

Is There a Real Estate Bubble in Kenya? & Cytonn Weekly #04/2020

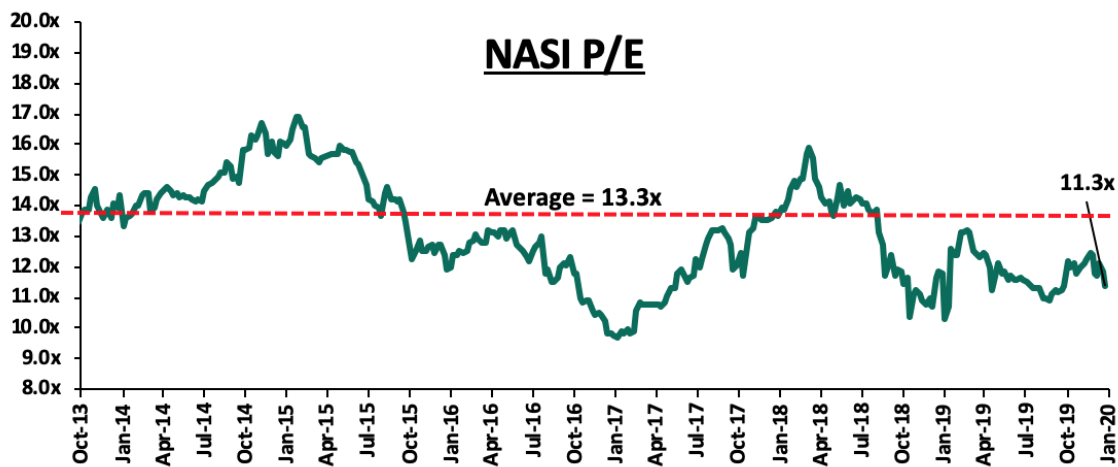
Equities

Market Performance

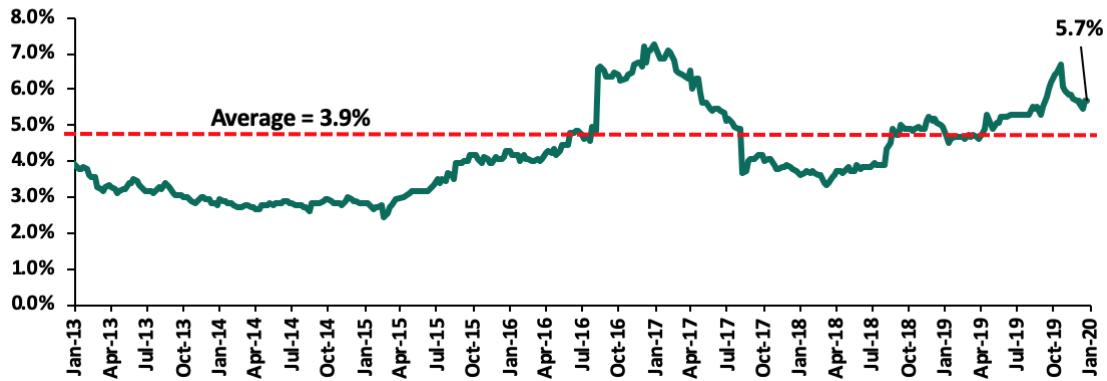
During the week, the equities market was on a downward trend with NASI, NSE 20, and NSE 25 recording declines of (0.8%), (1.0%), and (0.7%), respectively, taking their YTD performance to (0.9%), (0.4%) and (0.6%), for the NASI, NSE 20, and NSE 25, respectively. The performance in NASI was driven by losses recorded by large-cap stocks such as Bamburi, Barclays and Co-operative bank of (8.4%), (3.0%) and (2.5%), respectively.

Equities turnover decreased by 29.9% during the week to USD 28.2 mn, from USD 40.2 mn recorded the previous week, taking the YTD turnover to USD 97.1 mn. Foreign investors remained net buyers for the week, with a net buying position of USD 1.6 mn, a 75.0% decrease from a net buying position of USD 6.6 mn recorded the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 11.3x, 15.0% below the historical average of 13.3x, and a dividend yield of 5.7%, 1.8% points above the historical average of 3.9%. With the market trading at valuations below the historical average, we believe there is value in the market. The current P/E valuation of 11.3x is 16.6% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 36.3% 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.



NASI Dividend Yield



Weekly Highlight

During the week, Jubilee Holdings announced plans to lay off 52 employees as it completes splitting of its insurance business in Kenya to increase efficiency and management focus and to comply with the revised 2010 Insurance Act, cap 487, which requires all composite companies to have separate entities, by separating short-term underwriting business from the long-term underwriting business. The separation has led to the creation of two new companies, Jubilee Health Insurance offering medical covers and Jubilee General Insurance offering general insurance covers. In H1'2019 Jubilee's net profits dropped marginally by 1.6% to Kshs 1.8 bn, from Kshs 1.9bn in H1'2018, attributable to a tough operating environment, which affected the top-line revenue, coupled with rising inefficiencies, consequently leading to declines in net income. Similarly in 2019, Sanlam Kenya PLC also undertook restructuring as part of a cost-cutting strategy aimed at trimming operating costs, as the company aimed to record a profitable performance following the depletion of earnings in 2018 to record a Kshs 2.0 bn loss. Over the last few years, companies have continued to face economic challenges that has seen them restructure their staffing, with others declaring redundancies, and others opting for outright closure. The table below shows some of the listed companies that have announced or undertook restructuring in the last one year. In our view, restructuring continues to be a major theme shaping various sectors' business models into 2020, with companies adopting cost-saving measures to boost bottom-line performance, attributable to a tough business environment;

Kenya Listed Companies Restructuring

Company	Staff Retrenchment	Date
Jubilee Holdings	52	Jan-20
East Africa Portland Cement	800*	Aug-19
Stanbic Bank of Kenya	88	Aug-19
East Africa Breweries Limited	100	Jul-19
Sanlam Kenya	19	Sep-19
Mumias Sugar**	All staff	Nov-19

*EAPC declared all its staff redundant and required them to reapply under new terms

**Mumias sugar was placed in receivership on 20th September 2019

During the week, the Capital Markets Authority released the Q4'2019 Statistical Bulletin, highlighting the performance of the Equities market during the quarter under review;

- i. During the quarter, four companies remained suspended, namely Atlas African Industries Ltd, Deacons East Africa Plc, ARM Cement Plc, and Mumias Sugar Company Ltd,
- ii. There was increased trading at the bourse with equity turnover increasing by 27.0% to Kshs 45.0

- bn in Q4'2019, from Kshs 35.4 bn in Q4'2018, attributable to the improved financial performance of listed commercial banks in the country, coupled with the repeal of the rate cap law in the last quarter of the year, which led to increased activity at the bourse,
- iii. In Q4'2019, the NASI and the NSE 20, stood at 166.4 and 2,654.4 points, respectively, recording gains/(losses) of 18.5% and (6.3%), respectively, from 140.4 and 2,833.8 points, respectively, recorded in the same period of review in 2018. The gain recorded by NASI is attributable to the rallying of banking stocks following the removal of the interest rate cap,
 - iv. Foreign investor participation decreased by 12.1% points in Q4'2019 to 63.0%, from 75.1% in Q4'2018, attributable to investors shifting to developed markets following the announcement of the phase one U.S- China trade deal in the fourth quarter giving a boost to global equities,
 - v. The derivatives market recorded a 44.1% decrease in trading with 205 contracts traded in Q4'2019, from 367 contracts traded in Q3'2019. Safaricom was the most liquid counter with 133 contracts followed by banking contracts (Equity at 35 and KCB Group at 27). The NEXT derivatives market is expected to provide new opportunities to investors enabling them to diversify, manage risk, and allocate capital efficiently, however, it remains extremely small with little activity, and,
 - vi. During the period under review, two medium-term notes and one corporate Infrastructure bond issued by Housing Finance, CIC Insurance, and Kengen, respectively, matured. Housing Finance issued a Kshs 3.0 bn medium-term note in October 2012 with a maturity date of October 2019. CIC's medium term note worth Kshs 5.0 bn, issued in September 2014, matured in October 2019. Lastly, Kengen's Infrastructure bond worth Kshs 14.1 bn was issued on November 2009 and matured in October 2019. The local corporate bond market has witnessed reduced activity, with the Acorn Green Bond being the only issued corporate bond in the last five years, attributable to defaults witnessed over the past five years by issuers such as ARM Cement, Nakumatt and Imperial Bank.

We maintain our view that to improve the performance of the equities market, the following should be addressed;

- i. Investors and Issuers Education- There remains the need for increased focus towards extensive investor education and public awareness initiatives, in order to boost domestic investor participation, either through saving, investing or borrowing, in order to grow the local capital market,
- ii. Shifting Reliance Away from Bank Loans towards Capital Market Instruments - Banks are the primary source of business funding in the country, providing 95.0% of funding, with other alternative sources such as the capital markets providing a combined 5.0%, compared to developed markets where banks provide only 40.0% of the credit in the economy. Several SMEs have a poor understanding of the capital markets and are unaware of ways in which they can use them to raise funds. The first step towards achieving this would be investor education/ awareness campaigns in order to educate SMEs on how they can use the stock exchange better and build their confidence in the financial system of the capital markets,
- iii. Reduce Minimum Amount Investable in all Real Estate Investment Trusts (REIT) - In order to attract capital into capital market vehicles such as Real Estate Investment Trusts (REIT's) for real estate development, the minimum investment amount needs to be amended. The current regulations, which define the minimum subscription amount per investor at Kshs 5.0 mn for a Development REIT (D-REIT) is too high to attract significant interest from investors. An amount of Kshs 1.0 mn ensures the investor is sophisticated while also allowing a larger pool of investors to participate, and,
- iv. Improve Market Access and Efficiency - In order to achieve efficiency, there is need for high quality and timely information, which is derived from better disclosures by listed companies. Borrowing from South Africa, we recommend that the NSE develop policies which will require listed firms to disclose corporate news and price sensitive information to the bourse before going

to the media,

Universe of Coverage

Banks	Price at 17/01/2020	Price at 24/01/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
Kenya Reinsurance	3.0	3.0	0.0%	(1.0%)	3.0	4.8	15.0%	75.0%	0.3x	Buy
Diamond Trust Bank	117.0	116.8	(0.2%)	7.1%	109.0	189.0	2.2%	64.1%	0.6x	Buy
I&M Holdings***	58.3	57.5	(1.3%)	6.5%	54.0	75.2	6.8%	37.6%	1.0x	Buy
KCB Group***	51.8	51.8	0.0%	(4.2%)	54.0	64.2	6.8%	30.8%	1.4x	Buy
Jubilee Holdings	360.0	360.0	0.0%	2.6%	351.0	453.4	2.5%	28.4%	1.2x	Buy
Sanlam	17.5	17.3	(1.1%)	0.6%	17.2	21.7	0.0%	25.4%	0.7x	Buy
Co-op Bank***	16.0	15.6	(2.5%)	(4.6%)	16.4	18.1	6.4%	22.4%	1.3x	Buy
Equity Group***	51.3	51.5	0.5%	(3.7%)	53.5	56.7	3.9%	14.0%	1.9x	Accumulate
Standard Chartered	204.5	205.0	0.2%	1.2%	202.5	211.6	9.3%	12.5%	1.5x	Accumulate
Barclays Bank***	13.5	13.1	(3.0%)	(1.9%)	13.4	13.0	8.4%	7.6%	1.7x	Hold
Stanbic Holdings	112.8	100.8	(10.6%)	(7.8%)	109.3	103.1	4.8%	7.1%	1.1x	Hold
NCBA	36.3	36.5	0.7%	(0.9%)	36.9	37.0	4.1%	5.5%	0.8x	Hold
Liberty Holdings	10.4	10.4	(0.5%)	0.0%	10.4	10.1	4.8%	2.1%	0.9x	Lighten
CIC Group	2.9	2.9	1.4%	9.0%	2.7	2.6	4.5%	(5.2%)	1.0x	Sell
HF Group	6.1	5.7	(6.9%)	(11.8%)	6.5	4.2	0.0%	(26.3%)	0.2x	Sell
Britam	9.2	9.2	0.4%	2.7%	9.0	6.8	0.0%	(26.9%)	0.9x	Sell

*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

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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