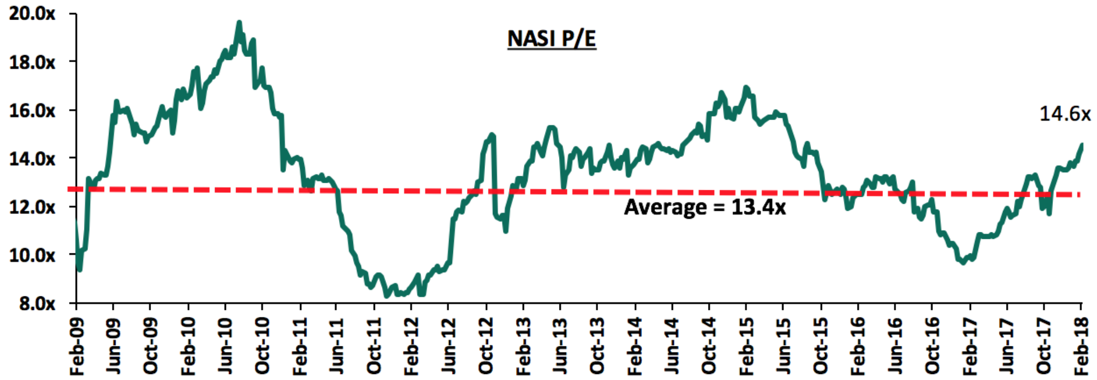
Update on Kigali Real Estate Investment Opportunity, & Cytonn Weekly #8/2018

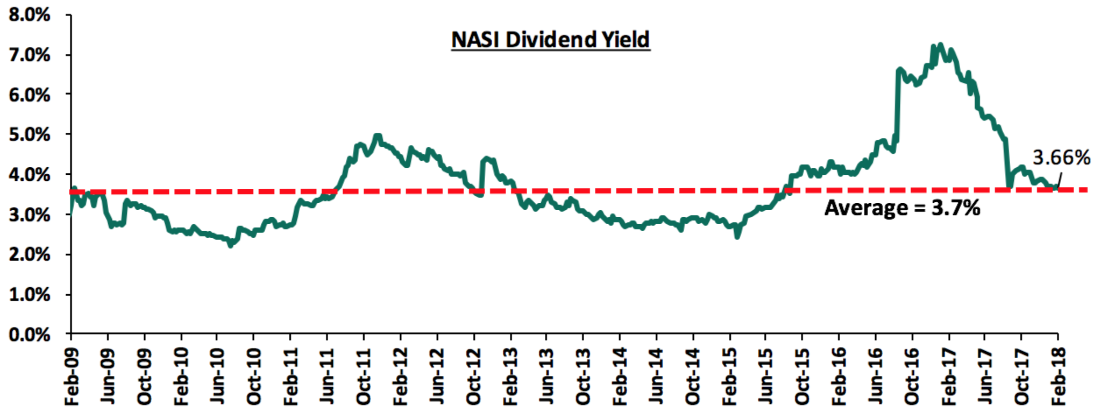
Equities

During the week, the equities market exhibited mixed trends with NASI gaining 0.3%, while NSE 25 and NSE 20 both lost 0.1%, taking their YTD performance to 5.6% and5.3% for NASI and NSE 25, respectively, while NSE 20 is flat. For the last twelve months (LTM), NASI, NSE 25 and NSE 20 have gained 44.6%, 38.3% and 27.6%, respectively. This week's performance was attributed to gains by select large-cap stocks such as Barclays Bank and Co-op Bank, which gained 1.9%, and 0.6%, respectively.

Equities turnover increased by 64.2% to USD 44.0 mn from USD 26.8 mn the previous week. We expect the market to remain supported by positive investor sentiment this year, as investors take advantage of the attractive stock valuations in select counters.

The market is currently trading at a price to earnings ratio (P/E) of 14.6x, which is 8.6% above the historical average of 13.4x, and a dividend yield of 3.7%, similar to the historical average of 3.7%. The current P/E valuation of 14.6x is 50.2% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 75.3% 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 13.9% 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 IMF has once again urged Members of Parliament (MPs) to repeal the law capping interest rates, recommending total abolition of the rate cap, stating that it has had a negative impact on the economy, crowding out the private sector and curtailing growth of SMEs. They re-iterated that the caps were meant to sort out the issue of high lending rates charged by banks that discouraged borrowing but instead have now resulted in banks not extending credit to the private sector, estimating a 10.0% drop in lending to SMEs. This comes at the same time when BMI Research, in their Africa Monitor, projected slower credit growth in 2018, noting that following the passing of the September 2016 rate cap law, banks reduced their lending to clients deemed as "*high risk*". Last week, the Kenya Parliamentary Budget Office (KPBO) proposed to review the law in a bid to (i) boost private sector credit growth, which was at an average of 2.4% in 2017 compared to a 5-year average of 14.4%, and (ii) to increase flexibility of the Central Bank Rate (CBR), which has remained at 10.0% since the law was passed. As we have previously mentioned in our topical notes on the interest rate cap, with the latest one being the Update on Effect of Interest Rate Cap on Credit Growth & Cost of Credit, amending or even repealing the Act would be key in sparking private sector credit growth and in turn boosting economic growth, and hence we share the IMF's sentiments.

A.M. Best, an American-based rating agency, has downgraded Kenya Re's financial strength rating to "*B*" from "*B+*", and its long term issuer rating to "*bb+*" from "*bbb-* "; but revised its outlook to "stable" from "*negative*", previously. The downgrades were attributed to (i) concerns around the re-insurer's enterprise risk management (ERM) function, with the conclusion that it might be weak and incapable of accommodating growing business, (ii) uncertainty around Kenya Re's long term ability to grow its capital base at the same rate as it is growing its revenue, and (iii) an expectation that the company might not be able to fund its regional expansion strategy. ERM involves identification of risks and opportunities specific to a business, assessing the likelihood of occurrence & magnitude of their impact, and coming up with a monitoring framework and response strategy for both. Kenya Re posted an EPS growth of 3.7% in H1'2017 driven by total revenue that grew by 7.1%, and ranked first in our Kenya Listed Insurance Sector Report, H1'2017, affirming the company's fundamental strength. Going forward, the company should work on strengthening its ERM to enable it incorporate growing business going forward, in order to sustain its financial strength as it pursues its regional expansion strategy.

Jubilee Insurance has launched 3 mobile apps: (i) JubiAgent Medical and JubiAgent Motor Apps for use by its agents, which will enable them sell the insurer's motor and medical insurance policies via mobile phone, and (ii) JubiCare App for use by its customers, which will give them quick and easy access to any data on its insurance policies as well as enable them to complete renewals and carry out transactions on their policies. Just recently, Jubilee also launched an Al-based chat personal assistant Julie to enhance customers' digital experience. In our view, the launch of the apps is part of the financial services sector embracing technology to attract a wider customer base while improving operational efficiency. The apps will serve to (i) enhance Jubilee's customer experience thus attracting more customers who have become more tech-savvy as their tastes and preferences become more skewed towards shorter, more accessible procedures, (ii) increase Jubilee's gross earned premiums which stood at Kshs 15.6 bn in H1'2017, 14.5% up from Kshs 13.6 bn in H1'2016, the increase expected to be generated from agents, thus increasing the amount of commission paid out.

In an effort to keep our rankings of companies on the Cytonn Corporate Governance Ranking (Cytonn CGR) Report up-to-date, we continually update the rankings whenever there are changes on any of the 24 metrics that we track, and how this affects the company ranking. This week, KCB Group appointed a Non-Executive Directors to its board, Ms. Josephine Tata Djirackor, to replace Dr. Nancy Asiko Onyango who stepped down from the board following her appointment to head the Internal Audit and Inspection Office at the IMF in December 2017. KCB's score based on our 24 metrics has remained unchanged at 91.7%, retaining its no. 1 position.

Below is our Equities Universe of Financial Services Coverage:

Cytonn Equities Universe of Financial Services Coverage

all prices in Kshs unless stated otherwise

No.	Company	Price as at 16/02/18	Price as at 23/02/18	w/w Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	NIC***	36.0	35.3	(2.1%)	4.4%	61.4	3.5%	77.7%
2.	KCB Group	45.5	45.5	0.0%	6.4%	59.7	6.6%	37.8%
3.	DTBK	210.0	210.0	0.0%	9.4%	281.7	1.3%	35.4%
4.	I&M Holdings	120.0	116.0	(3.3%)	(8.7%)	150.4	2.5%	32.2%
5.	Kenya Re	19.5	19.2	(1.8%)	5.8%	24.4	3.8%	31.3%
6.	Barclays	10.7	10.9	1.9%	13.0%	12.8	9.4%	27.4%
7.	Liberty Holdings	13.0	13.0	0.0%	6.6%	16.4	0.0%	26.2%
8.	Britam	12.5	12.5	(0.4%)	(6.7%)	15.2	1.8%	23.9%
9.	CIC Group	5.3	5.4	1.9%	(3.6%)	6.2	1.8%	16.6%
10.	Jubilee Insurance	505.0	504.0	(0.2%)	1.0%	575.4	1.7%	15.9%
11.	HF Group***	10.7	10.3	(4.2%)	(1.4%)	11.7	0.8%	15.2%
12.	Sanlam Kenya	29.0	27.5	(5.2%)	(0.9%)	31.4	1.1%	15.1%
13.	Co-op Bank	17.1	17.2	0.6%	7.5%	18.6	5.4%	13.5%
14.	Equity Group	42.8	42.8	0.0%	7.5%	42.3	4.2%	3.1%
15.	Standard Chartered	207.0	208.0	0.5%	0.0%	201.1	4.3%	1.0%
16.	Stanbic Holdings	81.0	82.5	1.9%	1.9%	79.0	5.1%	0.9%
17.	NBK	8.5	8.3	(1.8%)	(11.2%)	5.6	0.0%	(32.9%)

**Target Price as per Cytonn Analyst estimates*

***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 Group, ranking as the 6th largest shareholder

We maintain a "NEUTRAL" recommendation on equities for investors with short-term investment horizon since the market has rallied and brought the market P/E slightly above its' historical average. However, pockets of value exist, with a number of undervalued sectors like Financial Services, and with expectations of higher corporate earnings this year, the market will be cheaper for long-term investors hence we are "POSITIVE" for investors with long-term horizon.