FAIDA INVESTMENT BANK

INVESTMENT RECOMMENDATIONS REPORT

10th May 2019

Market Recommendations

BANKING SECTOR:

KCB Group

We recommend a **LONG TERM BUY** on KCB. The counter is currently trading at a P/B of 1.09x (at a price of KES 40.50) against an industry average of 0.90x as at 10th May 2019. Furthermore, KCB has a dividend yield of 8.5%, higher than the industry average of 5.1%. KCB has a high ROaE of 21.9% against an industry average of 13.5%. We believe the group's strategic partnerships and digital transformation will continue to deliver growth. However, we note with concern on the sluggish growth of operating income, as we opine that the group's cost minimization efforts can't be solely relied on to support bottom-line growth.

In a bid to grow its market presence and leadership position, the company has resulted to mergers and acquisitions (inorganic growth). The bank is currently expected to takeover certain assets and liabilities of Imperial bank and has also offered to fully (100%) takeover National Bank of Kenya (NBK).

In the proposed NBK takeover, KCB Group has offered 1 KCB share for every 10 shares of NBK. Our initial thoughts are that takeover of NBK is more of a bailout. NBK will benefit from better corporate governance (a key concern for us) and shareholders will not need to inject additional capital (NBK's capital ratios are below the statutory minimums). KCB will benefit from the additional deposits but it will be interesting to see how KCB deals with NBK's low asset (loan book) quality.

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 88.0% of transactions were performed outside the branch with revenue outside the branch growing by 27% to over 5.2 billion. We also optimistic that

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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. Currently, Equity is trading at a P/B of 1.56x (at a price of KES 39.15) compared to the average banking sector P/B of 0.90x as at 10th May 2019. We attribute the high P/B ratio to high growth expectations by investors. Equity has a high ROaE of 21.1% (the second highest in the banking sector) which is well above the industry average of 13.5%.

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.

The group's business model is 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

In a bid to increase their footprint across Africa, the bank is set to acquire four banks in Rwanda, Zambia, Tanzania and Mozambique. Equity Bank expects to acquire 62% stake in Banque Populaire du Rwanda and full ownership of BancABC Zambia, BancABC Tanzania and BancABC Mozambique in a share- swap deal valued at KES 10.6 billion with London-listed Company Atlas Mara. This will expand the bank's operations to 8 countries within the African Continent.

1Q2019 Results commentary:

The Group registered a 4.9% y/y growth in after tax profits to KES 6.2 billion from KES 5.9 billion posted in 1Q2018. The performance was characterised by growth in both net interest income (+6.3% y/y to KES 10.4 billion) and non-funded income (+6.9% y/y to KES 7.2 billion) and a rise in operating expenses (including provisions) by 7.0% y/y to KES 8.8 billion. The main highlights were the recovery in the contribution of non-funded income to total income which had dipped in 1Q2018 and the continued underperformance in Tanzania. Additionally, the Group's asset quality deteriorated as the NPL ratio rose to 9.0% (1Q2018: 6.3%) mainly due to the challenging business environment in Tanzania as well an increase in non-performing loans in the SME and large enterprise sectors in Kenya. C/I (excl. provisions) remained flat at 47.5%.

Going forward, the bank is keen on growing non-funded income in Tanzania (for instance, through merchant commission) and improving the quality of its loan book (lend less to the real estate sector and focus more on other sectors such as the consumer sector). In 1Q2019, the bank's subsidiaries contributed 17.0% to the profits before tax (KES 1.5 billion). The bank is in the process of acquiring four banks from Atlas Mara. The move will see it expand its operations in Tanzania and Rwanda (through merging with existing subsidiaries) and enter into Zambia and Mozambique markets. The acquisitions are part of its strategy to operate in fifteen countries by FY2024. We opine that the acquisition of the four new banks will help build economies of scale for the bank.

As mentioned in our FY2018 results commentary, the bank is focused on lending more to customers and investing less in government securities (due to the decline in the yield on government securities). We opine

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that this shift will see an increase in the bank's cost of risk. Additionally, the bank is collaborating with Safaricom to enhance customer access to financial services, a partnership which it expects will grow its non-funded income.

Cooperative Bank

We recommend a **LONG TERM BUY** on Cooperative Bank with the counter trading at a P/B of 1.05x (at a price of KES 12.50) against an industry average of 0.90x as at 10th May 2019. The counter has a high ROaE of 18.2%, which is above the industry average of 13.5% with a dividend yield of 8.0%. 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 Micro, Small and Medium Enterprises (MSME) segment.

FY2018 Results commentary:

The Group posted an 11.6% y/y growth in after tax profits to KES 12.7 billion (FY2017: KES 11.4 billion). Total net interest income grew by 9.5% y/y to KES 30.8 billion. Non-funded income declined by 4.4% y/y to KES 12.9 billion. Total operating expenses (incl. provisions) grew by 1.4% y/y to KES 25.7 billion. See a more detailed breakdown of these results here: The Group anticipates increased contribution to its bottom-line from its South Sudan subsidiary in FY2019, following the peace agreement and the decline in inflation. In FY2018 the subsidiary's loss before tax improved to KES 30.8 million (FY2017: KES 605.9 million). The bank is keen on digitization of banking services and proactive risk management in order to lower costs. The digitization is supported by technical advisory services from the International Finance Corporation (IFC). We opine that the cost to income ratio will decline as benefits are reaped from investments made in FY2018. Additionally, the group has allocated KES 15.2 billion for MSME lending which we expect to boost the group's loan book(management anticipates 10.9% growth). We express concern over the Group's deteriorated asset quality given the high NPL ratio.

Long Term Buy (for the 3 banks) - To allow the banks to fully exploit their digital assets. The holding view also supported by consistency in dividend payout which should enhance total return.
For KCB, the long term view is also recommended due its recent M&A activity (to enable full exploitation of the synergies identified or benefits from the restructuring efforts on the targets).

Tactical Portfolio Play: Of the three banks, (KCB, Equity and Co-operative bank), we recommend investors to be overweight on Equity bank. This recommendation is based on organic growth (that is, excluding impact of mergers and acquisitions on KCB and Equity). Equity's FY2018 performance was negatively impacted by compliance with IFRS 9 accounting standards (making comparability in 2018 with previous years somewhat "unfair") and promotional activities that led to a waiver of some of the transactional fees (leading to low growth in non-credit related fees and commissions). We view these events as "non-recurring". Management indicated full compliance with the accounting standards and signalled end of the promotional activities. The Group's non-funded income is therefore set to improve in FY2019, which will favour bottom-line performance. KCB Group, on the other hand, registered a positive performance that was predominantly propelled by a significant reduction in operating costs as operating income growth was sluggish. Although KCB's cost base is much improved, the significant drop in operating expenses is unlikely to recur (we don't expect restructuring efforts at the same scale as those done in FY2017). KCB's cost of risk is also expected to increase.

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I&M Bank

We recommend a **HOLD** on I&M Holdings. The bank is trading at a P/B ratio of 1.03x (at a price of KES 118.75 as at 10th May 2019), against the banking industry average P/B ratio of 0.90x. The counter has a ROaE of 17.9% in FY2018, higher than the industry (listed banks) average of 13.5%. Additionally, the bank's cost-to-income ratio(C/I ratio) of 36.6% is currently the lowest in the industry (average of 58.1%). The bank is keen on growing in contribution from its regional subsidiaries which contributed KES 2.3 billion (19.0%) to profit before tax in FY2018. For instance, in Uganda, it plans to expand its operations through acquisitions. We are also optimistic about the bank's revenue diversification (through its bancassurance and advisory business), given the prevailing interest capping, which we expect to boost non-funded income. The bank acquired Youjays Insurance Brokers in FY2018 to scale up its bancassurance business. Non-funded income registered significant growth in FY2018 (+31.8% y/y to KES 7.6 billion) boosting its contribution to total income to 32.8% (FY2017: 27.0%). Additionally, the low C/I ratio signals general improvement in the bank's efficiency, which we expect to be sustained going forward. We express concern over the high NPL ratio of 14.3% reported in FY2018 against the industry average of 12.0% and the decline in asset quality. The management attributed the high NPL ratio to loan book exposure to Real estate, Building and Construction and Manufacturing sectors (with the highest industry NPLs). According to the company, data analytics will be enhanced to lower the NPLs.

FY2018 Results Breakdown:

The Group posted a 17.1% y/y growth in after tax profits for FY2018 to KES 8.5 billion (FY2017: KES 7.3 billion). The performance was characterized by a slight increase in net interest income, significant growth in non-funded income and a marginal increase in operating expenses. Total interest income grew by 6.4% y/y to KES 26.0 billion. The rise in total interest income was predominantly driven by a 9.5% y/y increase in interest income from loans and advances to KES 20.7 billion due to a 9.0% y/y growth in loans and advances to customers (net) to KES 166.7 billion. The yield on loans dipped by 20bps to 12.9%. Interest income from government securities fell by 7.4% y/y to KES 5.0 billion, owing to a decline in the Group's holdings of government securities by 20.0% y/y to KES 39.0 billion. Yield on government securities remained flat at 11.3%. Total interest expenses increased by 17.3% y/y to KES 10.4 billion mainly due to a 16.2% y/y rise in interest expenses from customer deposits. Customer deposits grew by 25.9% y/y to KES 213.1 billion. The growth in customer deposits was highest in business banking with a growth of 35.0%, while corporate & institutional and retail deposits grew by 7.4% and 5.0% respectively. The cost of funds declined by 30bps to 4.9% (FY2017: 5.2%). The cost of risk fell to 2.3% (FY2017: 2.7%). Absolute net interest margin grew by 0.3% y/y to KES 15.6 billion. The net interest margin dipped by 100bps to 7.0%. Non-funded income grew by 31.8% y/y to KES 7.6 billion supported by a growth in foreign exchange trading income (+40.4% y/y to KES 2.6 billion) and an increase in income from fees and commissions on loans and advances (+59.1% to KES 1.8 billion). This drove non funded income contribution to 32.8% (FY2017: 27.0%). Operating expenses (excl. provisions) rose by 8.3% y/y to KES 8.5 billion primarily owing to a 9.7% y/y growth in staff costs to KES 4.1 billion and a 7.1% y/y growth in other expenses to KES 3.1 billion. C/I (excl. provisions) edged up by 20bps to 36.6%. Loan loss provisions declined by 8.1% y/y to KES 3.8 billion. The bank's asset quality however deteriorated as NPLs stood at 14.3% (FY2017: 12.7%) driven by exposure to building and construction, real estate and manufacturing sectors. We expect continued growth in non-funded income over the medium term. We however express concern over the bank's decline in asset quality.

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Barclays Bank of Kenya

We recommend a **HOLD** on Barclays Bank with the counter trading at a P/B of 1.31x (at a price of KES 10.65) against an industry average of 0.90x as at 10th May 2019. The counter has a high ROaE of 17.1%, which is above the industry average of 13.5%. Additionally, the counter has a high dividend yield at 10.3%. 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.

FY2018 Results commentary:

The Group posted a 7.1% y/y growth in after tax profits for FY2018 to KES 7.4 billion (FY2017: KES 6.9 billion). The performance was characterized by marginal growth in net interest income, significant growth in non-interest income and a slight increase in operating costs. Net interest income grew marginally by 1.0% y/y to KES 22.0 billion. The net interest margin eased by 50bps to 9.1% as the net interest income grew at a faster rate than interest earning assets (+8.1% y/y to KES 247.2 billion) The non-funded income growth (+14.7% y/y to KES 31.7 billion) was buoyed by a 148.4% y/y surge in other income to KES 797.7 million, a 14.5% y/y rise in foreign exchange income to KES 3.3 billion and a 65.5% y/y rise in fees on commissions against the loan book to KES 1.1 billion. According to management, non-funded income growth was significantly supported by fees derived from their mobile app Timiza (issued loans worth KES 10.0 billion since its launch). The group is focused on reducing dependency on net interest income to grow its top-line. We remain concerned over the slow growth in net interest income. We are however optimistic about the new direction the company is taking in terms of reinventing its business model to better suit the Kenyan (African) market.

Diamond Trust Bank

We recommend a **HOLD** on Diamond Trust Bank. Trading at a P/B ratio of 0.64x (at a price of KES 122.00 as at 10th May 2019), makes the counter attractive when compared against the banking industry average P/B ratio of 0.90x. Additionally, the counter realized a ROaE of 13.9% in FY2018 – in line with the industry average of 13.5%. 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). DTB has leveraged this ecosystem to diversify its revenues. The bank has a very conservative and defensive business model. Although this model has benefited them with low NPLs, it has also lowered returns for the bank. Going forward, we expect DTB to continue to diversify its revenue streams while leveraging on technology to improve operational efficiency.

National Bank of Kenya

We recommend a **HOLD (to take up the offer)** on National Bank of Kenya (NBK). NBK is currently trading at a P/B of 0.21x, compared to industry (listed banks) average of 0.90x at a price of KES 4.42 as at 10th May 2019. We believe this low P/B is a value trap i.e. it's more of a case of "cheap is expensive" rather than attractiveness. The bank has a significantly high cost to income ratio at 92.0 %(industry average is 58.1%). 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 0.1%.

KCB Group has offered to fully takeover NBK. KCB has proposed an all equity deal where shareholders of NBK will get 1 KCB share for every 10 shares of NBK. **We recommend taking up the offer**. Our biggest concern

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with NBK is its weak corporate governance. We believe this is an area that NBK shareholders will greatly benefit from once (and if) KCB takeovers NBK. With better management, we expect to see a better utilization of some its resources (loan origination from its deposits), a more rapid pace in embracing alternative channels and growth in non-funded income streams.

FY2018 Results commentary:

The Group posted a 98.3% y/y decline in after tax profits for FY2018 to KES 7.40 million (FY2017: KES 410.8 million). The performance was characterized by a decline in net interest income (-10.0% y/y to KES 6.0 billion), significant decrease in non-interest income (-18.0% y/y to KES 2.0 billion) and a dip in operating costs (-9.6% y/y to KES 7.6 billion). We remain concerned about the Group's weak corporate governance as it continues to be a hindrance to growth. We also express concern over the decline in both non-funded and net interest income.

INSURANCE SECTOR:

The insurance sector in Kenya has been persistently characterized by low insurance penetration rates. Although the low penetration rates indicate a huge potential for this sector, they more accurately reflect several challenges that plague the sector. These challenges include: the affordability of insurance premiums, lack of trust (especially in regard to claim settlement) and negative perceptions informed by cultural beliefs. These factors have derailed the little product innovation coming out of this sector. For instance, micro insurance has not gained much traction. Fraud (and costs associated with reducing its prevalence) and intense competition (characterized by price undercutting) among the players are also hampering profitability of the insurance sector. In other segments such as health insurance, competition comes from government sponsored initiatives such as the National Health Insurance Fund that are tackling some the challenges faced by private players (notably affordability of premiums).

Due to these challenges, insurance companies are more dependent on investment income which tends to be volatile (particularly for players overweight in listed equities).

Due to the aforementioned challenges, we recommend **underweighting** the insurance sector.

Jubilee Holdings

We place Jubilee Holdings **UNDER REVIEW**. 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 1.13x (at a price of KES 410.00) against an industry average of 0.88x as at 10th May 2019 – higher due to its attractive fundamentals.

CONSTRUCTION SECTOR:

Bamburi Cement

We place a **HOLD** recommendation on Bamburi Cement. The company has a dividend yield of 4.3% (at a price of KES 118.00 as at 10th May 2019) and is trading at a P/E ratio of 48.16x, (high due to its low EPS). Bamburi Cement has a strong market presence in the East African region with key markets in Kenya, Uganda and Rwanda. In FY2018 the company completed the first phase of its capacity expansion project in both Kenya and Uganda which cost KES 7.9 billion. As competition continues to intensify within the cement sector

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(particularly in the retail market), 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.

FY2018 Results commentary:

The company encountered a challenging year in FY2018 – resulting in a 68.9% y/y decline in after tax profits mainly due to a challenging operating environment in Kenya and Uganda. Bamburi Cement realized a ROaE of 0.5% in FY2018 significantly lower than 6.4% recorded in FY2017. According to the company, the decline in performance is due to: a higher cost environment owing to higher energy costs (power, coal and petcoke), imported clinker and raw materials' input prices (in both Kenya and Uganda). Additionally, Uganda was impacted by further provisioning primarily on receivables. The company has a dividend yield of 4.1% (at a price of KES 125.00 as at 10th May 2019) and is trading at a P/E ratio of 27.53x, (high due to its low EPS). The increase in dividends (from KES 4.10 to KES 5.10) suggests the current investments in place are enough to fully exploit the current growth opportunities in the market (the company noted that installed capacity continues to outstrip cement demand).

TELECOMMUNICATIONS SECTOR:

Safaricom

We place Safaricom **UNDER REVIEW**. The counter is currently trading at a P/E multiple of 17.37x (at a price of KES 27.45, as at 10th May 2019). The company is a market leader in the telecommunications industry with a market share of 63.3% (4Q2018) of total mobile subscriptions. This represents a 39.9% 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.

Safaricom is expected to release its FY2019 results on 10th May 2019.

MANUFACTURING SECTOR:

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

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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 3.6%. The company is trading at a P/E ratio of 29.03x, (at a price of KES 208.75) as at 10th May 2019.

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. 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.

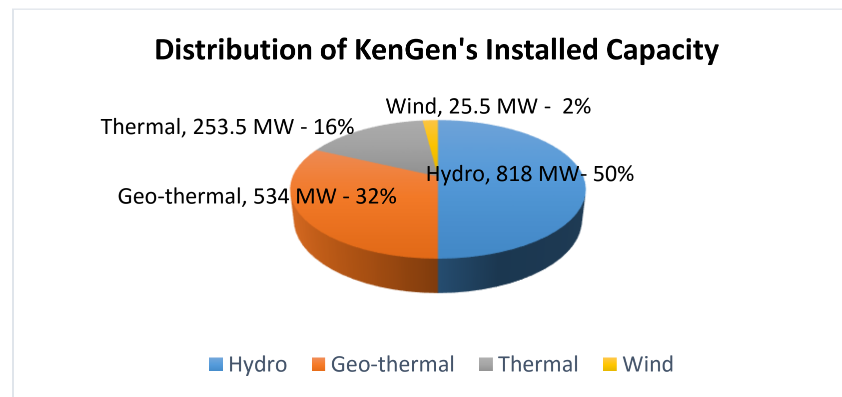
H12019 Results commentary:

For H12019, revenues declined by 96% y/y to KES 26.0 million. Loss for the same period narrowed by 21% y/y to KES 1.5 billion from KES 2.0 billion. According to management, the loss was predominantly driven by shortage of cane which forced the company to bank on the sale of ethanol. This performance confirms that the company is not in a position to take advantage of the opportunities in the sugar industry.

ENERGY SECTOR:

KenGen

We revise our **LONG-TERM BUY (essentially a BUY and HOLD)** recommendation on KenGen to a **TRADING** one. 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 5.13x, (at a price of KES 6.16) as at 10th May 2019, lower than the industry average of 5.59x (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:

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Development Projects	MW	Status
Olkaria Wellheads	25	Commissioned
Ngong Phase 3	10	Optimization Study
Olkaria I AU Uprating	30	Financing
Olkaria IV Uprating	30	Financing
Olkaria I Unit 6	70	Procurement of Contractors
Olkaria 1 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.

INVESTMENT SECTOR:

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 73.2 (reflecting a CAGR of 20.8% between FY2014 and FY2018), a 56.7% discount to the company's share price of KES 31.70 as at 10th May 2019.

We opine that the company's NAV (and asset valuations[1]) 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] Except for Sidian Bank. We opine that the 1.16x P/B is too high

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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.

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Summary

Counter	Recommendation	52-Week High	52-Week Low	YTD Change	Price as at 10th May 2019
KCB Group	Long-term Buy	52.00	34.00	8.14%	40.50
Equity Group Holdings	Long-term Buy	53.50	33.40	12.34%	39.15
Cooperative Bank	Long-term Buy	20.00	12.40	-12.59%	12.50
I&M	Hold	125.00	81.00	39.71%	118.75
Barclays Bank of Kenya	Hold	12.75	9.50	-2.74%	10.65
Diamond Trust Bank	Hold	205.00	109.00	-22.04%	122.00
NBK	Hold	7.90	4.05	-16.92%	4.42
Jubilee Holdings	Buy	535.00	355.25	1.30%	410.00
Bamburi Cement	Hold	190.00	112.50	-10.94%	118.00
Safaricom	Under Review	30.50	21.00	23.65%	27.45
EABL	Hold	252.00	160.00	19.46%	208.75
KenGen	Trading	8.15	5.10	-12.25%	6.16
Mumias	Sell	0.90	0.29	-46.55%	0.31
Centum	Long-term Buy	41.00	22.50	8.38%	31.70

For Online Share Trading (OST) via browser, please click here:
For the Faida M-Trader Application, please click here:

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Recommendation Guide:

LONG-TERM BUY: The company has strong fundamentals (strong financial performance, clear/reasonable strategy, competent management team etc.). However, there are certain investments or strategies that would require an investor to have a long term view of the company to allow for capital appreciation.

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%

TRADING: The stock's price tends to be volatile (rises and falls often). Investors should therefore trade more frequently (timely entries and exits) to take advantage of the movements in price

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