Kshs 3.19 tn in September 2021. Other key take-outs from the report include:

?. Profit before Tax (PBT) for the banking sector increased by 109.2% y/y to Kshs 49.3 bn in Q4'2021, from Kshs 23.6 bn in Q4'2020. Quarterly, Profit before Tax increased by 0.4% to Kshs 49.3 bn in December 2021, from Kshs 49.1 bn in September 2021 attributable to the higher increase in operating income by 8.4%, compared to the 5.9% increase recorded by operating expenses. Additionally, Return on Assets (RoA) remained unchanged at 2.6% in December 2021, as was recorded in September 2021. This however marked a 1.0% point increase from the RoA of 1.6% recorded in December 2020,

i. The aggregate balance sheet expanded by 10.8% y/y, to Kshs 6.0 tn in December 2021, from Kshs 5.4 tn in December 2020 driven by an 8.3% increase in gross loans to Kshs 3.2 tn in Q4'2021, from Kshs 3.0 tn in Q4'2020. Quarterly, the balance sheet grew by 3.2% from the Kshs 5.7 tn recorded in September 2021,

ii. Asset quality in the banking sector improved, with the Gross NPL ratio declining to 13.1% as at December 2021, from 14.1% recorded in December 2020 and 13.6% recorded in September 2021. The improvement in asset quality during the quarter is attributable to the improved business environment in the country which has in turn led to improved loan repayment capacity by creditors and helped reduce credit risk,

iii. The banks' capital adequacy remained favorable, with the total capital to risk weighted assets ratio increasing to 19.6% in December 2021, from 19.2% recorded in December 2020. Quarterly, the total capital to risk weighted assets ratio also increased from the 18.8% in September 2021. The q/q performance was attributable to higher increase in the total capital of 6.7% compared to the 2.3% increase in total risk weighted assets during the quarter, bringing the total capital to risk weighted assets ratio to 19.6%, 5.1% points above the minimum statutory limit of 14.5%,

iv. 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,

v. Average liquidity in the banking sector increased to 56.2% in December 2021, from 54.6% in December 2020. The improved liquidity position was attributed to; i) increase in deposit mobilization contributing 53.0%, ii) loan recovery efforts contributing 30.0%, iii) maturity of government securities contributing 12.0%, and iv) capital injection contributing 5.0%. However, liquidity declined quarterly to 56.2% in December 2021 from 56.7% in September 2021, and 36.2% points above the minimum statutory ratio of 20.0%.

The gradual reopening of the economy on the back of the lifting of COVID-19 restrictions and increased vaccination rollout, has led to an improved business environment, and subsequently seen credit risk continue to decline as highlighted in our Q3'2021 Banking report and an improved asset quality demonstrated by banks' NPL ratio declining to 13.1% in Q4'2021, from 14.1% in Q4'2020 and 13.6% in Q3'2021. Going forward, we expect lending to increase supported by two main factors; (i) Improving asset quality – as the Kenyan economy to recover from the COVID-19 adverse effects, the credit risk will gradually decline as borrowers will be in a better position to repay their loans and banks will extend more credit as there is relatively lower risk of defaults, and, ii) Approvals of risk based lending models. The Central Bank of Kenya having started the approvals for the banks' risk pricing models that will enable banks to price loans according to the perceived risk and hence increase their willingness to lend to riskier borrowers they would have previously shunned out. Overall, the banking sector has remained resilient in 2021 as the aggregate balance sheet expanded by 10.8% y/y from December 2020 and profit before tax recorded by 109.2% y/y increase to Kshs 49.3 bn in December 2021, from Kshs 23.6 bn in December 2020 and recorded a quarterly increase of 0.4%, from Kshs 49.1 bn in September 2021. Despite the possible risks to the sector and overall business environment posed by the upcoming August 2022 general elections and possible discovery of new COVID-19 variants, we expect the sector to continue to exhibit resiliency and stability going forward supported by adequate liquidity and capital levels.

Cytonn Coverage:

Company	Price as at 04/03/2022	Price as at 11/03/2022	w/w change	YTD Change	Year Open 2022	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Kenya Reinsurance	2.3	2.3	(0.9%)	(0.9%)	2.3	3.2	8.8%	48.8%	0.2x	Buy
Jubilee Holdings	275.0	275.0	0.0%	(13.2%)	316.8	381.7	3.3%	42.1%	0.5x	Buy
I&M Group***	21.1	20.8	(1.4%)	(2.8%)	21.4	24.4	10.8%	28.0%	0.6x	Buy
KCB Group***	45.4	44.7	(1.4%)	(1.9%)	45.6	51.4	2.2%	17.1%	0.9x	Accumulate
Stanbic Holdings	99.8	100.0	0.3%	14.9%	87.0	105.2	9.0%	14.2%	0.9x	Accumulate
NCBA***	24.7	24.6	(0.6%)	(3.5%)	25.5	26.4	6.1%	13.6%	0.6x	Accumulate
Standard Chartered***	132.0	131.0	(0.8%)	0.8%	130.0	137.7	8.0%	13.1%	1.0x	Accumulate
Britam	6.9	7.0	0.6%	(7.7%)	7.6	7.9	0.0%	12.8%	1.2x	Accumulate
Liberty Holdings	6.6	6.9	3.6%	(2.8%)	7.1	7.7	0.0%	11.6%	0.5x	Accumulate
Equity Group***	51.8	51.3	(1.0%)	(2.8%)	52.8	56.6	0.0%	10.5%	1.3x	Accumulate
Diamond Trust Bank***	56.5	56.0	(0.9%)	(5.9%)	59.5	61.8	0.0%	10.3%	0.2x	Accumulate
Co-op Bank***	13.0	12.9	(0.8%)	(1.2%)	13.0	13.1	7.8%	9.4%	1.0x	Hold
ABSA Bank***	12.0	12.1	1.3%	3.0%	11.8	11.9	0.0%	(1.6%)	1.2x	Sell
Sanlam	11.9	12.8	7.1%	10.4%	11.6	12.1	0.0%	(5.4%)	1.3x	Sell
CIC Group	2.0	2.0	0.5%	(6.0%)	2.2	1.9	0.0%	(7.7%)	0.7x	Sell
HF Group	3.4	3.5	2.1%	(9.2%)	3.8	3.0	0.0%	(14.4%)	0.2x	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**

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 1.3x), we believe that investors should reposition towards value stocks with strong earnings growth and that are trading at discounts to their intrinsic value. We expect the discovery of new COVID-19 variants, the

upcoming Kenyan general elections and the slow vaccine rollout to continue weighing down the economic outlook. On the upside, we believe that the relaxation of COVID-19 containment measures in the country will lead to improved investor sentiments.

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