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SIB Standard Investment Bank

RIDE THE BULL AND CHART THE BONANZA

'The rising tide lifts all the boats.' — John F. Kennedy

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Executive Summary

As the year unfolds and resets, all eyes are on the fiscal space. A key point of concern remains the Finance Bill, which has gained significant traction over the past two years, especially in 2024. However, despite the aggressive increase in the additional revenues proposed by the bill, little has been accomplished, as debt servicing costs continue to devour much of the revenue.

2025 is particularly noteworthy, as the IMF-Kenya program concludes. The big question is: Will Kenya propose a renewal of the program? This question looms large, given the weight of debt servicing costs, sluggish revenue growth, and steadily increasing expenditure. In recent years, Kenya has relied on the IMF for dollar inflows and forex reserves at a time when the global debt market was relatively out of reach. Meanwhile, the National Treasury has hinted at reducing tax revenue targets for both the current and next fiscal year, while the spending needle remains firmly stuck in the upward direction. It has also hinted on a leaner finance bill which leads us to believe that more than half of the country's expenditure will continue to be financed by debt.

On the other hand, credit rating agencies are keeping a close watch on the country, assessing and evaluating every fiscal move. But the government appears to be playing its cards well. Instead of the previously planned switch, the government has opted for a buyback of three high-value bonds—originally put up for the switch that was eventually abandoned. This signals expectations of lower interest rates in the future, a crucial factor for rating agencies. With interest rates indeed trending lower, fixed-income securities in 2025 are poised to return to their traditional role as low-risk, low-return investments—a safe haven for capital-intensive portfolios. As such, we may see capital flight toward markets and asset classes offering higher returns.

For equities, capital bookings registered in 2024 (+34.1% returned by NASI) rode on base effects, with 2022 and 2023 being years of persistent value erosion. The banking sector did the heavy lifting with an estimated 57.9% contribution to 34.1% NASI returns. Looking ahead, we anticipate a sustained bull run in 2025 on the back of;

i. Technicals continue to speak of an upswing

Shy of the banking sector, mean reversion suggests that the deep discounts registered in 2022 and 2023 are set to continue seeing an upward reversal in 2025.

ii. Fundamentals remaining relatively strong across key sectors

Banking sector – A higher interest rate environment underpins the positive outlook for FY24 performance and dividend prospects. Key headwinds remain the sub-par economic growth, mounting pending bills, macro volatility, costs associated with managing risk and tightening regulatory requirements. Net interest margins are expected to smoothen as revenue growth slows from the high base in 2024, as projected lower interest rates take effect.

Telecommunication sector – We maintain an optimistic outlook on the investment by Safaricom in Ethiopia and continue to see latent potential in the financial service business in Kenya that the group can explore through license acquisition into the broader financial services. A key risk remains disruption from satellite internet providers in the GSM business.

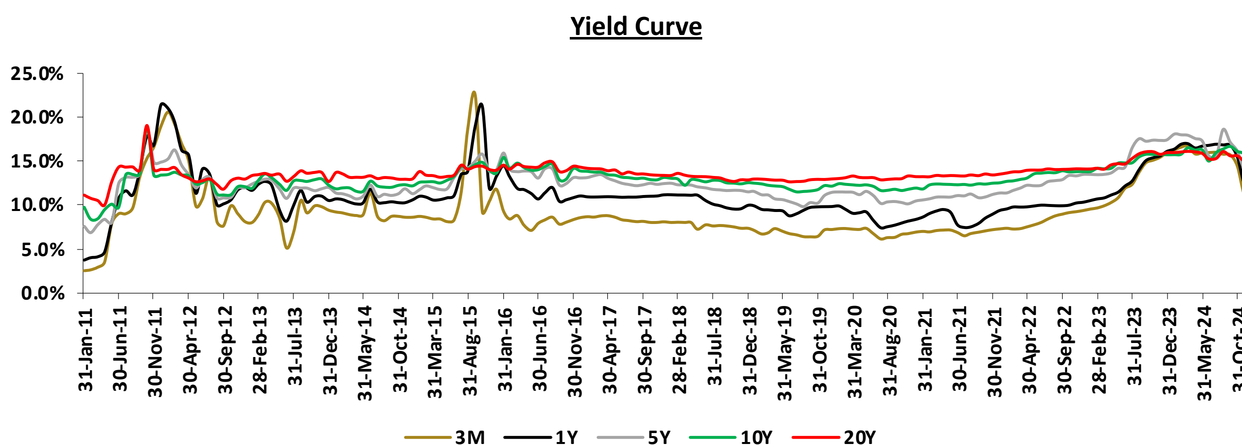
Energy sector – For both listed counters, we see better dividend prospects on the government's intent for parastatals to remit 80% of their earnings in dividends – a win for investors. For KenGen, we see the initiative to look into the use case for brine and invest in battery energy storage systems as a positive for long-term revenues and overall improved efficiency albeit with heavy capex requirements.

Agricultural sector – Tea and coffee prices are expected to remain volatile, with an expectation of upward price movement due to the likely impact of adverse weather conditions on other major global producers.

Fixed Income Investments Play

Shifting Gears: Engaging Back to Low Risk, Low Return Mode

Over the year leading to October 2024, fixed-income investors savored record-high rates— an indulgence granted by the whims of the market's grace. Yields on government securities surged in 2H2023, peaking for some instruments in July and August 2024. However, as the year drew to a close, the rates leveled off, with the 91-Day Treasury bill ending the year in single-digit territory.



Source: NSE, Chart: SIB

In 2025, we anticipate yields on all government securities will continue to decline, reflecting a lower benchmark rate and the government's strategy of rejecting expensive bids. This decline will hinge on three critical factors:

i. Robust demand for government securities,

ii. Access to external financing to ease domestic borrowing pressure, and,

iii. A leaner budget to curb funding needs, although this remains elusive as expenditures persistently escalate.

We expect investor preference for non-competitive bids—typically favored in falling-yield environments—to intensify, amplifying the downward pressure on rates. Furthermore, the government's inclination to reopen long-tenure bonds rather than issue new ones is likely to cap returns in this segment at an average of 13% or lower. This trajectory signals a full normalization of the yield curve, with rates potentially reverting to early 2022 levels.

Our concerns, however, center on the potential for capital flight toward markets and asset classes offering higher returns, which could dampen demand for government securities. That said, increased interest in options such as equities might drive up prices and reduce entry opportunities, potentially redirecting investors to fixed income—where pockets of opportunities still exist. In addition, we foresee improved liquidity in the year supported by:

i. Lower lending rates – which could boost capital flow into the real economy, and,

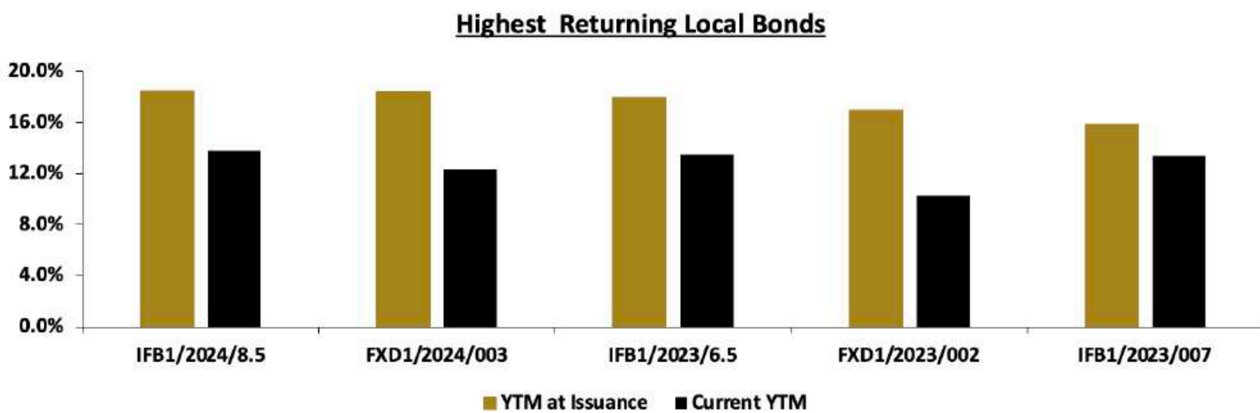
ii. Profitable instruments, as declining yields bolster returns relative to cost.

Balancing the dynamics, fixed-income securities in 2025 are poised to return to their traditional role as low-risk, low-return investments, a haven for capital intensive portfolios. We however have our reservation on the low-risk component given the risks of debt distress that Kenya finds itself in and the uncertainties surrounding fiscal sustainability.

Robust Domestic Bond Market: The Underestimated Wildcard

In 2024, the February infrastructure bond (IFB1/2024/8.5) issuance stood out as the heavyweight champion, driving the year's turnover with its unparalleled size (KES 240.96bn, 1.86bn)) and attractive return (18.5%). Its tax-free status drew immense interest, both locally and internationally, making it the backbone of market activity.

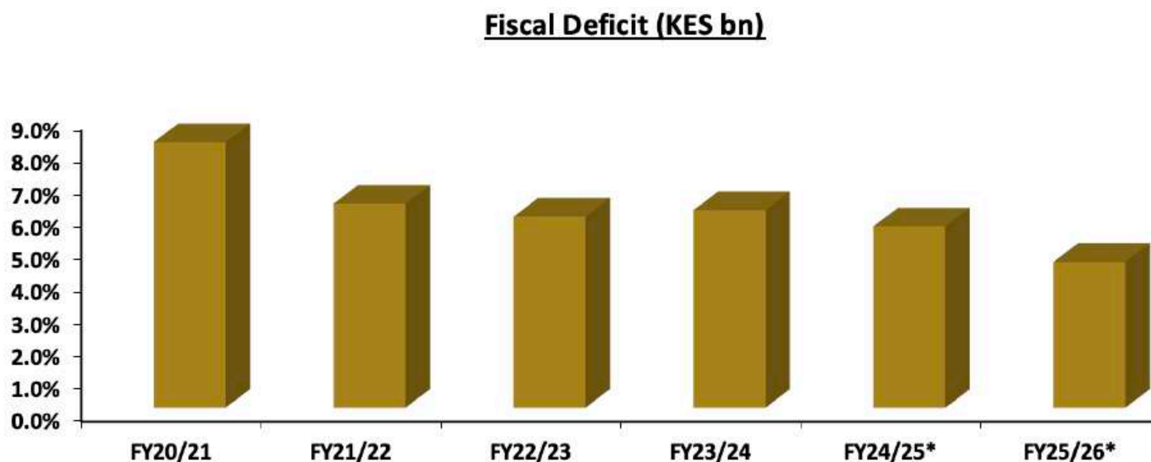
Looking ahead to 2025, the government has signaled plans to reopen long-term bonds ranging from 10 to 20 years, at least for the first half of the year, which has been the recent trend. If this continues, these papers—offering moderate returns—are likely to dominate the market. Also, the government has opted for a buyback of three high-value bonds—originally put up for a switch that was eventually abandoned. This signals expectations of lower interest rates in the near future. In addition, as yields decline further, bond prices will continue to climb, potentially deterring new buyers and investors who secured bonds at lower prices may hold onto their positions, drawn by their locked-in attractive yields.



Source: NSE, Chart: SIB

This dynamic sets the stage for reduced demand in the secondary market, especially for buyers who may find papers more expensive. On the other hand, lower interest rates could raise volumes due to profit taking activities. All factors considered, we expect turnover to revert to historical averages for the majority of the year, especially without the issuance of new infrastructure bonds to energize the market,

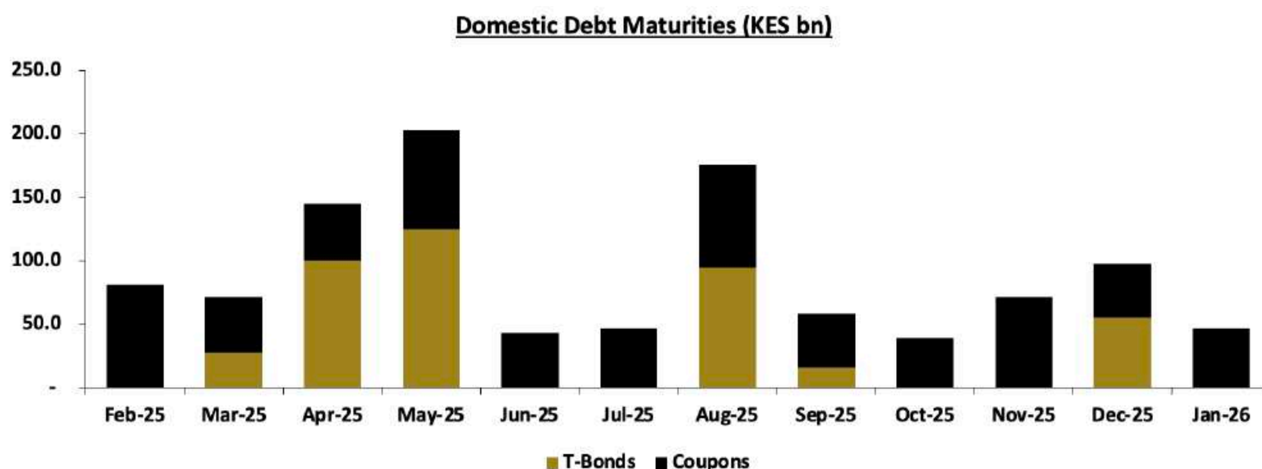
On the flip side, a higher budget paired with revenue shortfalls will likely lead to an upward revision of the deficit in the supplementary budget for the current fiscal year, despite lower projections. See below the fiscal deficit play;



*Source: NSE, Chart: SIB, *Projected*

As such, we foresee heightened financing needs—a stage where infrastructure bonds have historically stolen the spotlight, consistently outperforming their regular counterparts in investor appeal.

Additionally, 1H25 is set for substantial bond maturities totaling KES 252.23bn (see chart below). Stacking this up against the total domestic borrowing target, it effectively wipes out more than half of the government's current net borrowing position. In total, bonds worth KES 417.93bn, are expected to mature in 2025. This underscores the likelihood of intensified efforts to ramp up domestic borrowing to meet the set targets.



Source: NSE, Chart: SIB

Adding to the complexity is a tightening global debt and aid market, where external funding now carries heftier price tags. Meanwhile, conservative investment options like money market funds are poised to gradually slide back to pre-high-interest rate returns.

In the secondary market, some bonds are likely to trade at a discount, while others might fetch higher prices than recent trends suggest. For buy-and-hold investors, opportunities remain, but the era of easy gains appears to have run its course. However, without a significant improvement in fiscal breathing room, the cycle may come full circle sooner than anticipated.

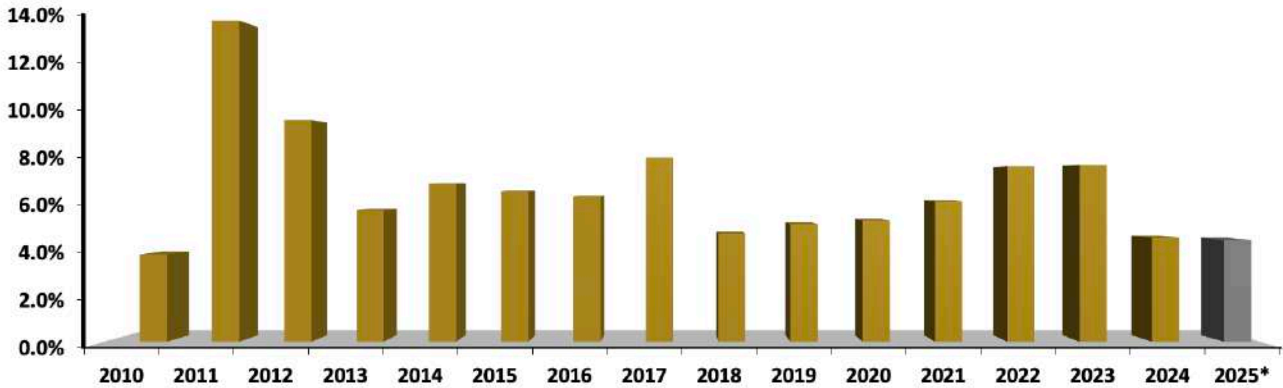
Benchmark Rate: A Bold Turn Ahead

In 2024, the CBK's Monetary Policy Committee (MPC) slashed the Central Bank Rate (CBR) by a total of 175bps, bringing it down from 13.0% to 11.25%. Looking ahead to 2025, we foresee an even more aggressive rate adjustment, projecting a deeper cut that could see the CBR end the year at 9.0%—a cumulative reduction of 225bps from the current level.

This expectation is anchored on;

i. Inflation projections to Remain Below Mid-range – but Local Policies could Rock the Boat

In 2024, annual average inflation settled at 4.5%, with the second half of the year driving the decline, primarily due to a higher base effect. *Looking ahead to 2025, we project a marginally higher average inflation rate of 4.8%—reflecting a 30 basis points increase.*



Source: CBK, Treasury

We expect this relative stability to be underpinned by the following factors:

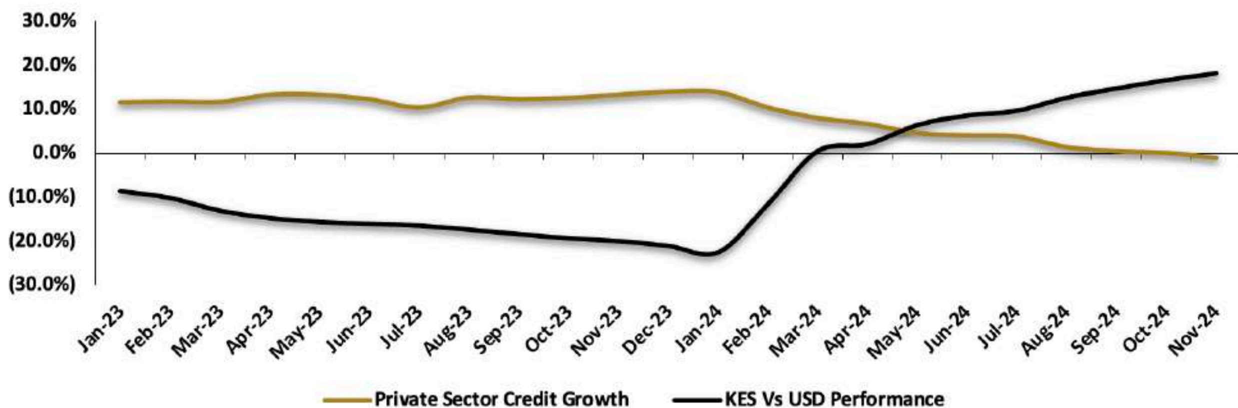
a. **Stable Food Inflation -** While stability is anticipated, downside risks persist due to unfavorable weather forecasts,

b. **Stable Fuel Inflation** - Lower international fuel prices are expected to keep fuel inflation in check. However, local tax adjustments and the depletion of the price stabilization fund could offset these gains,

c. **Lower Core Inflation -** A higher base effect should contribute to a decline in core inflation. Nonetheless, persistent structural challenges may continue to exert upward pressure on this metric,

ii. Stifled Private Credit Growth – Crowding Out Effect at Work

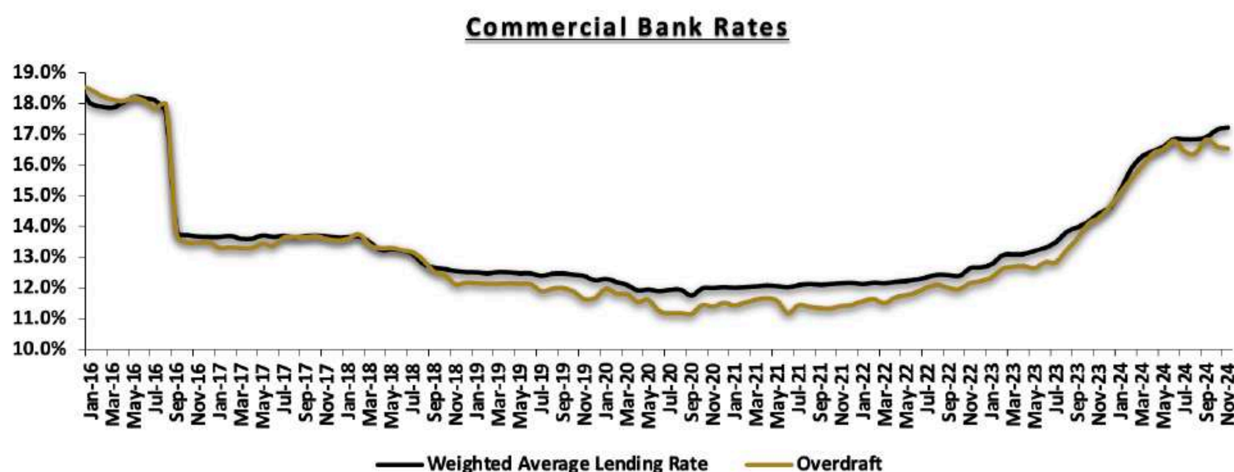
The elevated interest rate environment has significantly crowded out the private sector, as banks—holding over 40% of the government's domestic debt—continue to favor lending to the government. Moreover, the appreciation of the shilling against the dollar eroded the portfolio value of dollar-denominated loans, hitting sectors with substantial foreign currency exposure, including manufacturing, finance and insurance, trade (exports), and building and construction. Below, we outline the performance of credit advanced to the private sector, adjacent to currency performance;



Source: CBK, Treasury, Chart: SIB

In our assessment on the other hand, the business environment has grown increasingly precarious, marked by an unpredictable tax regime and heightened public unrest. Over the past two years, a series of challenges—including political and economic disruptions as well as weather-related catastrophes—have eroded borrowers' credit ratings.

As a result, under the risk-based pricing model, credit has become more expensive, further compounded by rising benchmark rates - lending rates reached their highest levels in 2024 post interest rate cap removal, as illustrated below;



Source: CBK, Chart: SIB

In 2025, we anticipate the monetary authority will adopt a balanced approach to stimulate credit growth and boost the supply of capital to the private sector through lower lending rates. With the Kenyan shilling now stabilized, any credit growth is expected to be organic. However, a further decline in credit activity may be observed in the first month of 2025 linked to foreign currency loans due to the significant depreciation of the shilling against the USD in January 2024.

Beyond that, gradual improvement is expected, contingent on the following factors:

a) **The Magnitude and Timing of CBR Cuts** - Early and significant reductions in the Central Bank Rate (CBR) will allow sufficient time for monetary easing to transmit through the economy and stimulate positive effects. However, the Central Bank of Kenya (CBK) has shown a cautious stance given the prevailing unprecedented risks,

b) **Business Environment Resilience** - Businesses are still struggling with soaring input costs, largely driven by higher taxes and statutory deductions, which have significantly squeezed margins. The outlook remains cloudy, as fiscal constraints are likely to push costs even higher. Further, pending bills remain a heavy burden on the sector. A swift resolution of these outstanding payments would provide much-needed relief and help stabilize the situation.,

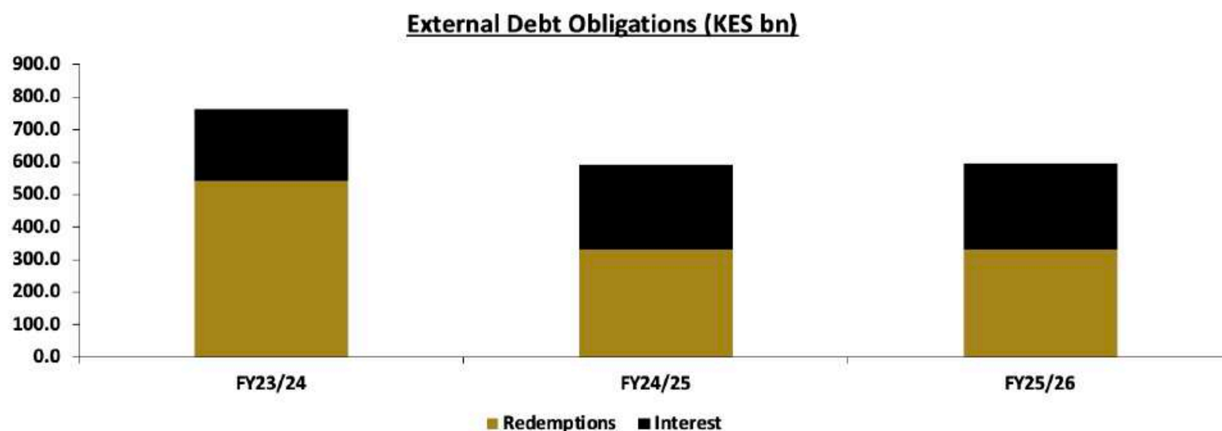
c) **Government Securities Yields** - The extent and duration of the decline in yields on government securities will play a critical role. While lower interest rates are expected, downside risks persist due to increased borrowing requirements driven by rising expenditure needs,

d) **Exchange Rate Stability** - Sustained stability of the exchange rate at current levels will be essential in preserving the value of dollar-denominated loan portfolios,

iii. Stable exchange rate – hinged on less external debt obligations

In 2024, the shilling strengthened by 21.0% against the dollar following a significant shift in sentiment after the Eurobond refinancing. However, the second half of the year saw widespread stability, driven by reduced dollar outflow needs and external financing that bolstered dollar inflows.

Looking ahead, we anticipate heightened stability in the foreign exchange market, supported by the absence of major external maturity pressures, as illustrated below;



Source: Treasury, Chart: SIB

Unlike the hefty Eurobond bullet payment in 2024, this year's first amortization installment for the 8-year 2019 Eurobond comes in at a more manageable KES 45.0bn, due for settlement in May. With this lighter load, we're in for smoother sailing and fewer currency jitters.

IMF Program

External funding is poised to provide a much-needed boost to Kenya's reserves, with the anticipated disbursement of approximately USD 789 million from the final tranche of the IMF-Kenya program, including the Resilience and Sustainability Facility.

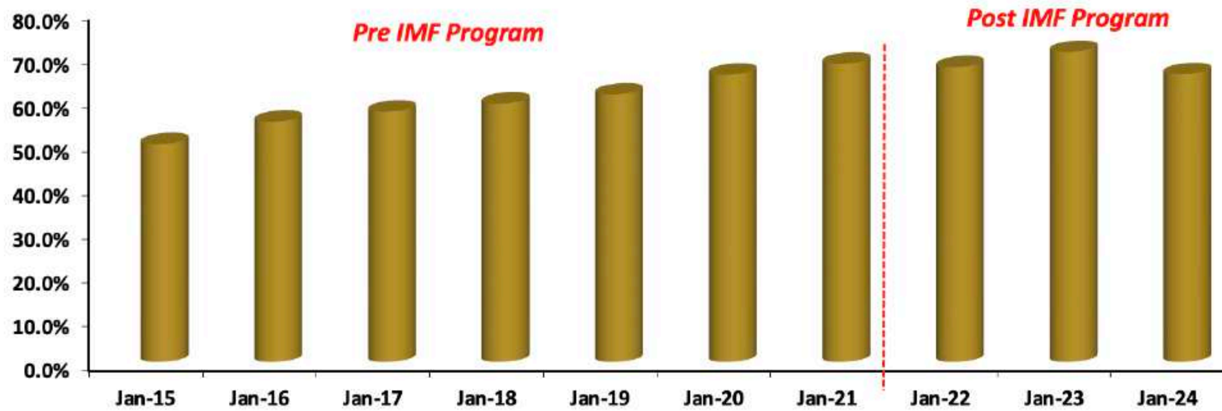
Looking ahead, we foresee a renewal of the program as Kenya remains highly vulnerable to debt distress. However, it is evident that the current program has fallen short of fully achieving its objectives. Initially established under the Extended Fund Facility (EFF) and Extended Credit Facility (ECF), the program aimed to:

- Reduce debt vulnerabilities
- Strengthen fiscal management
- Support economic recovery beyond the COVID-19 pandemic
- Enhance governance and transparency

A critical objective of the IMF-Kenya program is to reduce debt vulnerabilities by ensuring sustainable debt levels while safeguarding resources for essential social and developmental needs. However, the current debt situation paints a different picture:

- **High Debt Servicing** - More than 50% of ordinary revenues goes to debt servicing, constraining funds for investments in the future, including development projects.
- **Debt Surge** - Kenya's public debt has surged by 37.5%, rising from KES 7.70 billion in June 2021 to KES 10.58 billion in June 2024.
- **Steady Debt-to-GDP Ratio** - Despite the debt increase, the debt-to-GDP ratio has remained relatively steady, a reflection of the parallel growth in both debt and GDP. See the chart below;

Debt to GDP Ratio

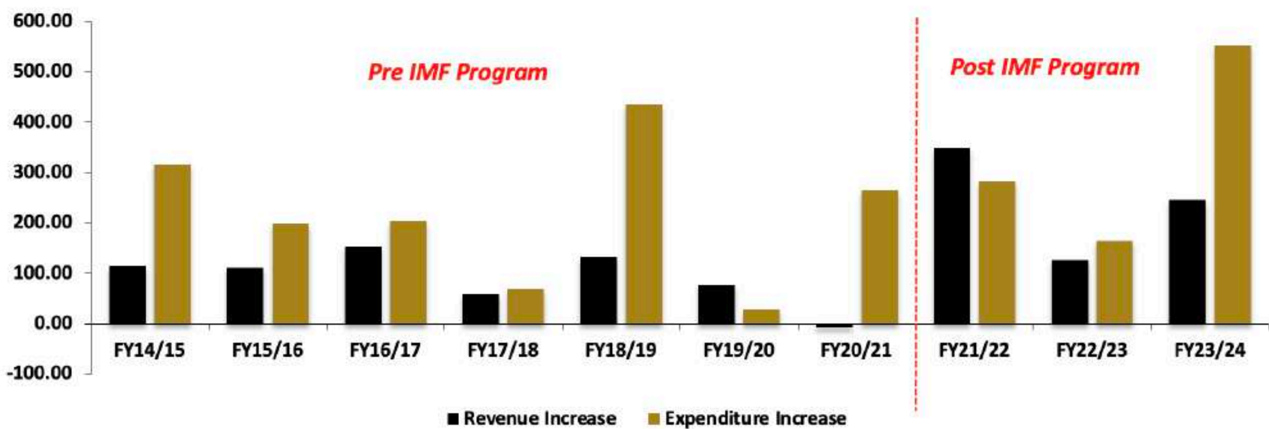


Source: Treasury, Chart: SIB

We believe the program will be renewed to drive the agenda forward, though we remain skeptical about its success if spending continues to rise. With the significant burden of debt servicing on the exchequer, we think more multilateral loans would be a smarter option than commercial loans considering the heightened dependency on debt to finance the budget. What concerns us most, however, is the relentless push to boost revenue collections, particularly through tax increases.

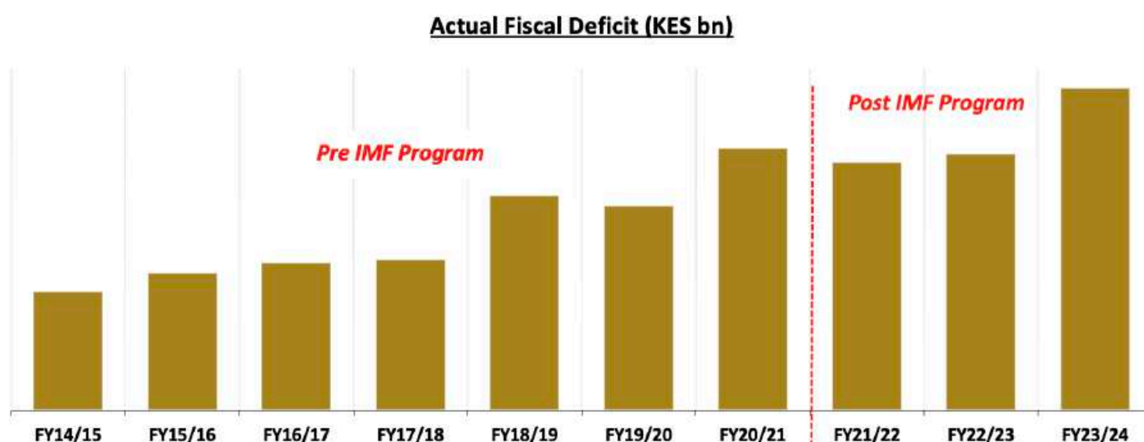
On matters fiscal consolidation and expenditure management, the focus has been more on ramping up revenue collections, with less emphasis on trimming down spending. See the chart below;

Actual Additional Revenue vs. Expenditure (KES bn)



Source: Treasury, Chart: SIB

As a result, the absolute fiscal deficit has been widening, driven by the automatic rise in expenditure. This sets the stage for more tax hikes in the future, alongside growing uncertainty fueled by unfulfilled austerity measures. See the chart below;



Source: Treasury, Chart: SIB

Diaspora Remittances: Single Largest Foreign Exchange Earner for Kenya

On the flip side, diaspora remittances have remained robust, and with expectations of further economic rebound in the US, we anticipate more growth in this segment in 2025. In addition, as the cost of living continues to rise, we expect remittance inflows to increase as family members boost their support amounts.

Leaping Like Lemmings: Credit Ratings Upward Revision Expected in 2025

One more piece of the puzzle is the credit rating and outlook from various agencies. We expect a positive shift in 2025, fueled by the absence of major market disruptions and a more strategic push towards revenue generation. This could create a wave of optimism, boosting dollar inflows into the market.

Moody's, in its first review cycle, revised the country's outlook to positive but held the long-term rating at Caa1. Meanwhile, Fitch Ratings maintained both the B- rating and a stable outlook. The elephant in the room remains the country's liquidity crunch, especially as the IMF program nears its end.

If renewed—despite being debt-driven—the IMF program would likely be viewed as critical funding support, offering a buffer for debt obligations. We also expect a softer stance on tax hikes to ease public discontent. A smooth passage of the 2025 Finance Bill could pave the way for an upgrade in the credit score—and potentially the overall outlook.

Nonetheless, concerns linger over the relentless rise in expenditure, fueled by debt servicing and recurrent costs—both of which are sinking liabilities that could weigh heavily on the country's fiscal outlook.

On the downside, the shilling may face pressure from imports, particularly fuel, though the extended G-G deal is expected to help mitigate speculative activities.

All things considered, we project a relatively stable currency, facilitating entry and exit in the investment market and helping to boost investor sentiment and confidence.

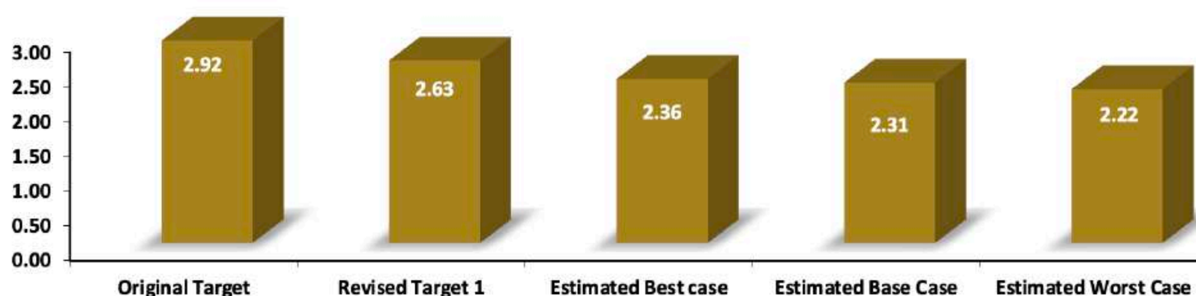
The Fiscal Space

Will 2025 Offer a Softer Tax Blow Amid Treasury's New Tone?

Tax collections have consistently fallen short of prorated targets throughout the fiscal year, with only end-quarter – as expected due to quarterly installments - settlements providing a temporary lift. However, these quarterly spikes have been insufficient to cover the deficits in the intervening months. Factoring in inflation, tax collections have actually been on a downward spiral since the Finance Bill withdrawal. Yet, government spending continues to paint a picture of affluence, seemingly detached from fiscal priorities.

Overall, for FY24/25, meeting revenue targets appears improbable unless it is revised downwards in the supplementary budget, of which has been hinted. Even then, we anticipate only a modest revision, given the government's habitual overestimation of revenue projections. On the expenditure front, it is almost inevitable that the absorption rate will fall short—particularly for development spending. Based on our assessment, we project a performance rate of 89.8%, with a worst-case scenario of 84.3%.

Ordinary Revenue Outlay - FY24/25



Source: Treasury, Chart & Estimates: SIB

In 2025, the Finance Bill is expected to propose additional revenues surpassing KES 100 billion—though less aggressive than the bold 2024 projections. This move is likely to ignite another round of tax adjustments, sparking concerns about potential public backlash and the mounting risk of over-taxation.

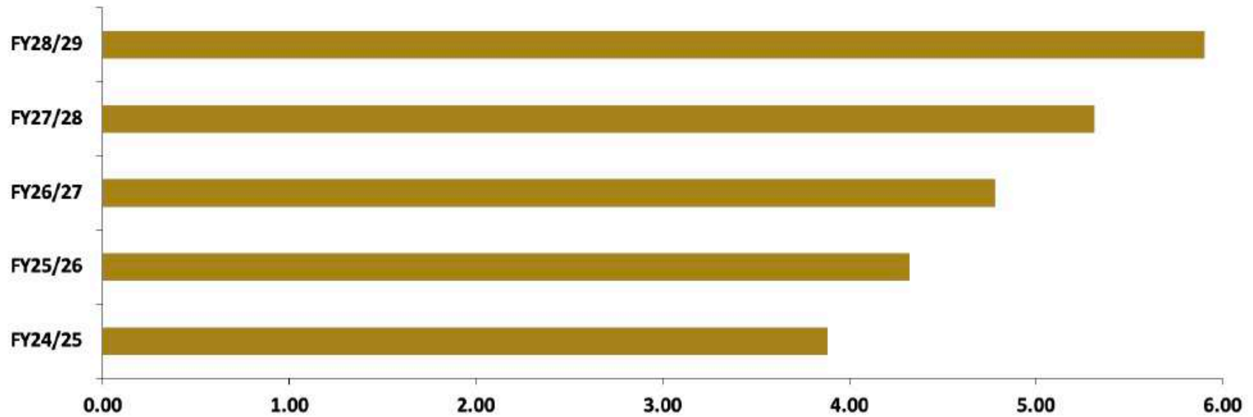
The Treasury has, however, hinted at a leaner and more accommodative bill, signaling a shift towards balancing fiscal needs with public sentiment. Despite this, tax revisions are anticipated to impact the following areas;

i. Private Sector Business Environment

Despite the presence of a national tax policy, tax adjustments in Kenya remain highly unpredictable. In our view, this volatility is driven by the country's growing spending needs and a narrow tax base, compounded by the cyclical nature of aggressive taxation that stifles investment and dampens demand. With many sectors currently grappling with squeezed margins, there's a real concern that further tax hikes and levies could be on the horizon. Ultimately, the predictability of taxation and the creation of a more favorable tax environment will be crucial in shaping the pace and scale of recovery within this sector. However, a stable currency and declining lending rates could provide some breathing room for growth.

ii. Private Investments

With more than half of the country's expenditure being funded by debt, a fiscal stabilization is inevitable sooner or later. This is because, despite rising taxes, government expenditure continues to climb in lockstep, as illustrated below:

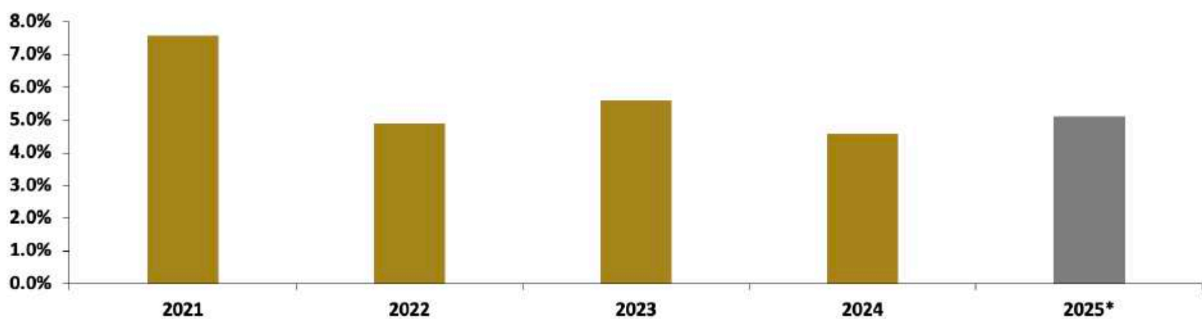


Source: Treasury, Chart: SIB

Essentially, the longer it takes to address or reduce expenditure, the steeper the taxes will need to rise, or the deeper the spending cuts will have to be in the future. As things stand, the country fosters significant uncertainty around potential tax hikes, which deters private investment and dampens demand from investors who are particularly sensitive to long-term uncertainty. Given the forward-looking nature of their plans, this unpredictability is a major deterrent. The general consensus is clear: unless the automatic increase in spending is tackled, taxes will continue to rise to cover the growing outlays. Consequently, the confidence boost from tax plans is likely to be minimal, as expectations of future tax hikes will persist and continue to rise.

iii. Economic Growth

Kenya's economy is projected to grow at an average rate of 5.1% in 2025, assuming favorable weather conditions and a gradual recovery in the private sector. However, we foresee that higher taxes will reduce disposable income, leading to lower demand and stifled business innovation. As a result, most sectors are likely to either stagnate or experience slower growth, limiting the overall economic momentum;



Source: Treasury, KNBS Chart: SIB

Equities Market: Ride the bull and chart the bonanza

'The rising tide lifts all the boats.' — John F. Kennedy

Recap of 2024

The 2024 market performance came in line with our expectations – of an upward reversal in pricing. We believed, and continue to believe, that the fundamental view remains strong across key sectors and that technicals continue to speak of an upswing that should extend to 2025.

Looking back, the significant capital bookings registered in 2024 primarily rode on base effects — with 2022 and 2023 being years of persistent value erosion. Most notably, in 2023 key blue chips[1] touched multi-year lows which we opined were detached from their fundamental value.

The banking sector did the heavy lifting in 2024 with an estimated 19.7% contribution to the 34.1% returns posted by NASI. We believe this was on the back of investors pricing in higher interest earnings and an overall expectation of strong dividends for the financial year 2024. Company-specific[2] corporate announcements chaperoned this, further bolstering investor excitement in the sector.

Select Sector Performance in 2024 and Contribution to NASI

Select Sector	Median Return	% of Market Cap	Contribution est. to NASI
Banking	44.3%	44.5%	19.7%
Telecommunication & Technology	22.7%	35.4%	8.0%
Energy & Petroleum	46.1%	3.3%	1.5%
Manufacturing & Allied	8.2%	9.6%	0.8%
Construction & Allied	32.4%	1.7%	0.6%

Source: NSE, Standard Investment Bank

[1] Safaricom, KCB Group, Co-op Bank, Bamburi Cement, Equity Group, BAT, EABL, among others

[2] (i) Transaction between AfricInvest and British International Investment for 10.13% shareholding in I&M Group at KES 48.42.
(ii) KCB Group's announcement of signing a binding offer with Access Bank on the sale of National Bank of Kenya.
(iii) HF Group rights issue.

Other salient developments that drove company-specific performance in 2024 included;

- ***Bamburi's takeover offer by Amson's to acquire up to 100% shareholding at an offer price of KES 65.00***. The offer received a 95.54% acceptance by shareholders, and we anticipate to see a squeeze-out notice[3] for the 3.46% minority shareholding in 1Q2025.

  From a price perspective, news on this coupled with the special dividend payout from the sale of Hima Cement and the competing take-over offer from Savannah Clinker (that was later withdrawn) saw the counter register a pick performance of +128.7% capital returns.

- ***KPLC's commendable FY24 results performance, with reported net profits of KES 30.1bn up from KES 3.2bn loss position in FY23 driven largely by finance gains and topline growth***. Furthermore, the Board announced a dividend payout of KES 0.70 per share, which came as a relief to shareholders following a 6-year dividend drought. As such, the firm's share price rallied by 238.7%y/y.

- ***EAPCC's surprise first and final dividend payment of KES 1.00, which was funded by the sale of idle assets***. Market speculation activity before the results release, coupled with the announcement led to a 282.5%y/y jump in its share price.

- ***Kenya Orchard (KOL) announced a notice of intention by Africa Mega Agriculture Centre Limited (AMAC) to acquire up to 10,863,537 ordinary shares in KOL by way of a private transaction***. The firm's shareholders approved the transaction during its EGM on 19th August 2024, with AMAC now directly controlling up to 84.423% of KOL's issued share capital. Resultantly, the counter witnessed an upsurge of 259.0% y/y.

- ***Kenya Re's shareholders approved a 1:1 bonus share issue that doubled the company's stock from 2.8bn shares to 5.6bn shares***. In addition, the reinsurer increased its dividend to KES 0.30 (+50.0%y/y). The counter's price function weakened by 31.9%y/y.

Top 10 Gainers (2024)

Company	Price	% Y/Y
E.A. Portland Cement	30.60	282.5%
Kenya Orchards	70.00	259.0%
Kenya Power	4.81	238.7%
I&M Holdings	36.25	107.1%
KCB Group	41.60	90.0%
KenGen	3.64	81.1%
Liberty Kenya Holdings	6.68	81.0%
StanChart	279.75	72.7%
ABSA Bank Kenya	18.05	57.6%
EABL	175.50	53.9%

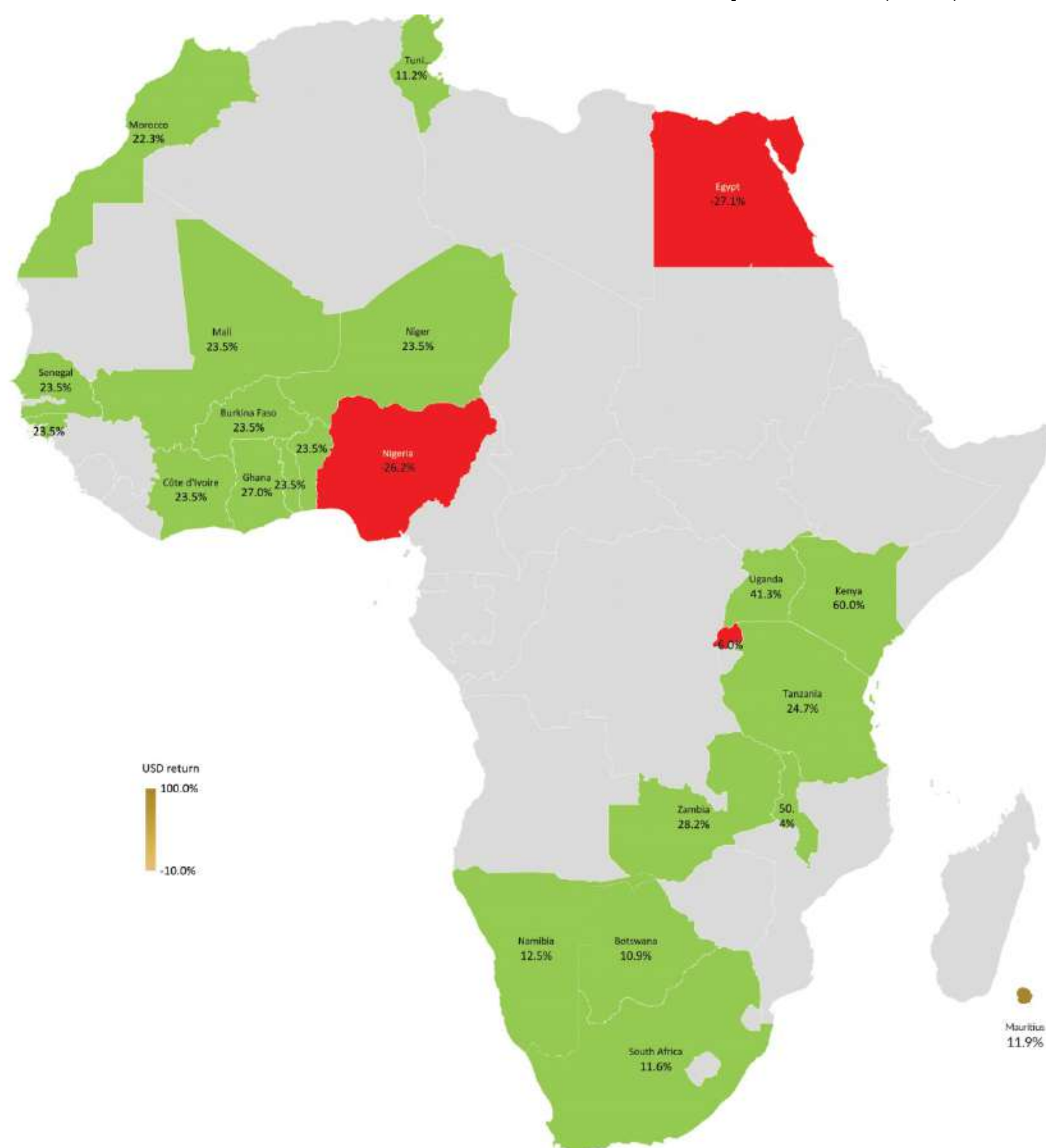
Top 10 Losers (2024)

Company	Price	% Y/Y
Standard Group	5.02	-35.1%
Kenya Re-Insurance	1.28	-31.9%
Nation Media Group	14.40	-28.2%
NBV	2.01	-25.6%
Sasini	15.00	-25.0%
Sanlam Kenya	4.95	-17.5%
Olympia Capital Holdings	2.80	-14.4%
Eaagads	12.00	-14.0%
Unga Group	15.00	-11.0%
TPS Serena	14.90	-9.4%

Source: NSE, Standard Investment Bank

[3] Expected within three months from 20th December 2024. By the Companies Act, Amsons, having acquired more than 90% shareholding through the take-over offer, has the right (but not obligation) to issue a squeeze-out notice to minority shareholders at the price of KES 65.00.

Select African countries' benchmark index dollar capital returns (2024)



Source: Bloomberg, Standard Investment Bank

Looking ahead, we anticipate a sustained bull run in 2025 on the back of;

i. Technicals continue to speak of an upswing

Shy of the banking sector, mean reversion suggests that the deep discounts – largely misaligned to fundamentals – registered in 2022 and 2023 are set to continue seeing an upward reversal in 2025. In our view, small caps may rise the highest, benefiting the most from this tide, on the back of increased local investor participation as attention shifts from fixed-income assets to equities.

For large caps, the case remains strong for an upswing, however we worry about the building uncertainty on Trump's 2.0 policies ripples – which may upend foreign flows with investor attention in the US market remaining high, for longer than expected.

ii. Better market visibility with more stocks on international indices

Morgan Stanley Capital International (MSCI) added KCB Group and Coop Bank in May and August 2024 to their frontier market index, with BAT Kenya, DTB, KenGen, Kenya Re, Bamburi Cement, Kenya Power, and Carbacid added to their small-cap index within the year. We believe this move will position these stocks, as well as the broader market, favorably for foreign investments that are linked to index weighting.

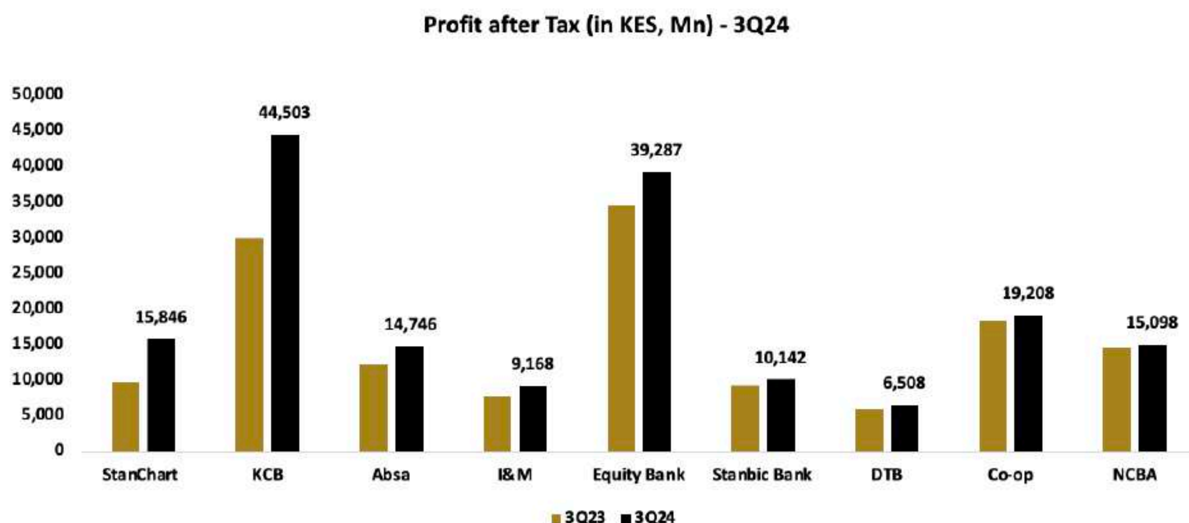
Further, the Nairobi Securities Exchange was reclassified by the FSTE (Financial Times Stock Exchange) Russel Index Governance Board in March 2024, from 'Restricted' to 'Pass', after it fixed delays in repatriating capital – a plus in attracting international investments.

iii. Fundamentals remaining relatively strong across key sectors

i. Banking Sector

We anticipate that the sector will report robust profits for FY24 – with announcements expected in March 2025. A higher interest rate environment underpins this positive outlook throughout the year compared to 2023 – with interest rates reaching their peak in July and August 2024, driving up lending rates and strategic investments in government securities offering favorable returns.

Additionally, the decline in bond yields towards the year's end boosted banks' portfolio values, further supporting this positive projection. Consequently, generous dividends are expected, as signaled by various banks. For example, KCB Group has resumed dividend payments and issued its largest interim dividend on record at KES 1.50. StanChart reported a 33.3%y/y increase in its interim dividend to KES 8.00, while I&M announced a rare interim dividend of KES 1.30. Additionally, Stanbic has declared a 60.0% y/y increase in its interim dividend to KES 1.84.



Source: Company filings, Standard Investment Bank

As lenders move to FY25, they are anticipated to face increased pressure to maintain profitability as interest rates continue to decline on the back of Central Bank Rate (CBR) cuts – locally and regionally. As a result, net interest margins are expected to smoothen as revenue growth slows from the high base in 2024. However, improvements in operational efficiency, tech investments growing AI adoption, lower cost of funds, geographical diversification, and the growth of alternative revenue streams should help support spreads. On regional diversification, Ethiopia's parliament passed legislation in November 2024 to open its banking sector to competition from foreign companies. This may provide an attractive opportunity for strategic partnerships, M&A activity, coupled with the opening of subsidiaries as they tap into Ethiopia's large and underserved market.

Private sector growth, which has been adversely affected by soaring loan rates, is expected to gradually recover as banks reduce lending rates, potentially boosting loan volumes from renewed credit demand. In the February Monetary Policy Committee (MPC) meeting, the Central Bank of Kenya decided to reduce the Central Bank Rate (CBR) by 50 basis points (bps) to 10.75%. Additionally, the Cash Reserve Ratio (CRR) was lowered by 100 basis points to 3.25%. These decisions were primarily driven by the need to stimulate economic growth and increase liquidity, thereby bolstering private-sector credit growth. We see continued pressure on lenders to lower internal benchmark rates as the apex bank begins onsite inspections to ensure banks are implementing the risk-based credit pricing model. Lenders who fail to comply with the Central Bank of Kenya (CBK) lending guidelines now risk penalties of KES 20.0m or 3x their monetary gain, with an additional daily penalty of up to Sh100,000 for each loan account. As such, we believe that banks that have relied heavily on interest income will need to recalibrate their revenue models and find innovative ways to increase non-interest income.

Regarding credit ratings, we see positive re-evaluations following the Moody's country rating upgrade in January 2025. The rating agency had downgraded the long-term deposit ratings of KCB Bank, Equity Bank and Co-operative Bank of Kenya, to Caa1 negative from B3, on the weakened government credit profile in July 2024 following the anti-Finance Bill protests. Additionally, Fitch Ratings downgraded KCB, NCBA, I&M Bank Limited, and their holding companies from 'B' to 'B-' with a negative outlook, attributable to their substantial exposure to government securities.

Bank	ROE		EPS (KES)		FY23 EPS	Estimated FY24 EPS**	Dividend yield	Total Div per share - FY23 (KES)	Interim Div 2024 (KES)	Trailing P/E	P/B	1 year change	Share price (KES)	Recommendation
	3Q23	3Q24	3Q23	3Q24										
ABSA	25.5%	26.8%	2.27	2.71	3.01	**3.62**	8.6%	1.55	0.20	6.0	1.4	**54.1%**	18.00	**BUY**
Co-op Bank	22.7%	20.9%	3.14	3.27	3.95	**4.36**	9.0%	1.50	N/A	4.2	0.9	**39.1%**	16.60	**BUY**
DTB	10.0%	10.2%	21.46	23.27	24.60	**31.03**	8.6%	6.00	N/A	2.8	0.2	**52.8%**	70.00	**BUY**
Equity Group	24.6%	23.5%	9.17	10.41	11.12	**13.88**	8.5%	4.00	N/A	4.2	0.8	**25.9%**	47.20	**BUY**
I&M Group	12.4%	13.3%	4.70	5.54	7.63	**9.10**	7.6%	2.55	1.30	4.4	0.6	**92.6%**	33.70	**BUY**
KCB Group	19.0%	24.9%	9.31	13.85	11.26	**18.47**	n/a	nil	1.50	3.7	0.6	**113.0%**	42.80	**BUY**
NCBA	22.8%	20.5%	8.89	9.16	13.02	**13.42**	9.8%	4.75	2.25	3.7	0.8	**28.8%**	48.50	**BUY**
Stanbic Bank	22.9%	22.6%	23.48	25.66	30.15	**34.21**	11.0%	15.35	1.84	4.5	0.8	**26.4%**	139.00	**BUY**
StanChart	22.4%	33.00%	25.77	41.94	36.62	**55.92**	10.4%	29.00	8.00	7.6	1.7	**74.1%**	278.50	**BUY**
Banking sector average (Listed)										**4.7**	**0.9**			

Source: Company filings, Standard Investment Bank, Bloomberg
**Data as at 31st January 2025*
*** Estimated FY24 EPS*

Key headwinds remain such as sub-par economic growth, mounting pending bills, macro volatility (especially due to geopolitical tensions, growing regional unrest in East Africa, and policy changes by the USA), costs associated with managing risk (including evolving cyber threats from AI and data privacy concerns) and tightening regulatory requirements (continued implementation of Basel III – proposed enhanced liquidity requirements and increase in core capital). In addition, we cannot ignore the impact of technical advancements on banking sector business models (cost implications of tech investments and pace of adaptability), as well as increasing competition from adjacent industries (such as fintech, private debt markets, however, banks remain the primary source of private credit). Elevated non-performing loans also remain a concern however rate cuts could help improve asset quality as well as free up capital from writebacks of loan loss provisions.

The CBK recently directed banks that fall below the enhanced capital requirement to submit their capital boost plans, outlining how they intend to meet the new capital requirements. We anticipate smaller banks will start looking into M&A and capital raising opportunities in 2025 in a bid to meet the requisite capital requirements. Despite challenging market conditions, HF Group's oversubscribed rights issue last in 2024 (which garnered KES 6.2bn against a target of KES 4.6bn), points to positive sentiments around the banking sector. We note that as some lenders race to meet the KES 3.0bn threshold this year, a better part of the outlined banks are above the KES 2.0bn mark save for Spire Bank, Consolidated Bank, Access Bank, HF Group and UBA.

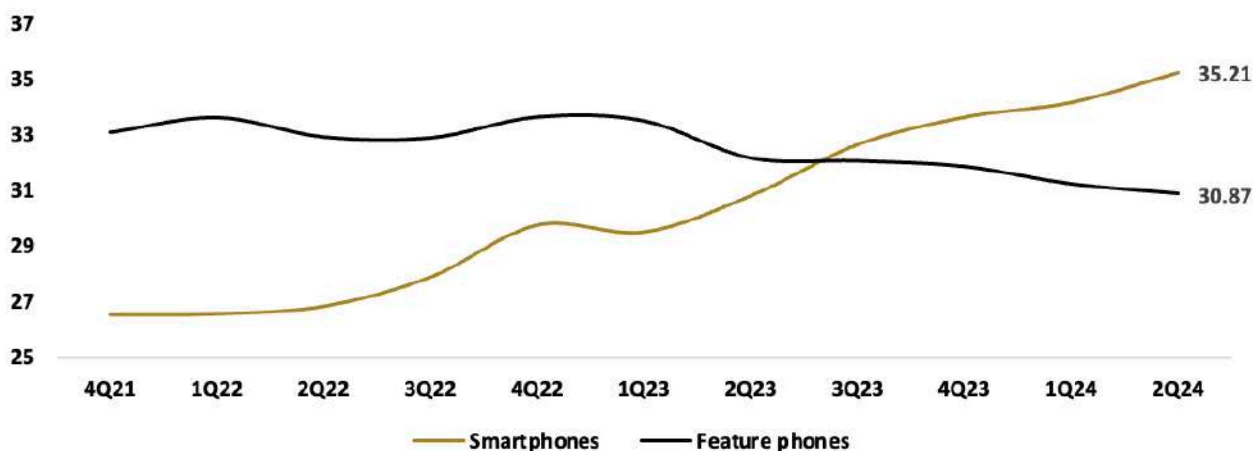
ii. Telecommunication Sector

We begin to worry about GSM trends in Kenya, with concerns about the negative publicity surrounding data privacy on companies' brands and financials long term. We believe this may spur accelerated maturities in its traditional revenue channels – likely catalyzed by a fastened voice communication switch to Voice over Internet Protocol (VoIP) e.g. Skype, Zoom, and WhatsApp calls.

While this may not be reflected in their numbers (yet), we opine GSM customer attrition may be another concern in the long run when satellite internet providers acquire licenses to issue Direct-to-Device (D2D) services – which we suspect may cause customer migration. Indeed, this attrition may be spurred by an overall change in consumer preference, potentially lower usage costs on better price propositions, and likely a "better feel" of data privacy.

On mobile data, our past publications have highlighted that voice and SMS revenues are expected to mature long-term and that data should be the offsetting factor as smartphone penetration deepens. While our view remains largely unchanged, *a momentous risk for mobile data may be in satellite internet providers moving to acquire licenses to offer D2D services. A probable price war with D2D providers may significantly erode data's topline contribution all the while triggering a decline in mobile data active user base and their spending*.

From a utility point of view, we note that smartphone penetration in Kenya stands at c. 68.3%, with smartphone devices surpassing feature phones in the country's mobile network in the 3Q23 calendar period on a strong growth trajectory. As of 2Q24, the regulator reported feature phones at 30.9m while smartphones were at 35.2m. The regulator further noted that 4G remained at the centre stage of internet uptake in Kenya on both mobile broadband subscriptions and mobile data volumes.



Source: Competition Authority

On fixed data, we noted in our FY25 valuation update report that Starlink is a disruptor to the fixed data services market – with their competitive edge being in, (i) the ease of rolling out, and (ii) vast geographical coverage. At the time of the publication, high setup cost was a key challenge we linked to its uptake. The provider however softened its pricing model shortly after causing a skyrocket in its demand – pointing to a positive market reception. Further, their move to set up a point-of-presence (POP) in Nairobi is expected to lower latency and increase network capacity – pushing its competitive edge to fiber optic cable.

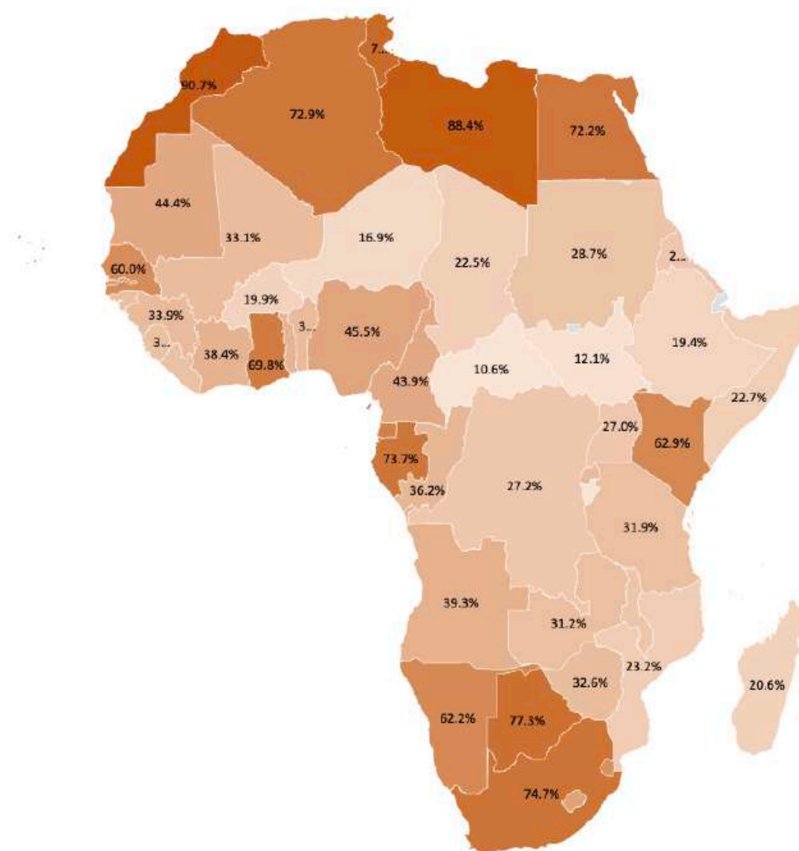
From our analysis and inquiry, we opine that its usage is skewed towards urban areas, with the provider reported to have halted new subscriptions in Nairobi due to network capacity overload. *This, in our view, implies that its expansion remains upbeat (into rural and semi-urban parts of Kenya) which may suffocate fiber optic rollout prospects – a move we contemplate may significantly impact fixed data revenues*.

On financial services, we take to ease that the Finance Bill 2024 proposition to increase mobile money excise duty did not see the light of day as it would have otherwise increased maturities that were starting to show in the mobile money ecosystem. That said, we are concerned about the likely reversal to cash transactions following the anticipated conversion of mobile money pay bills and till accounts into electronic tax registers – which potentially would impact mobile money revenues booked from customer-to-business transactions.

For Safaricom, we continue to see latent potential in the financial service business that the group can explore in Kenya and believe the next frontier will be unlocked with license acquisition into the broader financial services. We are impressed by the management's move to acquire an insurance agency license, with operations launched in August 2024.

We maintain an optimistic outlook on their investment in Ethiopia. For the GSM business, we expect mobile data to remain the key value proposition to customers and a significant revenue driver for the business in the medium term. *We however foresee voice revenue augments in the long run as the business gains critical mass, and on-net traffic builds within the Safaricom Ethiopia network*.

Internet Penetration in Africa 2024



Source: Statista, Standard Investment Bank estimates
We note that Ethiopia's internet penetration in SSA is lagging in the sub-20s, just above Niger, South Sudan, Burundi, and CAR

With c. 80% of the population offline, we see opportunities for data services in the market for Safaricom. Also, the low smartphone penetration may open the Ethiopian market for EADAK. The relative stability on the Birr may cool off the impact of depreciation leaving 1H25 with the biggest impact, a plus going forward.

For mobile money, we maintain the view that a strong agency rollout coupled with low transaction costs will be key to achieving scale. It is worth noting that digital payments are not new in the country as banks and microfinance institutions have offered mobile banking services since 2015 – but have failed to achieve scale. Fully aware that mobile money profitability is reliant on high adoption, achieving scale will be essential for M-Pesa's success in Ethiopia – which we opine could be achieved through bundled GSM offers to attract and lock in users.

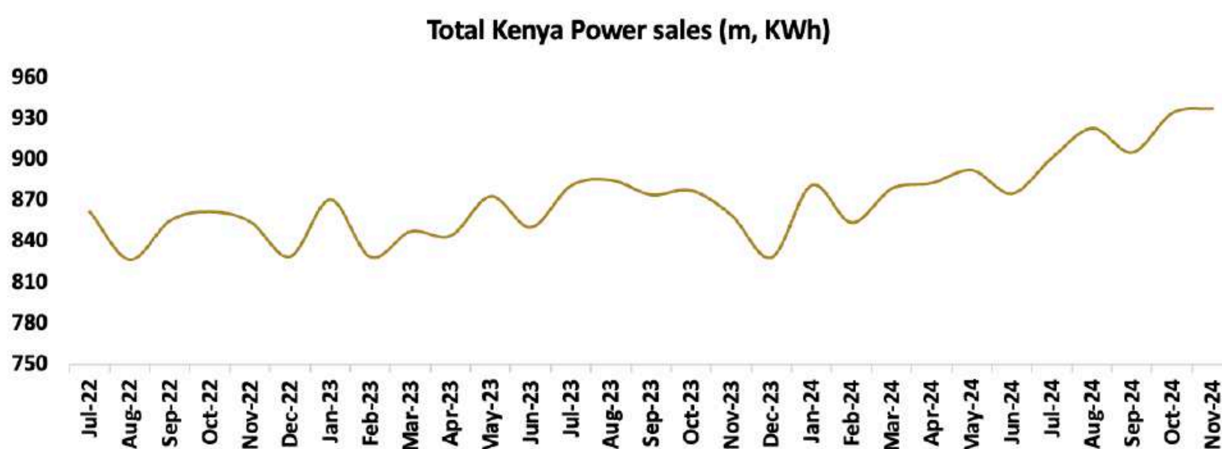
A GSMA report on mobile money in Ethiopia indicated several nascent opportunities that mobile money could easily ride on while pushing financial inclusion to the last mile. That said, there is a need for aggressive marketing and a strong agency network. GSMA cited that c. 30% of mobile owners in Ethiopia aware of mobile money pointed to the lack of a strong agency network as a key challenge to adoption. The cost of mobile money might be another headwind. GSMA noted that a fifth and a quarter of men and women with mobile phones and aware of mobile money but do not utilize it pointed to costs as a barrier.

We believe the telco player with the best cost structure, a rich agency network, and widespread customer education through marketing will successfully achieve scale. From our vantage point, the catch-22 for telco players concerning scaling agency networks, in the long run, might be the interoperability of mobile money agents. This is because in as much as it might enable mobile money services to scale faster, competitors will ride on each other's agency network thus eating free lunches – in a way discouraging aggressive rollout. This is however yet to play out.

iii. Energy Sector

We believe that The Energy (Electricity Market, Bulk Supply, and Open Access) Regulations 2024 will open the market of power generation, importation, exportation, transmission, distribution, and retail supply of electrical energy to independent power producers which may *affect Kenya Power's topline in the long run, which has for long enjoyed privileges from its exclusive edge as a monopoly*. It's worth noting that setting up a distribution network is capital-intensive, hence the impact of the regulation may take time to show in the company's financials.

Further, system losses (technical and non-technical) at 23.16% in 2024 remain a key challenge in electricity transmission. We believe efforts by Kenya Power with regard to the implementation of grid digitization and maintenance programs – with an aim of reducing system losses to 15.5% by 2028 – will translate to higher profitability and better margins in the long run if successful.



Source: KNBS

From a power utility point of view, we are impressed by the improvement in power sales – which had signaled a drop in May 2024. A deep dive in power sales by customer category signals that commercial and industrial consumers (accounting for c. 55.2% of Kenya Power sales) posted the fasted growth of c.5.4%y/y in the 2023/2024 financial year while the domestic customers segment, was the only category to post a declined, easing by 1.0%y/y. *A key risk for the power distributor in the long run is the rise in captive power plants by industries which may see lower utility in the long run on reduced reliance on the grid*.

Kenya Power sales by customer category in GWh

Customer Category	2019/20	2020/21	2021/22	2022/23	2023/24	y/y
Domestic	2,508	2,630	2,728	2,798	2,769	-1.0%
Small Commercial	1,262	1,326	1,474	1,504	1,526	1.5%
Commercial and Industrial	4,308	4,514	4,851	5,137	5,415	5.4%
Street lighting	76	84	95	99	102	3.0%
E-Mobility					1	
TOTAL	**8,154**	**8,554**	**9,148**	**9,538**	**9,813**	**2.9%**

Source: Kenya Power, Standard Investment Bank estimates

We note that Kenya Power's COVID-19 moratorium on debt service lapped in June 2024 with the company resuming payments. Management projects a full-year payment at c. KES 12.0bn in FY25. Further, management stated that they are targeting to retire its commercial hard currency debt by 2025/2026 – c. KES 20.0Bn. On financial performance, the business's operating profitability is primarily hinged on unit sales – given its ability to pass through power-related costs to consumers. This, from our vantage point, implies that the company is poised to augment cash generation in the long run (given its capex-light balance sheet) and better its margins as power consumption grows and finance costs ease.

Percentage of Local Electricity Generation by Source (m, KWh)

	Hydro	Geo - Thermal	Thermal	Wind	Solar	Co-Generation	Total
Jan-23	17.4%	49.2%	10.1%	19.0%	4.4%	0.0%	**100.0%**
Feb-23	11.8%	49.1%	14.8%	19.8%	4.5%	0.0%	**100.0%**
Mar-23	12.7%	51.2%	16.8%	15.3%	4.1%	0.0%	**100.0%**
Apr-23	19.4%	48.5%	12.2%	16.0%	4.0%	0.0%	**100.0%**
May-23	22.2%	47.7%	8.9%	17.0%	4.1%	0.0%	**100.0%**
Jun-23	24.9%	48.7%	6.6%	16.2%	3.5%	0.0%	**100.0%**
Jul-23	25.0%	44.2%	9.7%	17.7%	3.4%	0.0%	**100.0%**
Aug-23	23.5%	47.6%	8.2%	17.0%	3.7%	0.0%	**100.0%**
Sep-23	23.1%	47.8%	12.2%	13.2%	3.7%	0.0%	**100.0%**
Oct-23	19.0%	47.1%	13.0%	17.0%	4.0%	0.0%	**100.0%**
Nov-23	27.5%	47.3%	6.5%	15.3%	3.4%	0.0%	**100.0%**
Dec-23	28.2%	51.3%	7.2%	8.8%	4.6%	0.0%	**100.0%**
Jan-24	24.8%	49.4%	8.8%	13.3%	3.7%	0.0%	**100.0%**
Feb-24	26.7%	45.6%	7.6%	15.9%	4.1%	0.0%	**100.0%**
Mar-24	27.7%	42.1%	7.5%	18.9%	3.8%	0.0%	**100.0%**
Apr-24	36.3%	42.3%	9.4%	8.3%	3.7%	0.0%	**100.0%**
May-24	34.1%	43.0%	9.7%	9.3%	3.8%	0.0%	**100.0%**
Jun-24	31.9%	40.9%	8.2%	15.3%	3.8%	0.0%	**100.0%**
Jul-24	32.6%	42.9%	9.4%	12.3%	2.9%	0.0%	**100.0%**
Aug-24	29.3%	44.1%	9.1%	14.4%	3.1%	0.0%	**100.0%**
Sep-24	25.9%	43.5%	8.8%	18.2%	3.5%	0.0%	**100.0%**
Oct-24	25.1%	44.7%	10.0%	16.5%	3.7%	0.0%	**100.0%**
Nov-24	25.7%	46.4%	9.4%	14.8%	3.8%	0.0%	**100.0%**

Source: KNBS, Standard Investment Bank estimates

Shifting gears to power generation, geothermal remains pivotal to the grid – accounting for c. 45% of local electricity production – underpinning the county's base load and green energy drive. We believe geothermal stable power generation – derived from the consistently available heat from the earth's core – should continue to offset fluctuations from hydro, solar, and wind – dependent on weather conditions. We note in 2023 KenGen management noted that geothermal energy 'saved the day' by providing much-needed electricity, with no power rationing, offsetting the impact drought had on hydro generation.

KenGen's plan to leverage innovative technologies like Battery Energy Storage Systems (BESS) to store excess energy from variable renewable energy sources, is expected to aid in load balancing while offering ancillary services to the grid. The Least Cost Power Development Plan (LCPDP) proposed introducing 250MW BESS to be installed in the medium term, with KenGen in the process of implementing the first 100MW/200MWh which is expected to begin operations in 2027.

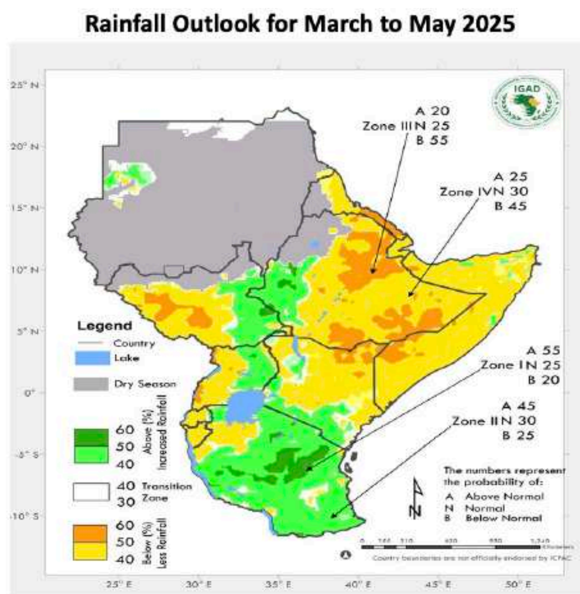
Further, the company's commission of a feasibility study on the possibility of generating power from geothermal brine is a plus in increasing renewable energy capacity. We opine that if this is successful, it will be a double barrel that will see a growth in revenues on improved efficiency and carbon credits alike. Management highlighted the possibility of silica mining from brine (as part of the feasibility study), which will certainly aid in revenue diversification and prop up the top line. Capex associated with these initiatives may however be dilutive in the near term.

We note that KenGen's installed capacity was reduced to 1,726MW from 1,904MW in 2023 due to the non-renewal of the Kipevu 1 and Muhoroni Gas Turbines power plants.

For both listed counters, we see better dividend prospects on the government's intent for parastatals to remit 80% of their earnings in dividends – a win for investors.

iv. Agricultural Sector

We worry about the below-normal rainfall forecasted for the [March to May 2025 (MAM) season] for most parts of Kenya chaperoned by warmer-than-normal temperatures. The forecasts are warning of a challenging climate scenario in 2025 with significant implications for agriculture and food security. Behind the adverse forecast are temperature anomalies and La Niña conditions.



Source: ICPAC

From a price perspective, coffee prices are expected to remain volatile through 2025 albeit with an upward trajectory. It is worth noting that Brazil, with an estimated market share of c.39% of global coffee production, faced its worst drought in modern history and recorded its hottest year in 2024.

Safras & Mercado – a consultancy group domiciled in Brazil focused on agribusiness information and analysis – estimates the 2025/2026 Brazilian coffee crop down by c. 5%y/y with arabica output falling by c. 15%y/y. Vietnam, the second largest coffee producer at c. 17% global market share, may also see a decline in production against the backdrop of erratic weather patterns in key coffee-growing areas.

For Tea, we see the forecasted increased chance of a La Niña pattern affecting China for the early months of 2025 may impact production volumes from China, and keep prices volatile throughout the year.

v. Manufacturing Sector

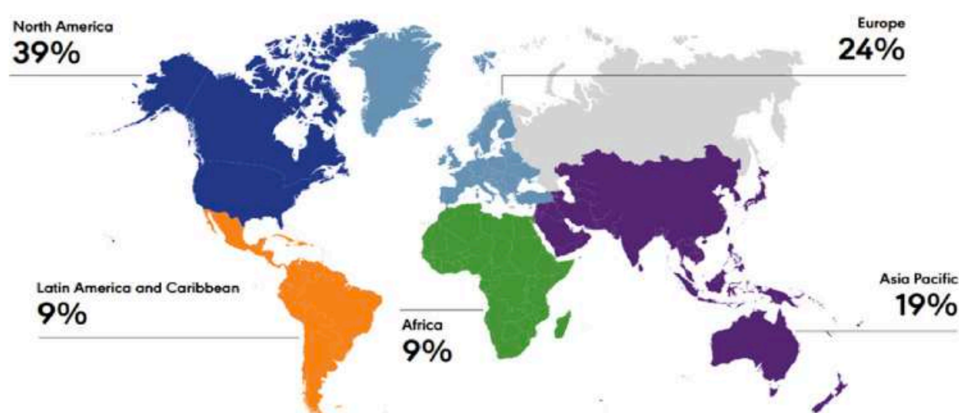
The **alcoholic beverage** industry continues to witness shifting trends. The formal beer market's disruption from craft beer and cedars – seems to be riding on the repositioning of consumer preference (within the low-alcoholic alternatives) towards novel drinking experiences and flavor experimentation. We note that the non-alcoholic beer market is gaining traction globally in the broader beer segment, and we expect this trend to show in the Kenyan market over time. This, in our view, points to the need for industry players to invest in product innovation.

To this end, we are impressed by the move by EABL to set up a micro-brewery dedicated to small-batch production, fostering creativity and innovation. From a consumption vantage point, we note that the drinking culture of Gen-Z and millennials globally is reported to be skewing more toward low and non-alcoholic alternatives – signaling likely maturities for high alcohol by volume (ABV) mainstream brands in the long run.

Spirit brands are also expected to witness disruption from ready-to-drink (RTD) cocktails, which are growing in popularity globally. With most RTD falling within the 4% to 7% ABV range, we opine their appeal will augment as customers increasingly look to moderate alcohol consumption.

With Diageo plc leaning towards its rich spirit portfolio globally and its continued exit from beer in Africa, we begin to speculate on a likely strategic exit by the shareholder (similar to Nigeria and Ghana) in EABL in the medium term. From its 2024 annual report, Africa accounted for 9% of its net sales, with East African sales driving the African performance at c. 46% (*or c. 4.1% of the group's topline*).

Diageo's Composition of Net Sales for the year ended 30th June 2024



Source: Diageo 2024 Annual Report
The above map is intended to illustrate general geographic regions where Diageo has a presence and/or in which its products are sold. It is not intended to imply that Diageo has a presence in and/or that its products are sold in every country or territory within a geographic region.

From Diageo's current market capitalization and our value generation estimate, our back-of-the-envelope calculation places the East African subsidiary (EABL) at an estimated market worth of c. USD 2.79Bn – 2.35x its current market cap (including debt), which not only signals a likely case of undervaluation (from a revenue generation point of view), but also potentially higher multiples in the event of an exit compared to current levels. That said, EABL would need a major buyer given its size and geographical coverage that includes subsidiaries in Uganda & Tanzania. Based on its scale, it may well be a stake that Diageo may wish to keep on the continent.

In Nigeria, Diageo inked a deal to sell its 58.02% shareholding for a consideration of c. USD 70.0m – which from a price perspective was a 63% premium to the 30-day VWAP. The exit consideration was chaperoned by new royalty fees (that we opine are an upward revision of the previous 0.5% in royalty and 2.0% in technical service fee – charged to net sales). This model (also used in the sale of Guinness Ghana) implies that Diageo is set to continue benefiting from its brand's value creation in those markets without bearing the burden relating to operations and strategy execution – a big win in our view. *We foresee a similar playbook in our speculation of a potential exit – that will blend an exit consideration with royalty fees for select brands*.

For the **tobacco industry**, illicit trade (c. 27% of the market) remains a key concern for combustible tobacco products in Kenya. Further, we note that the Tobacco Control Act of 2007 (revised in 2012) – which restricts the sale and prohibits the advertisement and promotion of tobacco products – is not clear on restrictions applicable to modern oral nicotine with little differentiation in the regulation of new category products.

Specific to BAT Kenya, the company's efforts towards a sustainable regulatory framework are a silver lining towards a near-term resumption of commercial operations of Velo – which we believe will boost earnings and valuation.

For **industrial gases**, the industry – made of a bulk of small and medium-sized businesses – should experience continued disruptions for market players from persistent competition which is expected to affect prices and revenues. That said, improvements in oxygen infrastructure in the healthcare sector should lead to increased demand for medical oxygen across the country in the long run – a plus for BOC.

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