Nanyuki Real Estate Investment Opportunity, 2019, & Cytonn Weekly #23/2019

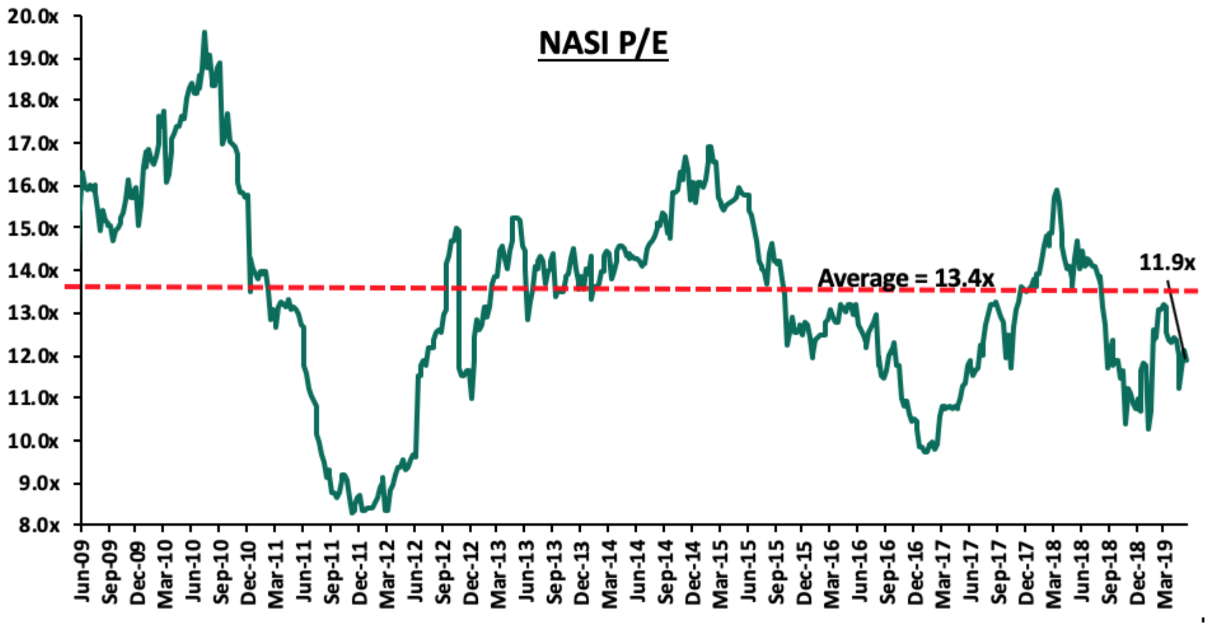
Equities

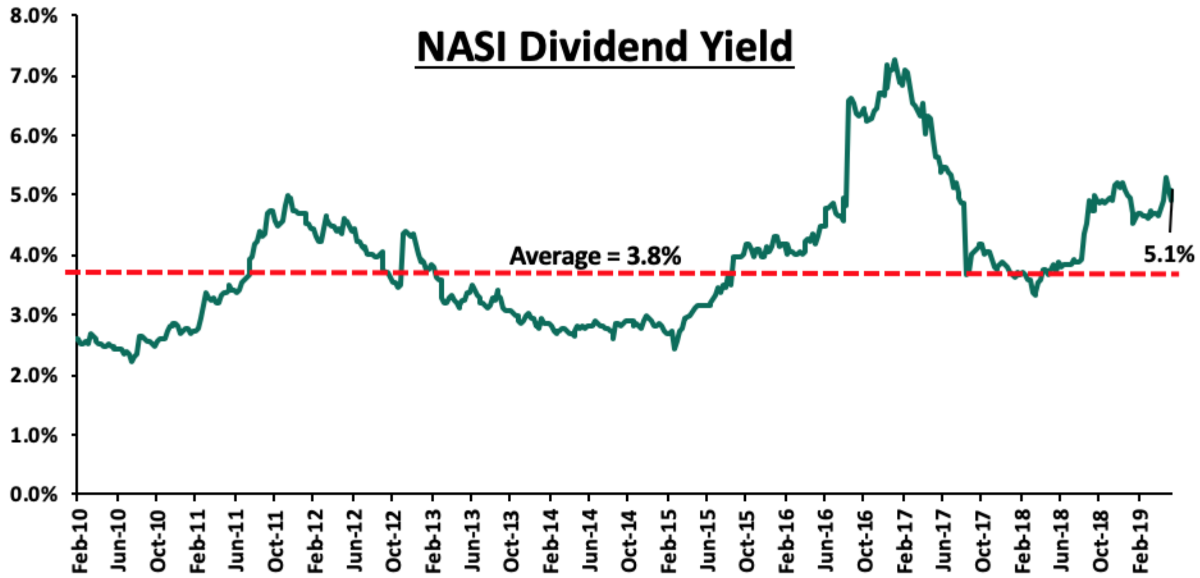
Market Performance:

During the week, the equities market recorded a positive performance, with NASI, NSE 20 and NSE 25 gaining by 0.4%, 0.9% and 0.9%, taking their YTD performance to gains/ (losses) of 7.1%, (4.7%) and 2.7%, for NASI, NSE 20 and NSE 25, respectively. The performance of NASI was driven by gains in large-cap stocks such as Bamburi, EABL, Equity Group and Barclays Bank, which recorded gains of 9.4%, 3.0%, 3.0% and 2.5%, respectively. The gain in the NASI was however weighed down by declines in BAT, Standard Chartered Bank Kenya (SCBK) and Safaricom, which recorded declines of 2.6%, 1.6% and 1.5%, respectively.

Equities turnover declined by 65.8% during the week to USD 12.9 mn, from USD 37.6 mn the previous week, due to reduced market activity and a shortened trading week, taking the YTD turnover to USD 680.0 mn. Foreign investors remained net buyers for the week, with a net buying position of USD 0.3 mn, a 97.5% decline from a net buying position of USD 11.2 mn last week.

The market is currently trading at a price to earnings ratio (P/E) of 11.9x, 10.9% below the historical average of 13.4x, and a dividend yield of 5.1%, 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 11.9x is 21.4% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 43.4% 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

National Bank of Kenya (NBK) shareholders approved the buyout offer by KCB Group, in agreement with the company's Board of Directors who also unanimously agreed on the buyout offer by KCB Group. NBK's two main principal shareholders The National Treasury, and the National Social Security Fund who will own a combined 93.2% after the conversion of the preference shares into ordinary shares, voted in favor of the transaction, as both the major shareholders and the board of directors expect the acquisition to be beneficial to both shareholders and the bank's clients. If successful, the transaction will see KCB Group significantly increase its balance sheet, with management highlighting in a circular sent to shareholders, that they expected to reach the Kshs 1.0 tn mark by the end of 2022, consequently cementing KCB Group's position as the largest bank by assets. In a bid to streamline the operations of the group, management also highlighted that there may be job cuts, as the bank removes overlapping roles, reduce the associated expenses, and consequently improve the overall efficiency. We expect completion of the transaction to negatively affect KCB Group's asset quality in the short term, largely due to NBK's relatively larger Non-Performing Loans Ratio of 47.6% as at FY'2018. With adequate capital buffers, we do not expect a significant impact on KCB Group's capital base, which would necessitate a capital raise by the bank. The merger should aid KCB in getting a majority of the government business handled by NBK, and presumably aid in keeping the cost of funds relatively low, as NBK's cost of funds of 3.3%, as at Q1'2019, and KCB's cost of funds of 3.1%, should see the combined entity maintain the cost of funds below the market average of 3.4%, as at Q1'2019. We maintain our view that Kenya remains overbanked, and there is the need to remove the struggling banks that are undercapitalized, do not serve any niche, and do not have any systemic importance, so as to improve the sector's overall stability.

Co-operative Bank of Kenya highlighted its plan of growing the business of its leasing-focused subsidiary Co-op Bank Fleet. Co-op Bank Fleet intends to leverage on the synergies created by Co-operative Bank's client base to grow its business, with the main business case of the subsidiary being the easing of the cash flow constraints of acquisitions of fleets, repair and maintenance, thus allowing businesses to focus on their core business. Thus, with lower costs, firms would be able to acquire more fixed assets, which would aid in boosting their productivity. With a leasing deal of Kshs 890.0 mn already sealed with the government, the subsidiary focusses not only on government entities but also on non-government entities. As the business gains traction, we are of the view that this would continue to aid Co-operative Bank in growing its Non-Funded Income (NFI) as the bank continues to focus on this segment of income. We note that continued focus on this segment has seen its contribution to total operating income rise to 37.7% in Q1'2019, from 32.2% in Q1'2018. This should continue to buffer the bank's bottom line from significant declines, as interest revenue remains depressed in the current interest-capped regime.

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Banks	Price as at 31/05/2019	Price as at 7/06/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank	120.0	120.0	0.0%	(23.3%)	241.5	2.2%	103.4%	**0.6x**	**Buy**
UBA Bank	6.3	6.3	0.0%	(18.8%)	10.7	13.6%	84.8%	**0.4x**	**Buy**
Zenith Bank	20.1	20.4	1.2%	(11.7%)	33.3	13.3%	77.0%	**0.9x**	**Buy**
CRDB	120.0	120.0	0.0%	(20.0%)	207.7	0.0%	73.1%	**0.4x**	**Buy**
CAL Bank	0.8	0.8	(1.2%)	(17.3%)	1.4	0.0%	72.8%	**0.7x**	**Buy**
NIC Group	30.5	30.6	0.2%	9.9%	48.8	3.3%	63.0%	**0.8x**	**Buy**
KCB Group***	39.5	39.5	0.0%	5.5%	60.0	8.9%	60.8%	**1.0x**	**Buy**
GCB Bank	5.0	5.1	0.2%	9.8%	7.7	7.5%	60.4%	**1.2x**	**Buy**
Access Bank	6.1	6.3	3.3%	(7.4%)	9.5	6.3%	57.1%	**0.4x**	**Buy**
Co-operative Bank	12.5	12.5	0.0%	(12.9%)	18.5	8.0%	56.6%	**1.1x**	**Buy**
I&M Holdings	57.0	58.0	1.8%	36.5%	83.9	6.0%	50.6%	**1.2x**	**Buy**
Equity Group	38.9	40.0	3.0%	14.8%	58.1	5.0%	50.3%	**1.7x**	**Buy**
Barclays Bank	10.2	10.5	2.5%	(4.6%)	13.1	10.5%	35.9%	**1.4x**	**Buy**
Ecobank	8.0	8.0	0.0%	6.7%	10.7	0.0%	34.1%	**1.8x**	**Buy**
Guaranty Trust Bank	31.6	30.4	(3.8%)	(11.8%)	37.1	7.9%	29.9%	**1.9x**	**Buy**
Stanbic Bank Uganda	30.0	29.1	(3.0%)	(6.2%)	36.3	4.0%	28.7%	**2.1x**	**Buy**
Stanbic Holdings	98.0	98.3	0.3%	8.3%	115.6	6.0%	23.6%	**0.9x**	**Buy**
Bank of Kigali	265.0	265.0	0.0%	(11.7%)	299.9	5.2%	18.4%	**1.5x**	**Accumulate**
National Bank	4.1	4.4	8.3%	(16.5%)	5.2	0.0%	17.1%	**0.3x**	**Accumulate**
SBM Holdings	5.9	5.9	0.0%	(1.7%)	6.6	5.1%	17.1%	**0.8x**	**Accumulate**
Union Bank Plc	6.3	7.0	12.0%	25.0%	8.2	0.0%	16.4%	**0.7x**	**Accumulate**
Standard Chartered	186.5	190.0	1.9%	(2.3%)	203.8	6.6%	13.8%	**1.4x**	**Accumulate**
Bank of Baroda	129.0	128.2	(0.6%)	(8.4%)	130.6	1.9%	3.8%	**1.1x**	**Lighten**
FBN Holdings	7.1	7.0	(1.4%)	(12.6%)	6.6	3.6%	(1.0%)	**0.4x**	**Sell**
Ecobank Transnational	11.2	10.0	(10.3%)	(41.2%)	9.3	0.0%	(7.2%)	**0.4x**	**Sell**
Standard Chartered GH	21.7	21.7	(0.2%)	3.1%	19.5	0.0%	(10.1%)	**2.7x**	**Sell**
Stanbic IBTC Holdings	42.0	42.5	1.2%	(11.4%)	37.0	1.4%	(11.5%)	**2.2x**	**Sell**

Banks	Price as at 31/05/2019	Price as at 7/06/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
HF Group	4.4	4.4	0.0%	(20.6%)	2.9	8.0%	(26.1%)	**0.2x**	**Sell**

**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.*

*****Stock prices indicated in respective country currencies*

We are "Positive" on equities for investors as the sustained price declines have 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.

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