Financial Planning Amidst COVID-19, & Cytonn Weekly #26/2020

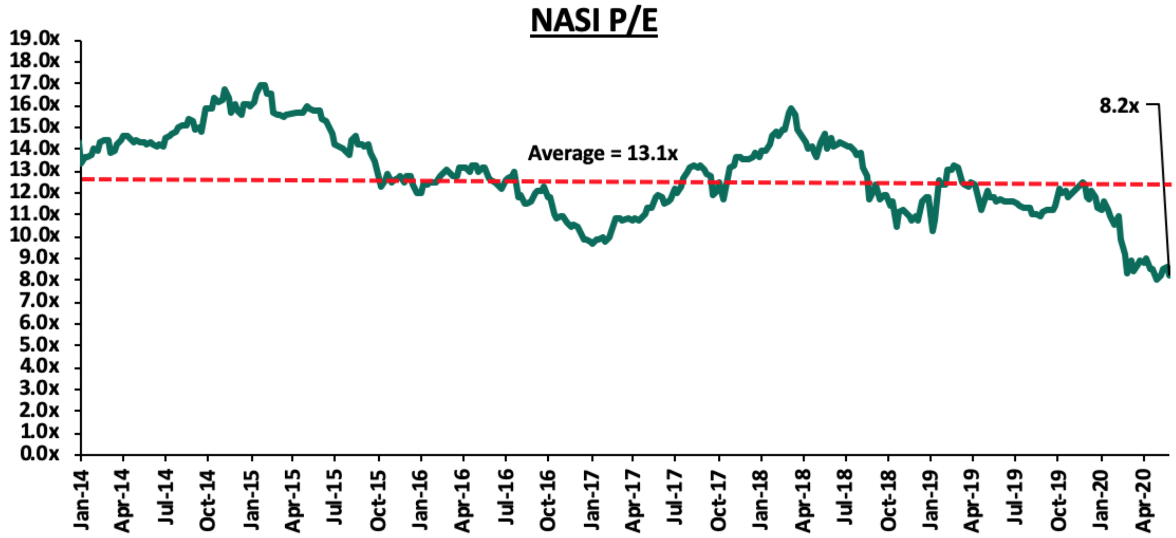
Equities

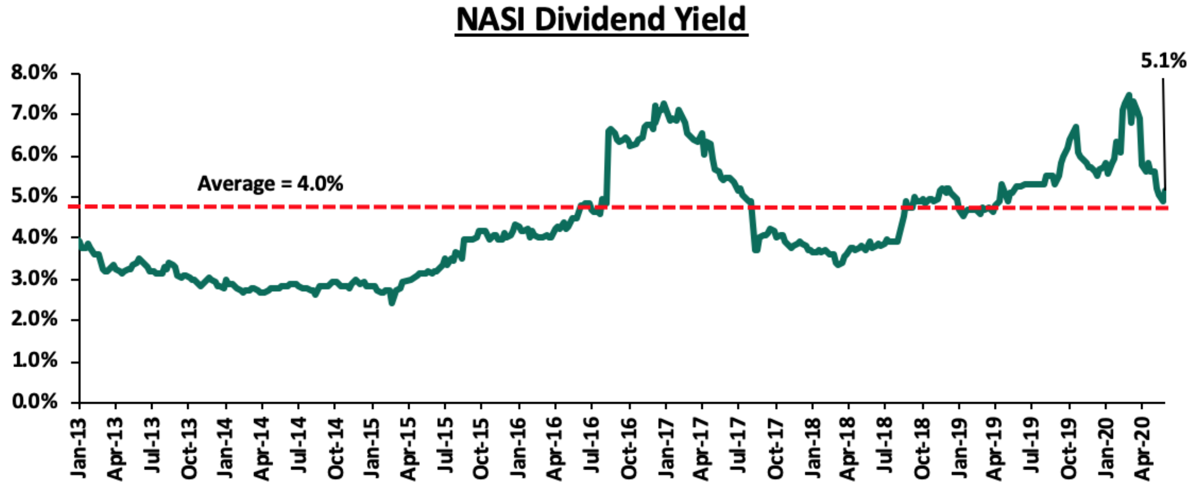
Markets Performance

During the week, the equities market was on a downward trajectory, with NASI, NSE 20 and NSE 25 recording declines of 4.7%, 1.6% and 3.0%, respectively, taking their YTD performance to losses of 17.2%, 27.0%, and 21.2%, for NASI, NSE 20 and NSE 25, respectively. The NASI performance was driven by losses recorded by large-cap stocks such as Bamburi, Safaricom, EABL, Equity Group, and NCBA, which lost by 20.3%, 7.8%, 2.9%, 2.2% and 1.6%, respectively. The loss was however slowed down by gains recorded by other large-cap stocks such as DTBK, ABSA and BAT of 2.9%, 2.4% and 1.3%, respectively.

Equities turnover declined by 14.0% during the week to USD 26.1 mn, from USD 30.3 mn recorded the previous week, taking the YTD turnover to USD 803.0 mn. Foreign investors remained net sellers during the week, with a net selling position of USD 12.3 mn, from a net selling position of USD 0.5 mn recorded the previous week, taking the YTD net selling position to USD 213.7 mn.

The market is currently trading at a price to earnings ratio (P/E) of 8.2x, 37.5% below the historical average of 13.1x. The average dividend yield is currently at 5.1%, an increase from the 4.9% recorded the previous week, and 1.1% points above the historical average of 4.0%. The increase in dividend yield is mainly attributable to price declines recorded by most stocks during the week. With the market trading at valuations below the historical average, we believe there are pockets of value in the market for investors with higher risk tolerance and are willing to wait out the pandemic. The current P/E valuation of 8.2x is 2.0% above the most recent valuation trough of 8.0x experienced in the last week of May 2020. The charts below indicate the historical P/E and dividend yields of the market.





Weekly Highlight

During the week, Equity Group announced it had mutually agreed with Atlas Mara to call off plans to acquire banking assets in four countries in exchange for shares in Equity Group. This follows a January announcement by the board of Equity Group announcing the extension of discussions between the Group and Atlas Mara after the expiry of the transaction period before the two parties could sign a detailed transaction agreement. During the extended period, the two parties were to continue further discussions to try to reach mutually acceptable commercial terms with respect to the proposed transaction or a variant of it. The lender had entered into a binding term sheet in 2019 with Atlas Mara Limited to acquire:

I. 62.0% of the share capital of Banque Populaire du Rwanda (BPR);
II. 100.0% of the share capital of Africa Banking Corporation Zambia (ABCZam) Ltd.;
III. 100.0% of the share capital of Africa Banking Corporation Tanzania (ABCTz); and,
IV. 100.0% of the share capital of Africa Banking Corporation Mozambique Ltd (ABCMoz).

The transaction was to be funded by a share swap whereby Atlas Mara would be allotted 252.5 mn shares of Equity Group, equivalent to a 6.7% stake valued at about Kshs 8.9 bn using the closing price of Kshs 35.1 on 26th June 2020 and effectively valuing Equity Group at Kshs 132.3 bn. As part of its growth strategy, Equity Group had undertaken to expand its regional footprint by leveraging on its strong retail banking expertise as well as its strong digital banking capability via its subsidiary- Finserve.

In our view, the bank's geographical diversification strategy has continued to emerge as a net positive, with the bank's various subsidiaries in Uganda, DRC, Rwanda, and South Sudan cumulatively contributing 25.0% of the bank's total profitability and 28.0% of the group's total asset base in Q1'2020. However, the completion of the Atlas Mara deal would have caused a strain on the balance sheet of Equity Group given the current tough operating environment and the poor performance of some of its subsidiaries especially the Tanzanian subsidiary, which recorded a loss of Kshs 0.07 bn in Q1'2020 from Kshs 0.10 bn in Q1'2019. We are of the view that the drop off plan is commendable and in line with the Group's strategy of exercising prudence, aimed at preserving capital in the wake of the COVID-19 pandemic. Key to note, according to Atlas Mara's Banking components results for the year ended 31 December 2019, of the four banks Equity Group was to acquire, there was an improvement in performance in Rwanda, and underperformance in Mozambique, Tanzania, and Zambia, attributable to challenging macroeconomic and market environment, thus underpinning the major concerns in Equity's regional expansion to those countries.

During the week, Equity Group also announced it would pay the final Kshs 2.1 bn for acquisition of a 66.5% controlling stake in Banque Commerciale du Congo (BCDC), over 2 years. In a move aimed at protecting Equity Group against potential unforeseen liabilities in the target company, the Kshs 2.1

bn will be kept in an escrow account (an account where funds are held in trust while two or more parties complete a transaction), with part of the funds being released to the George Arthur Forest family, a year after the completion date of the deal, provided Equity does not encounter new liabilities in BCDC, while the remaining balance will be released after 2 years. In a circular to its shareholders, Equity Group also disclosed the agreement provides for a claims mechanism that enables the Group to seek compensation in certain circumstances post-completion. In our view, the approach by Equity Group will ensure its investors are able to get value from the acquisition and ensure Equity's expansion into DRC continues to contribute positively to the Group.

During the week, Jamii Bora Bank (JBB), disclosed Co-operative bank had offered an initial Kshs 1.0 bn for a 90.0% stake in Jamii Bora Bank, effectively valuing Jamii Bora Bank at Kshs 1.1 bn. The offer from Co-operative bank is a variation of the earlier discussion of a 100.0% buyout as highlighted in our Cytonn Weekly #25/2020. Details of the implied transaction are as follows;

I. The transaction will involve the issuance of additional 224.1 mn new Class A shares to Co-operative bank, subject to Co-operative Bank paying the aggregate subscription price of Kshs 1.0 bn, effectively valuing the new shares at Kshs 4.46 per share,
II. The existing issued 24.9 mn shares in JBB of Kshs 66.0 per share will be reclassified to Class B and will retain their existing rights. This will increase JBB's total shares outstanding to 249.0 mn shares from the current 24.9 mn shares, and current shareholders will be diluted to 10.0%,
III. As at Q1'2018 (last time JBB released its financial results), JBB had a book value of Kshs 3.4 bn. As such the implied transaction is being carried out at a price-to-book value (P/Bv) of 0.3x, which is a 70.0% discount to the current listed banks trading book value of 1.0x, and 78.6% below the historical average P/Bv of 1.4x for the Kenyan Bank transactions in the last 5 years.

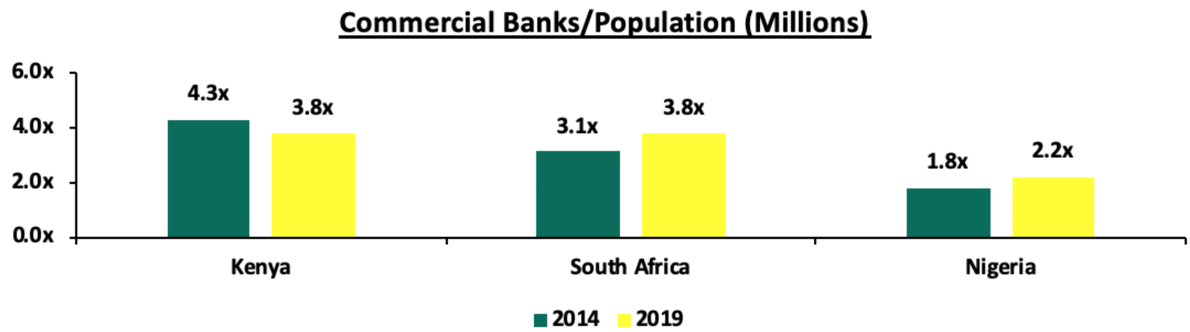
The acquisition of the bank at a discount is reflective of Jamii Bora Bank's financial performance, having recorded losses of Kshs 51.3 mn in Q1'2018, and Kshs 96.8 mn in Q1'2017, coupled with the Bank's capital position. In our view, the acquisition will have little impact on increasing Co-operative bank's market share and is more likely a rescue deal. The table below highlights the various transactions in the banking sector in the last 5-years that have either happened, been announced or expected to be concluded:

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	90.0%	1.0	0.3x	Mar-20**
Commercial International Bank	Mayfair Bank Limited	1.0	51.0%	Undisclosed	N/A	May-20*
Access Bank PLC (Nigeria)	Transnational Bank PLC.	1.9	100.0%	Undisclosed	N/A	Feb-20*
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

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs. Bns)	Transaction Stake	Transaction Value	P/Bv Multiple	Date
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**	

***Announcement date**
****Deals that were dropped**

The number of commercial banks in Kenya will be 38, compared to 43 banks from 5-years ago. The ratio of the number of banks per 10.0 million people in Kenya now stands at 3.8x, compared with a ratio of 4.3x, 5 years ago. However, despite the ratio improving, Kenya still remains overbanked as the number of banks remains relatively high compared to the population. The chart below highlights the ratio of the number of banks per 10.0 mn people in Kenya, South Africa and Nigeria



We believe that continued bank consolidation efforts in Kenya, as highlighted in our Q1’2020 Banking Report, will lead to a stable banking sector, as consolidation continues to eliminate weaker banks. In our view, banks will continue to consolidate to form strategic partnerships and well-capitalized entities capable of navigating the relatively tough operating environment induced by stiff competition.

Universe of Coverage:

Company	Price at 19/06/2020	Price at 26/06/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank* **	68.0	70.0	2.9%	(35.8%)	109.0	175.0	3.9%	153.9%	**0.4x**	**Buy**
Kenya Reinsurance	2.2	2.2	0.9%	(26.7%)	3.0	4.6	5.0%	112.2%	**0.2x**	**Buy**
KCB Group* **	36.2	36.4	0.7%	(32.6%)	54.0	56.2	10.0%	64.4%	**0.9x**	**Buy**
I&M Holdings* **	48.3	50.0	3.6%	(7.4%)	54.0	76.3	5.1%	57.7%	**0.8x**	**Buy**
Co-op Bank* **	12.5	12.5	0.0%	(23.5%)	16.4	18.0	8.2%	52.2%	**1.0x**	**Buy**
Stanbic Holdings	82.0	82.0	0.0%	(24.9%)	109.3	111.2	9.2%	44.8%	**1.0x**	**Buy**
Equity Group* **	35.9	35.1	(2.2%)	(34.5%)	53.5	50.7	0.0%	44.7%	**1.2x**	**Buy**

Company	Price at 19/06/2020	Price at 26/06/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
ABSA Bank* **	9.9	10.1	2.4%	(24.3%)	13.4	13.2	11.1%	41.8%	**1.3x**	**Buy**
Jubilee Holdings	250.0	250.0	0.0%	(28.8%)	351.0	334.8	3.5%	37.4%	**0.9x**	**Buy**
Liberty Holdings	7.9	7.2	(8.6%)	(30.2%)	10.4	9.8	0.0%	36.2%	**0.7x**	**Buy**
Sanlam	13.6	13.7	0.7%	(20.6%)	17.2	18.4	0.0%	34.8%	**1.3x**	**Buy**
NCBA* **	27.5	27.1	(1.6%)	(26.6%)	36.9	35.6	0.9%	32.5%	**0.8x**	**Buy**
Standard Chartered* **	167.5	167.0	(0.3%)	(17.5%)	202.5	202.7	7.4%	28.7%	**1.5x**	**Buy**
Britam	8.5	7.8	(7.8%)	(13.3%)	9.0	7.6	2.6%	0.0%	**0.7x**	**Sell**
CIC Group	2.3	2.3	2.2%	(14.2%)	2.7	2.1	0.0%	(8.7%)	**0.8x**	**Sell**
HF Group	4.0	4.5	13.3%	(29.9%)	6.5	4.0	0.0%	(11.7%)	**0.2x**	**Sell**

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

We are "Neutral" on equities for investors because, despite the sustained price declines, which have seen the market P/E decline to below its historical average presenting investors with attractive valuations in the market, the economic outlook remains grim.

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