

8th March 2019

Market Review

The stock market has exhibited a downward trend in the last few weeks owing to profit taking activities as investors seek to book gains derived from the recent market rally. In as much as we expect the profit taking activities to continue, we expect this to be short lived. This is informed by the upcoming FY2018 banking results which may provide some uplift to the market.

Market Recommendations

KCB Group

We recommend a **LONG TERM BUY** on KCB. The counter is currently trading at a P/B of 1.27 (at a price of KES 43.95) against an industry average of 0.97x as at 8th March. Furthermore, KCB has a dividend yield of 6.8%, higher than the industry average of 5.0%. KCB has a high ROaE of 19.5% against an industry average of 13.4%. We believe the group's strategic partnerships and digital transformation will continue to deliver growth. Whilst we expect the rebound in interest income to continue in the short-term (given the improvement in the operating environment),

non-funded income to total income given the increasing need for revenue diversification as regulatory pressure continues to intensify.

FY2018 Results commentary:

The Group posted a 21.8% y/y growth in after tax profits for FY2018 to KES 24.0 billion. The performance was characterized by sluggish growth in operating income (0.6% y/y to KES 71.8 billion) but a significant decline in operating expenses (10.2% y/y to KES 37.9 billion). The decline in operating expenses was mainly due to a decrease in staff costs (11.2% y/y to KES 17.0 billion) and loan loss provisions (50.2% y/y to KES 2.9 billion). We do not expect the declines in operating expenses posted in the year to recur. Management has already guided that the cost of risk (and therefore provisions) will rise to from 0.7% in FY2018 to 1.2% in FY2019. We also do not expect restructuring efforts at the same scale as the one done in FY2017. It's therefore imperative for the group to grow operating income since cost optimization is not a sustainable way to grow profits. We are optimistic of the group's commitment to grow its loan book (and therefore interest income) despite the interest rate caps. We are also encouraged by its investments in digital assets particularly in the mobile space. We note that during the year 88% of

transactions were performed outside the branch with revenue outside the branch growing by 27% to over 5.2 billion. We also optimistic that South Sudan is on a recovery path following the peace deal (boost business confidence) and also the progressively lower inflation rates (should mitigate impact of hyperinflationary accounting).

Equity Group Holdings

We recommend a **LONG TERM BUY** on Equity Group Holdings with a one-year target price of KES 54.11 – representing an upside potential of 29.8% from the current market price of KES 41.70 (as at 8th March 2019). Currently, Equity is trading at a P/B of 1.69x compared to the average banking sector P/B of 0.97x as at 8th March 2019.

We attribute the high P/B ratio to high growth expectations by investors. Equity has a high ROaE of 21.6% (the highest in the banking sector) which is well above the industry average of 13.4%.

The current business model, hinged on technology, innovation and business diversification affirms the group's competitive advantage in an industry adapting to the digitization strategy amidst the current regulatory challenges. Thus, we believe this business model will support growth in the long-term.

Equity has a new dynamic business model tailored to address the emerging challenges in the banking sector. The model is hinged on the following focus areas:

- Non funded income growth - to support net interest income
- Regional diversification - to mitigate against regulatory risk
- Strengthening liquidity and balance sheet agility
- Treasury operations - to enhance treasury income
- Asset quality (especially with tougher regulations in the horizon)
- Innovation and digitization
- Efficiencies and cost optimization

Bamburi Cement

We place a **HOLD** recommendation on Bamburi Cement. Bamburi Cement has a strong market presence in the East African region with key markets in Kenya, Uganda and Rwanda. The company plans to increase its cement capacity (in both Kenya and Uganda) by 1.8 million metric tonnes in FY2018. The company has already completed construction on its Athi River grinding plant which is expected to increase the company's annual production capacity by 900,000 metric tonnes. As competition continues to intensify within the cement sector, we expect Bamburi to register subdued revenue growths (as compared to historical trends) due to lower prices. In light of this, cost minimization strategies will be key in driving growth in the bottom-line. The company has consistently been implementing various cost reduction initiatives specifically aimed at energy costs such as the use of alternative fuels such as petcoke and biomass. The company encountered a challenging year in FY2017 – resulting in a 66.5% y/y decline in after tax profits mainly due to a challenging macroeconomic environment in Kenya. Bamburi Cement realized a ROaE of 6.4% in FY2017 considerably lower than 19.8% recorded in FY2016. Bamburi issued a profit warning for FY2018, as it expects after tax profits for FY2018 to decline by more than 25.0%. According to the company, the decline in performance is due to: difficult market conditions (in both Kenya and Uganda), rising international energy prices, higher power costs and additional provisions (for receivables in Uganda). The company has a dividend yield of 3.1% (at a price of KES 130.00 as at 8th March 2019) and is trading at a P/E ratio of 28.63x, (high due to its low EPS).

Safaricom

We recommend a **HOLD** on Safaricom. The counter is currently trading at a P/E multiple of 19.29x (at a price of KES 27.00, as at 8th March 2019). The company is a market leader in the telecommunications industry with a market share of 64.2%. (3Q2018) of total mobile subscriptions. This represents a 41.9% market lead over its closest competitor Airtel Kenya. The market share gap between Safaricom and its competitors has been

supported by the company's heavy CAPEX spend over the years. Mobile data and M-PESA continue to be a key revenue drivers for Safaricom. The company has continued to leverage on the success of MPESA with new initiatives being based on the money transfer platform. We also note that the company is also pursuing opportunities outside Kenya. For instance, Safaricom is in talks with the Ethiopian government to introduce M-PESA in Ethiopia. In spite of the rising competitive and regulatory pressure (anticipated regulations based on the dominance study) we remain optimistic that the company will remain competitive. Furthermore, even with the recent increase in excise taxes (on mobile money transfer services, telephone and data services), we opine that subscription numbers will not be significantly affected owing to the high costs of switching to other networks. The large M-PESA ecosystem (agent network, customers, business vendors...) coupled with better coverage and reliability will deter users from shifting to other networks. A key risk we see with the MPESA ecosystem is the proposal by CA to enhance and extend the mobile interoperability. This may see the introduction agent to agent interoperability. This coupled with the current wallet to wallet interoperability may help smaller operators grow their ecosystems much faster. Agent to agent interoperability will likely require lengthy and wide consultations to implement and thus will only be a possibility in the medium to long term.

EABL

We place a **HOLD** recommendation on EABL. The company is the largest branded alcohol beverage business within East Africa. Furthermore, the company is 50.03% owned by Diageo – a multinational alcoholic beverage company. We expect EABL to focus on sustaining the growth momentum of spirits and value beer, through capacity investments. The company has been redirecting its focus towards the spirits and value beer categories as opposed to the mainstream and premium beer categories due to declining beer sales occasioned by evolving consumer trends and higher excise taxes. The company is constructing a KES 14.0 billion brewery in Kisumu – which will initially produce Senator Keg (value beer). This brewery is expected to

commence operations in July 2019. Moreover, the company has completed the construction of a new spirits line at its headquarters in Ruaraka at a cost of KES 600.0 million, in order to meet the rising demand for spirits (being driven by a growing middle class with higher disposable income). However, we note with concern on the implementation of the Excise Act that gives the Treasury and the Kenya Revenue Authority the power to implement inflation-based tax increases. This may hamper demand through higher retail prices. EABL has an attractive ROaE of 61.4% with a modest dividend yield of 3.9%. The company is trading at a P/E ratio of 29.17x, (at a price of KES 209.75) as at 8th March 2019.

Jubilee Holdings

We recommend a **BUY** on Jubilee Holdings. The company, through its subsidiaries, provides all classes of insurance and has a strong market presence in East Africa. Moreover, the company's associate businesses (Bujagali Energy Limited, Farmers Choice Limited, and Seacom...) have strong fundamentals. Jubilee's growth strategy in the long-term business has been hinged on sustained product development, pricing efficiency and adaptability to market trends. We expect the Group to continue to focus on fraud management especially in their short-term business in order to minimize claims. With regards to medical insurance, we expect the Group to implement cost minimization measures to enable the provision of affordable premiums. Jubilee is currently trading at a P/B of 1.21x (at a price of KES 420.00 against an industry average of 0.89x as at 8th March 2019 – higher due to its attractive fundamentals.

Barclays Bank of Kenya

We recommend a **HOLD** on Barclays Bank with the counter trading at a P/B of 1.49x (at a price of KES 11.60) against an industry average of 0.97x as at 8th March 2019. The counter has a high ROaE of 16.3%, which is above the industry average of 13.4%. Additionally, the counter has the high dividend yield at 8.8%. The Bank has been relying on its investments in technology – leveraging it to improve operational efficiency. This has notably been evidenced through the reduction in

the number of traditional branches (and consequently staff headcount) and focus on alternative banking channels (mobile and internet banking). We expect the bank to continue focusing on alternative banking channels to drive revenue growth and improve efficiencies. Moreover, following the reduction of Barclays PLC's stake in Absa Group (formerly Barclays Africa Group), we expect the bank to utilize this new 'freedom' to pursue new products more tailored towards the local market.

Diamond Trust Bank

We recommend a **HOLD** on Diamond Trust Bank. Trading at a P/B ratio of 0.73x (at a price of KES 140.00 as at 8th March 2019), makes the counter attractive when compared against the banking industry average P/B ratio of 0.97x. Additionally, the counter realized a ROaE of 13.0% in FY2017 – in line with the industry average of 13.4%. With the Aga Khan Fund for Economic Development as the top shareholder, the bank has continued to reap the benefits arising from shared ownership with organizations in other industries (Jubilee Holdings and NMG). The company has leveraged this ecosystem to diversify its revenues. Going forward, we expect DTB to continue to diversify its revenue streams while leveraging on technology to improve operational efficiency.

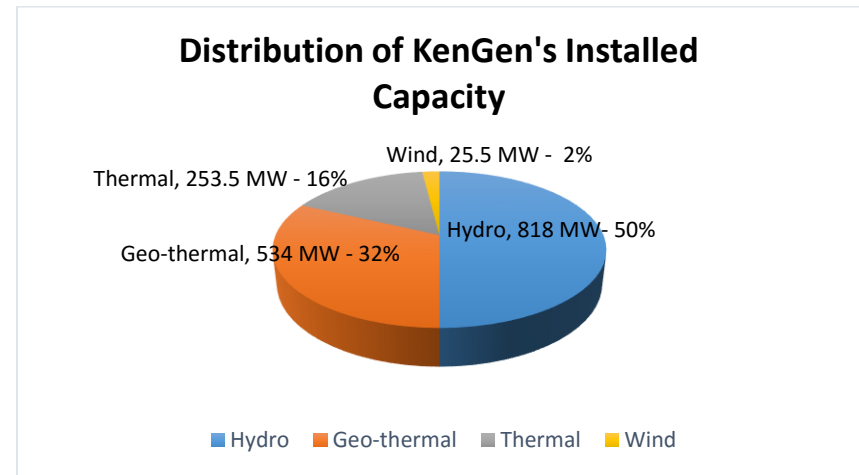
Cooperative Bank

We recommend a **LONG TERM BUY** on Cooperative Bank with the counter trading at a P/B of 1.21x (at a price of KES 14.55) against an industry average of 0.97x as at 8th March 2019. The counter has a high ROaE of 17.4%, which is above the industry average of 13.4% with a dividend yield of 5.5%. - commensurate with the industry average. Given the digital disruption in the banking industry, through its Soaring Eagle transformational agenda, the bank has been focusing on migrating banking transactions to alternative banking channels and automating key processes. We expect this to enable the bank to improve its efficiency. The bank is also exploring the use of data analytics (big data) to aid the development of systems and infrastructure while also providing insights on clients. Notably, the bank

intends to undertake various initiatives to position itself as the leading bank in the MSME segment.

KenGen

We recommend a **LONG TERM BUY** on KenGen. As at the end of FY2018, the counter had a market share of 69.0% with an installed capacity of 1,631 MW distributed amongst various power sources as shown below. The company is currently trading at a P/E of 5.08x, (at a price of KES 6.10) as at 8th March 2019, lower than the industry average of 7.25x (excluding Umeme).



Source: Company Reports

The company plans to increase installed capacity by an additional 721 MW by 2020 through a geothermal led strategy. We expect these additions to enhance revenues in the long-term. The development projects lined up are shown below:

Development Projects	MW	Status
Olkaria Wellheads	25	Commissioned
Ngong Phase 3	10	Optimization Study
Olkaria I AU Upgrading	30	Financing

Olkaria IV Uprating	30	Financing
Olkaria I Unit 6	70	Procurement of Contractors
Olkaria I Rehab	6	Financing Committed
Olkaria V	140	Construction Ongoing
Wellhead Plants	50	Procurement of Developers
Meru Wind Phase 1	80	Financing Committed
Olkaria VI	140	Project Development
Olkaria VII	140	Project Development
Total	721	

Source: Company Reports

KenGen also recently revealed that it is currently seeking KES 5.7 billion from multiple financiers to fund the construction of a 45 MW solar power plant.

KenGen's after tax profits for FY2018 declined by 12.4% y/y to KES 7.9 billion from KES 9.0 billion recorded in FY2017. The dip in after tax profits was predominantly attributable to an 8.5% y/y rise in operating expenses to KES 23.7 billion (FY2017: KES 21.8 billion), a 57.0% y/y increase in the income tax expense to KES 3.4 billion and a 405.9% y/y decline in other net gains from KES 343.3 million to a net loss of KES 1.0 billion (impacted by revaluation losses attributable to adverse currency movements).

As the next power plant is expected to be commissioned in FY2020, we do not expect KenGen to benefit from any tax allowances in FY2019. We also note that since the company has been exempted from paying compensating tax in the Finance Bill 2018, we expect their dividend policy to be much more consistent, going forward.

Britam Holdings

We revise our recommendation from a **BUY** to a **HOLD** on Britam. The counter trading at a P/B ratio of 0.91x (at a price of KES 9.58) against an

industry average of 0.89x as at 8th March 2019. The company has well diversified business lines in the insurance, asset management and property development businesses. Furthermore, the company is regionally diversified with operations in six other African countries including Tanzania, Uganda, South Sudan, Rwanda and Mozambique. The company has the largest market share in the life assurance business and has the largest distribution network (over 46 branches). Moreover, the company is actively pursuing the use of technology in delivering its products to clients. The company recently completed the sale of 360.8 million new shares worth KES 5.7 billion to private equity fund AfricInvest. According to the company, these funds will be used to ramp up property development, increase investment in its subsidiaries and improve its digital delivery channels.

Britam has announced a profit warning for FY2018, expecting after tax profits for FY2018 to contract by at least 25.0% y/y compared to FY2017. Some of the factors that affected Britam's performance include the bear run at NSE and a challenging operating environment. Going forward, we remain cautious on the impact of Britam's relatively high weighting in equities and real estate investments (as at 1H2018, Britam's investment in equities and real estate stood at 41% of total investment assets).

Centum

We recommend a **LONG TERM BUY** on Centum. Our recommendation is based on the relatively good financial performance. In 1H2019, Centum posted a 27.5% y/y growth in consolidated after tax profits for 1H2019 to KES 2.1 billion (1H2018: KES 1.6 billion). The rise in profitability was mainly driven by higher investment income, which surged by 84.1% y/y to KES 4.1 billion. Investment income was lifted by a KES 1.2 billion gain from the sale of GenAfrica Asset Managers, and a 33.1% y/y rise in valuation gains owing to improved investment property valuations validated by revenue potential for pre-sales worth KES 1.8 billion. We also note that the company's share price is trading at a significant

discount to the Net Asset Value (NAV) per share. At the end of the 1H2019, the company's NAV per share stood at KES 73.6 (reflecting a CAGR of 20.8% between FY2014 and FY2018), a 56.5% discount to the company's share price of KES 32.05 as at 8th March 2019.

We opine that the company's NAV (and asset valuations¹) is conservative. For instance the company does not recognize control premiums where they have a controlling stake. Furthermore, development rights are being carried at a discount to actual valuations. For instance, the available Two Rivers development rights (est. 1.37 million SQM) are carried at a 50.0% discount to the valuation. We also see the conservative valuations in the exits. The company has had eight exits in the last five years with each valued higher than the carrying value. In the GenAfrica exit, for instance, the company realized a sale value of KES 2.3 billion compared to a carrying value of 1.4 billion on selling its 73.4% stake. We expect the company to channel exit proceeds towards reducing their debt burden and for investment in cash generative assets. The shift from Greenfield ventures to cash generative ventures is hinged on 3 business lines: (i) private equity to invest in large ticket assets (50.0 billion PE fund), (ii) real estate (selling unserviced land, development rights and apartments) and (iii) marketable securities. This move will enhance net cashflow for the company, ultimately enabling a higher dividend payout.

NBK

We recommend a **SELL** on National Bank of Kenya. Our biggest concern with National Bank is its weak corporate governance. We are not yet sure whether the bank has instituted enough reforms in its corporate governance that will drive growth. National Bank of Kenya is currently trading at a P/B of 0.27x, compared to industry (listed banks) average of 0.97x at a price of KES 5.68 as at 8th March 2019. We believe this low P/B is more of a case of "cheap is expensive" rather than attractiveness. The bank has the highest cost to income ratio amongst the listed lenders

¹ Except for Sidian Bank. We opine that the 1.16x P/B is too high

at 83.2 % (industry average is 54.4%). We attribute this to bank's slow pace in embracing alternative channels. National Bank also has the second lowest return on equity amongst the listed banks, at 4.5%.

Mumias

We recommend a **SELL** on Mumias Sugar. Despite the strong brand, we opine that Mumias Sugar cannot effectively compete in its current state and the challenges in the local sugar industry. We also note the historically weak corporate governance which have contributed lack of a clear strategy to reverse its fortunes. For FY2017, revenues declined by 66.75 to KES 2.1 billion. Loss for the same period widened to KES 6.7 billion from KES 4.8 billion. Mumias sugar continues to face several challenges in its operations including cane supply shortage, competition from other millers, sub optimal plant due to aging and sugar imports.

Summary

Counter	Recommendation	52-Week High	52-Week Low	YTD Change	Price as at 8th March 2019
KCB Group	Long-term Buy	55.00	34.00	17.4%	43.95
Equity Group Holdings	Long-term Buy	57.00	33.40	19.7%	41.70
Bamburi Cement	Hold	190.00	117.00	-1.9%	130.00
Safaricom	Hold	33.50	21.00	21.6%	27.00
EABL	Hold	270.00	160.00	20.0%	209.75
Jubilee Holdings	Buy	550.00	355.25	3.8%	420.00
Barclays Bank of Kenya	Hold	13.50	9.50	5.9%	11.60
Diamond Trust Bank	Hold	220.00	130.00	-10.6%	140.00
Cooperative Bank	Long-term Buy	20.00	12.65	1.7%	14.55
KenGen	Long-term Buy	9.25	5.50	-13.1%	6.10
Britam Holdings	Hold	15.85	9.00	-4.2%	9.58
Centum	Long-term Buy	47.25	22.50	9.6%	32.05
NBK	Sell	9.65	4.05	6.8%	5.68
Mumias	Sell	1.10	0.50	0.0%	0.58

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Recommendation Guide:

LONG-TERM BUY: Strong fundamentals. Upside likely to be realized in the long-term

BUY: Strong fundamentals. Target price represents an upside higher than 15%

HOLD: Stock is correctly priced. Target price represents a downside/upside within the -15% to 15% range

SELL: Deteriorating fundamentals. Target price represents a downside lower than -15%

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