Karen Investment Opportunity, & Cytonn Weekly #04/2019

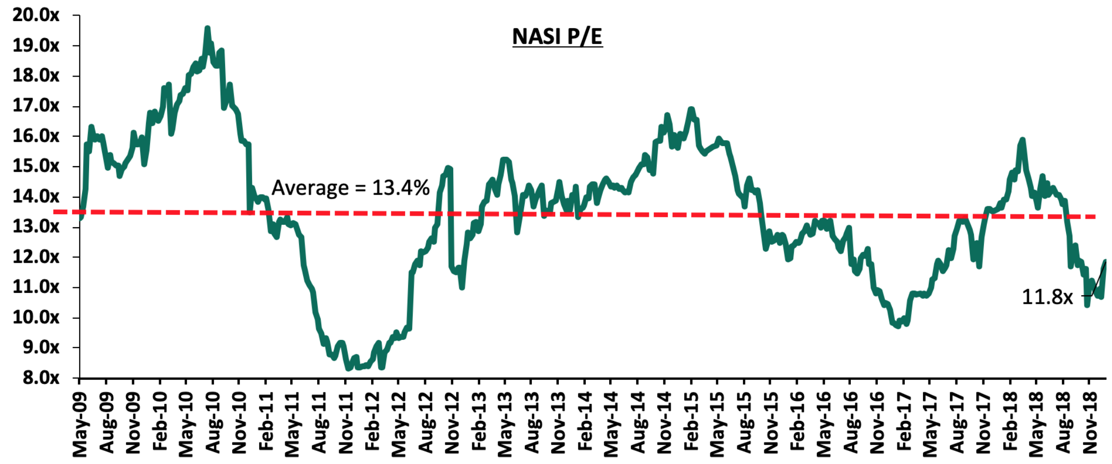
Equities

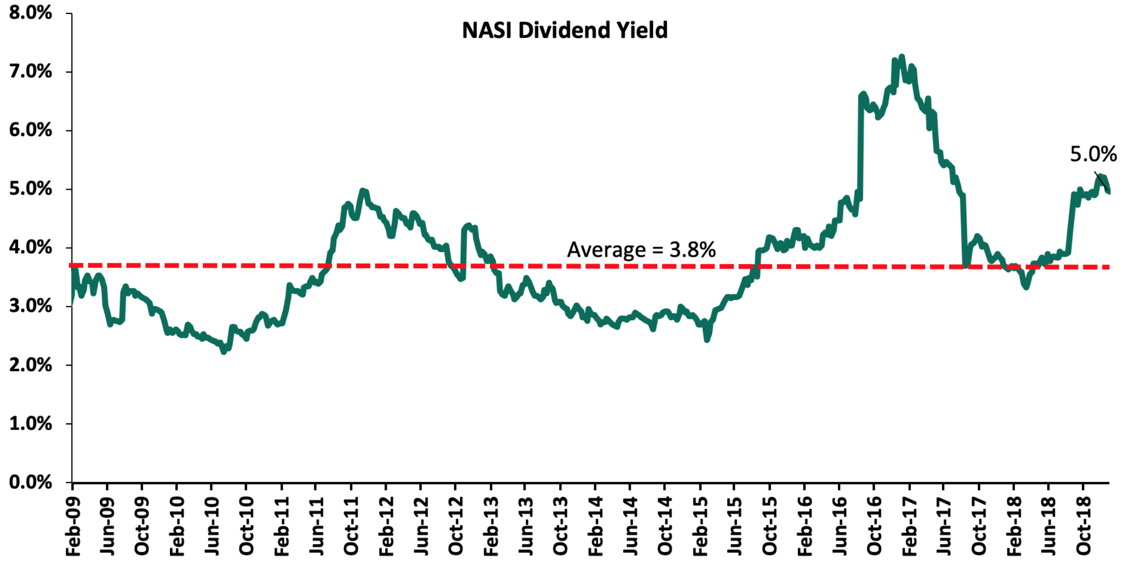
Market Performance

During the week, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining by 0.8%, 2.0%, and 0.8%, respectively, taking their YTD performance to 4.3%, 2.6% and 4.9%, for NASI, NSE 20 and NSE 25, respectively. The gain in NASI was mainly driven by gains in large cap stocks such as East African Breweries Limited (EABL), Co-operative Bank of Kenya, KCB Group and Equity Group, which gained by 11.0%, 8.6%, 2.8% and 1.7%, respectively.

Equities turnover declined by 5.4% during the week to USD 32.9 mn, from USD 34.7 mn the previous week, taking the YTD turnover to USD 96.8 mn. Foreign investors remained net sellers for the week, with a net selling position of USD 0.3 mn, which is a 85.3% decrease from last week's net selling position of USD 2.2 mn.

The market is currently trading at a price to earnings ratio (P/E) of 11.8x, 13.8% below the historical average of 13.4x, and a dividend yield of 5.0%, above the historical average of 3.8%. With the market trading at valuations below the historical average, we believe there is value in the market. The current P/E valuation of 11.8x is 21.6% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 42.2% 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.





Weekly Highlights

The Capital Markets Authority (CMA) and the Nairobi Securities Exchange (NSE) have moved to fully suspend a law that allowed listed companies to buy back their own shares from the capital markets. The regulators noted that the law would erode market liquidity, provide a window for companies to manipulate share prices and generally stiffle activity at the bourse. Share buy-backs, a trading strategy that is common in Europe and the United States, are suitable for listed companies trading below book values and wish to enhance the share price and earnings per share while maintaninig policy on issuing of dividends and retained earnings. In the US, Apple Inc. spent USD 20.8 bn in share buy-back programs in Q3'2018, highighting a surge in stock buy-back in S&P 500 companies, with the total buyback authorization reaching USD 754.0 bn by the close of Q3'2018. The share buy-back law in Kenya, enacted in September 2015 as part of the New Companies Act, was suspended in November the same year after regulators noted that there was need for further work relating to mitigating against challenges expected to be brought about by the new law especially with regards to stiffling liquidity in the market. In our view, the new move is likely to lock out well-capitalized firms such as Safaricom Plc and East African Breweries Ltd, who in the past expressed a desire to repurchase shares in the market, from reducing the number of minority-held shares in the market and require them to find other avenues of improving their net asset value.

Co-op Bank, through its joint leasing partner Super Group, a South African logistics firm, announced that it concluded a deal with the Government to provide 125 vehicles, worth over Kshs. 890.0 mn, which is part of an agreement to provide 412 vehicles to the state. Through the joint venture, Co-op Bank aims to leverage on Super Goup's capabilities in product structuring, technology and customer risk management while at the same time, Super Group will tap into the bank's large customer base of over 8 million clients. The partnership will target collaboration of the two entities in undertaking infrastructure projects, exploration and mining activites, government leasing, and ICT. Through the joint venture, Co-op Bank is likely to stamp its presence in the leasing market, a move that will enhance the bank's diversification strategy on growing its non-funded income that stood at Kshs. 10.6 bn in Q3'2018, a growth of 4.3% from Kshs 10.1 in Q3'2017. Co-op Bank reported a funded to non-funded income ratio of 67:33 in Q3'2018 compared to an industry average of 66:35. The broad move by the government to lease state vehicles with the aim of enhancing the cost-efectiveness of acquiring government assets, is likely to expand the leasing market paving way to new entrants including banks seeking to tap into the opportunites at hand. Banks have been making forays in various segments to grow their fee income, to try and mitigate the impact of compressed Net Interest Margins (NIMs) whose growth declined from 9.6% in 2016 to 8.3% in 2017, in the wake of the interest rate capping regime. Despite the recent push by various stakeholders to amend the Banking (Amendment) Act 2015 that is likely to improve credit growth and consequently improve interest income for banks, we expect that banks will continue diversifying their income sources by focusing on the Non-Funded Income (NFI) which include; venturing in bancassurance and transactional income from alternative channels, as the cap on interest rates remains in place.

Universe of Coverage

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Banks	**Price as at 18/1/2019**	**Price as at 25/1/2019**	**w/w change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/Downside****	**P/TBv Multiple**
Diamond Trust Bank	150.0	150.0	0.0%	(4.2%)	283.7	1.7%	90.9%	**0.9x**
Ghana Commercial Bank***	4.5	4.5	0.0%	(2.2%)	7.7	8.4%	80.0%	**1.1x**
Access Bank	5.6	5.6	0.0%	(17.6%)	9.5	7.1%	76.8%	**0.4x**
NIC Bank	29.7	29.7	0.0%	6.7%	48.8	3.4%	68.0%	**0.8x**
Zenith Bank***	21.5	21.5	0.0%	(6.7%)	33.3	12.6%	67.5%	**1.0x**
KCB Group	38.8	38.8	0.0%	3.6%	61.3	7.7%	65.7%	**1.2x**
UBA Bank	7.3	7.7	5.5%	0.0%	10.7	11.0%	50.0%	**0.5x**
I&M Holdings	94.3	95.0	0.8%	11.8%	138.6	3.7%	49.6%	**1.0x**
Co-operative Bank	14.0	15.2	8.6%	5.9%	19.9	5.3%	36.6%	**1.3x**
CRDB	140.0	135.0	(3.6%)	(10.0%)	207.7	0.0%	53.9%	**0.5x**
Equity Group	39.3	40.0	1.7%	14.6%	56.2	5.0%	45.7%	**1.9x**
Ecobank	7.5	7.2	(3.6%)	(4.0%)	10.7	0.0%	49.0%	**1.6x**
CAL Bank	1.0	0.9	(12.1%)	(11.2%)	1.4	0.0%	60.9%	**0.7x**
Stanbic Bank Uganda	30.0	30.0	0.0%	(3.2%)	36.3	3.9%	24.8%	**2.1x**
Guaranty Trust Bank	32.0	34.5	8.0%	0.1%	37.1	7.0%	14.5%	**2.2x**
Union Bank Plc	6.8	6.2	(8.9%)	9.8%	8.2	0.0%	32.5%	**0.6x**
HF Group	5.8	6.1	5.5%	10.5%	6.6	5.7%	13.6%	**0.2x**
Barclays	11.7	11.4	(2.6%)	3.7%	12.5	8.8%	18.9%	**1.5x**
SBM Holdings	6.1	6.1	0.0%	2.3%	6.6	4.9%	12.5%	**0.9x**
Bank of Kigali	278.0	278.0	0.0%	(7.3%)	299.9	5.0%	12.9%	**1.5x**
Standard Chartered	195.8	194.3	(0.8%)	(0.1%)	196.3	6.4%	7.5%	**1.6x**
Stanbic Holdings	95.0	92.0	(3.2%)	1.4%	92.6	2.4%	3.1%	**0.9x**
Bank of Baroda	135.0	135.0	0.0%	(3.6%)	130.6	1.9%	(1.4%)	**1.2x**
FBN Holdings	7.3	7.7	4.8%	(3.8%)	6.6	3.3%	(10.1%)	**0.4x**
Standard Chartered	21.1	21.4	1.5%	1.9%	19.5	0.0%	(9.1%)	**2.7x**
National Bank	5.2	5.3	2.3%	(0.8%)	4.9	0.0%	(7.2%)	**0.4x**
Stanbic IBTC Holdings	47.0	47.0	0.0%	(2.0%)	37.0	1.3%	(20.0%)	**2.4x**
Ecobank Transnational	14.0	15.0	7.1%	(11.8%)	9.3	0.0%	(38.1%)	**0.5x**

**Target Price as per Cytonn Analyst estimates*
***Upside / (Downside) is adjusted for Dividend Yield*
****Banks in which Cytonn and/or its affiliates are invested in*
*****Stock prices indicated in respective country currencies*

We are "Positive" on equities for investors as the sustained price declines has seen the market P/E decline to below its historical average. We expect increased market activity, and possibly increased inflows from foreign investors, as they take advantage of the attractive valuations, to support the positive performance.