Investment Options in the Kenyan Market, & Cytonn Weekly #30/2019

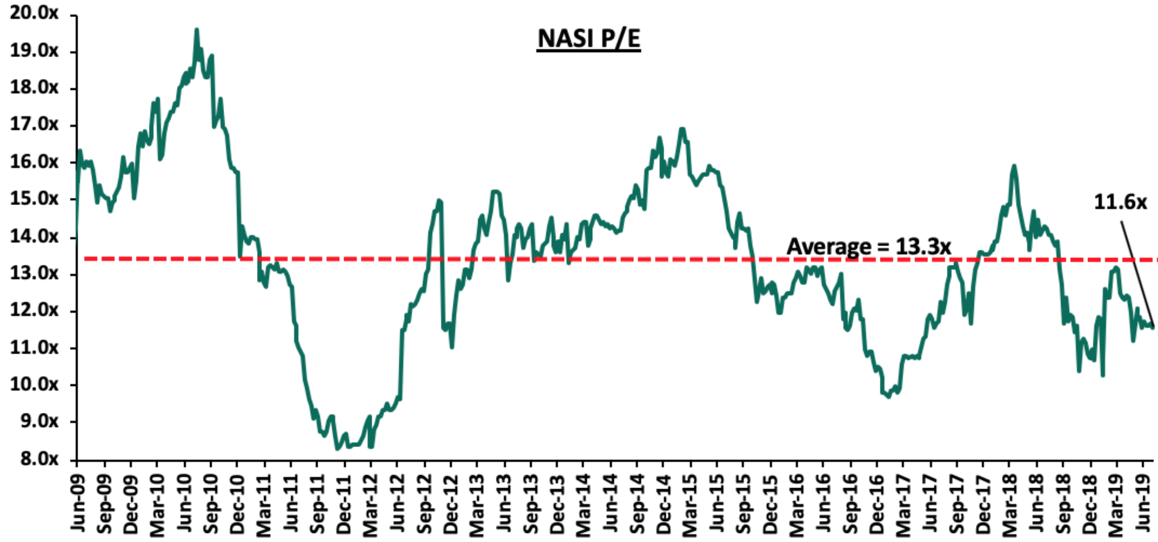
Equities

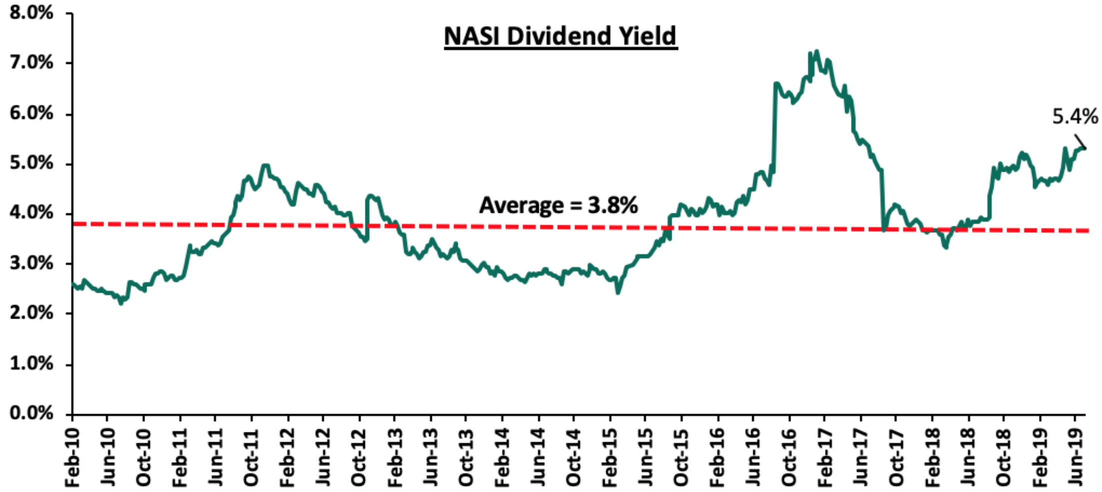
Market Performance

During the week, the equities markets was on an downward trend with NASI, NSE 20 and NSE 25 falling by 0.7%, 0.9% and 0.3%, respectively, taking their YTD performance to gains/losses of 5.9%, (6.0%) and 1.4%, for NASI, NSE 20 and NSE 25, respectively. The performance in NASI was driven by declines in Equity Group, BAT, Safaricom, and NIC Group, which declined by 4.1%, 1.5%, 1.4%, and 1.3%, respectively.

Equities turnover increased by 18.0% during the week to USD 26.0 mn, from USD 22.0 mn the previous week, taking the YTD turnover to USD 864.1 mn. Foreign investors remained net sellers for the week, with the net selling position decreasing by 60.1% to USD 4.3 mn, from USD 7.2 mn the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 11.6x, 12.8% below the historical average of 13.3x, and a dividend yield of 5.4%, 1.6% points 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 11.6x is 19.4% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 39.4% 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:

During the week, the Banking Amendment Bill was tabled in the National Assembly. The Bill seeks to seal the loopholes in the wordings of the Banking (Amendment) Act 2015. In March 2019, the High Court suspended the Banking (Amendment) Act 2015 in a ruling that declared Section 33B (1) and (2) of the Banking Act unconstitutional, and gave the National Assembly one year to amend the anomalies, failure to which will mean a reversion to a free-floating interest rates regime. A three-Judge bench determined that the wordings the Parliament used to define the terms ‘credit facility’ and the ‘Central Bank Rate’ are vague and open to multiple interpretations. The anomalies and ambiguity arise in Section 33B (1) of the Banking Act which states that, “a bank or a financial institution shall set the maximum interest rate chargeable for a credit facility in Kenya at no more than four percent, the Central Bank Rate set and published by the Central Bank of Kenya (now at 9.0%)”. The judges noted that the words “at no more than four percent, the Central Bank Rate” are vague since it is not clear if it is above or below CBR. In September 2018, the National Assembly blocked a section the Finance Bill 2018 that sought to repeal the cap on lending rates, and instead, the floor cap on deposit rates was scrapped off. The outcome of the proposed bill remains uncertain, as we expect the President to possibly decline to ascent the bill. We however continue to strongly advocate for a repeal or at least significantly review the Banking (Amendment) Act, 2015; our position for a repeal is based on the fact that the rate cap legislation (i) has hampered credit growth, evidenced by the continued decline of private sector credit growth, which came in at 4.9% as at April 2019, below the 5-year average of 11.2%, (ii) is harming the very people it was meant to protect – those who are likely to be charged high interest rates because of their credit risk rating. Because of rate caps, banks have shied away from lending to them, leaving them with no options except to approach shylocks and digital lenders, who charge exploitative rates. A proposition to repeal the law was also included in the Finance Bill 2019, where we expected a possible review, in the form of a change in the benchmark from the Central Bank Rate (CBR), to probably the Kenya Bank Reference Rate (KBRR), and an increase in the margin from the current 4.0%. We are also of the view that a reversion to the free-floating rate regime will likely see the following benefits accrue to the economy:

a. Growth in private sector credit: As of April 2019, the private sector credit growth rate stood at 4.9% according to the MPC market perception survey. With the repeal of the rate cap law, we expect that access to credit by Micro, Small and Medium Enterprises (MSMEs) will increase as banks will have sufficient margin to compensate for risks. The target credit growth rate that is conducive to a sustainably growing the Kenyan economy is between 7.0-8.0%, according to the Central Bank of Kenya,
b. GDP growth: Credit and economic growth are positively correlated and we expect that with increased access to credit by MSMEs, the economy is bound to expand as MSMEs make a significant contribution to the economy. According to data from the KNBS, Micro, Small and Medium Enterprises (MSMEs) 2016 survey, MSMEs account for approximately 28.4% of Kenya's GDP, and,
c. Increased monetary policy effectiveness: With the repeal of the rate cap law, the Central Bank of Kenya will be free to adjust the monetary policy rate in response to economic developments such as inflation and growth.

For additional information, please see our topical on interest rates cap here.

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Banks	Price as at 19/07/2019	Price as at 26/07/2019	w/w change	YTD Change	Target Price*	Upside/Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank	115	114	(0.9%)	(27.2%)	228.4	96.2%	0.6x	Buy
CRDB	105.0	105.0	0.0%	(30.0%)	207.7	88.8%	0.4x	Buy
UBA Bank	5.5	5.5	0.0%	(28.6%)	10.7	88.0%	0.4x	Buy
Zenith Bank	18.5	18.5	(0.3%)	(20.0%)	33.3	82.9%	0.8x	Buy
KCB Group***	39.6	39.8	0.5%	6.1%	60.4	66.8%	1.1x	Buy
GCB Bank	5.0	5.0	0.0%	7.6%	7.7	64.3%	1.2x	Buy
I&M Holdings	52.0	53.0	1.9%	24.7%	81.5	54.8%	1.0x	Buy
Access Bank	6.4	6.5	1.6%	(4.4%)	9.5	52.3%	0.4x	Buy
Co-operative Bank	12.1	12.1	0.0%	(15.4%)	17.1	50.4%	1.0x	Buy
Equity Group	42.0	40.3	(4.1%)	15.5%	53.7	42.7%	1.7x	Buy
NIC Group	30.2	29.8	(1.3%)	7.0%	42.5	42.3%	0.6x	Buy
CAL Bank	1.0	1.0	(1.0%)	0.0%	1.4	40.0%	0.8x	Buy
Barclays Bank	10.3	10.5	1.5%	(4.6%)	12.8	33.0%	1.3x	Buy
Stanbic Bank Uganda	29.0	29.0	0.0%	(6.5%)	36.3	29.1%	2.1x	Buy
SBM Holdings	5.5	5.5	(0.4%)	(8.4%)	6.6	23.1%	0.8x	Buy
Guaranty Trust Bank	29.3	28.7	(2.2%)	(16.8%)	37.1	21.1%	1.8x	Buy
Stanbic Holdings	96.0	98.5	2.6%	8.5%	113.6	20.6%	1.1x	Buy
Ecobank	8.1	8.5	5.6%	13.3%	10.7	19.2%	1.9x	Accumulate
Union Bank Plc	6.5	6.4	(1.5%)	14.3%	8.2	16.4%	0.7x	Accumulate
Standard Chartered	195.3	196.0	0.4%	0.8%	200.6	9.5%	1.4x	Hold

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