DYER & BLAIR INVESTMENT BANK
MACROECONOMIC OUTLOOK 2020

Founder Member of the Nairobi Securities Exchange

3RD FEBRUARY 2020

DYER & BLAIR
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KEY METRICS: KENYA

2019E Real GDP (USD TR)	0.05
2019E GDP/Capita (USD)	1,050.87
2019E Real GDP Growth (%)	5.8
FY18/19 Fiscal Deficit (% of GDP)	7.70
FY19/20 Fiscal Deficit (% of GDP)	6.20
FY19/20 Public Debt (% of GDP)	57.90
FY19 Current Deficit (% of GDP)	4.60
KES/USD 2019 Performance (%)	-0.49
2019 Inflation (%)	5.82
Key index performance-2019 (%)	-5.97

Interest Rates	2019	2018
91-day T-Bill (%)	7.20	7.34
5 year rate (%)	11.49	11.55
Interbank Lending (%)	5.46	8.15
REPO (%)	6.90	8.63
Lending Rate (%)	12.47	12.61
Deposit Rate (%)	6.98	5.70
CBR (%)	8.50	9.90

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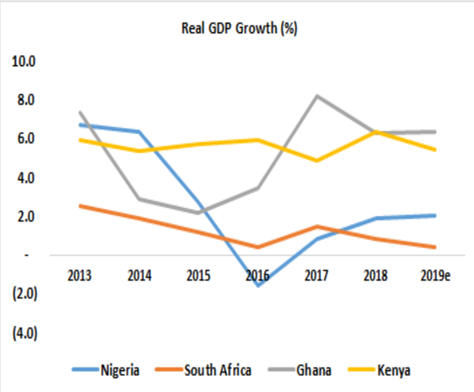
WORLD ECONOMIC OUTLOOK: VULNERABLE & VOLATILE

According to the IMF, global growth may be bottoming out going into 2020 partly on the back of lagged effects from the substantial support provided by monetary easing in several countries in 2H19, positive developments on US-China trade relationship and the unlikelihood of a hard Brexit. They estimate global growth at 2.9% in 2019, 3.3% in 2020 and 3.4% in 2021, a downward revision from their October 2019 update which underscores (at least in our view), the intractability of key challenges facing the World and the susceptibility of the World's economy to isolated events.

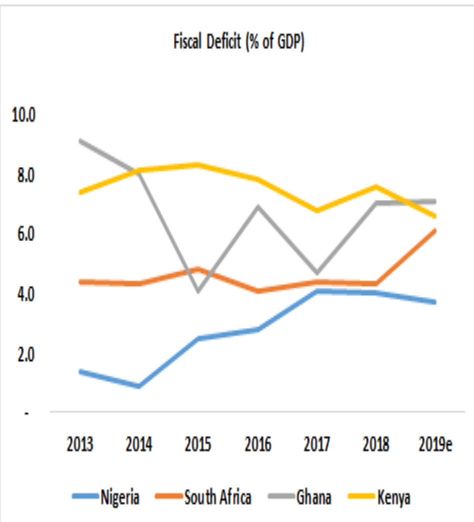
	Est	Est	Proj	Proj	Diff from Oct-19 Proj -	
	2018	2019	2020	2021	2020	2021
World Output	3.6	2.9	3.3	3.4	(0.1)	(0.2)
Advanced Economies	2.2	1.7	1.6	1.6	(0.1)	0.0
United States	2.9	2.3	2.0	1.7	(0.1)	0.0
Euro Area	1.9	1.2	1.3	1.4	(0.1)	0.0
Japan	0.3	1.0	0.7	0.5	0.2	0.0
United Kingdom	1.3	1.3	1.4	1.5	0.0	0.0
Emerging Market & Dev Economies	4.5	3.7	4.4	4.6	(0.2)	(0.2)
China	6.6	6.1	6.0	5.8	0.2	(0.1)
India	6.8	4.8	5.8	6.5	(1.2)	(0.9)
Sub-Saharan Africa	3.2	3.3	3.5	3.5	(0.1)	(0.2)
Nigeria	1.9	2.3	2.5	2.5	0.0	0.0
South Africa	0.8	0.4	0.8	1.0	(0.3)	(0.4)
Kenya	6.3	5.8	6.0	5.8	0.0	-

(Source: IMF)

We believe that changes in US-China trade relationship are a consequence of the continued rise of China, now expected to surpass USA by GDP by 2020/21. With both economies fairly interdependent and preoccupied by domestic problems in the near term, a quick transition to a new equilibrium is unlikely. Secondly, we think that the impact of Brexit on the Euro zone remains unknown so more changes are likely over time. Thirdly, whereas 2H19's easing partly explains continued recovery of the global economy, there is unanimity that Central Banks have less ammunition to deal with emerging weaknesses moving forward. Thus, we see global uncertainty as a new norm that will keep the global economy susceptible to retrospectively unpredictable events such as the Saudi-oil attack of 3Q19, US-Iran conflict of 1Q20, the spread of Coronavirus in 1Q20 etc. Each of these events will trigger reactionary responses from politicians (many of whom tilt populist), and exacerbate the narrative of doom and chaos (fear spreads faster) in effect ensuring markets volatility.



(Source: IMF, World Bank)



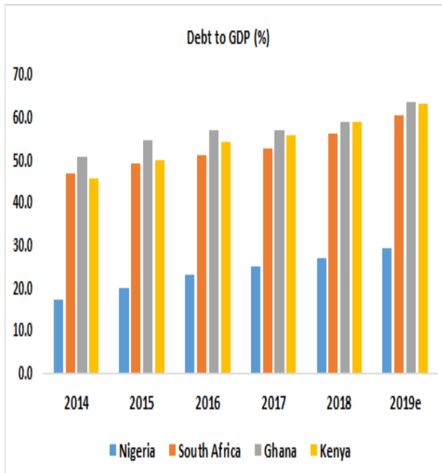
(Source: IMF, World Bank)

Key point is that Kenya's macro position, growth and diversified economy can still help her out-compete comparable economies (from a strictly inflows standpoint) for inflows in 2020.

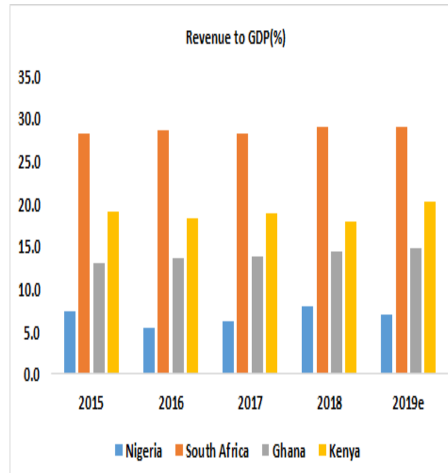
SSA: STRONGER GROWTH, FISCAL DEFICITS, VOLATILITY OF CURRENCIES

The IMF expects SSA's growth to strengthen to 3.5 percent in 2020–21 (from 3.3 percent in 2019). The projection is 0.1 percentage point lower than in the October update 2020 and 0.2 percentage point weaker for 2021 reflecting weaknesses in South Africa, Ethiopia, and Nigeria etc. Downside risks include spillovers from slowing growth globally, subdued commodity prices and impact of limited fiscal space on public investments.

Among the main economies, fiscal deficits will remain a key theme as countries navigate shrinking fiscal space, revenue underperformance and rising debt levels.

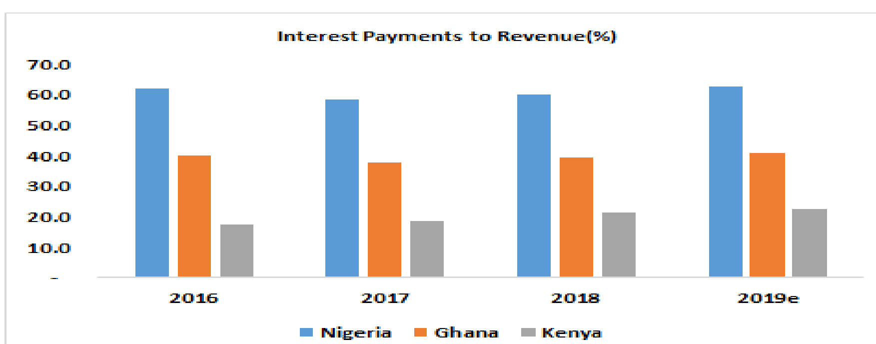


(Source: IMF, World Bank)

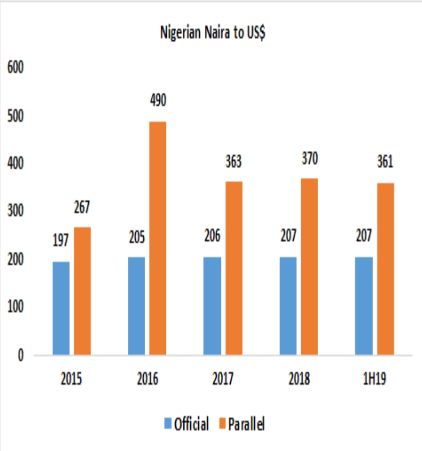


(Source: IMF, World Bank)

Amidst debt financing pressures, revenue mobilization efforts will be difficult due to subdued economic growth in Nigeria and South Africa and nascent political campaigns in Ghana and Kenya. With Ghana's election in 2020, investors will anticipate the typical election year fiscal slippages, while the apparent schism between the Kenyan political elites is likely to find expression in opposition to new revenue growth measures.

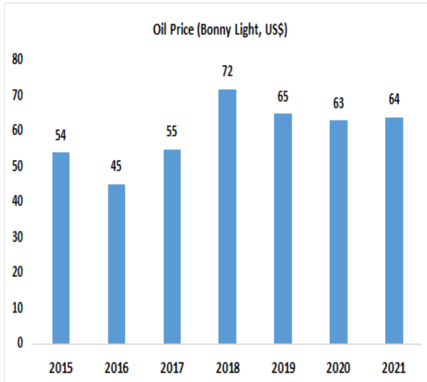


(Source: IMF, World Bank, Kenya's Treasury)

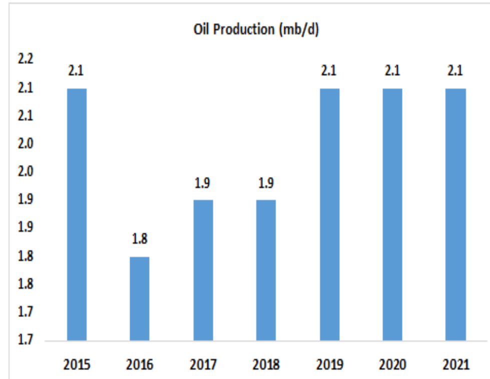


(Source: World Bank)

Nigeria's parallel exchange rates are set to continue following the re-appointment of Governor Godwin Emiefele for a second and final term but more importantly, because oil production is likely to remain flat while global prices are unlikely to rise above mid 60s per barrel.

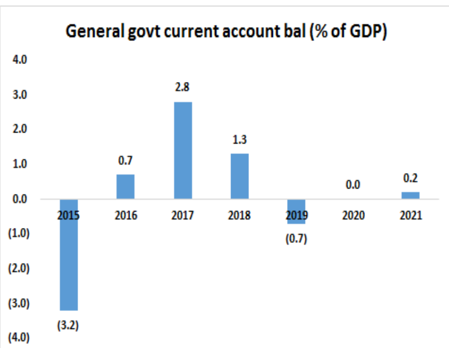


(Source: World Bank)



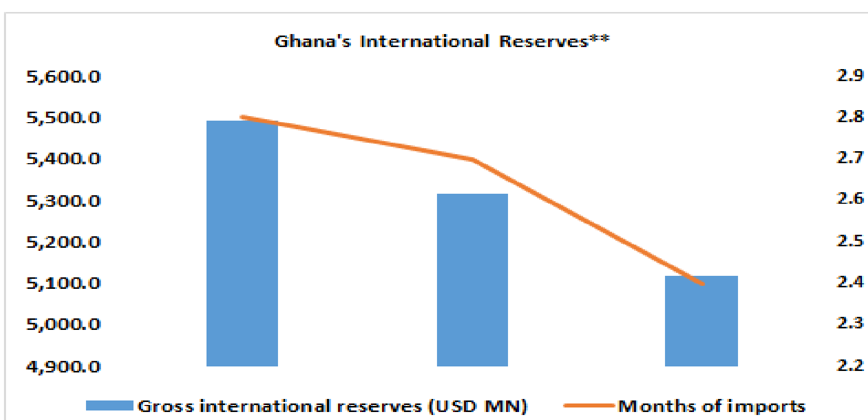
(Source: World Bank)

A weakening current account at a time when the country has been downgraded partly due to the overvaluation of the Naira will likely be a strong concern for foreign investors. Further, according to the World Bank, a reliance on foreign inflows for short term government funding is a source of considerable risk as a sudden reversal of flows due to an external shock would have near immediate consequences for the exchange rate.



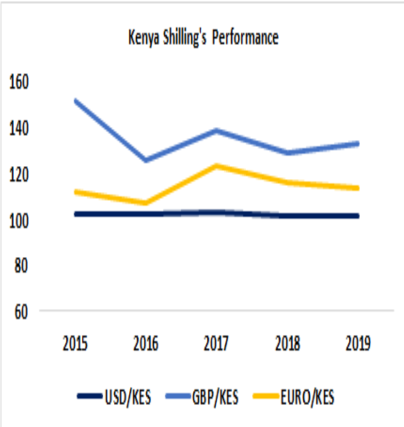
(Source: World Bank)

Ghana's currency outlook is complex: The forex reserves are weak at 2.4 months of import cover as at December 2019 and the IMF projects them to remain below the 3 month of imports benchmark over the medium term. In addition, despite frequent interventions by the Central Bank and regular external borrowing, the Cedi has continued to weaken having depreciated 12.9% and 8.4% against the USD in the last two years. However, according to IMF's EBA-lite model, the current account and the exchange rate remain broadly in line with the macroeconomic fundamentals. Thus, whereas Cedi appears cheap, we can expect a lot more uncertainty driven volatility this year.

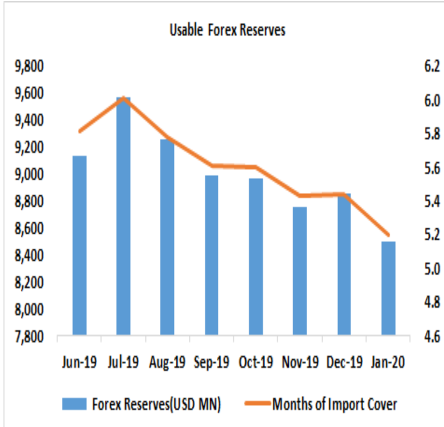


*(Source: IMF, ** excludes foreign encumbered assets and oil funds*

We expect that the Kenya Shilling will remain fairly flat against the USD at 100.0-103.00 despite disagreement between the IMF and the Central Bank of Kenya over its valuation due to significant reserves and a narrowing current account.



(Source: CBK)



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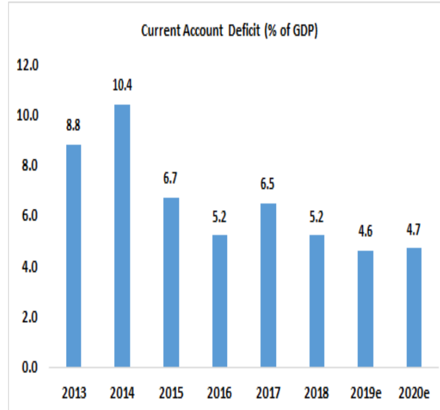


(Source: CBK, World Bank)

Kenya could benefit from the outlook position on comparable economies by various ratings agencies

NIGERIA

Rating Agency	Rating	Outlook	Last Update	Action
Moody's Investor Service	B2	Negative	4-Dec-19	Outlook downgrade from stable
Fitch	B+	Negative	19-Dec-19	Outlook downgrade from stable
S&P (Long/Short)	B/B	Stable	14-Sep-18	Rating and outlook maintained

(Source: Moody, Fitch, S&P)

SOUTH AFRICA

Rating Agency	Rating	Outlook	Last Update	Action
Moody's	Baa3	Negative	1-Nov-19	Outlook Downgrade from stable
Fitch	BB+	Negative	26-Jul-19	Outlook Downgrade from stable
S&P (Long/Short)	BB/B	Negative	22-Nov-19	Outlook Downgrade from stable

(Source: Moody, Fitch, S&P)

GHANA

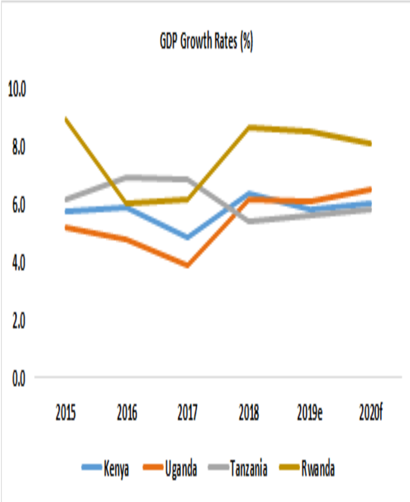
Rating Agency	Rating	Outlook	Last Update	Action
Moody's	B3	Stable	16-Feb-19	Rating and outlook maintained
Fitch	B	Stable	11-Oct-19	Rating and outlook maintained
S&P (Long/Short)	B/B	Stable	15-Mar-19	Rating and outlook maintained

(Source: Moody, Fitch, S&P)

KENYA

Rating Agency	Rating	Outlook	Last Update	Action
Moody's	B2	Stable	25-Nov-19	Rating and outlook maintained
Fitch	B+	Stable	2-May-19	Rating and outlook maintained
S&P (Long/Short)	B+/B	-	14-May-19	Rating and outlook maintained

(Source: Moody, Fitch, S&P)

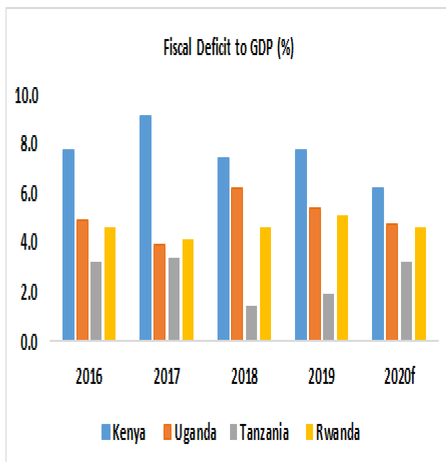


(Source: World Bank, IMF)

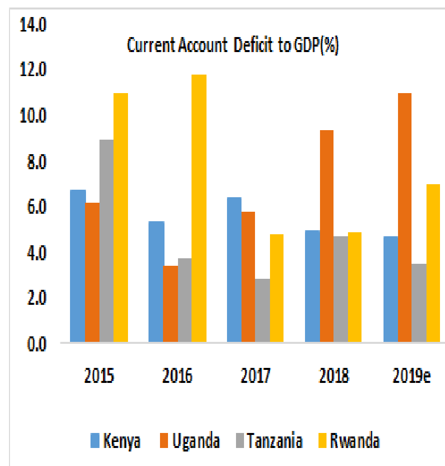
EAST AFRICAN COMMUNITY –FASTEST GROWING REGION IN SSA

Strong and consistent growth in EAC is good for FDI and portfolio inflows in 2020. The recent repeal of interest rate caps in Kenya, a good rainfall outlook and commitment to settle unpaid bills to public contractors can boost growth further while stability of global oil prices can keep current accounts stable year on year. The beginning of political campaigns in Tanzania with elections in 2020, Uganda with elections in 2021, and in Kenya with a potential referendum in 2020 and elections in 2022 could however see investors adopt a wait and see attitude.

Wide fiscal deficits may see crowding out slowing the expected private sector credit growth and hence economic growth. A material consolidation of the deficit, though unlikely, would also be growth negative unless sufficient reforms to crowd in the private sector are pursued. Current account deficits will remain relatively narrow due to low import bills and will continue to be adequately financed by FDI and portfolio inflows.



(Source: IMF)



(Source: IMF)

COUNTRY	KENYA
2019E REAL GDP (USD TR)	0.05
2019E REAL GDP/CAPITA (USD)	1,050.87
2019E REAL GDP GROWTH (%)	5.80
FY18/19 FISCAL DEFICIT (% OF GDP)	7.70
FY19/20 FISCAL DEFICIT (% OF GDP)	6.20
FY18/19 PUBLIC DEBT (% OF GDP)	56.9
FY19/20 FISCAL DEFICIT (% OF GDP)	57.9
FY19 CURRENT ACCOUNT DEFICIT	4.6
KES/USD 2019 PERFORMANCE (%)	-0.49
2019 INFLATION (%)	5.82
NSE 20-2019 (%)	-5.97

(Source: World Bank, Treasury, KNBS, NSE)

CONVICTION PICKS

1. KCB
2. EABL
3. DTB
4. BAT
5. KENGEN
6. BRITAM

INTERMEDIATE PICKS

1. SAFARICOM
2. EQUITY
3. KENYA RE
4. CO-OP
5. STANCHART
6. I&M
7. NCBA
8. STANBIC

INCOME PICKS

1. BARCLAYS
2. STANCHART
3. BAT
4. WTK
5. SCAN
6. LONGHORN

KENYA: UNCERTAINTY, STRONG GROWTH, POLITICS, VOLATILITY

While we recognize Kenya's macroeconomic issues, we express cautious optimism that reforms are nigh in the medium term, even as the self-fulfilling nature of the prevailing negativity and pessimism takes a toll on markets performance in the short term.

We expect a lot of noise on economic issues from both pundits and politicians especially on debt and taxation levels. This will see a number of market players adopt a wait and see attitude even as others benefit from the attendant markets volatility to realize trading gains.

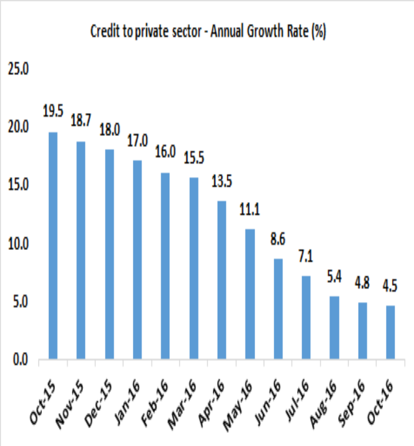
We observe that the strain on the real economy while still seemingly anecdotal, is no longer just a topic among intellectuals, but a recurring complaint among the very people the political class is trying to mobilize ahead of 2022 elections. As such, we expect that this mobilization will bear carrots that can delay a significant crisis until post 2022 unless the weaknesses in the global economy give in before. In the meantime, such short term measures are likely to have a positive impact on liquidity and banking sector's asset quality.

Amidst these chains of actions and reactions (foreign and domestic) we believe that the case for absolute growth in Kenyan equities will continue to be weak and limited to those that win from changes in regulations (removal of caps, changes in taxes, potential telecom sector regulations etc.) but better relative to peers in similar economies purely on account of foreign investor sentiment. Our conviction picks for 2020 include KCB Group, EABL Group, DTB Group, Britam Group, BAT Group and KenGen. We believe that these companies are fundamentally undervalued and stand to grow both their top line and bottom line as the private sector credit growth and hence economy recovers.

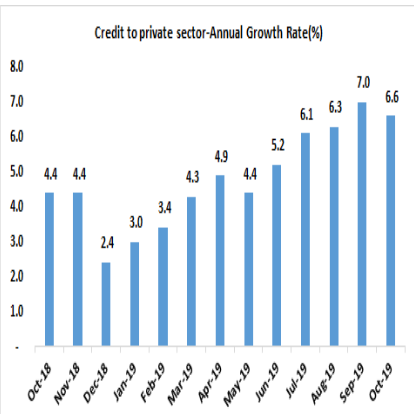
As fiscal deficit will remain wide, as foreign borrowing may slow down, and as caps on lending rates are now removed, the fixed income market will remain on its growth path, even as intermittent yield volatility engenders a wait and see attitude among local investors.

We expect politics to take center stage but remain optimistic that the inevitable divisions will not create instability. We highlight that part of the narrative for BBI is to stop the typical elections related economic shocks. With all key players supportive of the BBI process, we expect the fear of isolation to prevent dramatic escalations. We expect that there will be a political referendum in 2020.

With respect to market positioning, we remain overweight on fixed Income, and recommend a cherry picking strategy on equities around our conviction, intermediate and income picks.



(Source: CBK)



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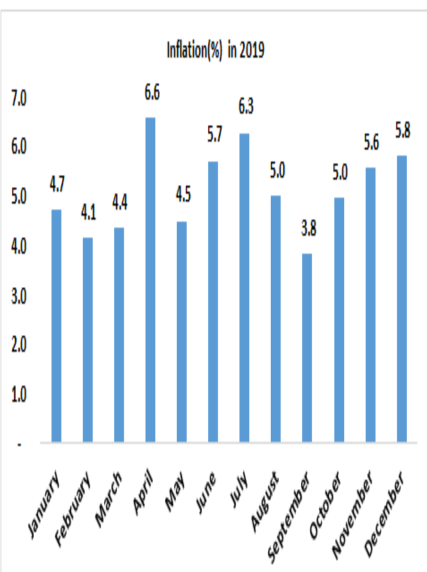


(Source: CBK)

Key Macro Metrics!

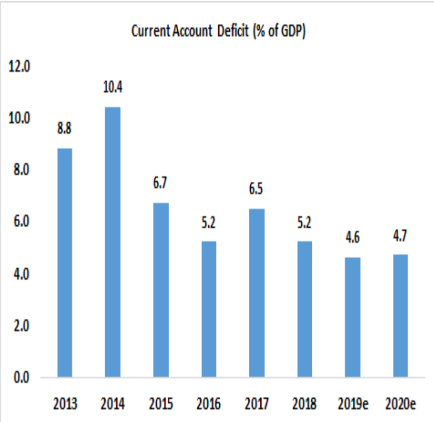
Private Sector Credit Growth: Still lots to juggle!

Private sector credit growth is on recovery following the repeal of the interest rate caps in 2019. The Central Bank of Kenya expects a growth rate of 11.8% in 2020 against the 6.6% as at October 2019. We see downside risks from existing asset quality problems in the banking sector, Central Bank governor's moral suasion against high lending rates at a time when yields on government securities are expected to rise, and the likely onset of 2022 political campaigns. On the side bar, we should private sector credit growth before the caps came into place, and after they came into place.

Although asset quality has improved, with Central Bank's MPC reporting that sector wide NPLs declined to 12.0% as at December 2019, we think that there remains some weaknesses in the real economy that could impede credit growth. We also think that Central Bank's moral suasion against high lending rates may in contrast to the expectation of rising government yields further drive crowding out if banks double down on government securities. The likely onset of 2022 political campaigns is likely to be growth negative hence not conducive for credit growth.

Inflation: To remain within range!

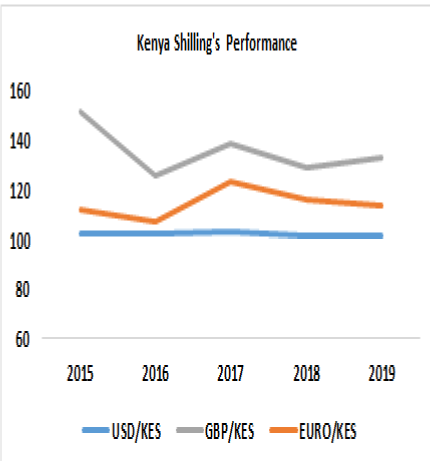
We expect the rate of inflation to remain within the upper policy limit of 7.5%. We observe that maize production will decline with an expected 33.0 million bags against the target 52.0 million and against 2018's 44.6 million. We think that the government will facilitate importation of maize and potentially implement a subsidy to prevent price escalation. We expect hydrology levels to remain above average following an above average rainfall from October 2019 through January 2020, this should keep the price of electricity at bay. Whereas the global price of oil will remain a source of unpredictability, we expect it to remain in the mid 60s (USD) per barrel especially due to the USA's Presidential election in 2020. While unexpected geopolitical developments such as the Saudi oil attack and the US-Iran conflict can be expected to negatively impact the price of oil, we do not expect such an impact to last long.



(Source: CBK)

Current Account: More narrowing!

In the absence of capital equipment imports (SGR) and in the context of stable oil prices, Kenya's current account balance will continue to narrow. Given negative outlooks on peer economies in Africa, we expect sufficient portfolio and FDI inflows to fund the balance of payments position. Although there are concerns that a rate cap repeal induced economic rebound could drive imports we believe that there is enough slack to compensate for, before the benefits of stable oil prices and fewer capital imports can be undone.



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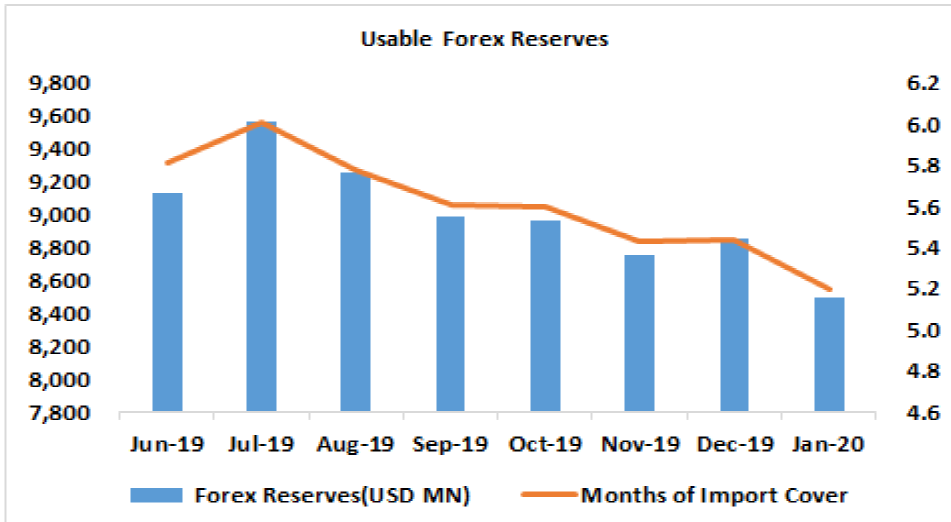


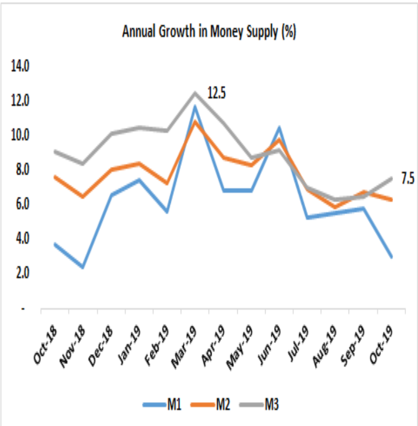
(Source: CBK)

Currency: More of the same but recognize risks from IMF's position.

Our currency outlook dovetails our current account position. In the absence of a material growth in imports, the Shilling will remain largely stable against the US Dollar (100.0-103.0). Further, in the absence of an external shock, we believe that Kenya's official reserves are sufficient to support her external obligations. We observe that the government is in negotiation with the IMF for a precautionary standby facility, but we think that such discussions may prove difficult given IMF's position that the Shilling remains significantly overvalued.

Money Supply growing– double digit growth likely in 2020

We expect that government efforts to clear pending bills and growth in private sector lending will drive growth in money supply to low to mid double digits. In addition, we expect that foreign investor's preference for Kenya and the East Africa region will sustain portfolio and FDI inflows unless in the case of a global economic crisis.



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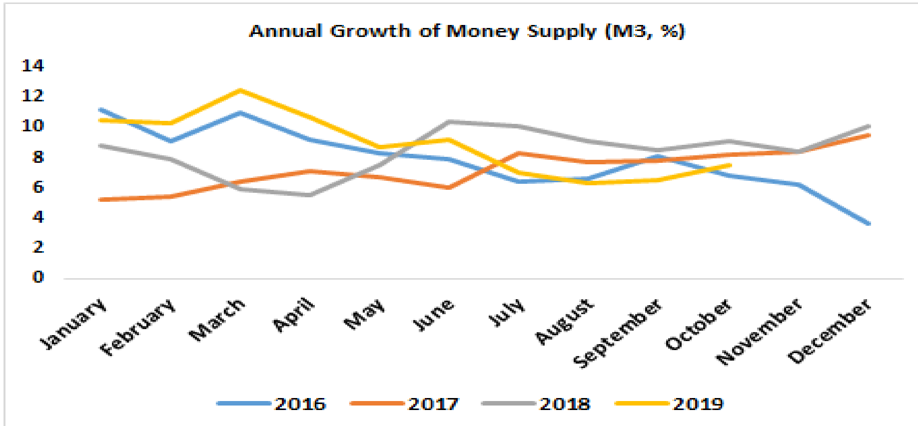
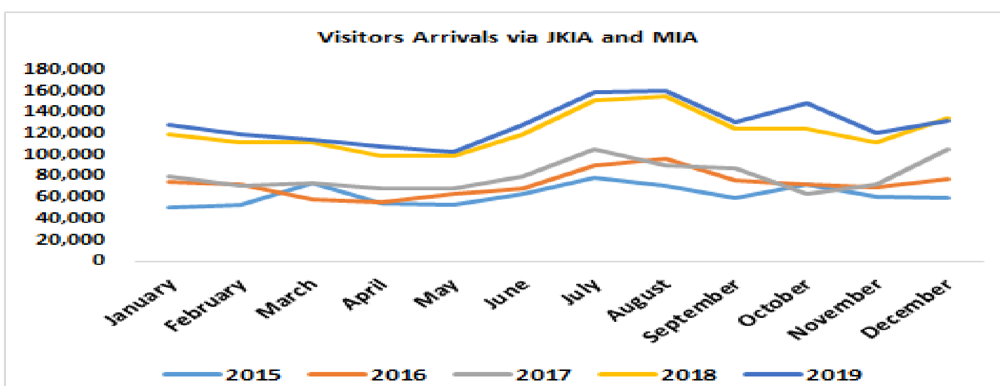


(Source: CBK)

Remittances, another key source of inflows, are expected to stabilize in terms of GDP at circa 2.9% with Central Bank of Kenya expecting about USD 2,992.0 MN in 2020 up from the circa USD 2,778.0 MN received in 2019. That said, since most of the remittances originate from USA, a potential slow down of the USA economy could weaken remittances moving forward.

We expect tourism performance to remain flat year-on-year with a bias for a decline if security risks in tourist hotspots such as Lamu remain elevated. The number of visitors through both Jomo Kenyatta International Airport (JKIA) and Moi International Airport (MIA) has risen over the years following marketing efforts by Brand Kenya, investments in security and removal of travel advisories by major economies.



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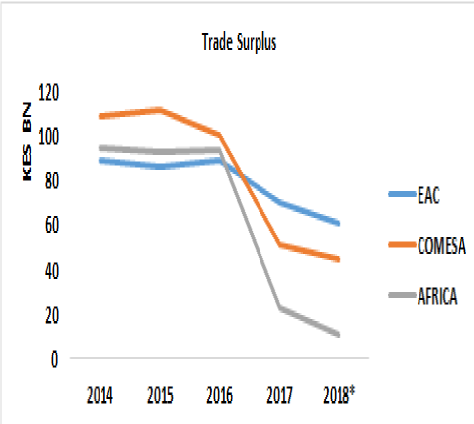

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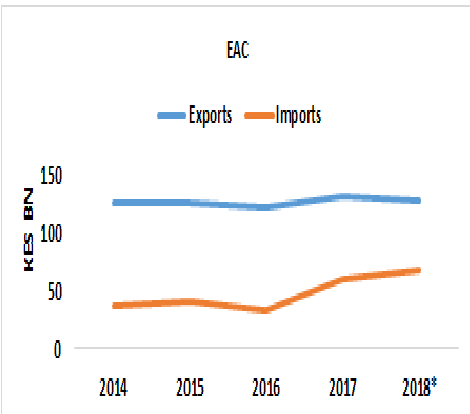

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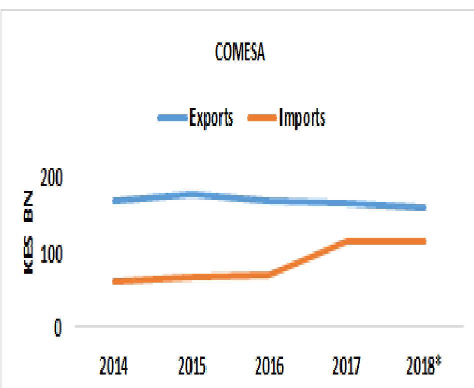

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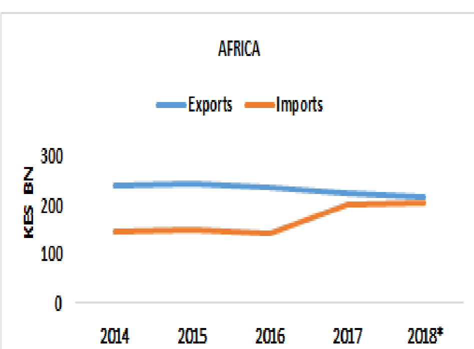
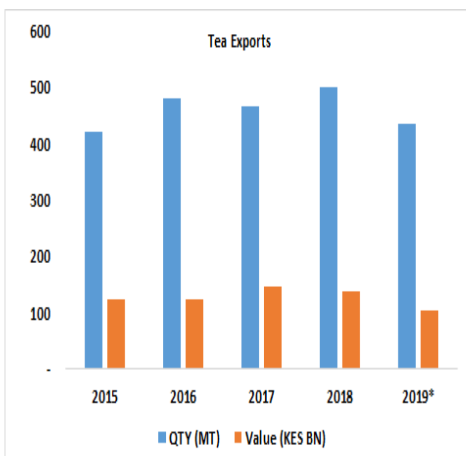


(Source: CBK)

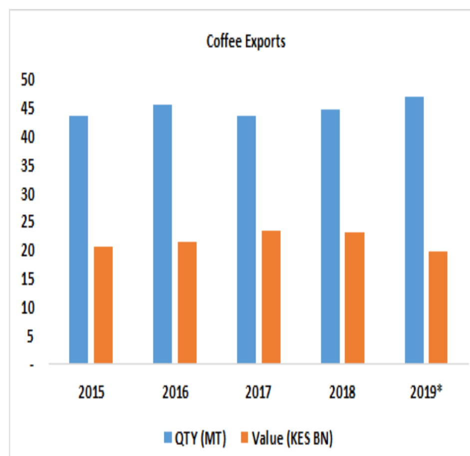
Exports: In need of reforms!

Trade surplus with the EAC, COMESA and Africa has been declining in part because exports have been flat while imports have risen over time. We attribute this to substitution as regional markets have continued to grow their domestic production vis-à-vis Kenya's weak manufacturing growth. There is also evidence that local market dynamics have seen imports become cheaper than local production. As we do not think that these problems have easy or quick fixes, we do not expect material growth in trade in 2020. Beyond Africa, there are prospects of Kenya negotiating new trade agreements with USA (under Trump's Africa plan) and UK (post Brexit). If successful, these would only have an impact in the long term.

The performance of tea and coffee exports could significantly improve if the ongoing push for reforms is achieved. In his new year message, the President highlighted how Kenya continues to earn less from its tea due to lack of value addition and governance issues in the Kenya Tea Development Authority (KTDA). With Kenya accounting for about 20.0% of global black tea output, value addition would create significant uplift for Kenya's exports. We are however skeptical that much will happen in 2020.



(Source: KNBS)



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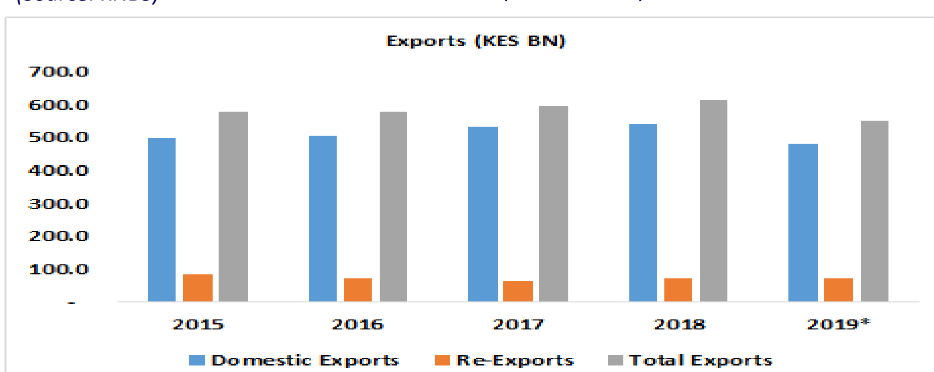


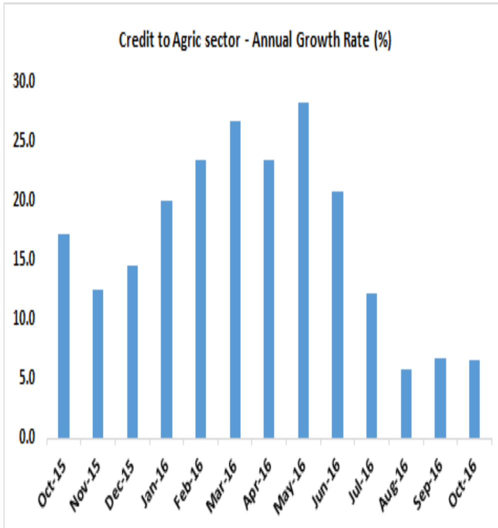
(Source: KNBS)

Key Sectors!

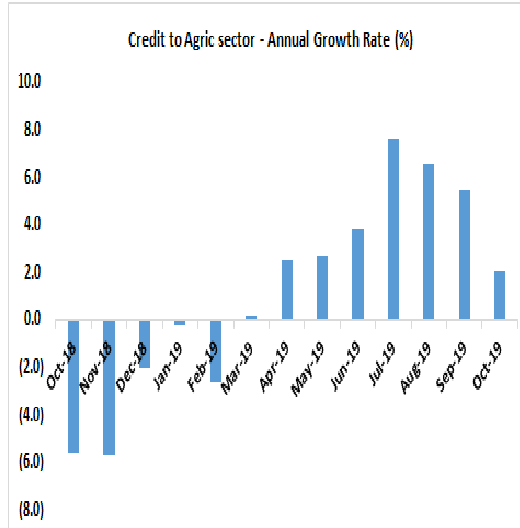
Agriculture

Although agriculture contributes about 33.0% to Kenya's GDP directly and another 27.0% indirectly, its performance has been handicapped by insufficient funding and over-reliance on rain-fed farming. We expect that contingent on successful long rains, agriculture should benefit from the repeal of interest rate caps to expand by at least 5.2% as in 2015. Below we show the resourcing in 2015/16 vs 2018/19.

(Source: KNBS)



(Source: KNBS)

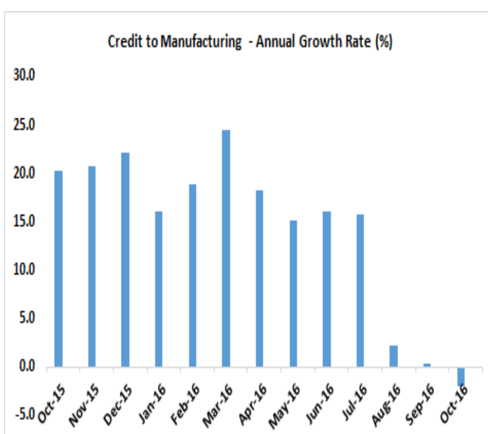


(Source: KNBS)

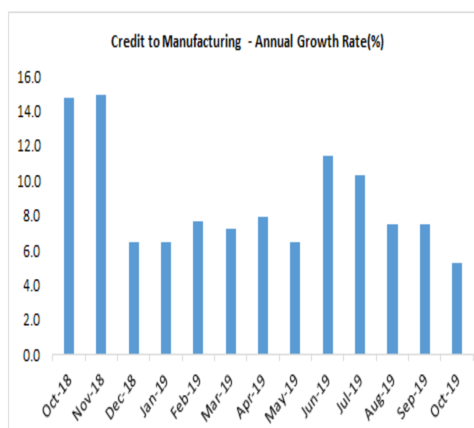
Manufacturing

We anticipate that manufacturing will also see significant growth of at least 4.5% on the back of more resourcing from commercial banks. However, unlike agriculture, there are bigger challenges holding back the sector including the cost of electricity, counterfeit products, and cheaper imports. In light of the 2017's slump, we are cautiously optimistic that the politics will not detract from the efforts already underway

(Source: KNBS)

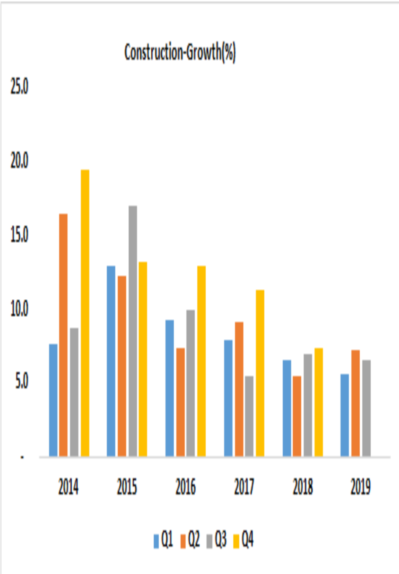


(Source: KNBS)



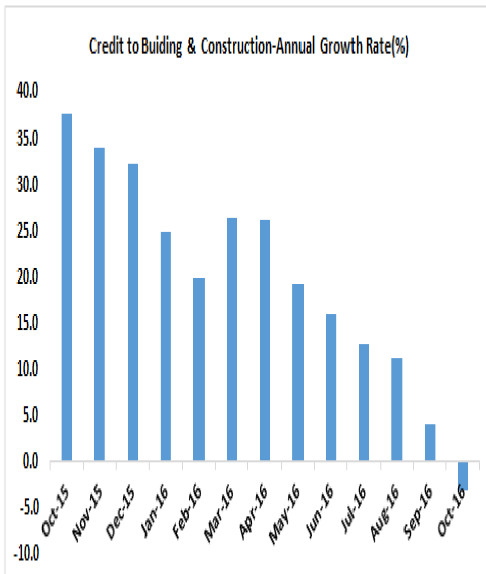
(Source: KNBS)

Construction: A bubble or a glut?

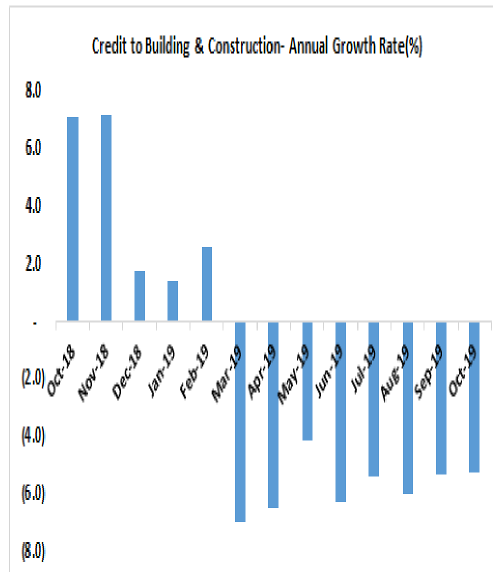


(Source: KNBS)

We observe that the building and construction sector has been seeing slowed growth since 2015 on the back of a number of factors including glut in the high end market, capping of interest rates, high real estate related NPLs etc. We anticipate that with the repeal of the interest rate caps and the government's focus on affordable housing, the sector will grow at least 7.0% in 2019 having grown at 5.6%, 7.2% and 6.6% in the first three quarters of 2019.

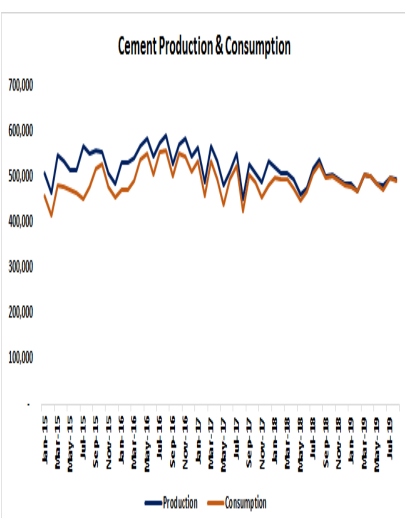


(Source: KNBS)



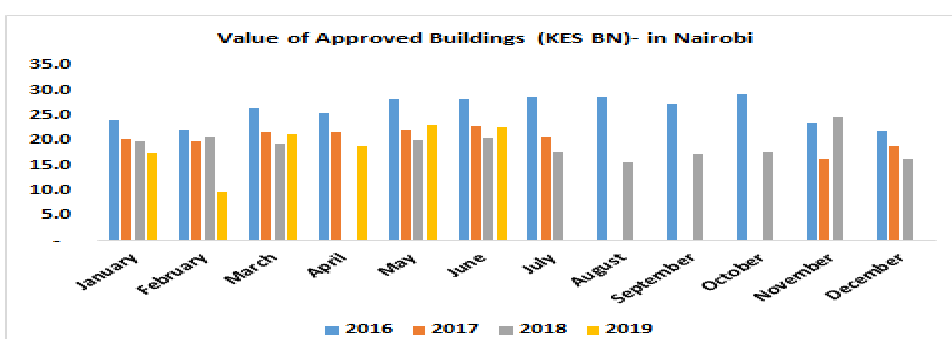
(Source: KNBS)

Declining local cement production: although government spending on infrastructure has been rising (adjusted for SGR), local cement production has been declining month on month, suggesting the impact of increased imports and possibly illicit cross border transfers. This has continued to see the performance of local listed cement businesses fall.



(Source: KNBS)

Declining value of approved buildings in Nairobi County: The value of approved buildings in Nairobi has been on a steady decline since 2016 from a monthly average of about KES 26.0 BN in 2016 to KES 15.0 BN in 2017, KES 18.0 BN in 2018 and KES 19.0 BN in the first 6 months of 2019.

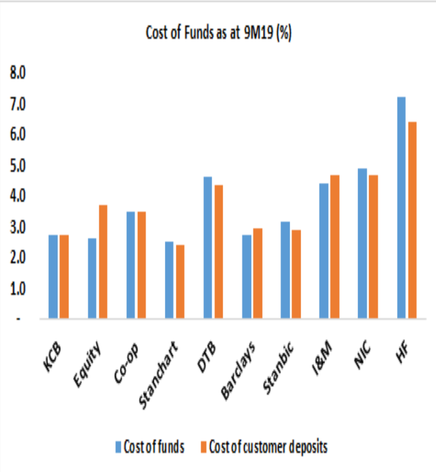


(Source: KNBS, 2019's data available till June, 2017 had no approvals between Aug-Oct)

Markets; Overweight Fixed Income, Cherry Pick Equities!

[**FOLLOW THE LINK TO READ OUR FIXED INCOME OUTLOOK-2020**]

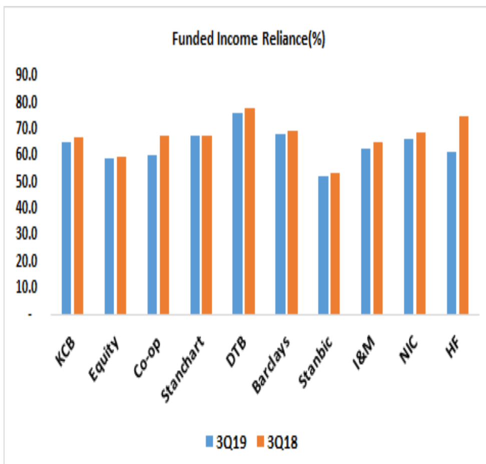
In 2020, we remain overweight on fixed income, and recommend a cherry picking strategy on equities with KCB, EABL, BAT, DTB, Britam, and KenGen as our **conviction picks** from a fundamental analysis standpoint.



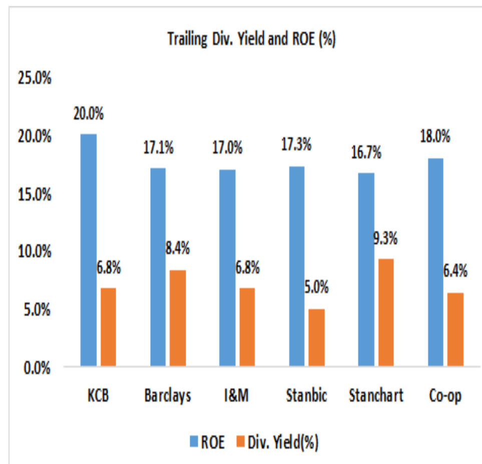
(Source: Company, DBIB Research)

KCB GROUP

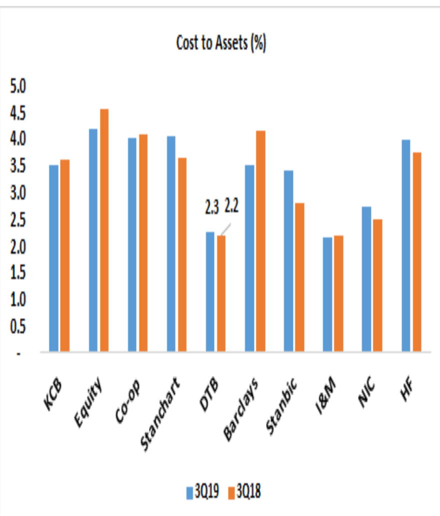
We expect that: (1) Acquisition of NBK will further anchor KCB's low cost of funds position, at a time when the cost of deposits will rise as banks transition back to lending and as competition for wholesale deposits kicks in, (2) Heretofore a weakness, KCB's non-interest income has risen following the revamp of KCB Mpesa to see funded income reliance fall and, (3)With continued growth in profitability we expect KCB's dividend payout policy of at least KES 3.00 per share to continue. Downside risks include asset quality concerns especially following acquisition of NBK and last year's downgrade from the MSCI large caps index.



(Source: Company, DBIB Research)



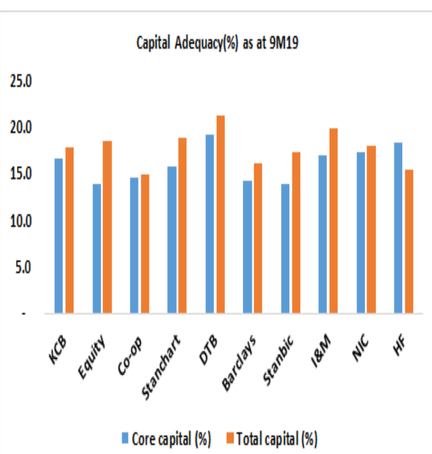
(Source: Company, DBIB Research)



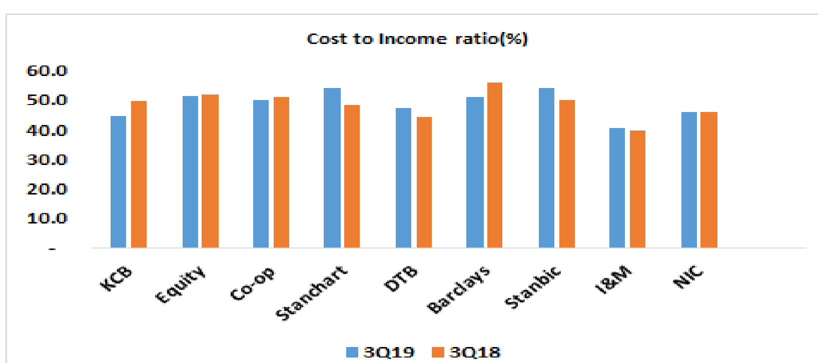
(Source: Company, DBIB Research)

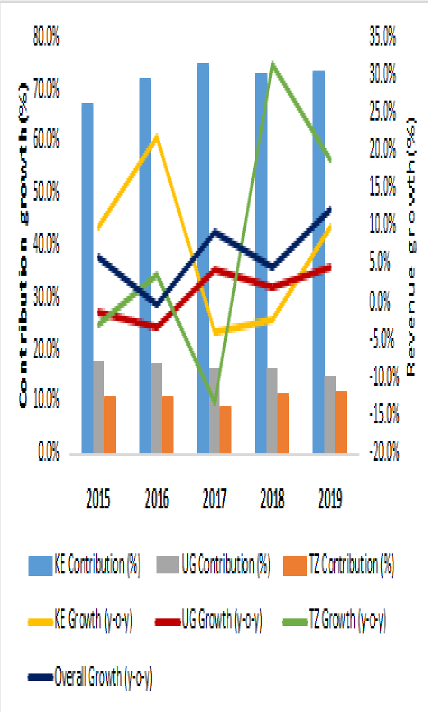
DTB GROUP

We expect management to review their strategy towards lending in the post rate cap environment. We see value in (1) The bank's adequate capital levels, (2) High efficiency levels as reflected in its low cost to assets and cost to income ratios and, (3) The most attractive valuation multiples in the banking sector. Downsides risks include persistent asset quality problems which in our view should ease in line with increased lending.



(Source: Company, DBIB Research)





(Source: Company, DBIB Research)

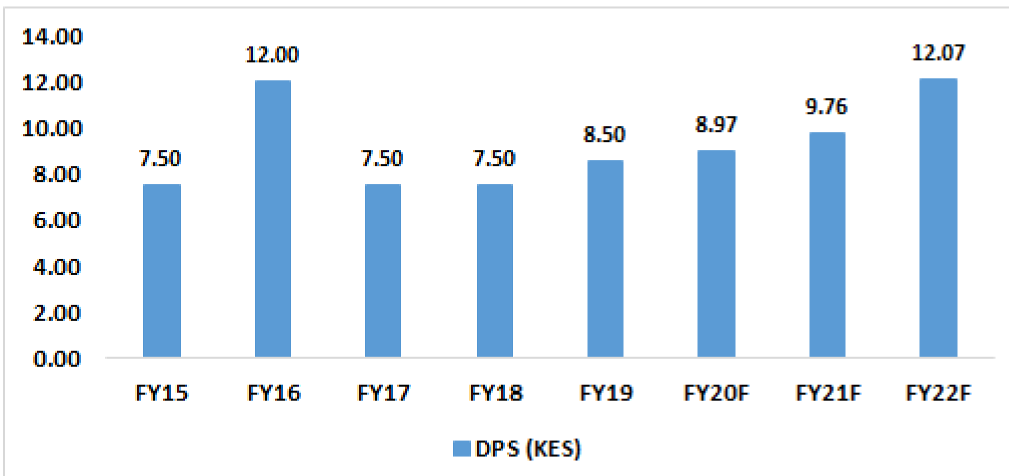
EABL GROUP

We see value in (1) Steady top line growth, (2) Sturdy growth of regional business and (3) Progressive increase of dividends.

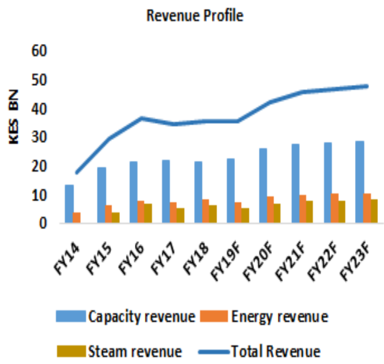
Steady top line growth: We expect consistent double digit growth in top line through the medium term driven by Senator Keg in Kenya, and continuous innovation across all markets

Sturdy growth of regional business: We highlight double digit growth in Tanzania in both FY19 and 1H20 which contributes about 12.0% of the groups total sales and the double digit growth in Uganda as key to the group's continued diversification strategy across the fastest growing region in Africa.

Progressive increase of dividends: With the completion of Kisumu brewery and the on-going efforts to restructure the company's debt position, we expect EABL to progressively enhance its dividend payout as they have done by raising their interim dividend twice in recent years.



(Source: Company, DBIB Research)



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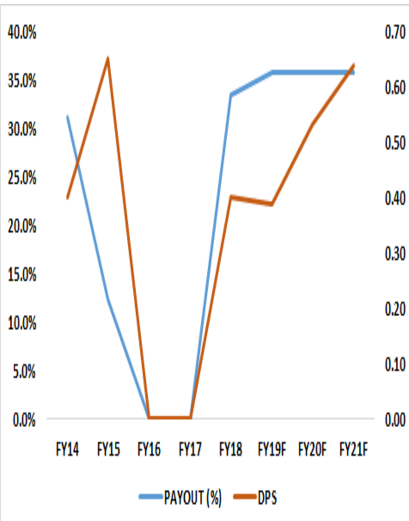


(Source: Company, DBIB Research)

KENGEN GROUP

We see value in (1) High capacity revenue projections, (2) Consistent dividend payout and (3) Attractive valuation multiples.

High capacity revenue projections: We project a 16.4% y-o-y increase in capacity revenue to KES 25.6 BN in FY20F and an overall 9.2% 3-year CAGR through FY21F. This is on account of increased capacity following the commissioning of Olkaria V (165.4MW) and Olkaria I unit 6 (83.3MW) in FY20F and FY21F respectively.

Consistent dividend payout: With guidance from management, we anticipate an increase in dividends per share from KES 0.40 in FY19F to KES 0.51 and KES 0.63 in FY20F and FY21F respectively. We are of the view that increased revenues from the commissioning of new projects (Olkaria V and Olkaria I unit 6), tax credits expected as a result of commissioning new plants outside the major cities and the enactment of the Finance Act 2018 that exempts the company from paying compensating tax effective from 1st January 2019 will improve KenGen's cash flows enabling them to payback their investors.

Attractive valuation multiples: Due to investor skepticism over investment into the utility sector and companies with significant government shareholding, KenGen's multiples are currently trading way below peer median multiples. On a trailing basis, KenGen has been trading at an EV/EBITDA ratio of 7.6x against a peer median of 7.7x and a P/E ratio of 4.7x relative to a peer median of 12.7x. We therefore believe that the stock is undervalued and presents an attractive entry point for investors

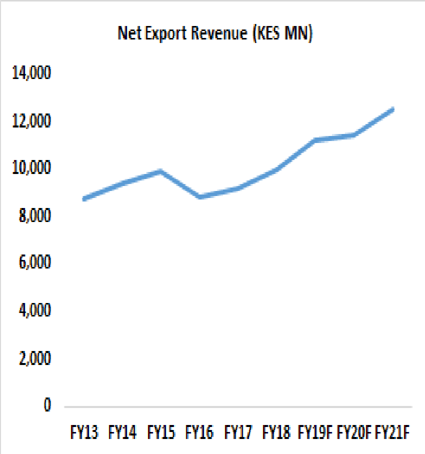
BRITAM GROUP

We see value in (1) Investment income growth (2) Return to profitability and dividend payment (3) Attractive entry multiples.

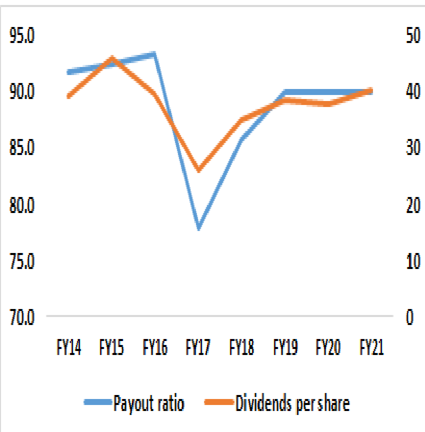
Investment income growth: We expect a y-o-y doubling of investment income in FY19F consistent with the group's investment income volatility that follows the performance of public markets and especially the performance of Equity Group. This alongside double digit premium growth driven in part by credit insurance (following repeal of interest rate caps) should see total income rise circa 20.5% y-o-y to KES 31.8 BN in FY19F.

Return to profitability and dividend payment: Growth in income and strategic investor led efforts to manage claims and other operating expenses should see the group return to profitability with forecast profit of KES 773.0 MN in FY19F, up from a loss of KES 2.2 BN in FY18. This could see the group resume dividend payment.

Attractive entry prices: We believe that current trading multiples offer an attractive entry point compared with the strategic investor entry prices of KES 15.85 by AfricInvest and IFC.



(Source: Company, DBIB Research)



(Source: Company, DBIB Research)

BAT GROUP

We see value in (1) Growing exports (2) Consistent dividend payout and (3) Attractive valuation multiples.

Growing exports : We anticipate a 12.2% y-o-y increase in net export revenues and 7.8% 3-year CAGR to 12.5 BN in FY21F on the back of an expected expansion within the East African Community (EAC) and the Common Markets for Eastern and Southern Africa (COMESA) and the gradual rebound in destination markets. In particular, we expect improved export performance to be supported by a rebounding economy in South Sudan occasioned by diminished fighting, improved business climate in Egypt, reduced excise duty in Uganda and reduced political tensions in DRC.

Consistent dividend payout : We expect a 10.0% y-o-y growth in dividends per share to KES 38.5 translating to a forward dividend yield of 7.9%. BATK is renowned for its high dividend payout. Between FY14 and FY16, it reported payout ratio north of 90% of net earnings. In 2017 however, a difficult trading environment characterized by a high excise tax regime, rise in illicit trade and a prolonged electioneering period in Kenya saw the company tighten its policy to 78%. It has since made a recovery, posting an 85.7% payout in FY18. We anticipate that going forward the company will maintain a payout ratio of at least 90.0%.

Attractive valuation multiples: On a trailing basis, the counter is trading at a price/sales ratio of 3.5x compared to peer median of 5.1x, a price/earnings ratio of 12.4x against a peer median of 26.3x and an EV/EBITDA ratio of 6.5x compared to a peer median of 18.3x. The above metrics highlight that the counter is currently significantly undervalued presenting an attractive entry point for investors.

Company	P/S	P/E	EV/ EBITDA
BAT Kenya	**3.49**	**12.36**	**6.55**
TCC	6.07	37.44	21.79
Eastern Co.	4.04	13.75	9.94
Al-Eqbal	4.14	15.12	14.73
Median	4.14	15.12	14.73

(Source: Company, DBIB Research)

Appendix

Company Investment ratings

Buy: Share price may generate more than 15.0% upside over the next 12 months

Overweight: Share price may generate between 10.0% and 15.0% upside over the next 12 months

Hold: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

Underweight: Share price may generate between 10.0% and 15.0% downside over the next 12 months

Sell: Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

Not Rated: Counter is not within regular research coverage

Sector Investment Ratings

Overweight： Industry performance better than that of the whole market

Equal weight： Industry performance about the same as that of the whole market

Underweight： Industry performance worse than that of the whole market

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