Cytonn Q3'2023 Markets Review

Equities

Market Performance:

During Q3’2023, the equities market was on a downward trajectory, with NASI, NSE 20 and NSE 25 declining by 11.0%, 4.2% and 9.4%, respectively, while the newly introduced NSE 10 declined by 4.1% since inception. The equities market performance during the quarter was driven by losses recorded by large caps such as KCB Group, Safaricom, EABL and Equity Group of 28.8%, 16.6%, 15.5% and 7.1%, respectively. The losses were however mitigated by gains recorded by banking stocks such as Standard Chartered Bank-Kenya and ABSA of 2.8% and 1.3%, respectively.

Equities turnover increased by 13.6% during the quarter to USD 119.3 mn, from USD 105.0 mn in Q2’2023. Foreign investors remained net sellers during the quarter, with a net selling position of USD 25.9 mn, from a net selling position of USD 10.9 mn recorded in Q2’2023.

During the week, the equities market was on a downward trajectory, with NASI declining the most by 1.8%, while NSE 20, NSE 25 and NSE 10 declined by 1.2%, 0.8% and 1.1% respectively, taking the YTD performance to losses of 26.6%, 11.0%, and 21.8% for NASI, NSE 20, and NSE 25, respectively. The equities market performance was mainly driven by losses recorded by large-cap stocks such as Bamburi, EABL and Safaricom of 6.9%, 5.3% and 4.1% respectively. The losses were however mitigated by gains recorded by stocks such as, NCBA Group, Equity Group and Diamond Trust Bank-Kenya of 3.3%, 2.8% and 1.5% respectively.

During the week, equities turnover increased by 117.0% to USD 7.5 mn from USD 3.5 mn recorded the previous week, taking the YTD total turnover to USD 580.2 mn. Foreign investors transitioned to net buyers for the first time in six weeks with a net buying position of USD 0.3 mn, from a net selling position of USD 0.5 mn recorded the previous week, taking the YTD foreign net selling position to USD 281.8 mn.

The market is currently trading at a price to earnings ratio (P/E) of 5.0x, 59.0% below the historical average of 12.2x. The dividend yield stands at 9.2%, 4.9% points above the historical average of 4.3%. Key to note, NASI’s PEG ratio currently stands at 0.6x, 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.

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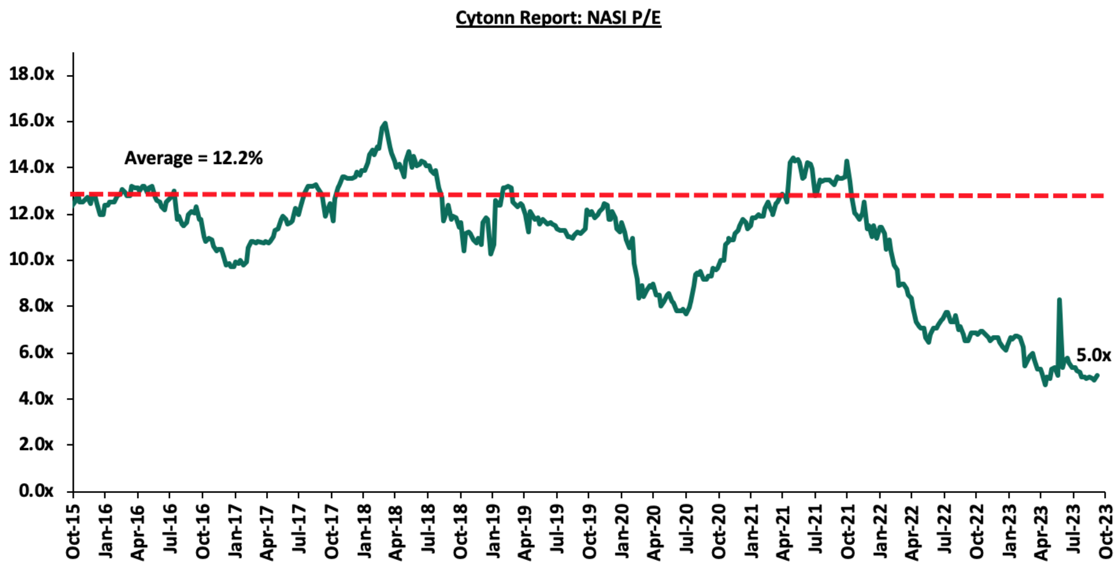

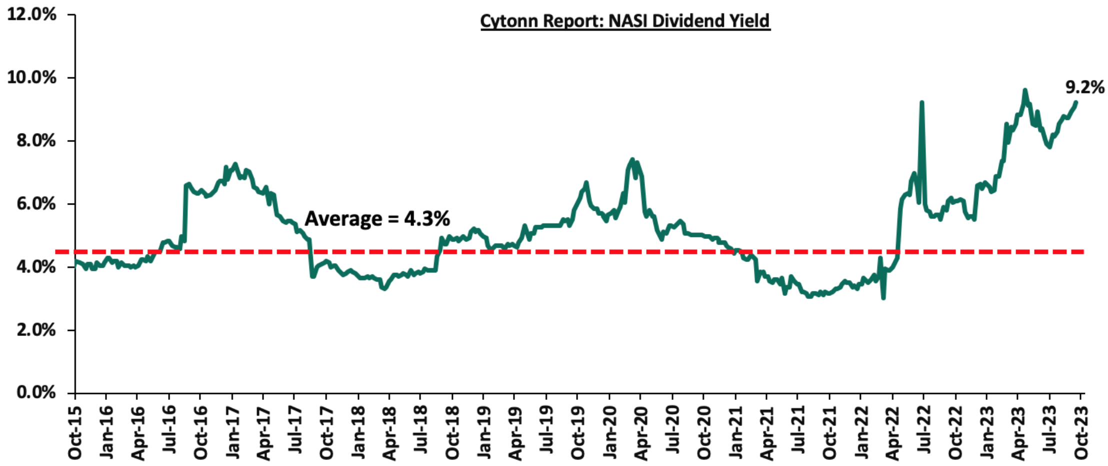

Listed Banks' H1'2023 Performance

During the third quarter of 2023, the listed banking sector released their H1'2023 results, recording y/y earnings growth of 13.4% in their core EPS in H1'2023, compared to a weighted average increase of 34.0% in H1'2022. The performance was largely attributable by the Strong EPS growth from HF Group, Stanbic Bank and ABSA Bank of 264.8%, 47.0% and 32.0%, respectively. For more information, please see our Kenya's Listed Banks H1'2023.

Key Q3,2023 Highlights:

During Q3'2023;

i. Cooperative Bank of Kenya disclosed that it had received a USD 100.0 mn (Kshs 13.8 bn) loan facility with a maturity of 7 years from the consortium of financial institutions led by DEG which is aimed at providing loans to Micro Small and Medium Enterprises (MSMEs) operating in Kenya. For more information, please see our Cytonn Weekly #29/2023,
ii. Nairobi Securities Exchange (NSE) announced that it had launched two new market indices, NSE 10 share index (N20) and the NSE Bond Index (NSE-BI) to track the performance of equities market and bond market respectively, please see our Cytonn Weekly #36/2023, and,
iii. Safaricom announced that it had secured a Kshs 15.0 bn deal that is scalable to Kshs 20.0 bn by accordion. The multi-billion Sustainability Linked Loan (SLL) facility is expected to support Safaricom Environmental, Social, Governance agenda. The facility is the largest ESG-linked loan facility ever undertaken in East Africa and the first of its kind for Safaricom. Furthermore, it is the first Kenya Shilling-denominated SLL in the market. The facility will enable Safaricom to access

funding based on the progressive achievement of milestones across key ESG areas, please see our Cytonn Weekly #36/2023.

Universe of Coverage:

Company	Price as at 29/09/2023	Price as at 06/10/2023	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
KCB Group* **	20.9	21.0	0.5%	(45.4%)	41.3	9.5%	106.5%	**0.4x**	**Buy**
Liberty Holdings	3.6	3.6	0.0%	(28.6%)	5.9	0.0%	64.4%	**0.3x**	**Buy**
Kenya Reinsurance	1.8	1.8	(0.6%)	(5.9%)	2.5	11.4%	54.0%	**0.1x**	**Buy**
Equity Group* **	35.6	36.6	2.8%	(18.9%)	51.2	10.9%	50.9%	**0.8x**	**Buy**
Jubilee Holdings	185.8	188.0	1.2%	(5.4%)	260.7	6.4%	45.0%	**0.3x**	**Buy**
Co-op Bank* **	11.8	11.6	(1.7%)	(4.1%)	15.0	12.9%	41.8%	**0.5x**	**Buy**
HF Group	4.4	4.2	(3.2%)	34.0%	5.8	0.0%	37.7%	**0.2x**	**Buy**
NCBA* **	37.9	39.1	3.3%	0.4%	48.9	10.9%	35.8%	**0.8x**	**Buy**
ABSA Bank* **	12.0	11.9	(0.4%)	(2.5%)	14.7	11.3%	34.6%	**1.0x**	**Buy**
Sanlam	6.5	7.7	17.7%	(19.6%)	10.3	0.0%	33.6%	**2.2x**	**Buy**
Standard Chartered* **	165.0	160.3	(2.9%)	10.5%	183.9	13.7%	28.5%	**1.1x**	**Buy**
Britam	5.0	4.7	(6.0%)	(9.8%)	6.0	0.0%	27.3%	**0.6x**	**Buy**
CIC Group	2.1	2.1	(3.3%)	8.4%	2.5	6.3%	27.1%	**0.7x**	**Buy**
Stanbic Holdings	115.3	115.0	(0.2%)	12.7%	127.9	11.0%	22.1%	**0.8x**	**Buy**
Diamond Trust Bank* **	48.1	48.8	1.5%	(2.1%)	54.6	10.2%	22.1%	**0.2x**	**Buy**
I&M Group* **	17.1	18.0	5.3%	5.3%	19.5	12.5%	20.9%	**0.4x**	**Buy**

Weekly Highlights

I. Q2’2023 Economic Review (Banking Sector)

During the week, the Central Bank of Kenya (CBK) released the Quarterly Economic Review for the period ending 30 June 2023, highlighting that the banking sector remained stable and resilient during the period owing to the strong liquidity and capital adequacy. According to the report, the sector’s total assets increased by 4.1% to Kshs 7.1 tn in June 2023, from Kshs 6.8 tn in March 2023. The increase was mainly attributable to a 3.3% increase in loans and advances to Kshs 4.0 tn, from Kshs 3.9 tn recorded in Q1’2023. On a yearly basis, total assets increased by 12.8% to Kshs 7.1 tn, from Kshs 6.2 tn in Q2’2022. Notably, loans and advances accounted for 51.8% of total assets in Q2’2023, which was a decrease from 52.1% of total assets in Q1’2023.

Other key take-outs from the report include:

i. The banking sector recorded a 15.4% decrease in Profit before Tax (PBT) to Kshs 55.1 bn in Q2’2023, from Kshs 65.1 bn in Q1’2023. The decrease in profitability was mainly attributable to a faster 13.0% increase in quarterly expenses, which outpaced the 3.9% increase in quarterly income. On a yearly basis, PBT decreased by 12.0%, to Kshs 55.1 bn, from Kshs 62.6 bn recorded in Q2’2022,
ii. The sector’s Return on Asset (ROA) decreased slightly to 2.7% in Q2’2023, from 3.1% recorded in Q1’2023. Similarly, Return on Equity (ROE) recorded a 1.6% points decrease to 25.4% in Q2’2023, from 27.0% in Q1’2023, and 1.4% points decrease from 26.8% recorded in Q2’2022,
iii. Lending increased by 3.3% to Kshs 4.0 tn in Q2’2023, from Kshs 3.9 tn in Q1’2023, attributable to

an increase in credit advanced to individual borrowers as well as for working capital purposes in sectors such as tourism, restaurant and hotels, trade, manufacturing, and transport and communication which increased by 7.1%, 6.6%, 6.1% and 5.2%, respectively. On a yearly basis, lending was up by 14.0% to Kshs 4.0 tn, from Kshs 3.5 tn in Q2’2022,

iv. Deposits recorded a 6.9% increase to Kshs 5.2 tn in Q2’2023, from Kshs 4.8 tn in Q1’2023, attributable to a 10.1% increase in foreign currency deposits which increased to Kshs 1.5 tn in Q2’2023, from Kshs 1.3 tn recorded in Q1’2023. Notably, on a yearly basis, deposits increased by 11.8% to Kshs 5.2 tn in Q2’2023, from Kshs 4.6 tn in Q2’2022. Key to note, customer deposits remain the main source of funding for banks, accounting for 73.2% of the sector’s total liabilities and shareholder’s funds as at Q2’2023, 1.9% points higher than the 71.3% recorded in Q1’2023 and a further 0.7% points decline from the 73.9% recorded in Q2’2022,

v. Credit risk remained elevated in the sector with the gross NPLs to gross loans ratio increasing to 14.5% in Q2’2023, from 14.0% in Q1’2023. The increase in gross NPL ratio was driven by a faster 6.5% increase in gross Non-Performing Loans (NPLs) to kshs 576.1 bn in Q2’2023, from Kshs 540.8 bn in Q1’2023, which outpaced the 3.3% increase in gross loans in the period under review. Manufacturing, Energy and water, Real Estate, Financial Services, and Building and construction sectors registered increases in NPLs by Kshs 33.6 bn as a result of delayed repayments attributed to a challenging operating environment. Notably, Mining and Quarrying, registered major decrease in NPLs, mainly due to repayments. Key to note, the asset quality declined on a year on year basis to 14.5% in Q2’2023, from 14.7% recorded in Q2’2022,

vi. The sector’s NPL coverage ratio decreased to 38.1% in Q2’2023, from 40.4% in Q1’2023, attributable to a faster 6.5% increase in gross Non-Performing Loans, which outpaced the slower 0.7% increase in specific provisions to Kshs 183.8 bn, from Kshs 177.0 bn in Q1’2023. We expect increased provisioning levels owing the elevated credit risks brought by the tough operating environments,

vii. The banking sector remained adequately capitalized, despite the aggregate Core Capital to Total Risk weighted Assets ratio decreasing marginally by 0.1% points to 15.4% in Q2’2023, from 15.5% in Q1’2023, and 0.7% points lower than the 16.1% recorded in Q2’2022. The core capital to Total Risk-Weighted Assets ratio was 4.9% points above the CBK’s minimum statutory ratio of 10.5%. On the other hand, Total Capital to Total Risk-Weighted Asset ratio, increased by 0.2% points to 18.6% in Q2’2023, from 18.4% recorded in Q1’2023 and 0.2% points lower than 18.8% recorded in Q2’2022. The Q1’2023 Total Capital to Total Risk-Weighted Assets ratio was 4.1% 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 3.9% as compared to the increases in core capital during the period under review, and,

viii. The sector remained sufficiently liquid during the period under review, despite the liquidity ratio decreasing to 49.7% in Q2’2023, from 49.9% in Q1’2023. Year on year, the ratio decreased by 2.8% points from 52.5% recorded in Q2’2022. This was 29.7% points above the minimum statutory level of 20.0%. The decrease in the banking sector’s liquidity is attributable to a faster 5.7% increase in short term liabilities, relative to a 5.2% increase in total liquid assets between the periods under review.

The decreased profitability in Q2’2023 evidenced by the 15.4% decrease in Pre-tax profits comes on the back of the deterioration of the business environment in Q2’2023 with the average Purchasing Managers Index (PMI) coming in at 48.1 as compared to an average of 48.2 in the similar period last year. However, the banking 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. Additionally, credit risk level remained elevated with Gross Non-Performing Loan ratio increasing in Q2’2023, attributable to increased cost of living exacerbated by inflationary pressures and continued depreciation of the Kenyan shilling. Going forward, 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.

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 0.6x), 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.
