Cytonn Weekly #13.2020

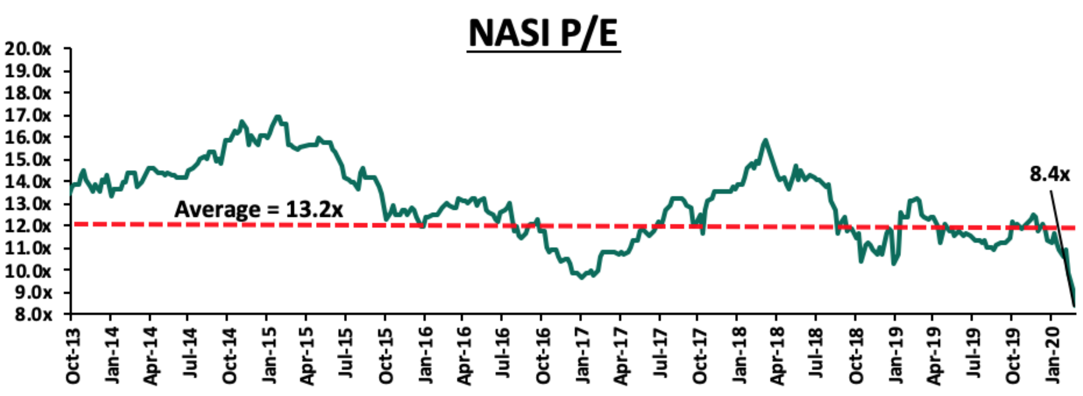
Equities

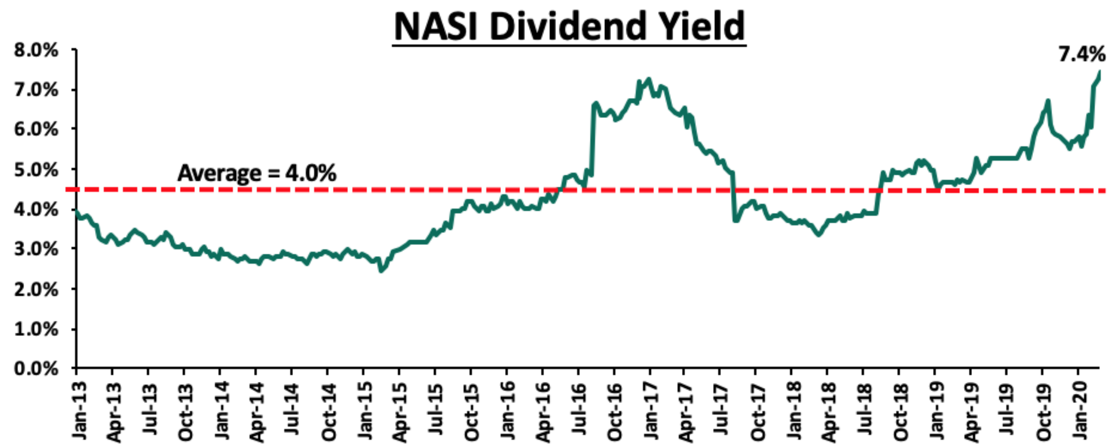
Market Performance

During the week, the equities market was on a downward trajectory, with NASI, NSE 20 and NSE 25 declining by 4.2%, 5.3%, and 7.1%, respectively, taking their YTD performance to losses of 23.5%, 27.8%, and 26.9%, for the NASI, NSE 20 and NSE 25, respectively, with the NSE 20 share index trading at a 17-year low, closing at 1,917.7 compared to the previous low of 1,948.5 recorded in 2003. The YTD losses of all the three indices breach the threshold of a bear market, which is a condition in which securities prices fall by 20.0% or more. The performance of the NASI was driven by losses recorded by most large-cap stocks, with EABL, Equity, KCB Group and ABSA recording losses of 15.1%, 14.8%, 13.7%, and 10.7%, respectively. The losses are attributable to the ongoing Coronavirus pandemic, with investors selling out of the equities market.

Equities turnover decreased by 25.3% during the week to USD 37.3 mn, from USD 50.0 mn recorded the previous week, taking the YTD turnover to USD 428.2 mn. Foreign investors remained net sellers for the week, with a net selling position of USD 17.6 mn, from a net selling position of USD 28.9 mn recorded the previous week. The trend reflects the global equity markets with foreign investors disposing riskier assets in favor of safe havens.

The market is currently trading at a price to earnings ratio (P/E) of 8.4x, 36.7% below the historical average of 13.2x, and a dividend yield of 7.4%, 3.4% points above the historical average of 4.0%. With the market trading at valuations below the historical average, we believe there is value in the market. The current P/E valuation of 8.4x is 13.8% below the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 0.7% above the previous trough valuation of 8.3x experienced in December 2011. The charts below indicate the historical P/E and dividend yields of the market.





Weekly Highlight

During the week, KCB group announced that it has set aside a Kshs 30.0 bn credit facility, in an effort to cushion individuals and businesses grappling with the effects of the Coronavirus pandemic. The credit facility will be accessed through the lender's mobile lending platform, KCB M-Pesa, and will issue loans from Kshs 50.0 to Kshs 1.0 mn, depending on the customer’s credit rating. The loan facility offers repayment periods of 30-days, 60-days, and 90-days with interest rates of between 2.0% and 6.0%, per month. The credit facility is part of measures announced by the Central Bank of Kenya (CBK) and Kenya Bankers Association (KBA) to cushion the economy against the impact of the Coronavirus pandemic. The move by KCB Group mirrors the actions of ABSA Bank Kenya to offer support to Small and Medium Enterprises (SMEs) and individuals amidst the pandemic. This is after ABSA Bank Kenya announced its intentions to pay all supplier invoices within 14-days, with invoices of Kshs 1.0 mn and below being paid within 7-days. This is part of the lender’s measures to help SMEs meet their financial obligations and ensure working capital is available to them. ABSA Bank Kenya is also willing to restructure the loan terms for their customers to enable them to cope with any financial difficulty that may arise due to the worldwide pandemic. This comes on the backdrop of Central Bank of Kenya Governor, Dr. Patrick Njoroge’s announcement that banks will provide on a case-to-case basis, a personal relief on loan repayments for up to one year, to individuals affected by circumstances arising from the Coronavirus pandemic. The Monetary Policy Committee (MPC) also lowered the Cash Reserve Ratio (CRR), which is a fraction of total customer deposits that the commercial banks have to hold with the central bank, from 5.25% to 4.25%. This move is expected to release approximately Kshs 35.2 bn in additional liquidity and will see banks get more headroom in terms of deposits they can allocate to loans. In our view, these measures by the Kenyan banks, which follow the global trend with the International Monetary Fund (IMF) saying that it is prepared to mobilize USD 1.0 tn in lending, will cushion SMEs and individuals against the economic impact of the Coronavirus pandemic. We, however, believe that this will also lead to a rise in non-performing loans, because of the lax measure that has seen the suspension of listing at the Credit Reference Bureau (CRB) for default loans for the next 90-days.

During the week, Equity group was given the green light by the Committee Responsible for Initial Determination (CID), a Commission mandated to monitor and investigate possible breaches of the COMESA Competition Regulations, to acquire a 66.5% controlling stake worth Kshs 10.9 bn in Banque Commerciale du Congo (BCDC), effectively valuing BCDC at Kshs 16.4 bn. BCDC’s profit after tax stood at 1.2 bn as at 2018 with a shareholders’ equity of Kshs 10.0 bn. The transaction will see Equity Group pay Kshs 17,430 per share to acquire 625,354 shares in BCDC, a deal inclusive of dividends issued as at 1st January 2020, from the George Arthur Forrest family, and will see Equity integrate the bank with its subsidiary, Equity Bank Congo, to create the second-largest bank in Democratic Republic of Congo (DRC). The Price to book (P/B) for the transaction is 1.6x, due to the transaction value being Kshs 10.9 bn, and the book value acquired by Equity being Kshs 6.7 bn. COMESA Competition Commission, noting the deal will increase Equity Group’s market share without hurting competition, also endorsed the decision. The transaction is still subject to regulatory approvals from the Central Bank of Kenya (CBK) and Banque Centrale du Congo. Below is a summary of the deals that have either happened, been announced or are expected to be concluded locally. Transactions have been carried out at an average P/BV of 1.4x, compared to the current listed banking sector average of 1.2x:

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs. Bns)	Transaction Stake	Transaction Value	P/Bv Multiple	Date
Co-operative Bank	Jamii Bora Bank	3.4	100.0%	Undisclosed	N/A	Mar-20**
Access Bank PLC (Nigeria)	Transnational Bank PLC.	1.9	100.0%	Undisclosed	N/A	Feb-20*
Commercial International Bank	Mayfair Bank	1.1	Undisclosed	Undisclosed	N/A	Dec-19**
Oiko Credit	Credit Bank	3.0	22.8%	1.0	1.5x	Aug-19
KCB Group	National Bank of Kenya	7.0	100.0%	6.6	0.9x	Sep-19
CBA Group	NIC Group	33.5	53%:47%	23.0	0.7x	Sep-19
CBA Group***	Jamii Bora Bank	3.4	100.0%	1.4	0.4x	Jan-19
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	1.0x	Jan-19
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	N/A	Dec-18
SBM Bank Kenya	Chase Bank Ltd	Unknown	75.0%	Undisclosed	N/A	Aug-18
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	0.8x	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	1.6x	Nov-16
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	1.4x	Jun-16
I&M Holdings	Giro Commercial Bank	3.0	100.0%	5.0	1.7x	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	2.3x	Mar-15
Centum	K-Rep Bank	2.1	66.0%	2.5	1.8x	Jul-14
GT Bank	Fina Bank Group	3.9	70.0%	8.6	3.2x	Nov-13
Average			**75.7%**		**1.4x**	

*** Expected completion date**
****Announcement date**
*****Deals that were dropped**

Earnings Release

During the week, ABSA Bank Kenya, I&M Holdings and NCBA Group released their FY'2019 financial results. Below is a summary of their earnings.

ABSA Bank Kenya;

Income Statement

- Core earnings per share (excluding exceptional items), increased by 21.2% to Kshs 1.65, from Kshs 1.37 in FY'2018, above our expectation of a 5.1% increase to Kshs 1.44. Earnings per share inclusive of exceptional items remained flat at Kshs 1.37, following a one-off exceptional item of Kshs 1.5 bn that the bank incurred in rebranding expenses from Barclays to Absa. The performance was driven by a 6.5% increase in total operating income, despite the 2.1% increase in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 8.5% increase in Loan Loss Provisions (LLP) to Kshs 4.2 bn, from Kshs 3.9 bn in FY'2018, against our expectation of a 31.4% increase in LLP to Kshs 5.1 bn,
- Total operating income rose by 6.5% to Kshs 33.8 bn, from Kshs 31.7 bn in FY'2018. This was due to a 9.1% rise in Non-Funded Income (NFI) to Kshs 10.6 bn, from Kshs 9.7 bn in FY'2018, coupled with a 5.4% rise in Net Interest Income (NII) to Kshs 23.2 bn, from Kshs 22.0 bn in FY'2018,

- Interest income rose by 6.8% to Kshs 31.0 bn, from Kshs 29.1 bn in FY'2018. This was driven by a 9.7% growth in interest income from government securities to Kshs 8.1 bn, from Kshs 7.4 bn in FY'2018, and a 4.7% increase in interest income on loans and advances to Kshs 22.5 bn, from Kshs 21.5 bn in FY'2018. The yield on interest-earning assets, however, declined to 10.4%, from 11.4% in FY'2018, attributed to the faster 17.6% y/y increase in average interest earning assets to Kshs 299.3 bn, from Kshs 254.5 bn in FY'2018, that outpaced the 6.8% growth in interest income,
- Interest expenses rose by 11.0% to Kshs 9 bn, from Kshs 7.1 bn in FY'2018, following a 32.8% increase in the interest expense on placement liabilities to Kshs 1.3 bn from Kshs 0.9 bn in FY'2018, coupled with the 5.4% rise in interest expense on customer deposits to Kshs 6.5 bn from Kshs 6.1 bn in FY'2018, on the back of the strong 14.6% y/y deposit growth recorded in 2019. Cost of funds, on the other hand, declined marginally to 3.45%, from 3.52% in FY'2018, owing to the faster 13.1% growth in average interest bearing liabilities, which outpaced the 11.0% growth in interest expense. The Net Interest Margin (NIM) however declined to 7.7%, from 8.6% in FY'2018, owing to the faster 17.6% growth in average interest earning assets which outpaced the 5.4% growth in Net Interest Income (NII),
- Non-Funded Income (NFI) rose by 9.1% to Kshs 10.6 bn, from Kshs 9.7 bn in FY'2018. The growth was mainly driven by an 11.0% rise in forex trading income to Kshs 3.6 bn, from Kshs 3.3 bn in FY'2018, coupled with an 8.8% growth in total fees and commissions on loans to Kshs 6.1 bn from Kshs 5.6 bn in FY'2018. As a result, the revenue mix adjusted marginally to 68.6:31.4 from 69.4:30.6 recorded in FY'2018, funded to non-funded income, owing to the faster 9.1% growth in NFI, that outpaced the 5.4% growth in NII,
- Total operating expenses rose by 2.1% to Kshs 21.5 bn from Kshs 21.1 bn, largely driven by an 8.5% increase in Loan Loss Provisions (LLP) to Kshs 4.2 bn in FY'2019, from Kshs 3.9 bn in FY'2018, coupled with a 4.0% increase in staff costs to Kshs 10.2 bn in FY'2019, from Kshs 9.8 bn in FY'2018, with the bank having hired an additional 463 staff as it undertook rebranding in 2019. The rise in operating expenses was however mitigated by a 91.9% decline in rental charges to Kshs 0.1 bn from Kshs 1.2 bn in FY'2018, owing to the bank closing some of its branches across the country and opting to rent smaller spaces in some areas,
- The Cost to Income Ratio (CIR) improved to 63.6%, from 66.4% in FY'2018, owing to the faster 6.5% rise in total operating income to Kshs 33.8 bn, from Kshs 31.7 bn in FY'2018, which outpaced the 2.1% rise in total operating expenses to Kshs 21.5 bn, from Kshs 21.1 bn in FY'2018. Without LLP, the cost to income ratio also improved to 51.2%, from 54.2% in FY'2018, an indication of improved efficiency,
- Profit before tax rose by 15.4% to Kshs 12.3 bn, from Kshs 10.6 bn in FY'2018. Profit after tax before exceptional items grew by 21.2% to Kshs 9.0 bn in FY'2019, from Kshs 7.4 bn in FY'2018, while profit after tax and exceptional items, which relates to a one-off transition expense of Kshs 1.5 bn, grew by a marginal 0.5% to Kshs 7.5 bn in FY'2019, from Kshs 7.4 bn in FY'2018, with the effective tax rate increasing to 30.7% from 30.0% in FY'2018, and,
- The bank recommends a final dividend of Kshs 0.9 per share, inclusive of a Kshs 0.2 per share interim dividend paid in October, translating to a total Dividend per Share (DPS) of Kshs 1.1 for the year, unchanged from the Kshs 1.1 per share paid in FY'2018. This translates to a dividend yield of 11.2% at the current price of Kshs 9.8, and a payout ratio of 80.1%.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 15.1% to Kshs 374.0 bn, from Kshs 324.8 bn in FY'2018. This growth was largely driven by a 32.3% increase in government securities to Kshs 123.0 bn, from Kshs 92.9 bn in FY'2018, coupled with a 9.9% increase in their loan book to Kshs 194.9 bn, from Kshs 177.4 bn in FY'2018,
- Total liabilities rose by 17.2% to Kshs 328.8 bn, from Kshs 280.6 bn in FY'2018, driven by a 14.6% increase in customer deposits to Kshs 237.7 bn, from Kshs 207.4 bn in FY'2018, coupled with a 26.2% increase in balances due to banking institutions in the group to Kshs 72.0 bn, from Kshs

57.0 bn in FY’2018. The growth in liabilities was mitigated by a 23.1% decline in placement liabilities to Kshs 4.1 bn, from Kshs 5.3 bn in FY’2018. Deposits per branch increased by 12.5% to Kshs 2.7 bn, from Kshs 2.4 bn in FY’2018, with the number of branches having increased by 4 to 88 from 84 in FY’2018,

- The faster 14.6% growth in deposits, which outpaced the 9.9% growth in loans led to a decline in the loan to deposit ratio to 82.0% from 85.5%, recorded in FY’2018,
- Gross Non-Performing Loans (NPLs) declined by 2.8% to Kshs 13.5 bn in FY’2019, from Kshs 13.9 bn in FY’2018. The NPL ratio thus improved to 6.6% in FY’2019, from 7.4% in FY’2018, owing to the faster 9.8% growth in gross loans (after adding back interest suspense), coupled with a 2.8% decline in non-performing loans. General Loan Loss Provisions rose by 19.3% to Kshs 7.8 bn, from Kshs 6.5 bn in FY’2018. Consequently, the NPL coverage increased to 77.0% in FY’2019, from 69.2% in FY’2018, owing to the 19.3% increase in general loan loss provisions, coupled with a 2.8% decline in gross non-performing loans,
- Shareholders’ funds increased by 2.2% to Kshs 45.2 bn in FY’2019 from Kshs 44.2 bn in FY’2018, driven by a 3.4% increase in retained earnings to Kshs 37.1 bn, from Kshs 35.9 bn in FY’2018. However, the growth was weighed down by a 46.9% decline in revaluation reserve to Kshs 0.3 bn from Kshs 0.5 bn in FY’2018,
- ABSA Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 13.9%, 3.4% points above the 10.5% statutory requirement. In addition, the total capital to risk-weighted assets ratio was 16.6%, exceeding the 14.5% statutory requirement by 2.1% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 14.3%, while total capital to risk-weighted assets came in at 17.0%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.3%, and a Return on Average Equity (ROaE) of 16.7%.

Key Take-Outs:

1. There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 51.2% from 54.2% in FY’2018. The improvement was largely attributable to a 91.9% decrease in rental charges to Kshs 0.1 bn from Kshs 1.2 bn in FY’2018, owing to the bank closing some of its branches across the country and opting to rent smaller spaces in some areas, which in turn boosted the bottom line,
2. The bank’s asset quality improved, with the NPL ratio improving to 6.6% from 7.4% in FY’2018. The improving NPL ratio is attributable to a 2.8% decline in gross non-performing loans to Kshs 13.5 bn, from Kshs 13.9 bn in FY’2018 compared to the 9.8% growth in gross loans to Kshs 205.3 bn, from Kshs 187.0 bn in FY’2018. The bank continued to demonstrate prudence, as the coverage remained relatively high, at 77.0%, higher than the 69.2% in FY’2018,
3. The banks’ reported earnings per share remained flat at Kshs 1.37, weighed down by the Kshs 1.5 bn one-off exceptional item that the bank incurred in rebranding expenses. However, core earnings per share recorded a 21.2% growth to Kshs 1.65, from Kshs 1.37 in FY’2018, and,
4. The bank recorded a relatively strong growth in its balance sheet, as deposits grew by 14.6% y/y, and were channeled to Government Securities investments, which grew by 32.3%, and loans and advances, which grew, by 9.9% y/y. The growth in interest earning assets helped support increased interest income revenue, despite the decline in yields of government securities.

Going forward, we expect the bank’s growth to be driven by:

i. Increased Channel diversification, which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt with “Timiza” already recording accelerated growth, and consequently higher Non-Interest. This coupled with the expansion of its agent-banking network and product offerings such as bancassurance and fixed income trading will see the bank expand its topline revenue, going forward.

For more analysis, please see our ABSA Bank Kenya FY’2019 Earnings Note.

I&M Holdings;

Income Statement

- Core earnings per share increased by 26.6% to Kshs 13.0, from Kshs 10.3 (normalized EPS) in FY'2018, largely in line with our projections of a 28.2% increase to Kshs 13.2. The performance was driven by a 2.6% increase in total operating income, as well as a 17.8% decrease in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 2.6% rise in total operating income to Kshs 23.8 bn, from Kshs 23.2 bn in FY'2018, which was slower than our expectation of an 11.8% rise,
- Total operating income rose by 2.6% to Kshs 23.8 bn, from Kshs 23.2 bn in FY'2018. This was driven by a 9.1% increase in Non-Funded Income (NFI) to Kshs 8.3 bn, from Kshs 7.6 bn in FY'2018, offsetting the 0.5% decline in Net Interest Income (NII) to Kshs 15.5 bn, from Kshs 15.6 bn in FY'2018,
- Interest income rose by 4.5% to Kshs 27.2 bn, from Kshs 26.0 bn in FY'2018. This was driven by an 8.2% growth in interest income from loans and advances to Kshs 22.4 bn, from Kshs 20.7 bn in FY'2018. The yield on interest-earning assets, however, declined to 10.4%, from 11.2% in FY'2018, largely attributable to a decline in yields on government securities recording a decline of 17.0% to Kshs 4.1 bn from Kshs 5.0 bn in FY'2018 offsetting the 2.2% increase in average government securities to Kshs 53.0 bn from 51.9 bn in FY' 2018,
- Interest expense rose by 12.0% to Kshs 11.7 bn, from Kshs 10.4 bn in FY'2018, following a 14.6% increase in the interest expense on customer deposits to Kshs 10.1 bn, from Kshs 8.8 bn in FY'2018, offsetting the 7.2% decline in interest expense on placements to Kshs 542.6 mn, from Kshs 584.7 mn in FY'2018. Other interest expenses also increased by 1.0% to Kshs 1.03 bn from Kshs 1.02 mn in FY'2018. Despite the higher interest expenses, the cost of funds declined marginally to 4.8% from 4.9% in FY'2018, owing to a slower increase in interest-bearing liabilities that rose by 6.9% to Kshs 249.0 bn from Kshs 232.5 bn in FY'2018 that was outpaced by the growth in interest expense. Net Interest Margin (NIM) declined to 6.3%, from 7.6% in FY'2018 due to a 0.5% decline in NII offsetting the 12.7% increase in average interest-earning assets,
- Non-Funded Income rose by 9.1% to Kshs 8.3 bn, from Kshs 7.6 bn in FY'2018. The increase was mainly due to a 5.0% increase in fees and commissions on loans to Kshs 1.9 bn from Kshs 1.8 bn in FY'2018. In addition, the FX trading income increased marginally by 0.4% to Kshs 2.58 bn from Kshs 2.57 bn in FY'2018 while other income rose by 56.7% to Kshs 1.7 bn from Kshs 1.1 bn. The revenue mix shifted to 65:35 funded to non-funded income, from 67:33, owing to the growth in NFI, coupled with the decline in NII,
- Total operating expenses declined by 17.8% to Kshs 10.1 bn from Kshs 12.3 bn in FY'2018, largely driven by an 83.3% decline in Loan Loss Provisions (LLP) to Kshs 636.5 mn from Kshs 3.8 bn in FY'2018. There was however a 15.1% increase in staff costs to Kshs 4.7 bn from Kshs 4.1 bn in FY'2018,
- Owing to the 83.3% decline in Loan Loss Provisions (LLP), Cost to Income Ratio (CIR), with LLP improved to 42.4%, from 53.0% in FY'2018. Without LLP, the cost to income ratio deteriorated to 39.8% from 36.6% in FY'2018, an indication of reduced efficiency,
- Profit before tax rose by 27.0% to Kshs 14.6 bn, up from Kshs 11.5 bn in FY'2018. Profit after tax grew by 26.6% to Kshs 10.8 bn in FY'2019, from Kshs 8.5 bn in FY'2018, with the effective tax rate increasing to 34.2%, from 30.5% in FY'2018,
- The bank recommends a first and final dividend of Kshs 2.55 per share, which is a 30.8% increase from Kshs 1.95 per share paid in FY'2018, which translates to a dividend yield of 5.1% at the current price of Kshs 49.8 and a payout ratio of 19.6%.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 9.3% to Kshs 315.4 bn, from Kshs 288.5 bn in FY'2018. Growth was supported by a 20.5% increase in placements to Kshs 40.6

bn from Kshs 33.7 bn in FY’2018. The loan book also expanded by 5.2% to Kshs 175.3 bn from Kshs 166.7 bn in FY’2018, while Government securities rose by 3.4% to Kshs 53.9 bn from Kshs 52.2 bn in FY’2018,

- Total liabilities rose by 7.1% to Kshs 254.4 bn, from Kshs 237.6 bn in FY’2018, driven by a 7.6% increase in customer deposits to Kshs 229.7 bn from Kshs 213.1 bn in FY’2018. Deposits per branch increased by 5.2% to Kshs 5.5 bn from Kshs 5.2 bn in FY’2018, with the number of branches increasing by 1 to 42 branches. Borrowings declined by 21.1% to Kshs 10.9 bn, from Kshs 13.8 bn in FY’2018,
- The faster growth in deposits as compared to the growth in loans led to a decline in the loan to deposit ratio to 76.3% from 78.2% in FY’2018,
- Gross non-performing loans declined by 5.3% to Kshs 21.3 bn in FY’2019 from Kshs 22.5 bn in FY’2018. The NPL ratio, thus, improved to 11.3% in FY’2019 from 12.6% in FY’2018 attributable to a 5.3% decline in Non-Performing Loans, outpacing the 5.1% growth in gross loans. With general Loan Loss Provisions increasing by 7.6% to Kshs 8.6 bn from Kshs 8.0 bn in FY’2018, the NPL coverage improved to 59.1% in FY’2019 from 53.9% in FY’2018 despite the 5.3% decline in gross non-performing loans,
- Shareholders’ funds increased by 20.6% to Kshs 57.7 bn in FY’2019, from Kshs 47.9 bn in FY’2018, supported by a 25.9% increase in retained earnings to Kshs 33.9 bn, from Kshs 26.9 bn,
- I&M Holdings Plc remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 17.3%, 6.8% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 21.2%, exceeding the statutory requirement by 6.7% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 17.2%, while total capital to risk-weighted assets came in at 21.0%.
- The bank currently has a Return on Average Assets (ROaA) of 3.4%, and a Return on Average Equity (ROaE) of 19.5%

Key Take-Outs:

1. The bank maintained its continued rise in NFI recording a 9.1% growth to Kshs 8.3 bn, from Kshs 7.6 bn in FY’2018. This resulted in the revenue contribution mix shifting to 65:35 funded to non-funded income, from 67:33, owing to the high growth in NFI that outpaced growth in NII. This, however, remains below the current industry average of 32.6% NFI,
2. The bank’s asset quality improved, with the NPL ratio improving to 11.3%, from 12.6% in FY’2018. NPL coverage also improved to 59.1%, up from 53.9% in FY’2018 as the 7.6% rise in general provisions to Kshs 8.6 bn, from Kshs 8.0 bn in FY’2018, outpaced the 5.3% decline in gross NPL to Kshs 21.3 bn in FY’2019 from Kshs 22.5 bn in FY’2018, and,
3. There was a decline in efficiency levels as the cost to income ratio without LLP worsened to 39.8% from 36.6% in FY’2018. The deterioration was largely attributable to a 15.1% rise in staff cost, which depressed the bottom line.

Going forward, the factors that would drive the bank’s growth would be:

i. Non-Funded Income Growth Initiatives – I&M Holdings’ NFI growth is improving as the bank focuses on digital innovation to augment transaction volumes and increase fee income. The bank needs to increase the capacity of its brokerage and advisory businesses to increase income contribution from investment and advisory services, and,
ii. Geographical Diversification – The bank has been aggressively expanding into other regions, namely Tanzania, Rwanda, and Uganda. This is expected to drive growth in the near future.

For a comprehensive analysis, please see our I&M Holdings FY’2019 Earnings Note.

NCBA Group;

Key to note: Results released by NCBA were on a prospective basis (a continuation of CBA)

representing the 9 months performance of CBA Bank and 3 months performance of NCBA Bank (Merged bank); prior year comparatives are of those of CBA Bank. In our analysis we have used the pro forma combined statements of the 2 Banks as a 2018 comparative;

Income Statement

- Core earnings per share declined by 12.4% to Kshs 11.1 from Kshs 12.7 in FY'2018. The performance was driven by a 7.6% decline in total operating income to Kshs 33.7 bn from Kshs 36.4 bn in FY'2018, despite the 15.7% decline in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 34.2% decline in Net Interest Income to Kshs 13.3 bn, from Kshs 20.3 bn in FY'2018, against our expectation of a 9.7% increase in NII to Kshs 22.3 bn, The downside was however mitigated by a 15.7% decline in total operating expenses to Kshs 20.4 bn in FY'2019, from Kshs 24.2 bn in FY'2018,
- Total operating income declined by 7.6% to Kshs 33.7 bn in FY'2019, from Kshs 36.4 bn in FY'2018. This was driven by a 34.2% decline in Net Interest Income (NII) to Kshs 13.3 bn from Kshs 20.3 bn recorded in 2018 which outpaced the 25.9% growth in Non-Funded Income (NFI) to Kshs 20.3 bn in FY'2019 from Kshs 16.1 bn in FY'2018,
- Interest income declined by 34.1% to Kshs 25.5 bn from Kshs 38.7 bn in FY'2018. This was driven by a 35.5% decline in interest income on government securities to Kshs 9.2 bn, from Kshs 14.2 bn in FY'2018, coupled with the 34.3% decline in interest from loans and advances to Kshs 15.7 bn, from Kshs 23.9 bn in FY'2018. The yield on interest earning assets declined to 6.3% in FY'2019 from 9.9% in FY'2018, attributable to the 6.8% y/y increase in average interest earning assets to Kshs 419.9 bn, from Kshs 393.0 bn, despite the 34.1% decline in interest income,
- Interest expense declined by 34.0% to Kshs 12.2 bn from Kshs 18.5 bn in FY'2018, following a 32.6% decline in interest expense on customer deposits to Kshs 10.6 bn, from Kshs 15.7 bn in FY'2018. The cost of funds fell to 3.1%, from 4.9% in FY'2018, owing to the 4.2% growth in average interest bearing liabilities, despite the 34.0% decline in interest expense. The Net Interest Margin declined to 3.3%, from 5.2% in FY'2018, owing to the faster 6.8% growth in average interest earning assets despite the 34.2% decline in Net Interest Income (NII),
- Non-Funded Income rose by 25.9% to Kshs 20.3 bn from Kshs 16.1 bn in FY'2018. The growth in NFI was driven by a 14.4% increase in fees and commissions on loans to Kshs 9.4 bn from Kshs 8.2 bn in FY'2018. Other incomes also grew to Kshs 5.6 bn, from Kshs 1.3 bn, recorded in FY'2018. As a result, the revenue mix shifted to 40:60 funded to non-funded income in FY'2019 from 56:44 in FY'2018, owing to the increase in NFI by 25.9% coupled with the decline in NII by 34.2%,
- Total operating expenses declined by 15.7% to Kshs 20.4 bn, from Kshs 24.2 bn in FY'2018, largely driven by a 26.0% decline in staff costs to Kshs 5.6 bn, from Kshs 7.5 bn in FY'2018, coupled with a 19.1% decline in other operating expenses to Kshs 8.5 bn, from Kshs 10.5 bn in FY'2018, however, the decline was mitigated by a 3.1% growth in loan loss provisions (LLP) to Kshs 6.3 bn, from Kshs 6.1 bn in FY'2018,
- The cost to income ratio improved to 60.5% from 66.3% in FY'2018, owing to the slower 7.6% decline in total operating income to Kshs 33.7 bn, from Kshs 36.4 bn in FY'2018, which was outpaced by the 15.7% decline in total operating expenses to Kshs 20.4 bn, from Kshs 24.1 bn in FY'2018. Without LLP, the cost to income ratio also improved to 41.9% from 49.7% in FY'2018, an indication of improved efficiency,
- Profit before tax declined by 7.8% to Kshs 11.3 bn from Kshs 12.3 bn in FY'2018. Profit after tax before exceptional items grew by 9.9% to Kshs 9.8 bn, from Kshs 8.9 bn in FY'2018, while profit after tax and exceptional items, which relates to merger costs of Kshs 2.0 bn, declined by 12.4% to Kshs 7.8 bn in FY'2019 from Kshs 8.9 bn in FY'2018, with the effective tax rate increasing to 30.7% from 27.1% in FY'2018, and,
- The bank recommends a final dividend of Kshs 1.5 per share, inclusive of a Kshs 0.25 per share interim dividend, translating to a total dividend of Kshs 1.75 per share for the year. This translates

to a dividend yield of 6.6% at the current price of 26.4, and a payout ratio of 33.4%.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 9.1% to Kshs 494.8 bn, from Kshs 453.6 bn in FY'2018. This growth was largely driven by an 11.8% increase in government securities to Kshs 145.0 bn, from Kshs 129.7 bn in FY'2018, coupled with a 4.1% growth in their loan book to Kshs 249.4 bn, from Kshs 239.6 bn in FY'2018,
- Total liabilities rose by 10.4% to Kshs 427.6 bn, from Kshs 387.2 bn in FY'2018, driven by a 10.9% increase in customer deposits to Kshs 378.2 bn, from Kshs 341.0 bn in FY'2018. The growth in liabilities was mitigated by a 29.0% decline in placement liabilities to Kshs 10.9 bn, from Kshs 15.4 bn in FY'2018. Deposits per branch stood at Kshs 8.8 bn with the bank operating 43 branches,
- The faster 10.9% growth in deposits, which outpaced the 4.1% growth in loans led to a decline in the loan to deposit ratio to 65.9% from 70.3%, recorded in FY'2018,
- Gross non-performing loans increased by 16.5% to Kshs 33.7 bn in FY'2019, from Kshs 28.9 bn in FY'2018. Consequently, the NPL ratio deteriorated to 12.6% in FY'2019 from 11.3% in FY'2018, owing to the faster 16.5% growth in gross non-performing loans which outpaced the 4.7% growth in gross loans (after adding back interest suspense),
- Shareholders' funds increased by 1.5% to Kshs 67.0 bn in FY'2019, from Kshs 66.0 bn in FY'2018, owing to the 186.7% increase in share premium to Kshs 22.2 bn in FY'2019, from Kshs 7.7 bn in FY'2018. The growth was however weighed down by a 16.6% decline in retained earnings to Kshs 36.0 bn, from Kshs 43.1 bn in FY'2018, coupled with a 2.6% decline in proposed dividends to Kshs 2.2 bn, from Kshs 2.3 bn in FY'2018,
- NCBA Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 16.6%, 6.1% points above the 10.5% statutory requirement. In addition, the total capital to risk weighted assets ratio is 17.3%, exceeding the 14.5% statutory requirement by 2.8% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 17.5%, while total capital to risk weighted assets came in at 18.2%, and,
- NCBA Group currently has a Return on Average Assets (ROaA) of 1.7% and a Return on Average Equity (ROaE) of 11.8%.

Key Take-Outs:

a. NCBA's Non-funded income (NFI) growth came in at 25.9%, higher than the industry average of 17.1%, mainly supported by the 14.4% increase in fees and commissions on loans to Kshs 9.4 bn from Kshs 8.2 bn in FY'2018,
b. The bank's NFI to total operating income came in at 60.0% compared to the industry average of 32.6%, meaning that a significant portion of the bank's revenue came from non-interest income,
c. The bank's asset quality deteriorated, with NPL ratio deteriorating to 12.6% in FY'2019 from 11.3% in FY'2018. The deteriorating NPL ratio is attributable to the faster 16.5% growth in gross non-performing loans, which outpaced the 4.7% growth in gross loans (after adding back interest suspense).

Going forward, we expect the bank's growth to be further driven by:

a. The completed merger has enabled NCBA capitalize on the strengths of the previous entities. We expect the value or "dividends" from the merger to be experienced in 2020

For a comprehensive analysis, please see our NCBA Group FY'2019 Earnings Note.

The table below summarizes the performance of listed banks that have released their FY'2019 results:

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-Funded Income Growth	NFI to Total Operating Income	Growth in Total Fees & Commissions	Deposit Growth	Growth in Government Securities	Loan to Deposit Ratio	Loan Growth	Return on Average Equity
I&M	26.6%	4.5%	12.0%	(0.5%)	6.3%	9.1%	34.8%	5.0%	7.6%	3.4%	76.3%	5.2%	19.5%
ABSA	21.2%	6.8%	11.0%	5.4%	7.7%	9.1%	31.4%	8.8%	14.6%	32.3%	82.0%	9.9%	16.7%
Equity	13.8%	12.2%	24.8%	8.6%	8.5%	19.0%	40.6%	16.1%	14.2%	6.2%	75.9%	23.3%	22.8%
COOP	12.4%	1.4%	0.8%	1.7%	8.5%	33.1%	5.9%	34.7%	8.7%	46.8%	80.1%	8.7%	19.2%
KCB	3.6%	12.2%	4.4%	15.0%	8.2%	22.6%	33.4%	39.0%	27.7%	41.0%	78.0%	17.4%	20.4%
SCBK	1.7%	(5.9%)	(22.4%)	0.4%	7.4%	0.3%	32.2%	(4.7%)	1.8%	0.9%	56.3%	8.5%	17.5%
DTBK	1.6%	(6.9%)	(7.3%)	(6.5%)	5.6%	6.2%	23.6%	3.1%	(0.9%)	12.9%	71.1%	3.1%	12.9%
Stanbic	1.6%	8.1%	7.1%	10.7%	5.2%	14.0%	46.1%	11.7%	2.4%	(12.7%)	85.1%	9.3%	13.6%
NCBA	(12.4%)	(34.1%)	(34.0%)	(34.2%)	3.3%	25.9%	60.0%	14.4%	10.9%	11.8%	65.9%	4.1%	11.8%
FY'19 Mkt Weighted Average*	**9.6%**	**5.0%**	**5.2%**	**5.1%**	**7.5%**	**17.1%**	**32.6%**	**18.5%**	**12.9%**	**19.7%**	**75.4%**	**13.4%**	**19.0%**
FY'18 Mkt Weighted Average**	**13.8%**	**6.5%**	**10.6%**	**2.6%**	**7.9%**	**3.8%**	**33.2%**	**(1.0%)**	**10.3%**	**9.1%**	**75.5%**	**4.3%**	**19.0%**

***Market cap weighted as at 27/03/2020**

****Market cap weighted as at 31/12/2018**

The key take-outs from the table above include:

i. Nine banks have released their FY'2019 financial results, recording a 9.6% average increase in core Earnings Per Share (EPS), compared to a growth of 13.8% in FY'2018 for the entire banking sector,
ii. The banks that have released results have recorded a deposit growth of 12.9%, faster than the 10.3% growth recorded in FY'2018. Despite the relatively fast deposit growth, interest expenses growth of 5.2% was slower than the 10.6% growth recorded in FY'2018, indicating that banks have been able to mobilize relatively cheaper deposits after the September 2018 implementation of the Finance Act 2018, which saw the removal of the minimum interest rate payable on deposits, which stood at 70.0% of the Central Bank Rate (CBR). This helped mitigate high increments in interest expense, despite the relatively fast deposit growth,
iii. Average loan growth came in at 13.4%, which was faster than the 4.3% recorded in FY'2018, indicating that there was an improvement in credit extension, with banks targeting select segments such as corporate entities and Small and Medium Enterprises (SMEs), the growth in loans was accelerated towards the tail end of FY'2019 following the repeal of interest rate cap in November 2019. Government securities, on the other hand, recorded a growth of 19.7% y/y, which was faster compared to the loans and the 9.1% growth recorded in FY'2018. This highlights banks' continued preference towards investing in government securities, which offer better risk-adjusted returns. Interest income increased by 5.0%, compared to a growth of 6.5% recorded in FY'2018. The growth in interest income, albeit slower than the 6.5% recorded in FY'2018, may be attributable to the 13.4% growth in loans and increased allocation to government securities. Consequently, the Net Interest Margin (NIM) now stands at 7.5%, compared to the 7.9% recorded in FY'2018 for the whole banking sector, and,
iv. Non-Funded Income grew by 17.1% y/y, faster than 3.8% recorded in FY'2018. The growth in NFI was supported by the 18.5% average increase in total fee and commission income, which was faster than the (1.0%) growth recorded in FY'2018.

Universe of Coverage

Banks	Price at 20/03/2020	Price at 27/03/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank	90.0	81.8	(9.2%)	(25.0%)	109.0	189.0	3.3%	104.9%	**0.4x**	**Buy**
Kenya Reinsurance	2.3	2.2	(3.9%)	(26.4%)	3.0	4.8	4.9%	94.7%	**0.2x**	**Buy**
I&M Holdings***	46.2	49.8	7.8%	(7.8%)	54.0	75.2	5.1%	67.5%	**0.7x**	**Buy**
KCB Group***	40.6	35.0	(13.7%)	(35.2%)	54.0	64.2	10.0%	60.5%	**0.9x**	**Buy**

Banks	Price at 20/03/2020	Price at 27/03/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/ TBv Multiple	Recommendation
Sanlam	15.0	13.9	(7.7%)	(19.5%)	17.2	21.7	0.0%	55.6%	**0.6x**	**Buy**
Jubilee Holdings	296.0	250.0	(15.5%)	(28.8%)	351.0	453.4	3.6%	53.5%	**0.8x**	**Buy**
Co-op Bank* **	12.8	12.1	(5.1%)	(26.0%)	16.4	18.1	8.3%	44.9%	**0.9x**	**Buy**
Equity Group* **	39.0	33.2	(14.8%)	(37.9%)	53.5	56.7	7.5%	42.9%	**1.2x**	**Buy**
Liberty Holdings	8.2	8.4	2.9%	(18.5%)	10.4	10.1	5.9%	37.6%	**0.7x**	**Buy**
NCBA	28.3	26.4	(6.5%)	(28.4%)	36.9	37.0	6.6%	30.2%	**0.6x**	**Buy**
ABSA Bank* **	11.0	9.8	(10.7%)	(26.4%)	13.4	13.0	11.2%	23.3%	**1.2x**	**Buy**
Standard Chartered	193.3	178.3	(7.8%)	(12.0%)	202.5	211.6	11.2%	22.6%	**1.4x**	**Buy**
Stanbic Holdings	99.0	92.0	(7.1%)	(15.8%)	109.3	103.1	7.7%	15.6%	**0.9x**	**Accumulate**
CIC Group	2.3	2.3	(0.4%)	(14.6%)	2.7	2.6	0.0%	13.3%	**0.8x**	**Accumulate**
HF Group	4.2	4.2	(0.5%)	(35.6%)	6.5	4.2	0.0%	1.9%	**0.2x**	**Lighten**
Britam	6.8	6.5	(4.1%)	(28.0%)	9.0	6.8	0.0%	(0.7%)	**0.7x**	**Sell**

***Target Price as per Cytonn Analyst estimates**
****Upside/ (Downside) is adjusted for Dividend Yield**
*****Banks in which Cytonn and/or its affiliates are invested in**

We are "Positive" on equities for investors as the sustained price declines have seen the market P/E decline to below its historical average. We expect increased market activity, and possibly increased inflows from foreign investors, as they take advantage of the attractive valuations, to support the positive performance.