Nairobi Metropolitan Area Infrastructure Report 2018, & Cytonn Weekly #41/2018

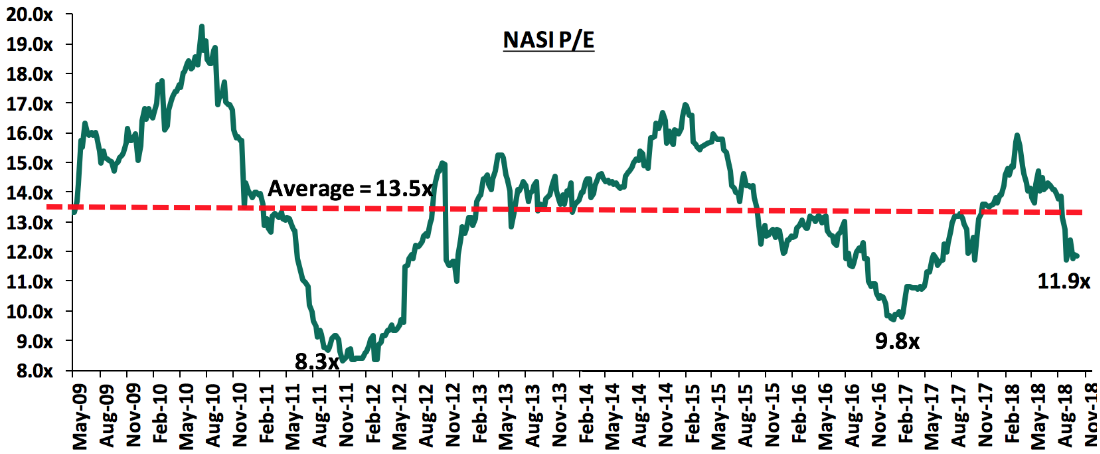
Equities

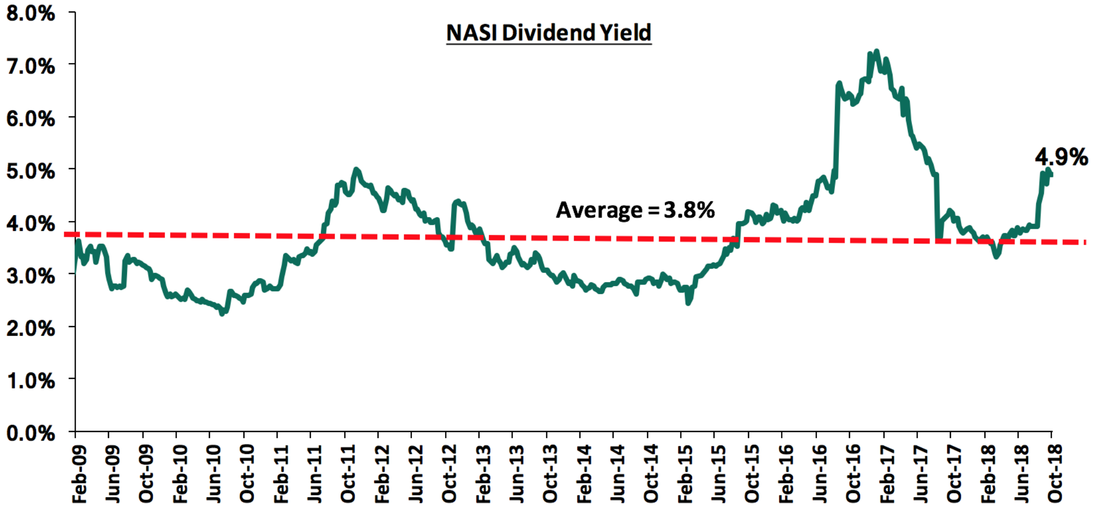
Market Performance:

During the week, the equities market recorded mixed performances with NSE 20 and NSE 25 gaining by 0.5% and 0.6% respectively, while NASI declined by 0.3%, taking their YTD performance to declines of 24.0%, 15.7% and 14.8%, for NSE 20, NSE 25 and NASI, respectively. This week's performance was driven by gains in large cap counters such as Bamburi, Equity, and KCB Group, which gained by 5.6%, 4.6%, and 0.7%, respectively. For the last twelve months (LTM), NASI, NSE 25 and NSE 20 have declined by 8.7%, 11.2% and 21.7%, respectively.

Equities turnover increased by 203.6% to USD 80.5 mn from USD 26.5 mn the previous week, bringing the YTD turnover to USD 1.6 bn. Foreign investors remained net sellers, with net weekly outflows decreasing by 9.6% to USD 11.7 mn, from USD 12.9 mn previously. We expect the market to remain subdued in the near-term as international investors exit the broader emerging markets due to the expectation of rising US interest rates coupled with the global strengthening US Dollar.

The market is currently trading at a price to earnings ratio (P/E) of 11.9x, which is 11.8% below the historical average of 13.5x, and a dividend yield of 4.9%, higher than the historical average of 3.8%. The current P/E valuation of 11.9x is 21.0% above the most recent trough valuation of 9.8x experienced in the first week of February 2017, and 42.7% above the previous trough valuation of 8.3x experienced in December 2011. The chart below indicates the historical P/E and dividend yields of the market:





Weekly Highlights:

During the Week, the Official Monetary and Financial Institutions Forum (OMFIF) in association with Absa Group Limited released the Absa Africa Financial Markets Index report 2018. The report evaluated financial market development in 20 Africa countries, as well as highlighting markets with clearest growth prospects. The report mainly analyzed and rank countries on six different pillars:

a. Market depth,
b. Access to foreign exchange,
c. Market transparency, tax and regulatory environment,
d. Capacity of local investors,
e. Macroeconomic opportunity,
f. Legality and enforceability of standard financial markets master agreements.

The top five highest ranked financial markets in Africa according to the index are; South Africa, Botswana, Kenya, Mauritius and Nigeria, respectively. Kenya climbed two spots to position three due to ease of access to foreign exchange as well as implementation of proper foreign trading policies such as reducing capital controls, which has boosted its performance.

Overall, Kenya had a score of 65% and was #3, an improvement from #5 last year. It ranked #1 on access to foreign exchange with a score of 93%, #8 on market depth with a score of 44%, #7 on capacity of local investors with a score of 33% and #6 on the macroeconomic opportunity with a score of 65%.

Key take-outs from the report include:

- Countries are progressing with policies that support the development of financial markets across

the continent. An example is Mozambique's 'financial sector development strategy' that stood out among the frameworks introduced over the past year. Such initiatives have boosted performance for the index as a whole,
- The greatest area for improvement for the continent remains the 'capacity of local investors'. This is mainly due to lack of knowledge and expertise of pension fund trustees and other asset owners and this hinders the development of new financial products,
- 'Market Transparency, Tax and Regulatory Environment' and 'Macroeconomic Opportunity' are the highest-ranking pillars in the industry, and,
- Foreign exchange liquidity remains low in Africa, with just three countries (South Africa, Kenya and Ghana) recording interbank foreign exchange turnover of above $20 bn.

We are of the view that the following should be addressed to facilitate growth in the number of investors in the country and facilitate growth in the number of new listings as well as develop the number of new products in the NSE:

i. Harmonizing tax incentives - We are of the view that tax incentives available to banks should also be made available to non-bank funding entities and new products such as unit trusts;
ii. Embarking on privatization of some of the state corporations through listing, this will increase the number of IPOs by state owned enterprises hence attracting a good number of private companies to list in the market; and
iii. Awareness programs aimed at enhancing literacy on capital markets. This will increase the knowledge of local investors on the new products available in the market.

For more information on Unlocking New listings on the Nairobi Bourse, see Cytonn Weekly #40

Corporate Governance Changes:

Liberty Holdings Ltd announced the resignation of Dr. Susan Mboya Kidero as the board chair.

Following the resignation, the following are the changes on the Corporate Governance metrics for Liberty Holdings Ltd:

- The board size has decreased to 5 from 6 hence an improvement of the metric score to 1 from 0.5 since the board consists of an odd number of members from an even number, raising the possibility that there will be no tie in case board members decide to vote on a decision;
- Gender diversity has declined to 0% from 16.7% since there is no longer a female member in the board;
- Ethnic diversity has improved to 60% from 66.7% since there are 2 out of 5 members of the board from the same ethnic group, a change from 2 out of 6; and;
- The proportion of non-executive members has changed to 80.0% from 83.3%;

Overall, the comprehensive score has remained the same at 77.1% and remains joint at position 9 with BAT, EABL and Jubilee Holdings in the 2018 Cytonn Corporate Governance Index.

KCB Group announced the appointment of Mr. Andrew Wambari Kairu as the new chairman, replacing Mr. Ngeny Biwott who held the position for five years.

Following the appointment to the KCB Group Board, the following are the implications on the Corporate Governance metrics for KCB Group;

- The board size has remained the same at 9 since Mr. Andrew Kairu was a non-independent director of KCB Bank Kenya and now joins the KCB Group board;
- Gender diversity has remained the same at 77.8%;
- Ethnic diversity has remained the same at 77.8%, since there are 2 out of 9 members of the board from the same ethnic group;
- The proportion of non-executive members has remained at 77.8%;

Overall, the comprehensive score has remained the same at 85.4% and remains joint at position 1 with NSE and Safaricom in the 2018 Cytonn Corporate Governance Index.

Equities Universe of Coverage:

Below is our Equities Universe of Coverage:

Banks	Price as at 19/10/2018	Price as at 26/10/2018	w/w change	YTD Change	LTM Change	Target Price	Dividend Yield	Upside/Downside	P/TBv Multiple
NIC Bank***	24.8	23.0	(7.1%)	(31.9%)	(31.2%)	48.8	4.3%	116.5%	**0.6x**
Diamond Trust Bank	164.0	158.0	(3.7%)	(17.7%)	(11.2%)	283.7	1.6%	81.2%	**0.9x**
KCB Group	38.3	38.5	0.7%	(9.9%)	0.7%	61.3	7.8%	67.0%	**1.2x**
Union Bank Plc	5.0	5.1	1.0%	(35.3%)	(17.6%)	8.2	0.0%	61.4%	**0.5x**
I&M Holdings***	95.0	90.0	(5.3%)	(29.1%)	(27.4%)	138.6	3.9%	57.9%	**0.9x**
Ecobank	8.0	6.9	(13.2%)	(9.2%)	0.1%	10.7	0.0%	55.5%	**1.5x**
Ghana Commercial Bank***	5.4	5.3	(0.9%)	5.0%	26.2%	7.7	7.2%	52.8%	**1.2x**
Zenith Bank***	22.9	24.0	4.8%	(6.4%)	(6.7%)	33.3	11.3%	50.1%	**1.1x**
Equity Group	38.3	40.0	4.6%	0.6%	10.3%	56.2	5.0%	45.5%	**1.9x**
UBA Bank	8.2	8.0	(1.8%)	(22.3%)	(14.1%)	10.7	10.6%	44.4%	**0.5x**
Co-operative Bank	14.6	14.6	(0.3%)	(9.1%)	(9.6%)	19.9	5.5%	42.3%	**1.3x**
CRDB	150.0	150.0	0.0%	(6.3%)	(11.8%)	207.7	0.0%	38.5%	**0.5x**
CAL Bank	1.1	1.0	(5.5%)	(3.7%)	13.2%	1.4	0.0%	34.6%	**0.9x**
Barclays	10.5	10.4	(0.5%)	8.3%	13.7%	12.5	9.6%	29.8%	**1.4x**
HF Group***	5.9	5.5	(7.6%)	(47.6%)	(46.0%)	6.6	6.4%	27.5%	**0.2x**
Access Bank	8.3	8.0	(4.2%)	(23.9%)	(16.3%)	9.5	5.0%	24.5%	**0.5x**
Standard Chartered	187.0	178.0	(4.8%)	(14.4%)	(17.2%)	196.3	7.0%	17.3%	**1.4x**
Stanbic Bank Uganda	32.5	33.0	1.5%	21.1%	20.0%	36.3	3.5%	13.5%	**2.3x**
SBM Holdings	6.3	6.1	(1.9%)	(18.1%)	(17.9%)	6.6	4.9%	11.7%	**0.9x**
Bank of Kigali	289.0	289.0	0.0%	(3.7%)	1.4%	299.9	4.8%	8.6%	**1.6x**
Guaranty Trust Bank	36.8	37.0	0.5%	(9.2%)	(11.9%)	37.1	6.5%	6.8%	**2.3x**
Stanbic Holdings	90.0	90.1	0.1%	11.2%	14.0%	92.6	2.5%	5.3%	**0.9x**
National Bank	5.0	5.0	0.0%	(46.5%)	(45.4%)	4.9	0.0%	(2.0%)	**0.4x**
Bank of Baroda	126.0	140.0	11.1%	23.9%	27.3%	130.6	1.8%	(4.9%)	**1.2x**
Stanbic IBTC Holdings	45.0	46.0	2.2%	10.8%	4.4%	37.0	1.3%	(18.3%)	**2.4x**
Standard Chartered	26.0	25.0	(3.8%)	(1.0%)	49.1%	19.5	0.0%	(22.2%)	**3.1x**
FBN Holdings	9.1	9.0	(1.1%)	2.3%	46.3%	6.6	2.8%	(23.6%)	**0.5x**
Ecobank Transnational	17.0	16.8	(1.5%)	(1.5%)	(1.5%)	9.3	0.0%	(44.6%)	**0.6x**

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 since the markets are currently trading below historical P/E averages. However, pockets of value continue to exist, with a number of undervalued sectors like Financial Services, which provide an attractive entry point for medium and long-term investors, and with expectations of higher corporate earnings this year, we are

"POSITIVE" for investors with a long-term investment horizon.

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