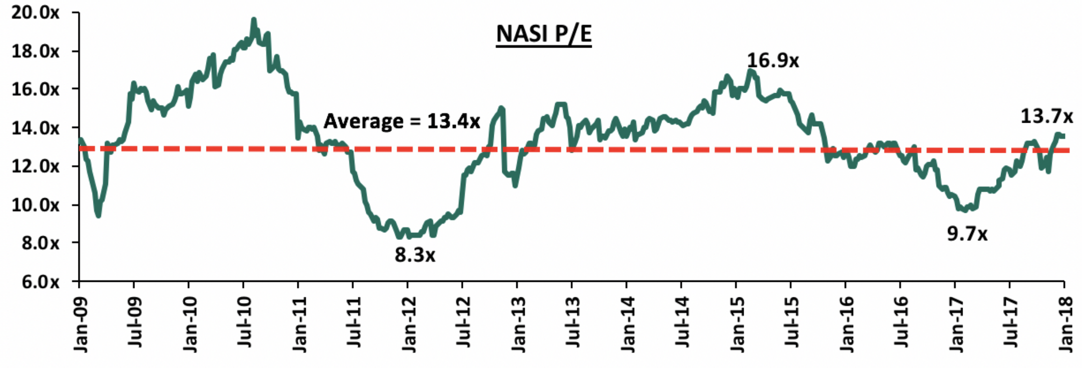
Why Stock Indices Performance Differ; A Case Study of NASI vs NSE 20, & Cytonn Weekly 04/2018

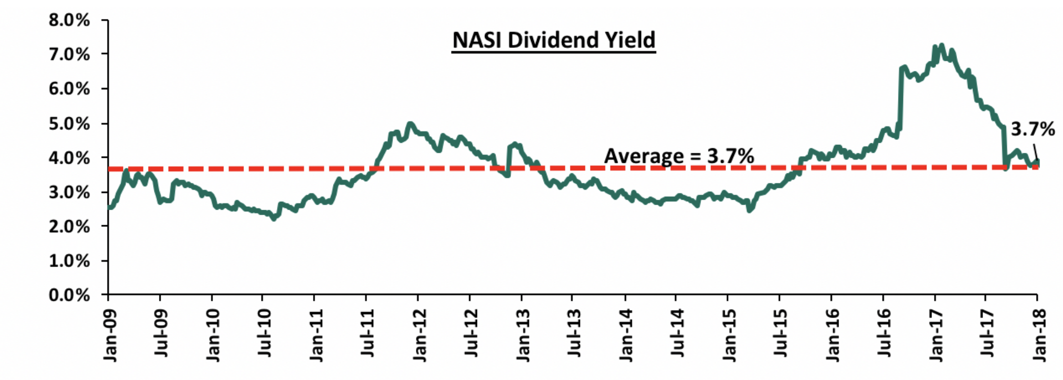
Equities

During the week, the equities market recorded mixed performance, with NASI and NSE 25 gaining 0.8% and 0.3%, respectively, while NSE 20 lost 0.2%, taking their YTD performance to 6.1%, 5.4% and 0.4% for NASI, NSE 25 and NSE 20, respectively. For the last 12-months, NASI, NSE 25 and NSE 20 have gained 48.4%, 42.8% and 32.0%, respectively. This week's performance was mainly driven by gains in Safaricom, which gained 1.7%, but was weighed down by losses in large cap banking stocks such as KCB Group, Co-operative Bank and Equity Group, which lost 3.3%, 1.5% and 1.1%, respectively. Since the February 2015 peak, the market has gained 2.4% for NASI and lost 32.2% for NSE 20.

Equities turnover decreased by 48.5% to USD 40.6 mn from USD 78.9 mn the previous week. Foreign investors turned net sellers with a net outflow of USD 7.6 mn compared to a net inflow of USD 1.9 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 13.7x, which is 1.8% 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 13.7x is 40.7% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 64.3% above the previous trough valuation of 8.3x experienced in December 2011. In our view, there still exists pockets of value in the market, with the current P/E valuation being 19.3% 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.





The Central Bank of Kenya (CBK) has renewed its push for a repeal of the law on interest rate capping, which it says is having a negative effect on the economy. This is evidenced by a declining private sector credit growth, which declined to an 8-year low of 1.4% in July 2017, attributable to the fact that banks preferred not to lend to consumers or businesses but invest in risk-free treasuries, which offer better returns on a risk-adjusted basis. CBK had expressed interest to have this law reversed and go back to a regime where interest rates are freely determined, but in a disciplined commercial banking environment. However, given that CBK has in the past failed in ensuring that there is discipline in the market, it would be unwise to expect banks to voluntarily become disciplined. We therefore maintain our view that a reversal of the rate caps regime should be accompanied with specific actions around consumer protection and improved competition to ensure banks remain disciplined in pricing of loans. This can be done by (i) establishment of a strong consumer protection agency to specifically develop and enforce a consumer protection framework for the financial services sector, (ii) establishment of a specialized tribunal that shall specifically handle consumer financial services matters and complaints, and (iii) development of capital markets and alternative sources of funding to bring down business funding dominance by banks in Kenya, in order to spur private sector credit growth. In a normal developed economy, 40% of business funding comes from the banking sector, with 60% coming from non-bank institutional funding. In Kenya, 95% of all business funding comes from bank funding, and only 5% from non-bank institutional funding, showing that the economy is over reliant on bank lending and should have more alternative and capital markets products funding businesses. This was highlighted in our Cytonn Weekly #02/2018.

During the week, Kenyan telecommunication firms, Airtel and Safaricom, begun trials for mobile money interoperability, which allows for cross network money transfers. Lack of interoperability has been highlighted as a major barrier to the development of the mobile money market and thus this move is expected to be part of the solution to concerns over Safaricom’s dominance. During the period ending September 2017, M-Pesa dominated the mobile money transfer service, where it commanded the largest market share of 80.8% followed by Equitel Money, which posted a market share of 6.8%. Mobikash, Airtel Money and Mobipay posted market shares of 6.3%, 5.8% and 0.3%, respectively. Interoperability will increase convenience for customers as well as improve access and efficiency in the industry, as it will boost competitiveness among the Telcos. We view this as a positive move as it will transform the mobile money transfer process, given that the consumers will be able to send and receive money across all networks, seamlessly. It will also contribute to the growth of the market as industry providers will be more competitive by paying keen attention to significant determinants for their success such as quality of service, agent quality and liquidity.

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise								
No.	**Company**	**Price as at 19/01/18**	**Price as at 26/01/18**	**w/w Change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/ (Downside)****
1.	NIC***	37.0	36.0	(2.7%)	6.7%	61.4	3.5%	74.1%
2.	KCB Group	45.3	43.8	(3.3%)	2.3%	59.7	6.8%	43.2%
3.	DTBK	200.0	202.0	1.0%	5.2%	281.7	1.4%	40.8%
4.	I&M Holdings	116.0	116.0	0.0%	(8.7%)	150.4	2.5%	32.2%
5.	Barclays	10.8	10.5	(2.8%)	9.4%	12.8	10.2%	32.1%
6.	Kenya Re	19.6	19.8	1.0%	9.1%	24.4	3.8%	27.4%
7.	Liberty Holdings	13.2	13.2	0.4%	8.2%	16.4	0.0%	24.2%
8.	Co-op Bank	16.8	16.5	(1.5%)	3.1%	18.6	5.6%	18.3%
9.	Britam	13.2	13.1	(0.4%)	(1.9%)	15.2	1.8%	17.8%
10.	Jubilee Insurance	505.0	500.0	(1.0%)	0.2%	575.4	1.7%	16.8%
11.	Sanlam Kenya	27.0	27.8	2.8%	0.0%	31.4	1.1%	14.1%
12.	HF Group***	11.0	10.6	(3.7%)	1.4%	11.7	0.9%	12.0%
13.	CIC Group	5.6	5.7	1.8%	1.8%	6.2	1.8%	10.6%
14.	Stanbic Holdings	81.0	81.0	0.0%	0.0%	79.0	5.1%	2.6%
15.	Stanchart	205.0	206.0	0.5%	(1.0%)	201.1	4.3%	1.9%
16.	Equity Group	44.0	43.5	(1.1%)	9.4%	42.3	4.3%	1.6%
17.	NBK	9.0	9.1	1.1%	(3.2%)	5.6	0.0%	(38.5%)
Target Price as per Cytonn Analyst estimates								

all prices in Kshs unless stated otherwise								
No.	**Company**	**Price as at 19/01/18**	**Price as at 26/01/18**	**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 since, 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 sectors like Financial Services, which provide an attractive entry point for long-term investors.

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