A look into July 2018

"Winter is here"

As we usher in the cold season that commences in July, we reminisce the eventful month of June. The month saw the country open up a can of worms in the NYS scandal which was followed by incidences of imported toxic sugar. The ray of sunshine came in from the Government's plan to lower power costs by c.30.0% as well as the planned repeal of the rate cap.

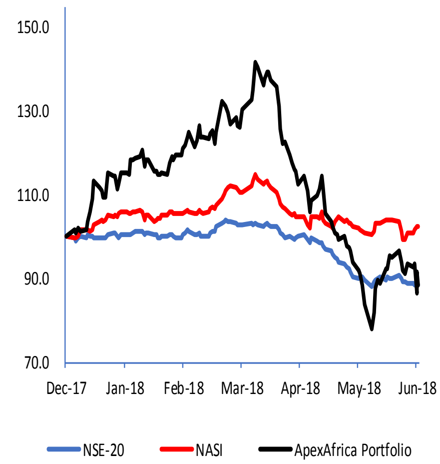
Having a closer look at the budget speech, the Government intends to introduce a raft of changes to widen the tax base and enhance revenue collection. Treasury CS has proposed a 35% tax bracket for firms earning more than KES 0.5B. This has been met with harsh criticism with firms arguing that the additional tax burden does not translate into better government services. In addition, the proposed tax will make the country the most heavily taxed which may direct investments elsewhere.

The government plans to cut power costs by 30% upon review of electricity tariffs. This is poised to ease production costs, making manufacturing viable which will enable the achievement of the Big Four agenda. Despite this, it has faced opposition from Kenya Power, which was anticipated, given that the proposed tariff reviews may translate to lower profit margins for the energy players.

Among the key takeaways from the budget speech was the proposed repeal of the rate cap. Its counter productive effects have been felt across the private sector, denting the sector's contribution to economic growth. The Big Four agenda is based on sustained contribution from the public sector as well as enhanced investment from the private sector. The proposal has been met with opposition from the legislature. We opine that, given that the country's legislature is partisan, goodwill from the head of state and leader of opposition are likely to see the repeal effected.
The impact of the repeal would be renewed interest from the lenders to advance credit to the private sector. This is poised to ease the crowding out of the private sector. However, with the government anticipated to sustain its debt appetite, the government debt yields are anticipated to rise.

Treasury bills continue eliciting sustained interest from investors with the total bids received for the month being 30.0% m/m higher than those received in May. The short-term nature of the securities coupled with increased liquidity in the market is seen as the driving force behind the elevated bids. In addition, investors anticipate a repeal of the rate cap to take effect some time in future and hence opt for the short-term government papers in anticipation of higher yields once the repeal is effected.

ApexAfrica Portfolio vs Mkt Indices



Source: Bloomberg, ApexAfrica Research

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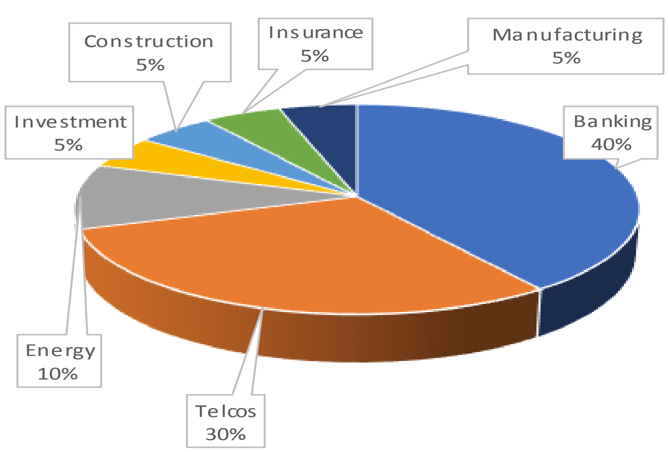
The preference for the short-term papers comes at the expense of the long-term papers with the 25-year treasury bond receiving KES 10.1B bids; 25.3% of the offered amount. Going forward, we anticipate investors to sustain interest in the treasury bills at the expense of the bonds, until the rate cap is repealed. Once the government yields edge up, we project renewed interest in the treasury bonds.

The current market prices of securities are a far cry from the elevated prices witnessed a few months ago. There have been considerable foreign exits exerting selling pressure on the market. There has been uncertainty regarding the timeliness of the repeal of the rate cap which have depressed most banking stocks. In addition, the banks are currently trading ex-dividend with the excitement around FY17 numbers dwindling. We opine that the current market prices are an opportune time for investors to take positions.

Hypothetical portfolio

In our quarterly analysis of our portfolio, we've decided to drop Kenya Airways, Kenya Re and TPS Serena opting for Jubilee, EABL and additional exposure in Equity and KCB. The former have witnessed a turbulent period during the period and are likely to remain depressed, whilst Jubilee, EABL and Equity have come down in price and are likely to rebound in the immediate short-term. Given the depressed prices of KenGen and Kenya Power and the expectations of lower power costs, we've decided to lower exposure.



Exposure by Sectors

Hypothetical Portfolio performance YTD	1.4%
NSE-20 YTD	-11.4%

Counter	29-Jun-2018	YTD	Weighting	Weighted YTD return
Safaricom	29.50	10.3%	30.0%	3.1%
Equity	46.25	16.4%	6.0%	1.0%
KCB	46.25	8.2%	6.0%	0.5%
NIC Bank	35.50	5.2%	6.0%	0.3%
Cooperative Bank	17.50	9.4%	6.0%	0.6%
DTB Bank	199.00	3.6%	6.0%	0.2%
KenGen	7.00	-18.1%	2.5%	-0.5%
Kenya Power	6.90	-24.2%	2.5%	-0.6%
KenolKobil	18.10	29.3%	5.0%	1.5%
Centum	37.75	-13.7%	5.0%	-0.7%
Bamburi Cement	179.00	-0.6%	5.0%	0.0%
Additions				
EABL	218.00	0.0%	5.0%	0.0%
Jubilee	505.00	0.0%	5.0%	0.0%
Equity	46.25	0.0%	5.0%	0.0%
KCB	46.25	0.0%	5.0%	0.0%
Exits				
Kenya Power	6.90	-24.2%	2.5%	-0.6%
KenGen	7.00	-18.1%	2.5%	-0.5%
TPS Serena	30.00	-7.7%	5.0%	-0.4%
Kenya Airways	10.65	-37.9%	5.0%	-1.9%
Kenya Re	16.00	-11.6%	5.0%	-0.6%

Safaricom

Current Price: KES 29.50

BUY, Fair Value: KES 33.00, Upside: 11.9%

- **Growing M-Pesa revenue** supported by a widening subscriber base and increasing number of transactions.
- **Growing revenue from both mobile data and fixed data.** Safaricom is anticipated to leverage on its market leadership position in mobile data to grow its top-line. Fibre to the Home program being implemented is anticipated to increase its market share in the segment from the current 15.2%.
- **Burgeoning e-commerce** to support M-Pesa revenue growth as well as increase traction on its e-commerce platform (*Masoko).*
- Change in ownership (*from Vodafone PLC to Vodacom Group)* hands Safaricom the go-ahead to **invest in other African countries**, leveraging on the growing mobile penetration rate.

- Significant **competitive advantage** in the midst of new service providers and products.

Downside:

- Possibility of adverse regulation which seeks to level the playing field for Safaricom's competitors

Kenya Commercial Bank (KCB)

Current Price: KES 46.25

STRONG BUY, Fair Value: KES 57.00, Upside: 23.2%

- **Attractive valuation metrics** (dividend yield: 6.5%)
- Increased investment in online platforms with launch of a revamped mobile banking platform later in the year.
- **Wide regional presence** & large balance sheet allows the group to shake off structural challenges.
- Recent measures to **reduce cost base** will bolster bottom line in a challenging business environment.
- **Strong corporate and HNW client base** allows room for loan-book expansion.

Downside:

- With IFRS 9 coming into play, provisions are anticipated to soar further, which will put pressure on the bank's net income.
- Competition from upcoming mobile money lenders that have gained a considered share in the fintech space.

Bamburi

Current Price: KES 179.00

Accumulate, Fair Value: 194.00, Upside: 8.4%

- Strategically positioned to leverage from the **projected 10.0% y/y growth in cement consumption** in the region.
- Phase 1 of capacity expansion was recently completed and is estimated to add 1.7M tonnes of grinding capacity**.** This may aid in dealing with competition as well as lowering production costs.
- **Product diversification** anticipated to sustain volumes as well as market share.
- **Remodeled distribution networks** anticipated to support volumes in the retail sector as well as elbow out competition.

Downside:

- **Increased competition** eating into market share and margins.
- The 66.5% y/y plunge in FY17 net earnings may pile pressure on the cement maker at the bourse. In addition, Bamburi has lost its allure as among the highest dividend paying counters at the bourse. However, the market is anticipated to overlook the current financial position given the recovering economy this year which may lead to a rebound in its profitability. As such, the decline in price is projected to be minimal.

Kenya Power (KPLC)

Current Price: KES 6.90
Buy, Fair Value: 7.70, Upside: 11.6%

- **Rebound in 2018 economic activity** to bolster electricity consumption more so from the large industrial consumers who recorded lower consumption in 2017.
- Introduction of **night and weekend tariffs** anticipated to augment power consumption especially during the off-peak hours.
- Continued investment in capex aimed at lowering **system losses** translating to an improving bottom-line.
- The KES 0.50 DPS points to a dividend yield of 7.3%, which is attractive.
- Production of cheap hydro-electric power with the onset of rains set to boost sales.

Downside:

- The plan by the Government to slash power costs by c.30.0% may lead to lower profit margins for the firm.
- Surge in recoverable fuel costs to KES 10.2B in FY17 (KES 0.8B in FY16) has seen the counter's share price depressed. We however don't expect the amounts to be written off, though this may pile pressure on its cash flows.
- Threat of stagnating and/or rising system losses as the firm expands its grid.
- The firm's image has been tainted by the issue of the fuel cost, overcharging clients and fraud. Until it cleans up its image in this respect, the counter is anticipated to remain depressed.

NIC Bank (NIC)

Current Price: KES 35.50

- The lender's **cost to income ratio** of 45.0%, is among the lowest in comparison to its peers. We anticipate increased cost efficiency to drive the bottom line in the future, supported by the bank's continued attempt to drive traffic towards its cheaper digital platform.

- NIC Bank has aggressively grown its **non-interest income** to support its low interest income in light of the cap on lending rates.
- NIC Bank is positioning itself to play a critical role in the region's economic development by constantly **innovating** (e.g. entering into strategic partnerships with Safaricom access float around the clock and in real time) to meet the needs of tech-savvy clientele.

Downside:

- In this rate cap regime, the lender is still struggling to attract cheap deposits which may raise its interest expense. Although, this could improve upon the repeal of the rate cap.
- IFRS 9 is anticipated to raise provisions thus contracting margins. The bank's NPL ratio currently stands at 13.1% against industry average of 12.0%

Equity Group (EQTY)

Current Price: KES 46.25

- **Growing customer deposits**, provides access to cheap deposits to fund loan-book growth.
- Prominent position among the **retail banking segment** on the back of an unparalleled national network serves as a key competitive advantage.
- Growing regional presence with improving profitability within the countries anticipated to bolster the bottom-line.
- **Rapidly growing mobile and agency banking** networks expected to reduce costs while increasing customer base.

Downside:

- The implementation of IFRS 9 coupled may necessitate an increase in provisioning over the medium term.
- Competition from upcoming mobile money lenders that have gained a considered share in the fintech space.

Cooperative Bank

Current Price: KES 17.50

- It has potential to grow its loan book with it's initiative to increase lending to **SMEs**.
- Co-op Bank's effort to **reduce costs** and **increase efficiency** will provide support to the bottom line going forward.
- The lender is venturing into a new business of **leasing** in a joint venture with Super Group of Africa. According to management, the joint venture will boost loan book growth from lending to the lessee as well as non-interest income.

Downside:

- The rise in **NPLs** remains worrisome and the bank will have to enhance its asset quality.
- The implementation of IFRS 9 coupled with a rise in non-performing assets may necessitate an increase in provisioning over the medium term.

DTB Bank

Current Price: KES 199.00

- DTB has successfully carved a niche in the **SME and retail lending space** and its partnerships with various AKFED companies has proven lucrative. Additionally, the lender has a broad **regional presence**, allowing it to mitigate country specific risks
- The lender is highly efficient (has one of the **lowest CTI** amongst Tier I banks at 45.0%)
- The bank is set to open a few more branches and state-of-the-art digital lobbies in the year. The expansion plan is in line with DTB's long-term strategy to dominate the market and increase its footprint in Kenya.
- **Growing regional presence** especially in Uganda, diversifies their revenue streams and mitigates company specific risk.

Downside:

- **Low dividend yield** of 1.3%
- In 1Q18, *gross NPLs ballooned* 82.4% y/y (+3.8% q/q) to KES 15.4B, which augmented loan loss provision expense (+9.7% y/y to KES 696.5M). The NPLs have been as a result of bad debts of some large corporates in its books bringing down its NPL ratio to 7.6% (+320bps y/y).

KenGen

Current Price KES 7.00

- **Growing electricity consumption** points to increasing electricity sales revenue.
- Pipeline of projects targeting to add 721MW of installed capacity by 2020 projected to **surge capacity revenue**. Increasing capacity and electricity sales revenue are projected to realize a 3-year CAGR of 8.8% in energy revenue.
- Energy bill set to be passed to allow the entry of new market entrants in power distribution. KenGen plans to set up an **industrial park at Olkaria**; promising higher profit margins.

Downside:

- Possible **dividend drought** given the capital intensive pipeline of projects. A dividend pay-out may come in from FY20F onwards given the projected easing of capex.
- The plan by the Government to slash power costs by c.30.0% may lead to lower profit margins for the firm.

KenolKobil Group (KENO)

Current Price: KES 18.10

- **Leading oil** marketer in East Africa with a prominent brand and well diversified business model.
- **Strong top-line growth** on the back of a rapidly expanding regional retail network, focus on high margin business segments, streamlining of the group's operations and steady deleveraging of the balance sheet expected to boost margins and drive growth.
- The possibility of the onboarding of a **strategic investor** in the medium term increases the probability of realizing significant capital gains.

Downside:

- **Loss of market share** to smaller and more dynamic competitors.

Centum

Current Price: KES 37.00

- **Pipeline of projects** in the real estate and energy sectors anticipated to augment the firm's top-line.
- **Almasi beverages** anticipated to sustain the 10.0% y/y growth in volume supporting top-line growth going forward.
- **Anticipated exits from its investments** by FY19 projected to realize gains on valuation which may support the bottom-line in FY19.
- Plans by the firm to increasingly improve its **dividend pay-out** to realize a dividend yield of 5.0% on the NAV.
- Trading at a **97.8% discount to the company's book value** of **KES 73.19** with management asserting measures to take bridge the gap between book value and market price.

Downside:

- The 66.4% y/y decline in FY18 has exerted pressure on the already depressed counter. Currently, it's trading cum-dividend of KES 1.20 and may dip once it goes ex-dividend. This presents an opportune entry point for value investors after the 2nd October 2018 books closure date.
- Overreliance on non-cash revenue streams that are erratic point to fluctuating earnings. We however take cognizance that management intends to grow its cash revenues and ease up on fair value gains going forward.

Jubilee Holdings

Current Price: KES 505.00

- Largest insurer in East Africa with a wide regional exposure
- Innovation and technology to drive corporate and retaul business and increase insurance penetration. The adoption of technology is anticipated to also mitigate
- Increased interest in micro-insurance aimed at growing its clientele and insurance premiums.
- Unlevered and cash rich points to muscle for funding new investment ventures.

Downside:

- Insurance fraud may raise claims eating into the bottom-line.
- Intensified competition serving a small insurance market has led to price under-cutting by some of the players. Though it's unsustainable in the long-run, the short-term ramifications may lead to loss of market share.

East African Breweries Limited

Current Price: KES 218.00

- Current price dip points to an alluring entry point for value investors.
- Anticipated commissioning of the Kisumu plant by mid-July anticipated to raise revenues and ease logistical costs.
- Regional presence diversifies revenue streams.
- Change in tact to focus on spirits which have higher profit margins as well as growing demand in the country. EABL plans to commence Diageo spirits which will drive its revenue going forward.

Downside:

- **FY18E** anticipated to be challenging given the 11.3% y/y dip in 1H18 profitability.
- Legislative risk in that the East African governments are looking to raise their revenues and may opt to raise excise duty for alcoholic beverages.

ApexAfrica CAPITAL LTD
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Equity Snapshot

Sector	Stock	Price 29-Jun	Δ YTD %	Δ WoW	M.Cap USD M	M.Cap %	P/E x	P/B x	Div Y %	ROE %	Avg TO* USD k
Banking	▲ Safaricom	29.50	10.3	4.4	11,596.4	47.4	21.4	9.5	3.7	47.8	3,006.4
	▼ Barclays Bank	11.45	19.3	-3.8	610.2	2.5	8.9	1.4	8.7	16.0	98.0
	▲ Diamond Trust Bank	199.00	3.6	1.5	520.0	2.1	8.4	1.1	1.3	20.8	256.2
	▼ Equity Group	46.25	16.4	-5.1	1,712.4	7.0	8.8	2.1	4.3	23.0	941.8
	▲ H. Finance Group	8.50	-18.3	1.2	29.4	0.1	23.6	0.3	4.1	1.1	3.7
	▼ I&M Holdings	115.00	-9.4	-0.9	442.7	1.8	7.0	0.9	3.0	17.9	49.4
	▼ KCB Group	46.25	8.2	-4.1	1,391.3	5.7	7.2	1.3	6.5	18.6	840.6
	— National Bank	6.25	-33.2	0.0	18.9	0.1	5.0	0.3	0.0	0.2	1.5
	▼ NIC Bank	35.50	5.2	-2.1	222.9	0.9	5.5	0.7	2.8	12.1	135.1
	▼ Stanbic Holdings	91.50	13.0	-0.5	354.9	1.5	8.4	0.8	5.7	10.0	20.3
	▼ Standard Chartered	198.00	-4.8	-2.0	667.3	2.7	9.8	1.5	8.6	15.1	23.4
	— Co-operative Bank	17.50	9.4	0.0	839.5	3.4	9.0	1.5	4.6	16.4	216.8
Comm & Services	▼ Kenya Airways	10.65	-37.9	-6.6	156.4	0.6	-	145.1	0.0	-	19.5
	— Longhorn Publishers	4.20	-22.2	0.0	15.2	0.1	8.9	1.2	8.3	13.2	1.3
	▼ Nation Media Group	90.00	-22.4	-4.3	166.5	0.7	13.0	2.1	11.1	16.1	31.0
	▼ Standard Group	26.50	-28.4	-1.9	21.3	0.1	-	1.2	0.0	-	2.8
	▼ TPS Eastern Africa	30.00	-7.7	-9.1	53.6	0.2	83.3	0.6	1.2	0.6	21.9
	— Uchumi Supermarket	1.45	-68.5	0.0	5.2	0.0	-	-	0.0	-	6.2
	— WPP Scangroup	15.55	-18.2	0.0	57.8	0.2	13.0	0.7	4.8	5.6	17.5
Energy	▼ KenGen	7.00	-18.1	-0.7	428.8	1.8	5.4	0.2	0.0	4.6	85.0
	▲ KenolKobil	18.10	29.3	0.6	261.4	1.1	10.8	2.4	3.3	22.0	1420.5
	▲ Kenya Power & Light.	6.90	-24.2	1.5	132.1	0.5	2.2	0.2	7.2	8.4	48.9
	▼ Total Kenya	29.75	26.6	-8.5	51.1	0.2	6.8	0.2	4.4	13.4	13.5
Insurance	▲ Britam Holdings	14.60	9.4	0.7	277.7	1.1	60.8	1.4	2.4	0.0	17.0
	— CIC Insurance Group	4.60	-17.9	0.0	118.0	0.5	25.6	25.1	2.6	6.3	12.3
	▲ Jubilee Holdings	505.00	1.2	0.4	326.4	1.3	9.3	1.6	1.8	18.1	39.3
	▼ Kenya Re Insurance	16.00	-11.6	-5.6	109.9	0.4	3.1	0.4	5.3	16.4	48.4
	▼ Liberty Kenya Hold.	13.00	6.6	-7.1	68.3	0.3	8.2	1.0	3.8	12.2	12.8
	▲ Sanlam Kenya	24.50	-11.7	5.4	34.6	0.1	116.7	0.9	0.0	0.0	1.2
Manufacturing	— BOC Kenya	90.00	-15.9	0.0	17.2	0.1	44.6	1.1	5.8	2.4	1.0
	▼ British. A. Tobacco	600.00	-21.1	-1.6	588.7	2.4	18.0	7.7	3.8	40.1	54.1
	▲ Carbacid Invest.	11.20	-7.8	1.8	28.0	0.1	10.3	1.1	6.3	10.0	20.5
	▲ East Afr. Breweries	218.00	-8.4	1.9	1,691.4	6.9	21.9	13.6	3.4	63.9	549.4
	— Eveaready E.A	1.50	-37.5	0.0	3.1	0.0	1.2	0.6	66.7	0.5	0.4
	▼ Mumias Sugar	0.70	-36.4	-12.5	10.5	0.0	-	1.4	0.0	-	4.7
	▲ Unga Group	39.25	35.3	3.3	29.2	0.1	11.5	0.7	2.5	0.1	22.9
Investment	▼ Centum Investment	37.00	-15.4	-0.7	241.6	1.0	9.3	0.5	3.2	5.6	87.5
	▼ Home Afrika	0.85	-39.3	-5.6	3.4	0.0	-	-	0.0	-	3.8
	▲ Trans-Century	4.05	-32.5	2.5	11.2	0.0	-	1.3	0.0	-	0.9
	— Nairobi Sec. Exch.	17.70	-10.2	0.0	45.1	0.2	21.3	2.3	1.7	11.2	32.6
Construc.	▲ ARM Cement	3.05	-76.5	13.0	28.7	0.1	-	0.1	0.0	-	36.3
	▲ Bamburi Cement	179.00	-0.6	1.7	637.4	2.6	39.4	2.2	2.2	6.7	164.9
	▼ E.A Portland Cement	20.00	-25.9	-3.6	17.7	0.1	-	0.1	0.0	-	1.0
	▼ Crown Paints Kenya	80.00	0.0	-10.0	55.9	0.2	25.5	3.2	0.8	13.5	1.1
Agric.	— Kakuzi	320.00	-2.7	0.0	61.5	0.3	11.9	1.5	2.2	14.5	4.9
	— Kapchorua Tea	67.00	2.3	0.0	5.1	0.02	22.5	0.4	4.5	-	0.4
	▼ Sasini	21.25	-28.0	-3.4	47.5	0.2	14.0	0.4	4.7	3.0	3.4
	▲ Williamson Tea	139.00	-12.6	0.7	23.9	0.1	4.7	0.4	7.2	-	2.5
	— Stanlib Fahari I-REIT	11.30	5.6	0.0	20.1	0.1	12	0.6	6.6	4.7	16.9

*Average Traded Value 3 Months - USD k

Appendix

Investment ratings

✦ **Strong Buy:** Issued on counters with strong fundamentals with a fair value above 20.0%. The counter is anticipated to register strong growth with and is currently undervalued.

✦ **Buy:** Issued on counters with strong fundamentals whose upside lies between 10.0% and 20.0%. The same may be issued for counters with challenged fundamentals whose upside is over 20.0%. Such a scenario is targeted for risk neutral investors.

✦ **Accumulate:** Issued on counters with an upside of between 5.0% - 10.0%. The counter may be facing contracting avenues for growth with a tepidly growing bottom-line.

✦ **Hold:** Issued on counters with an upside of between 0% and 5.0% with limited avenues for growth. Contracting bottom-line with an attractive dividend yield of about 5.0%.

✦ **Lighten:** The company is anticipated to record a moderate downside on its fair value, though it may have strong fundamentals.

✦ **Sell:** The counter currently has weak fundamentals coupled with significant potential downside.

Disclaimer

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