Mombasa Real Estate Investment Opportunity August 2018, & Cytonn Weekly #34/2018

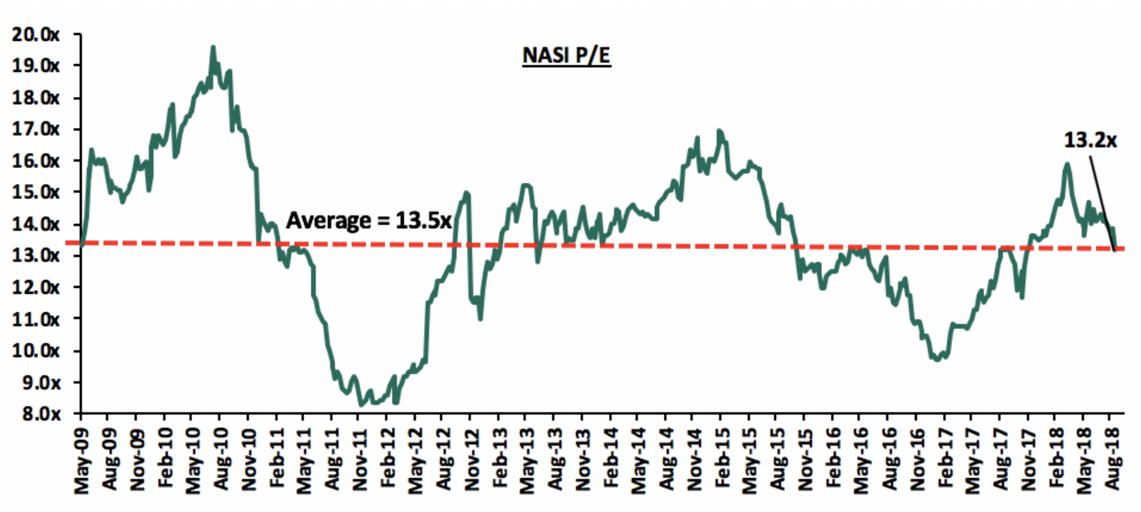
Equities

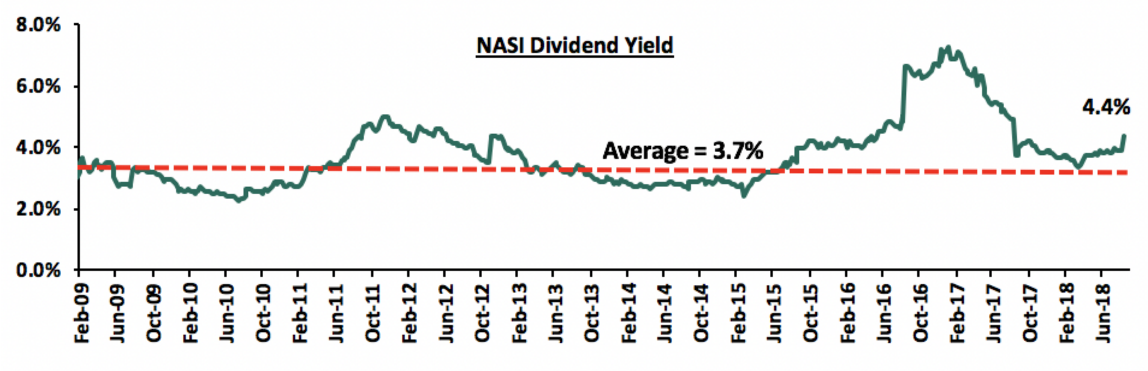
Market Performance:

During the week, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 declining by 2.3%, 3.2% and 2.7%, respectively, taking their YTD performance to (4.4%), (16.5%) and (2.7%) for NASI, NSE 20 and NSE 25, respectively. This week's performance was driven by declines in large cap stocks such as Safaricom and KCB Group, which declined by 5.2% and 5.0%, respectively. Banking sector counters also posted declines, with NIC Group and Equity Group both declining by 1.7%, while Diamond Trust Bank and Standard Chartered declined by 1.1% and 1.0%, respectively. For the last twelve months (LTM), NASI, NSE 20 and NSE 25 have declined by 3.0%, 23.5% and 7.2%, respectively.

Equities turnover decreased by 8.6% to USD 24.5 mn, from USD 26.8 mn the previous week, taking the YTD turnover to USD 1.3 bn. Foreign investors remained net sellers during the week, with a net selling position of USD 5.4 mn. 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 13.2x, which is 2.5% below the historical average of 13.5x, and a dividend yield of 4.4%, higher than the historical average of 3.7%. The current P/E valuation of 13.2x is 34.3% above the most recent trough valuation of 9.8x experienced in the first week of February 2017, and 58.6% above the previous trough valuation of 8.3x experienced in December 2011. The charts below indicate the historical P/E and dividend yields of the market.





Highlights of the Week:

Legislators have rejected amendments to the Finance Bill (2018) that would have required commercial banks to increase their minimum core capital to Kshs 5.0 bn, from Kshs 1.0 bn, over the next 4-years. The Bill would have required banks to increase core capital in three phases over the 4-years: (i) to a minimum of Kshs 2.0 bn by December 2019, (ii) to Kshs 3.5 bn by December 2020, and (iii) to Kshs 5.0 bn by December 2021. This is the second time in 3-years that Parliament has rejected the proposal, having rejected a similar move in August 2015. According to Mr Jude Njomo, the legislator who proposed the Bill, the changes were necessary to create financial stability following the collapse of Imperial Bank and Chase Bank. The MPs based their arguments on the premise that the amendment would likely force mergers and acquisitions, as small lenders struggle to survive as they faced difficulties in raising the minimum statutory capital of Kshs 1.0 bn. Data from the Central Bank of Kenya shows that 23 of the 43 local banks had less than Kshs 5.0 bn core capital by December 2017. The Treasury has supported consolidation among lenders in the past by suggesting increments in core capital, arguing that it would lead to stronger and better-capitalised lenders to support more investment. We are of the view that the minimum core capital should be increased in order to promote stability in the banking sector as well as create room for cost reduction from economies of scale, which may translate to lower lending rates.

Equity Group plans to roll out an e-commerce money transfer and payments platform that will serve its customers across the region, through its subsidiary, Finserve, in November 2018. The platform, dubbed 'mKey', will ride on the bank's regional network in Rwanda, Tanzania, DR Congo, Uganda and South Sudan. The move will help the bank offer more products and services, reduce operational costs as well as attract tech-savvy young population segments to use mobile internet for a range of services including paying for utilities, transfer of cash, buying goods and paying for services, in addition to borrowing of loans ranging from Kshs 300 to Kshs 1.0 mn. Finserve, a wholly owned mobile virtual network operator, employs 18 people that support Equity's 13 mn clients. The subsidiary will also be deployed in Nigeria and Ethiopia by December 2019, and will be used to push products to a global audience in order to enhance the uptake of loans, savings, sale and buying of securities and forex trading. Upon full deployment, the platform is expected to increase the bank's Non-Funded Income (NFI) streams by enabling users perform end-to-end transactions on the mKey platform, hence increasing transactional volumes and fee income for Equity Group. In our view, the mKey platform will boost Equity Group's earnings going forward as the bank leverages on technology to reduce operational redundancies and increase efficiency, in addition to increasing revenue earned from the fee income streams.

Equities Universe of Coverage:

Below is our Equities Universe of Coverage:

Banks	Price as at 31/08/2018	Price as at 7/09/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
NIC Bank***	30.0	29.5	(1.7%)	(12.6%)	(20.4%)	54.1	3.4%	83.7%	**0.7x**
I&M Holdings***	100.0	102.0	2.0%	2.0%	(17.1%)	169.5	3.4%	72.9%	**1.0x**
Zenith Bank***	21.2	20.9	(1.2%)	(18.5%)	(12.0%)	33.3	12.9%	70.5%	**0.9x**

Banks	Price as at 31/08/2018	Price as at 7/09/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
Ghana Commercial Bank***	5.4	5.4	0.0%	5.9%	7.0%	7.7	7.1%	51.4%	**1.3x**
Diamond Trust Bank***	190.0	188.0	(1.1%)	(2.1%)	6.2%	280.1	1.4%	48.8%	**1.1x**
UBA Bank	8.1	7.9	(2.5%)	(23.3%)	(10.4%)	10.7	10.8%	42.9%	**0.5x**
KCB Group***	45.0	42.8	(5.0%)	0.0%	1.2%	60.9	7.0%	42.4%	**1.4x**
Union Bank Plc	5.9	5.3	(9.4%)	(32.1%)	(13.1%)	8.2	0.0%	39.3%	**0.6x**
HF Group***	7.8	6.5	(16.1%)	(37.5%)	(38.6%)	10.2	4.9%	36.5%	**0.3x**
Barclays	11.0	11.0	0.0%	14.6%	6.3%	14.0	9.1%	36.4%	**1.5x**
CRDB	160.0	160.0	0.0%	0.0%	(20.0%)	207.7	0.0%	29.8%	**0.5x**
Equity Group	45.0	44.3	(1.7%)	11.3%	12.7%	55.5	4.5%	27.9%	**2.1x**
CAL Bank	1.1	1.3	18.2%	20.4%	48.6%	1.4	0.0%	27.3%	**0.9x**
Co-operative Bank	16.5	16.7	0.9%	4.1%	1.8%	19.7	4.8%	24.2%	**1.5x**
Ecobank	9.0	9.0	0.2%	18.3%	41.3%	10.7	0.0%	19.6%	**2.0x**
Stanbic Bank Uganda	33.0	33.0	0.0%	21.1%	21.1%	36.3	3.5%	13.5%	**2.3x**
Bank of Kigali	290.0	290.0	0.0%	(3.3%)	3.6%	299.9	4.8%	8.2%	**1.6x**
Guaranty Trust Bank	37.0	35.0	(5.4%)	(14.1%)	(9.2%)	37.1	6.9%	7.1%	**2.3x**
Access Bank	9.4	9.1	(3.2%)	(13.4%)	(5.7%)	9.5	4.4%	6.0%	**0.6x**
SBM Holdings	6.6	6.6	0.0%	(12.0%)	(14.7%)	6.6	4.5%	3.9%	**0.9x**
Standard Chartered	205.0	203.0	(1.0%)	(2.4%)	(13.2%)	184.3	6.2%	(3.9%)	**1.7x**
Bank of Baroda	144.0	144.0	0.0%	27.4%	30.9%	130.6	1.7%	(7.6%)	**1.3x**
Stanbic Holdings	100.0	96.0	(4.0%)	18.5%	20.0%	85.9	2.3%	(11.8%)	**1.0x**
Stanbic IBTC Holdings	48.0	45.0	(6.3%)	8.4%	12.8%	37.0	1.3%	(21.6%)	**2.5x**
FBN Holdings	9.0	9.0	0.6%	2.3%	56.3%	6.6	2.8%	(23.1%)	**0.5x**
Standard Chartered	26.0	26.0	0.0%	3.0%	19.1%	19.5	0.0%	(25.2%)	**3.3x**
National Bank	5.8	5.5	(5.2%)	(41.2%)	(49.5%)	2.8	0.0%	(51.7%)	**0.4x**
Ecobank Transnational	19.6	19.5	(0.3%)	14.7%	8.3%	9.3	0.0%	(52.5%)	**0.7x**

**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 Bank, ranking as the 5th largest shareholder*

***** Stock prices are in respective country currency*

We are "NEUTRAL" on equities for investors with a 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, which provide an attractive entry point for long-term investors, and with expectations of higher corporate earnings this year, we are "POSITIVE" for investors with a long-term investment horizon.