

Kenya's Real Estate Investment Trusts (REITs) H1'2023 Report, & Cytonn Weekly #33/2023

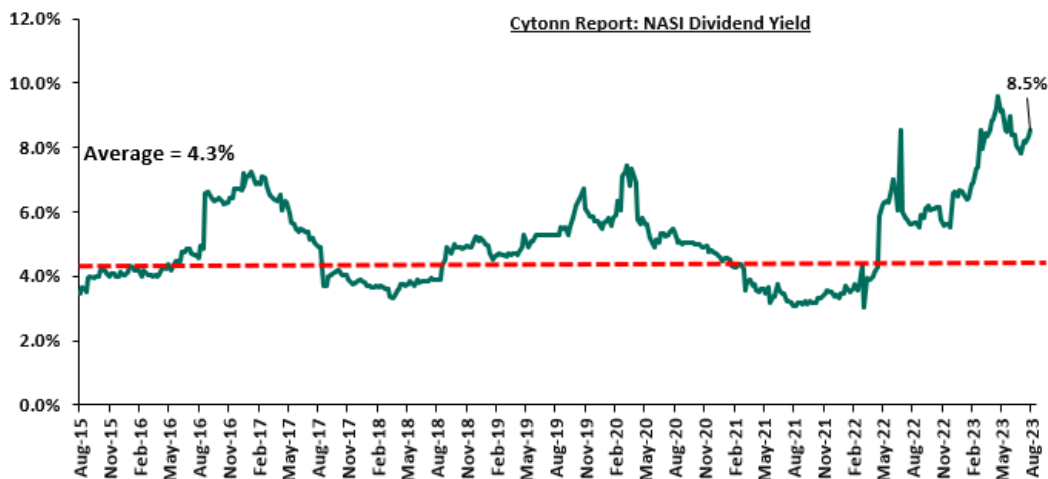
Equities

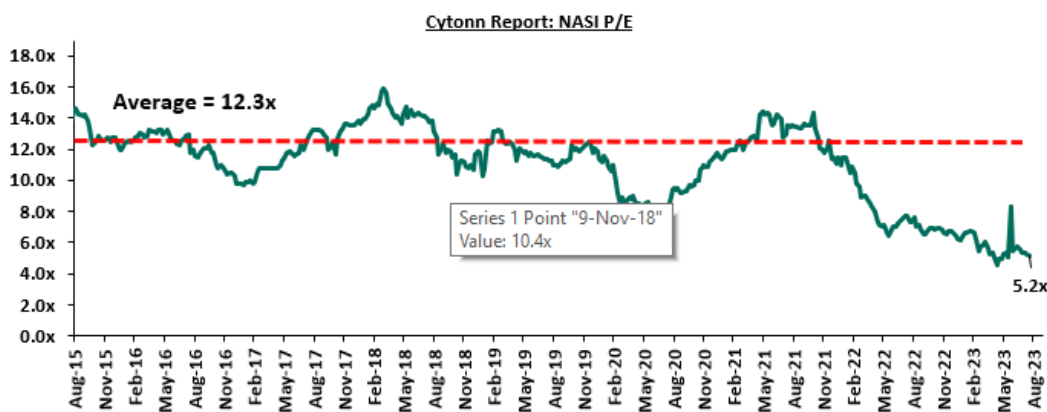
Market Performance:

During the week, the equities market was on a downward trajectory, with NASI, NSE 20, and NSE 25 declining by 2.5%, 3.9%, and 3.3%, respectively, taking the YTD performance to losses of 20.4%, 8.5%, and 16.5% for NASI, NSE 20, and NSE 25, respectively. The equities market performance was mainly driven by losses recorded by large-cap stocks such as EABL, Standard Chartered Bank-Kenya, Bamburi and KCB of 9.2%, 8.8%, 7.8% and 4.8%, respectively. The losses were, however, marginally mitigated by gains recorded by stocks such as DTB-K of 0.1%;

During the week, equities turnover increased by 35.4% to USD 11.7 mn from USD 8.7 mn recorded the previous week, taking the YTD total turnover to USD 530.0 mn. Foreign investors remained net buyers for the third consecutive week with a net buying position of USD 0.7 mn, from a net buying position of USD 4.8 mn recorded the previous week, taking the YTD foreign net selling position to USD 271.7 mn.

The market is currently trading at a price to earnings ratio (P/E) of 5.2x, 58.1% below the historical average of 12.3x. The dividend yield stands at 8.5%, 4.2% points above the historical average of 4.3%. Key to note, NASI's PEG ratio currently stands at 0.7x, an indication that the market is undervalued 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. Earnings Release

a. Equity Group H1'2023 Financial Performance

During the week, Equity Group released their H1'2023 financial results. Below is a summary of the performance.

Balance Sheet Items	H1'2022	H1'2023	y/y change
Government Securities	236.8	278.5	17.6%
Net Loans and Advances	650.6	817.2	25.6%
Total Assets	1333.9	1644.8	23.3%
Customer Deposits	970.9	1175.3	21.0%
Deposits per branch	2.9	3.3	15.2%
Total Liabilities	1183.5	1450.5	22.6%
Shareholders' Funds	143.7	186.1	29.5%

Balance Sheet Ratios	H1'2022	H1'2023	y/y change
Loan to Deposit Ratio	67.0%	69.5%	2.5%
Return on average equity	31.9%	29.1%	(2.8%)
Return on average assets	3.8%	3.2%	(0.6%)

Income Statement	H1'2022	H1'2023	y/y change
Net Interest Income	39.8	46.4	16.5%
Net non-Interest Income	25.8	36.5	41.2%
Total Operating income	65.6	82.9	26.2%
Loan Loss provision	(4.1)	(7.1)	73.6%

Income Statement	H1'2022	H1'2023	y/y change
Total Operating expenses	(34.7)	(47.7)	37.4%
Profit before tax	30.9	35.2	13.7%
Profit after tax	24.4	26.3	7.8%
Core EPS	6.5	7.0	7.8%

Income Statement Ratios	H1'2022	H1'2023	y/y change
Yield from interest-earning assets	4.9%	5.1%	0.3%
Cost of funding	2.8%	3.4%	0.5%
Cost of risk	6.2%	8.6%	2.3%
Net Interest Margin	7.3%	7.2%	(0.1%)
Net Interest Income as % of operating income	60.6%	56.0%	(4.7%)
Non-Funded Income as a % of operating income	39.4%	44.0%	4.7%
Cost to Income Ratio	52.9%	57.6%	4.7%
CIR without LLP	46.7%	49.0%	2.3%
Cost to Assets	2.5%	2.7%	0.2%

Capital Adequacy Ratios	H1'2022	H1'2023	% points change
Core Capital/Total Liabilities	15.5%	17.9%	2.4%
Minimum Statutory ratio	8.0%	8.0%	
Excess	7.5%	9.9%	2.4%
Core Capital/Total Risk Weighted Assets	14.1%	15.0%	0.9%
Minimum Statutory ratio	10.5%	10.5%	
Excess	3.6%	4.5%	0.9%
Total Capital/Total Risk Weighted Assets	18.8%	19.0%	0.2%
Minimum Statutory ratio	14.5%	14.5%	
Excess	4.3%	4.5%	0.2%
Liquidity Ratio	53.2%	51.1%	(2.1%)
Minimum Statutory ratio	20.0%	20.0%	
Excess	33.2%	31.1%	(2.1%)

Key Take Outs

- **Earnings growth** - Core earnings per share (EPS) grew by 7.8% to Kshs 7.0, from Kshs 6.5 in H1'2022, driven by the 26.2% growth in total operating income to Kshs 82.9 bn, from Kshs 65.6 bn in H1'2022. However, the performance was weighed down by a 37.4% growth in total operating expenses to Kshs 47.7 bn, from Kshs 34.7 bn in H1'2022
- **Increased Provisioning** - On the back of high credit risk occasioned by the deteriorated business environment, the bank increased its provisions holdings to cover for the anticipated losses in the future, with its provisions increasing by 26.1% to Kshs 34.7 bn from Kshs 27.5 bn recorded in H1'2022, and,

- **Revenue Diversification** - The Group's Non-Funded income increased by 41.2% to Kshs 36.5 bn in H1'2023, from Kshs 25.8 bn in H1'2022, which resulted to a shift in revenue mix to 56:44 in H1'2023 from 61:39 in H1'2022. The increase was mainly attributable to a faster 41.2% increase in non-funded income to Kshs 36.5 bn, from Kshs 25.8 bn in H1'2022, compared to the 16.5% increase in Funded income to kshs 46.4 bn, from kshs 39.8 bn in H1'2022.

For a more detailed analysis, please see the Equity Holding H1'2023 Earnings Note

b. Cooperative Bank Kenya H1'2023 Financial Performance

Balance Sheet Items	H1'2022	H1'2023	y/y change
Government Securities	183.2	188.5	2.9%
Net Loans and Advances	330.1	365.4	10.7%
Total Assets	603.9	664.9	10.1%
Customer Deposits	423.0	463.9	9.7%
Total Liabilities	506.9	556.4	9.8%
Shareholders Funds	96.7	108.3	11.9%

Balance Sheet Ratios	H1'2022	H1'2023	y/y change
Loan to Deposit Ratio	78.0%	78.8%	0.7%
Return on average equity	21.8%	22.2%	0.3%
Return on average assets	3.5%	3.6%	0.1%

Income Statement	H1'2022	H1'2023	y/y change
Net Interest Income	21.1	21.5	2.3%
Non-Interest Income	13.3	13.8	4.0%
Total Operating income	34.4	35.4	3.0%
Loan Loss provision	(3.3)	(2.9)	(14.4%)
Total Operating expenses	(19.2)	(19.1)	(0.1%)
Profit before tax	15.3	16.4	7.4%
Profit after tax	11.5	12.1	5.9%
Earning per share	2.0	2.1	5.9%

Income Statement Ratios	H1'2022	H1'2023	% point change
Yield from interest-earning assets	11.4%	11.6%	0.3%
Cost of funding	3.2%	3.8%	0.6%

Income Statement Ratios	H1'2022	H1'2023	% point change
Net Interest Spread	8.2%	7.8%	(0.4%)
Net Interest Income as % of operating income	61.3%	60.9%	(0.4%)
Non-Funded Income as a % of operating income	38.7%	39.1%	0.4%
Cost to Income	55.8%	54.1%	(1.7%)
CIR without provisions	46.0%	46.0%	0.0%
Cost to Assets	2.6%	2.5%	(0.1%)
Net Interest Margin	8.4%	8.2%	(0.2%)

Capital Adequacy Ratios	H1'2022	H1'2023	% points change
Core Capital/Total deposit Liabilities	19.7%	21.2%	1.5%
Minimum Statutory ratio	8.0%	8.0%	
Excess	11.7%	13.2%	1.5%
Core Capital/Total Risk Weighted Assets	15.5%	16.5%	1.0%
Minimum Statutory ratio	10.5%	10.5%	
Excess	5.0%	6.0%	1.0%
Total Capital/Total Risk Weighted Assets	16.6%	20.5%	3.9%
Minimum Statutory ratio	14.5%	14.5%	
Excess	2.1%	6.0%	3.9%
Liquidity Ratio	44.5%	52.3%	7.8%
Minimum Statutory ratio	20.0%	20.0%	
Excess	24.5%	32.3%	7.8%

Key Take Outs

- **Earnings growth** - Core earnings per share (EPS) grew by 5.9% to Kshs 2.1, from Kshs 2.0 in H1'2022, driven by the 3.0% growth in total operating income to Kshs 35.4 bn, from Kshs 34.4 bn in H1'2022.
- **Improved efficiency** - The bank's total operating expenses decreased by 0.1% to Kshs 19.1 bn in H1'2023 from Kshs 19.2 bn in H1'2022, attributable to a 14.4% decrease in loan loss provisions to Kshs 2.9 bn, from Kshs 3.3 bn recorded in H1'2022, coupled with a 4.9% decrease in other expenses to Kshs 8.3 bn from Kshs 8.7 bn in H1'2022, which outpaced the slower 12.6% increase in staff costs to Kshs 8.0 bn, from Kshs 7.1 bn in H1'2022, and,
- **Asset quality Deterioration-** The bank's asset quality deteriorated as evidenced by the NPL ratio increasing to 14.6% in H1'2023 from 14.1% in H1'2022, attributable to 14.2% increase in Gross non-performing loans to Kshs 58.4 bn, from Kshs 51.2 bn in H1'2022, compared to the 10.2% increase in gross loans to Kshs 400.9 bn, from Kshs 363.8 bn recorded in H1'2022,

For a more detailed analysis, please see the Cooperative Bank H1'2023 Earnings Note

Asset Quality

The table below is a summary of the listed banks that have released their H1'2023 results:

Cytonn Report: Listed Bank Asset Quality

	H1'2023 NPL Ratio*	H1'2022 NPL Ratio**	% point change in NPL Ratio	H1'2023 NPL Coverage*	H1'2022 NPL Coverage**	% point change in NPL Coverage
Equity Group	11.2%	8.8%	2.4%	54.5%	64.1%	(9.6%)
Co-operative Bank	14.6%	14.1%	0.5%	60.7%	65.8%	(5.1%)
Stanbic Bank	8.1%	9.4%	(1.3%)	57.4%	56.0%	1.4%
Mkt Weighted Average	11.5%	13.0%	(1.5%)	56.6%	62.3%	(5.7%)

*Market cap weighted as at 18/08/2023

**Market cap weighted as at 09/09/2022

Key take-outs from the table include:

- Asset quality for the listed banks that have released improved during the H1'2023, with market weighted average NPL declining by 1.5% points to 11.5% from a 13.0% in H1'2022. The improvement in asset quality was mainly driven by an improvement in Stanbic bank asset quality with its NPL ratio declining by 1.3% points to 8.1% from 9.4% in H1'2022,
- Equity Group had the highest NPL ratio jump by 2.4% points to 11.2% from 8.8% points in H1'2022, attributable to 59.8% increase in Gross non-performing loans to Kshs 97.5 bn, from Kshs 61.0 bn in H1'2022, which outpaced the 26.2% increase in gross loans to Kshs 870.3 bn, from Kshs 689.7 bn recorded in H1'2022
- Market weighted average NPL Coverage for the listed banks that have released decreased by 5.7% points to 56.6% in H1'2023, from 62.3% recorded in H1'2022, majorly on the back of decreased NPL coverage recorded by Equity Group and Co-operative Bank of Kenya by 9.6% and 5.1% respectively. However, Stanbic bank NPL coverage increased by 1.4% points to 57.4% in H1'2023 from 56.0% in H1'2022.

Summary Performance

The table below shows performance of listed banks using several metrics:

Cytonn Report: Listed Banks Performance in H1'2023													
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
Stanbic Bank	47.0%	46.3%	51.5%	44.4%	7.1%	29.7%	42.5%	22.5%	10.5%	10.1%	98.6%	15.3%	18.5%
Equity Group	8.0%	27.0%	54.3%	16.5%	7.2%	41.2%	44.0%	38.3%	21.0%	17.6%	69.5%	25.6%	29.1%
Co-op Bank	5.9%	12.0%	38.9%	2.3%	8.2%	4.0%	39.1%	8.4%	22.7%	2.9%	78.8%	10.7%	22.2%
H1'23 Mkt Weighted Average*	14.5%	27.2%	50.4%	18.4%	7.4%	30.9%	42.6%	28.8%	19.5%	13.0%	76.8%	20.4%	25.7%
H1'22 Mkt Weighted Average**	34.0%	18.0%	18.6%	17.7%	7.3%	24.4%	37.1%	17.9%	11.3%	11.6%	72.7%	17.7%	21.9%

*Market cap weighted as at 11/08/2023

**Market cap weighted as at 09/09/2022

Key take-outs from the table include:

- The listed banks that have released their H1'2023 earnings recorded a 14.5% growth in core Earnings per Share (EPS) in H1'2023, compared to the weighted average growth of 34.0% in H1'2022, an indication of sustained performance despite the tough operating environment

- experienced in H1'2023,
- ii. Non-Funded Income grew by 30.9% compared to market weighted average growth of 24.4% in H1'2022, an indication of increased revenue diversification efforts by the banks, and,
 - iii. The Banks recorded a deposit growth of 19.5%, higher than the market weighted average deposit growth of 11.3% in H1'2022,

Universe of coverage:

Company	Price as at 11/08/2023	Price as at 18/08/2023	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
Jubilee Holdings	189.3	170.0	(10.2%)	(14.5%)	260.7	7.1%	60.4%	0.3x	Buy
KCB Group***	28.9	27.5	(4.8%)	(28.3%)	41.3	7.3%	57.3%	0.5x	Buy
Liberty Holdings	4.0	3.9	(3.3%)	(23.4%)	5.9	0.0%	53.4%	0.3x	Buy
Kenya Reinsurance	1.9	1.8	(4.2%)	(3.2%)	2.5	11.0%	49.7%	0.1x	Buy
Co-op Bank***	12.0	11.5	(4.2%)	(5.4%)	15.0	13.1%	43.7%	0.5x	Buy
NCBA***	39.3	38.7	(1.4%)	(0.6%)	48.9	11.0%	37.2%	0.8x	Buy
Standard Chartered***	164.8	150.3	(8.8%)	3.6%	183.9	14.6%	37.0%	1.0x	Buy
Equity Group***	41.0	40.6	(1.0%)	(9.9%)	51.2	9.9%	35.9%	0.9x	Buy
ABSA Bank***	12.5	11.9	(4.4%)	(2.5%)	14.7	11.3%	34.6%	1.0x	Buy
CIC Group	2.1	2.0	(5.2%)	4.2%	2.5	6.5%	32.2%	0.6x	Buy
Sanlam	8.3	8.0	(3.6%)	(16.5%)	10.3	0.0%	28.6%	2.3x	Buy
Diamond Trust Bank***	47.0	47.1	0.1%	(5.6%)	54.6	10.6%	26.6%	0.2x	Buy
Britam	5.1	5.0	(3.5%)	(4.6%)	6.0	0.0%	20.4%	0.7x	Buy
Stanbic Holdings	120.0	117.0	(2.5%)	14.7%	127.9	10.8%	20.1%	0.8x	Buy
I&M Group***	19.0	18.5	(2.9%)	8.2%	19.5	12.2%	17.7%	0.4x	Accumulate
HF Group	5.0	5.0	0.6%	58.7%	5.8	0.0%	16.2%	0.2x	Accumulate

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 undervalued to its future growth (PEG Ratio at 0.7x), 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.

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