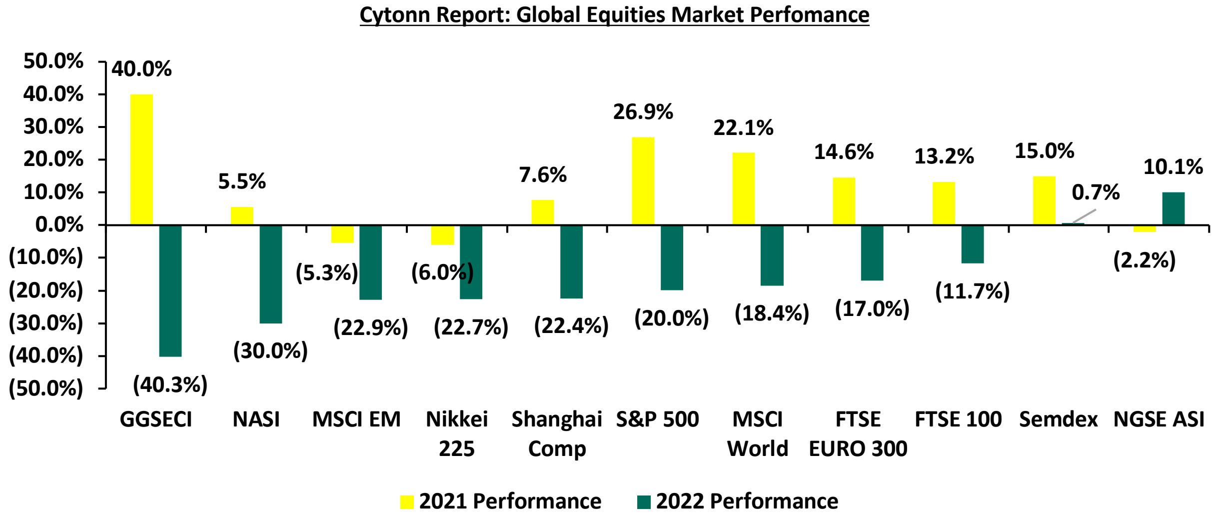
Cytonn FY'2022 Equities Markets Review Note

In 2022, the global equities markets registered mixed performance, with most indices declining, mainly due to uncertainty in the equities markets, which resulted in massive capital outflows as investors sought less riskier investments such as government papers and other investment alternatives. The Nigerian Stock Exchange All share Index (NGSEASI) recorded the largest gain of 10.1%, largely driven by increased investor sentiments following the rallying of crude oil prices with Nigeria being a net exporter of crude oil, while the Ghana Stock Exchange Composite Index (GGSECI) recorded the largest decline of 40.3%, attributable to the deteriorated macroeconomic environment, evidenced by Ghana's high inflation at 54.1% in December 2022 and regulatory policies such as the re-imposition of capital gains tax on listed equities securities, which adversely impacted the stock exchange by dampening investor sentiments, leading to capital outflows from the market as investors sought for other investment alternatives. In this note, we will analyze the 2022 Equities Markets Performances in the following sections;

i. Global Markets Review,
ii. SSA Regional Review,
iii. Kenya's Equities Market, and,
iv. Conclusion

Section I: Global Markets review

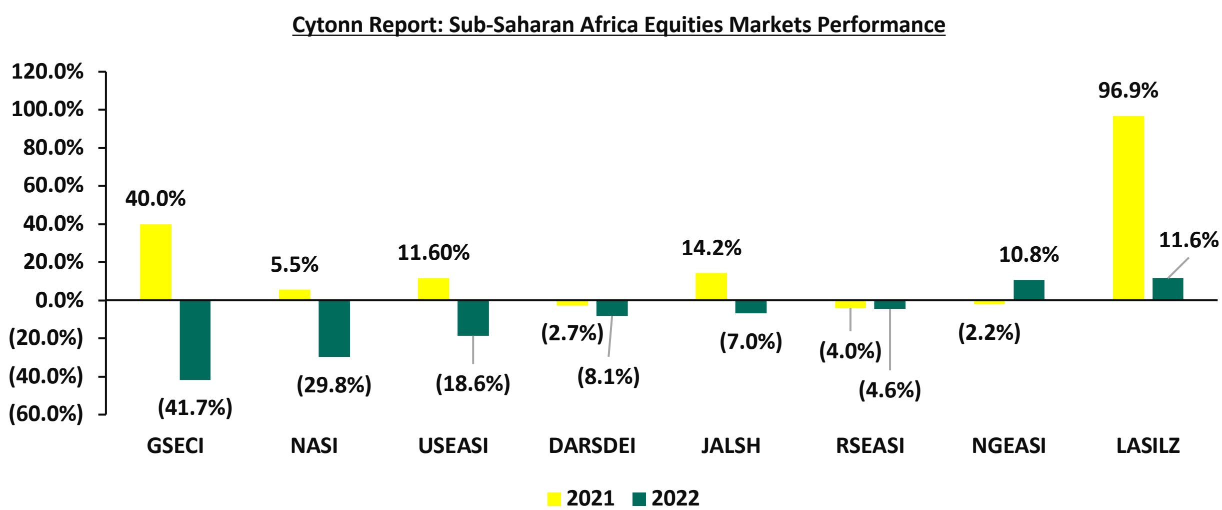
The global equities markets registered mixed performance in 2022, with Nigerian Stock Exchange All share Index (NGSEASI) and Mauritius Stock Exchange Index (SEMDEX) being the only gainers among the major world indices. The Nigeria All share index was the largest gainer, recording a 10.1% gain, largely driven by increased investor sentiments following the rallying of crude oil prices with Nigeria being a net exporter of crude oil. Additionally, the Nigerian banking stocks recorded significant gains on the back of the Central Bank of Nigeria's decision to gradually hike the Monetary Policy Rate (MPR) to 16.5% in November 2022, from 11.5% in January 2022, which consequently led to 0.4% points increase in maximum lending rate to 28.1% in November 2022, from 27.7% in January 2022. On the other hand, most indices declined attributable to capital outflows as investors sought less risky markets such as government papers and other investment alternatives. Moreover, stock markets in developing countries witnessed high capital flights and higher declines as a result of increased uncertainties about the economies following interest rate hikes around the world particularly in advanced economies aimed at anchoring inflationary pressures. The chart below highlights the performance of select stock indices;



Source: Dollarized Performance

Section II: Sub-Saharan Africa Review

The Sub-Saharan Africa (SSA) stock markets recorded mixed performance in 2022, with Zambia Stock Exchange (LASILZ) being the largest gainer following an 11.6% gain in 2022, due to improved macroeconomic environment supported by the IMF financial assistance maintaining investor confidence in the country. However, the performance was a decline from the 96.9% gain in 2021, following the 17.3% drop in global copper prices in 2022 compared to a 37.6% increase in copper prices in 2021. On the other hand, Ghana Stock Exchange Composite Index (GSCECI) was the worst performing index in 2022, declining by 41.7%, mainly due to the deteriorated macroeconomic environment evidenced by Ghana's high inflation at 54.1% in December 2022 and regulatory policies such as the re-imposition of capital gains tax on listed equities securities which adversely impacted the equities market as investors shift their capital to other investment alternatives. The chart below highlights the performance of key indices:



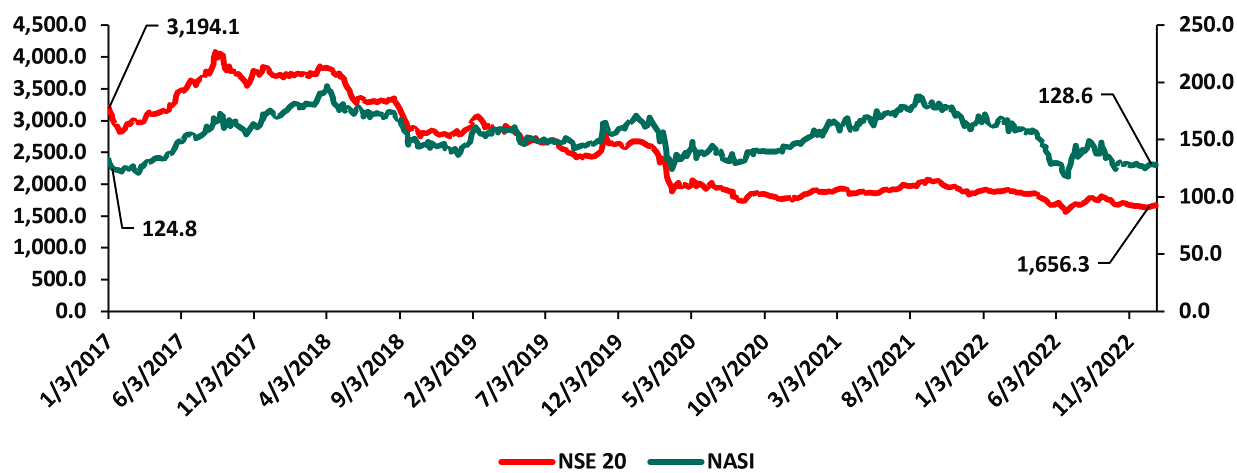
Source: Dollarized

Section III: Kenya Equities Markets Review

a. Stock Performance

In 2022, the Kenya equities market was on a downward trajectory, with NASI, NSE 20 and NSE 25 declining by 23.7%, 12.4% and 16.6%, respectively. The equities market performance was driven by losses recorded by large cap stocks such as Safaricom of 36.7%, Bamburi of 17.5%, as well as banking stocks such as KCB Group, Diamond Trust Bank Kenya, Equity Group and Co-operative Bank Kenya of 16.4%, 16.0%, 15.6%, and 5.4% respectively. The losses were however mitigated by gains recorded by other banking stocks such as NCBA Group, Standard Chartered Bank Kenya (SCBK) and ABSA Bank Kenya of 54.6%, 9.8% and 4.7%, respectively, while BAT Kenya and EABL gained by 4.5%, and 1.2%, respectively. Equities turnover declined by 36.5% to USD 0.8 bn, from USD 1.3 bn in 2021. Foreign investors remained net sellers, with a net outflow of USD 204.3 mn, compared to a net outflows of USD 91.9 mn recorded in 2021. The foreign-investor outflows during the year is largely attributed to investors fleeing emerging markets such as Kenya, to advanced economies such as United States and United Kingdom following interest rate hikes as well as increased concerns on macroeconomic deterioration. The graph below highlights the performance of the NASI and NSE 20 indices during the year;

Cytonn Report: NASI/NSE-20 Index Movements



Source: NSE

The table below highlights the performance of the some of the large cap stocks in the Kenyan stock market in 2022;

Cytonn Report: Kenyan Equities Performance – Large Cap Gainers and Losers 2022					
No.	**Company Name**	**Year Open Share Price-2022 (Kshs)**	**Year End Share Price-2022 (Kshs)**	**2021 Performance**	**2022 Performance**
1	NCBA Bank Kenya	25.5	39.4	(5.3%)	54.6%
2	Standard Chartered Bank Kenya	130.0	142.8	(11.2%)	9.8%
3	ABSA Bank Kenya	11.8	12.3	24.5%	4.7%
4	BAT Kenya	440.0	460.0	22.3%	4.5%
5	East African Breweries Limited (EABL)	165.5	167.5	7.1%	1.2%
6	Co-operative Bank Kenya	13.0	12.3	3.2%	(5.4%)
7	Equity Group	52.8	44.5	45.5%	(15.6%)
8	Diamond Trust Bank Kenya (DTB-K)	59.5	50.0	(22.5%)	(16.0%)
9	KCB Group	45.6	38.1	18.4%	(16.4%)
10	Bamburi Cement	38.2	31.5	(4.9%)	(17.5%)
11	Safaricom	38.2	24.2	10.8%	(36.7%)

The key take outs from the above table include:

i) The Banking sector stocks recorded mixed performance in 2022 with, NCBA Bank, Standard Chartered Bank Kenya and ABSA Bank Kenya, gaining by 54.6%, 9.8% and 4.7% respectively, while KCB Group, diamond Trust Bank Kenya, Equity Group and Co-operative Bank declining by 16.4%, 16.0%, 15.6% and 5.4% respectively. The significant gain recorded by NCBA Bank stock is largely attributable to the bank strong financial performance having recorded a 96.2% increase in core earnings per share to Kshs 7.8 bn in Q3'2022 from 4.0 in Q3'2021. Additionally, the bank declared an interim dividend of Kshs 2.0 per share in H1'2022, which continued to boost investors' confidence. On the other hand, the decline in value of the other banking stocks is primarily attributable to increased sell off by foreign investors as they flee emerging markets such as Kenya relocating their capital to developed economies. However, the listed banks showed resilience despite the deteriorated business environment, brought on by elevated inflationary pressures, evidenced by a weighted average growth in core earnings per share of 36.7% in Q3'2022, albeit lower than o the 102.0% growth recorded in Q3'2021. The increase in EPS was mainly attributable to a 30.1% growth in non-funded income coupled with a 17.6% growth in net interest income,

ii) The manufacturing sector continued to demonstrate resilience with BAT Kenya and East African Breweries Limited (EABL) recording increases in share price of 4.5% and 1.2%, respectively in 2022 adding to gains of 22.3% and 7.1% respectively in 2021. Despite the challenging economic conditions, BAT Kenya continued to display strong financial performance having recorded an 8.4% increase in profit after tax to Kshs 2.9 bn in H1'2022 from Kshs 2.7 bn recorded in H1'2021. The company also declared an interim dividend of Kshs 5.0 per share for the year ended 31st December 2022 which boosted investors' confidence in the company's stock. As well, EABL also recorded strong financial performance having recorded a 122.9% increase in profit after tax to Kshs 15.6 bn in the year ended 30th June 2022 from Kshs 7.0 bn recorded in 2021. Additionally, Diageo Kenya announced its intention to acquire an additional 15.0% stake in EABL to bring its shareholding to 65.0%, through a tender to minority shareholders. The move reflects the strategic importance of EABL to the group, having announced it will purchase each share at Kshs 192.0 which represented a 39.1% premium on the share price which closed at Kshs 138.0 on 13th October 2022, a day before announcement,

iii) On the Construction front, Bamburi's share price fell for a second year in a row having declined by 17.5% in 2022 adding to a 4.9% drop in 2021. The performance comes at a time when the company's earnings are in a disarray evidenced by its move to issue a profit warning, indicating that the expected decline in its earnings was largely due to a slowdown in market demand for cement, high energy costs, and increased costs of raw material brought on by disruptions in global supply chain. Figures from the Kenya National Bureau of Statistics (KNBS) showed that cement consumption fell 14.6% in Q3'2022 to 2.2 mn metric tonnes from 2.6 mn metric tonnes in Q3'2021. Furthermore, Bamburi Cement reported a 90.9% drop in profit before tax to Kshs 0.1 bn in H1'2022, from Kshs 1.1 bn in H1'2021. The performance continued to erode investor's confidence in the company's stock, leading to increased sell offs, and,

iv) In the Telecommunication Sector, Safaricom continued to exert its dominance in the bourse, with its market cap closing the year at 49.6% of the entire bourse as at 30th December 2022, a decline from 59.5% recorded in 2021. The counter lost 36.7% of its share value during the year attributable to increased sell off by foreign investors as they exited the market due to hiked interest rates in developed economies such as United States making dollar investments more appealing and thus lowering their appetite for risky investments in emerging markets such as Kenya. In its H1'2023 results, Safaricom reported a 10.0% drop in core earnings per share to Kshs 0.8 in H1'2023, from Kshs 0.9 in H1'2022. The decrease was largely due to a 32.2% increase in operating expenses to Kshs 31.0 bn from Kshs 23.4 bn recorded in H1'2022, with its Ethiopian subsidiary incurring Kshs 6.0 bn in operating expenses representing 24.0% of the group's total operating expenses. The Ethiopian subsidiary recorded a total revenue of Kshs 98.3 mn, with service revenue coming at Kshs 9.1 mn while operating cost came at Kshs 6.0 bn leading to a loss after tax of Kshs 7.3 bn which weighed down on the group's overall performance.

b. Listings and Suspensions

During the year, the Capital Markets Authority approved listing by introduction of the Local Authority Pension Trust (LAPTRUST) Imara Income Real Estate Investment Trust (I-REIT) on the Nairobi Securities Exchange (NSE) under the Restricted Sub-Segment. This implies that LAPTRUST held 100.0% of the Imara I-REIT shares with no initial offer to the public. For more information, please see our Cytonn Monthly – October 2022. Additionally, four companies remained suspended from trading at the Nairobi Securities Exchange (NSE) during the year, namely; Deacons (East Africa) PLC, ARM Cement PLC, Mumias Sugar Co. Ltd and Kenya Airways.

c. Profit Warnings

In 2022, 11 companies issued profit warnings, as compared to 4 companies in 2021, and 15 companies in 2020. The increased in number of companies that issued profit warning in 2022 is an indication of tough economic conditions brought by the continued effects of COVID-19 as well as the disruption of the global supply chain due to the ongoing Ukraine-Russia conflicts which has led to high cost of production and consequently reduced consumer demand. Companies are required to issue profit warnings if they project a more than 25.0% decline in profits year-on-year. The aforementioned companies are Kakuzi Plc, The Limuru Tea Kenya Plc, Sanlam Kenya Limited, Unga Group Ltd, Liberty Kenya Holdings Ltd, Centum Investments Co Plc, Sameer Africa plc, Nairobi Securities Exchange PLC, Bamburi Cement PLC, Crown Paints Kenya Plc and Flame Tree Group Holdings Ltd. For more information, see our 2022 Annual Review.

Section IV: Conclusion

As the global economy continues to face headwinds from elevated inflationary pressures and hiked interest rates, we expect equities markets to remain volatile in the short term as investors shift their capital to more alluring and less risky investments. Furthermore, major cause for concern lies on the persistent weakening of local currencies against the bullish US Dollar which has continued to erode corporate earnings and lowering valuation multiple of companies. As such, emerging markets such as Kenya remain exposed to the market headwinds on the back of adverse macroeconomic conditions. Therefore, we expect investors to continue to be biased towards growth stocks that are best placed with strong fundamentals amid the current low valuations.

We are "Neutral" on the Equities markets in the short term due to the current adverse operating environment and huge foreign investor outflows, and, "Bullish" in the long term due to current cheap valuations and expected global and local economic recovery.

With the market currently trading at a discount to its future growth (PEG Ratio at 0.8x), we believe that investors should reposition towards value stocks with strong earnings growth and that are trading at discounts to their intrinsic value. We expect the current high foreign investors sell-offs to continue weighing down the economic outlook in the short term.