Kenya's FY'2023/2024 Budget Review, & Cytonn Weekly #25/2023

Equities

Market Performance:

During the week, the equities market was on an upward trajectory with NASI, NSE 20 and NSE 25 gaining by 6.9%, 1.1% and 3.1% respectively, taking the YTD performance to losses of 15.8%, 5.5% and 13.4% for NASI, NSE 20 and NSE 25, respectively. The equities market performance was mainly driven by gains recorded by large-cap stocks such as Safaricom, Diamond Trust Bank (DTB-K), ABSA Bank, and BAT of 17.4%, 8.2%, 1.7% and 1.1 % respectively. The gains were however weighed down by losses recorded by stocks such as Bamburi and EABL of 6.7% and 4.3%, respectively;

During the week, equities turnover decreased by 57.5% to USD 5.0 mn, from USD 11.8 mn, recorded the previous week, taking the YTD turnover to USD 447.1 mn. Foreign investors remained net buyers with a net buying position of USD 0.4 mn, from a net buying position of USD 0.2 mn recorded the previous week, taking the YTD net selling position to USD 53.2 mn.

The market is currently trading at a price to earnings ratio (P/E) of 8.3x, 32.6% below the historical average of 12.4x. The dividend yield stands at 8.4%, 4.2% points above the historical average of 4.2%. Key to note, NASI's PEG ratio currently stands at 1.1x, an indication that the market is overvalued relative to its future growth. A PEG ratio greater than 1.0x indicates the market is overvalued while a PEG ratio less than 1.0x indicates that the market is undervalued. The charts below indicate the historical P/E and dividend yields of the market;

Weekly Highlight:

i. **Q1'2023 Quarterly Economic Review**

During the week, the Central Bank of Kenya (CBK) released the Quarterly Economic Review for the period ending 31 March 2023, highlighting that the banking sector remained stable and resilient during the period on the back of strong liquidity and capital adequacy. According to the report, the sector's total assets increased by 2.7% to Kshs 6.8 tn in March 2023, from Kshs 6.6 tn in December 2022. The increase was mainly attributable to a 4.8% increase in loans and advances to Kshs 3.9 tn, from Kshs 3.7 tn recorded in Q4'2022. On a yearly basis, total assets increased by 11.0% to Kshs 6.7 tn, from Kshs 6.1 tn in Q1'2022. Notably, loans and advances accounted for 56.9% of total assets in Q1'2023, which was an increase from 55.7% of total assets in Q4'2022.

Other key take-outs from the report include:

i. The banking sector recorded a 13.8% increase in Profit before Tax (PBT) q/q with the increase in profitability mainly attributable to 1.4% increase in quarterly income, coupled with a 3.6% decrease in quarterly expenses. On a yearly basis, PBT increased by 13.6%, to Kshs 65.1 bn, from Kshs 57.3 bn recorded in Q1'2022,

ii. The sector's Return on Asset (ROA) rose marginally by 0.1% points to 3.1%, from 3.0% in both Q4'2022 and Q1'2022. Additionally, Return on Equity (ROE) recorded 1.8% points increase to 27.0% in Q1'2023, from 25.2% in Q4'2022, and 1.9% points increase from 25.1% recorded in Q1'2022,
iii. Lending increased by 4.8% to Kshs 3.9 tn in Q1'2023, from Kshs 3.7 tn in Q4'2022, attributable to an increase in credit advanced to individual borrowers as well as for working capital purposes in sectors such as transport and communication, personal and household, and agriculture which increased by 9.7%, 3.5% and 3.1%, respectively. On a yearly basis, lending was up by 13.9% to Kshs 3.9 tn, from Kshs 3.4 tn in Q1'2022,
iv. Deposits recorded a 2.1 % increase to Kshs 4.8 tn in Q1'2023, from Kshs 4.7 tn in Q4'2022, attributable to a 7.3% increase in foreign currency deposits which increased to Kshs 1.3 tn in Q1'2023, from Kshs 1.2 bn recorded in Q4'2022. Notably, on a year on year basis, deposits increased by 8.1% to Kshs 4.8 tn in Q1'2023, from Kshs 4.5 tn in Q1'2021. Key to note, customer deposits remain the main source of funding for banks, accounting for 71.3% of the sector's total liabilities. The shareholder's funds as at Q1'2023, 0.4% points lower than the 71.7% recorded in Q4'2022 and a further 1.9% points decline from the 73.2% recorded in Q1'2022,
v. Credit risk remained elevated in the sector with the gross NPLs to gross loans ratio increasing to 14.0% in Q1'2023, from 13.3% in Q4'2022. The increase in gross NPL ratio was driven by a faster 10.9% increase in gross Non-Performing Loans (NPLs) to Kshs 540.8 bn in Q1'2023 from 487.7 bn in Q4'2022 relative to a slower 4.8% increase in gross loans in the period under review. Financial Services, Building and Construction, Manufacturing, Personal and Household, and Transport and Communication sectors registered increases in NPLs by Kshs 33.4 bn as a result of delayed repayments attributed to a challenging operating environment. Notably, Mining and Quarrying, registered a major decrease in NPLs, mainly due to repayments. Key to note, the asset quality remained unchanged on a year-on-year basis at 14.0% in Q1'2023 similar to what was recorded in Q1'2022,
vi. The sector's NPL coverage ratio decreased to 40.4% in Q1'2023, from 43.3% in Q4'2022, attributable to a faster 10.9% increase in gross Non-Performing Loan, which outpaced the slower 3.8% increase in specific provisions to Kshs 183.8 bn, from Kshs 177.0 bn in Q4'2022. We expect increased provisioning levels owing to the elevated credit risks brought by the tough operating environments,
vii. The banking sector remained adequately capitalized, with the aggregate Core Capital to Total Risk-weighted Assets ratio despite the ratio decreasing by 0.6% points to 15.5% in Q12023, from 16.1% in Q4'2022, and 0.7% points lower than 16.2% recorded in Q1'2022. The core capital to Total Risk-Weighted Assets ratio was 5.0% points above the CBK's minimum statutory ratio of 10.5%. On the other hand, Total Capital to Total Risk-Weighted Asset ratio, decreased by 0.6% points to 18.4% in Q1'2023, from 19.0% recorded in Q4'2022 and 0.5% points lower than 18.9% recorded in Q1'2022. The Q1'2023 Total Capital to Total Risk-Weighted Assets ratio was 3.9% points above the CBK's minimum statutory ratio of 14.5%. Key to note, the decreases in the capital ratios were mainly due to a higher increase in Total Risk-Weighted Asset by 4.9% as compared to the increases in capital during the period under review, and,
viii. The sector remained sufficiently liquid during the period under review, despite the liquidity ratio decreasing to 49.9% in Q1'2023, from 50.8% in Q4'2022. Year on year, the ratio decreased by 5.1% points from 55.0% recorded in Q1'2022. This was 29.9% points above the minimum statutory level of 20.0%. The decrease in the banking sector's liquidity is attributable to 2.7% increase in short-term liabilities, as compared to a 0.8% decrease in total liquid assets between the periods under review.

The increased profitability in Q1'2023 indicates the banking sector's continued resilience and profitability despite the deterioration of the business environment in Q1'2023 with the average Purchasing Managers Index (PMI) coming in at 49.3 as compared to an average of 50.3 in the similar period last year. Additionally, the sector remains sufficiently capitalized and with adequate liquidity levels above the minimum statutory requirement, evidenced by the capital adequacy and liquidity ratios remaining above the minimum statutory ratios. However, credit risk level remained elevated with Gross Non-Performing Loan ratio increasing in Q1'2023, attributable to increased cost of living exacerbated by inflationary pressures and continued depreciation of the Kenyan shilling. Overall, we expect the sector's profitability to be boosted by expected increase in interest income as a result of the continued adoption of risk-based pricing models.

Universe of coverage:

Company	Price as at 16/06/2023	Price as at 23/06/2023	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Liberty Holdings	3.9	3.6	(8.2%)	(28.6%)	5.9	0.0%	64.4%	0.3x	Buy
Jubilee Holdings	184.3	180.0	(2.3%)	(9.4%)	260.7	6.7%	51.5%	0.3x	Buy
Kenya Reinsurance	2.0	1.8	(8.6%)	(3.2%)	2.5	11.0%	49.7%	0.1x	Buy
Equity Group***	37.2	37.5	0.9%	(16.8%)	51.2	10.7%	47.1%	0.8x	Buy
KCB Group***	29.5	29.5	0.2%	(23.1%)	41.3	6.8%	46.6%	0.5x	Buy
CIC Group	1.9	1.9	2.2%	(0.5%)	2.5	6.8%	38.4%	0.6x	Buy
ABSA Bank***	11.6	11.8	1.7%	(3.7%)	14.7	11.5%	36.3%	0.9x	Buy
NCBA***	39.3	39.0	(0.9%)	0.0%	48.9	10.9%	36.3%	0.8x	Buy
Co-op Bank***	12.2	12.3	0.8%	1.7%	15.0	12.2%	33.7%	0.6x	Buy
Sanlam	7.8	8.0	2.6%	(16.7%)	10.3	0.0%	28.9%	2.3x	Buy
I&M Group***	17.0	17.0	0.0%	(0.6%)	19.5	13.3%	28.1%	0.4x	Buy
Standard Chartered***	160.8	161.8	0.6%	11.6%	183.9	13.6%	27.3%	1.1x	Buy
Stanbic Holdings	111.3	112.0	0.7%	9.8%	127.9	11.3%	25.4%	0.8x	Buy
Diamond Trust Bank***	45.8	49.6	8.2%	(0.6%)	54.6	10.1%	20.2%	0.2x	Buy
HF Group	5.0	5.0	0.8%	58.7%	5.8	0.0%	16.2%	0.2x	Accumulate
Britam	5.0	5.2	5.1%	0.0%	6.0	0.0%	14.8%	0.7x	Accumulate

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 due to the current tough operating environment and huge foreign investor outflows, and, "Bullish" in the long term due to current cheap valuations and expected global and local economic recovery.

With the market currently being overvalued to its future growth (PEG Ratio at 1.1x), 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 current high foreign investors sell-offs to continue weighing down the equities outlook in the short term.