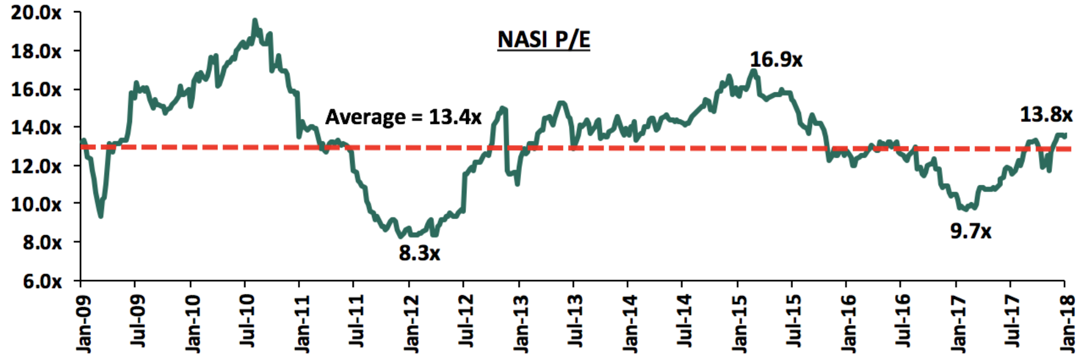
Nyeri Real Estate Investment Opportunity, & Cytonn Weekly #03/2018

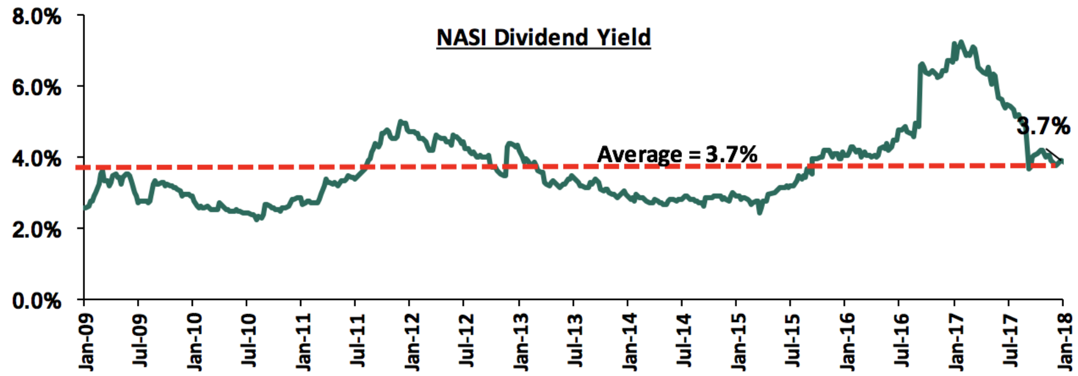
Equities

During the week, the equities market was on an upward trend, with NSE 25, NASI and NSE 20 gaining 2.6%, 2.3% and 0.8%, respectively, taking their YTD performance to 5.2%, 5.1% and 0.7% for NASI, NSE 25 and NSE 20, respectively. For the last twelve months, NASI, NSE 25 and NSE 20 have gained 45.1%, 39.1% and 27.8%, respectively. This week's performance was driven by gains in large cap stocks such as Barclays Bank of Kenya, Equity Group and Safaricom Ltd, which gained 10.8%, 6.0% and 4.4%, respectively. Since the February 2015 peak, the market has gained 1.5% for NASI and lost 32.0% for NSE 20.

Equities turnover increased by 149.7% to USD 78.9 mn from USD 31.6 mn the previous week. Foreign investors turned net buyers with a net inflow of USD 1.9 mn compared to a net outflow of USD 1.8 mn recorded the previous week. We expect the market to remain supported by improved investor sentiment this year, as investors take advantage of the attractive stock valuations in some of the stocks.

The market is currently trading at a price to earnings ratio (P/E) of 13.8x, which is 2.9% above the historical average of 13.4x, and a dividend yield of 3.7%, same as the historical average of 3.7%. The current P/E valuation of 13.8x is 42.3% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 66.3% above the previous trough valuation of 8.3x experienced in December 2011. In our view, there are still pockets of value in the market, with the current P/E valuation being 22.5% below the most recent peak of 16.9x in February 2015. The charts below indicate the historical P/E and dividend yields of the market.





During the week, the Cabinet Secretary for the National Treasury, Henry Rotich gazetted the Capital Markets (Securities Lending, Borrowing and Short-Selling) Regulations, 2017. This comes after Capital Markets Authority (CMA) gave Nairobi Stock Exchange (NSE) the approval to launch a short selling and supporting securities lending facility, which will be functional as from the second quarter of 2018. Short selling is defined as the sale of borrowed shares. In short selling, the ownership of the stock is transferred to the borrower/short-seller for a specified period and they need to transfer it back to the owner. However, because the short seller does not own the stock, he must pay the lender any dividend or rights resulting from the loan stocks. Short sales are motivated by the conviction that a security's price will decline, enabling it to be bought back at a lower price thus making a profit, and are normally prompted by speculation, or by the desire to hedge the downside risk of a long position in a security. These new regulations stipulate that securities lending and borrowing transaction shall be carried out by (i) a regulated person; or (ii) any other person specified for that purpose by the Authority, this will ensure that the level of activity is tracked, and the regulators will be able to monitor trends driving the stock market thus avoiding panic and unnecessary selling pressure. The Capital Markets (Securities Lending, Borrowing and Short-Selling) Regulations, 2017 is in line with CMA's Master Plan 2014-2023, which is aimed at deepening, diversifying and strengthening the securities industry. The Master plan is anchored on three key pillars, namely:

1. Developmental and economic transformation,
2. Infrastructure of the markets, and
3. The legal and regulatory environment.

This facility will increase the volume of securities potentially available for trading thus help boost liquidity in the Kenyan capital market and also attract investors. As highlighted in our Cytonn Weekly #28/2017, the Capital Markets Authority (CMA) has done a fantastic job in spearheading the introduction of new products such as Global Depositary Receipts and Global Depositary Notes thus providing faster and more convenient link to the market hence enabling market participants to exercise freedom of choice, which will in turn increase turnover. The current challenge in the market is low volume of trades on the new products and this could be attributed to lack of proper investor education, and our suggestion is more investment towards educating the public before rolling out new products.

Equity Bank effected a money transfer commission on its mobile App, Eazzyapp, a product which used to be free for internal cash transfers. The move is aimed at increasing revenue from the non-funded income sources to a target of 40.0% - 45.0% contribution of Non-Funded Income (NFI) to the total operating income. The lender has also introduced a 5.0% upfront processing fee on its Equitel loans, aimed at supporting its income stream. With banks registering compressed net interest margins following the capping of interest rates, much of the attention has shifted to diversifying income through non-funded income, as this section of the bank's revenue is not affected by the interest rate caps. Equity's Non-funded income (NFI) grew by 10.4% in Q3'2017 same as the average for Kenya's Listed Banks, taking its contribution to total income to 34.0%, from 27.8% registered in Q3'2016. In terms of pricing structures, as highlighted in our Cytonn Weekly #02/2018, most commercial banks have taken advantage of the gap allowing them to charge extra fees on the loans issued to increase the cost of credit well above the statutory ceiling of 14.0%. The total average cost of loans is at 18.0%, which is 4.0% above the 14.0% priced by the interest rate cap.

In order to ensure that the ranking of companies in the Cytonn Corporate Governance Report (Cytonn CGR) is up to date, we continually update the rankings whenever there are changes on any of the 24 metrics that we track and how they impact on the ranking. During the week, Stanbic Holdings Plc appointed Dorcas F. Kombo, CPA, as an Independent Non-Executive Director to the Board. Following this change, the gender diversity improved to 30.8% from 25.0%, resulting to an improvement in the gender score to 1.0 from 0.5. Stanbic Holding's comprehensive score therefore increased to 58.3% from 56.3% and thus the rank improved to Position 39 from Position 41.

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise								
No.	**Company**	**Price as at 12/01/18**	**Price as at 19/01/18**	**w/w Change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/ (Downside)****
1.	NIC***	35.3	37.0	5.0%	9.6%	61.4	3.5%	69.5%
2.	DTBK	196.0	200.0	2.0%	4.2%	281.7	1.4%	42.2%
3.	KCB Group	44.3	45.3	2.3%	5.8%	59.7	6.8%	38.7%
4.	I&M Holdings	119.0	116.0	(2.5%)	(8.7%)	150.4	2.5%	32.2%
5.	Barclays	9.8	10.8	10.8%	12.5%	12.8	10.2%	28.7%
6.	Kenya Re	19.8	19.6	(1.0%)	8.0%	24.4	3.8%	28.7%
7.	Liberty Holdings	13.5	13.2	(2.6%)	7.8%	16.4	0.0%	24.7%
8.	Britam	13.0	13.2	1.2%	(1.5%)	15.2	1.8%	17.4%
9.	Sanlam Kenya	27.8	27.0	(2.7%)	(2.7%)	31.4	1.1%	17.2%
10.	Co-op Bank	16.5	16.8	1.5%	4.7%	18.6	5.6%	16.6%
11.	Jubilee Insurance	499.0	505.0	1.2%	1.2%	575.4	1.7%	15.7%
12.	CIC Group	5.6	5.6	0.9%	0.0%	6.2	1.8%	12.5%
13.	HF Group***	10.2	11.0	7.9%	5.3%	11.7	0.9%	7.9%
14.	Stanbic Holdings	82.5	81.0	(1.8%)	0.0%	79.0	5.1%	2.6%
15.	Stanchart	207.0	205.0	(1.0%)	(1.4%)	201.1	4.3%	2.4%
16.	Equity Group	41.5	44.0	6.0%	10.7%	42.3	4.3%	0.5%
18.	NBK	9.3	9.0	(3.2%)	(4.3%)	5.6	0.0%	(37.8%)
Target Price as per Cytonn Analyst estimates								

all prices in Kshs unless stated otherwise								
No.	Company	Price as at 12/01/18	Price as at 19/01/18	w/w Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
**Upside / (Downside) is adjusted for Dividend Yield								
***Banks in which Cytonn and/or its affiliates holds a stake								
For full disclosure, Cytonn and/or its affiliates holds a significant stake in NIC Bank, ranking as the 9th largest shareholder								

We remain neutral on equities for investors with short-term investment horizon, but are positive for investors with a long-term investment horizon. Despite the lower earnings growth prospects for 2017, the market has rallied and brought the market P/E closer to its historical average. Pockets of value exist, with a number of undervalued counters in some sectors like Financial Services, which provide an attractive entry point for long-term investors.

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