Financial Planning For Retirement, & Cytonn Weekly #33/2020

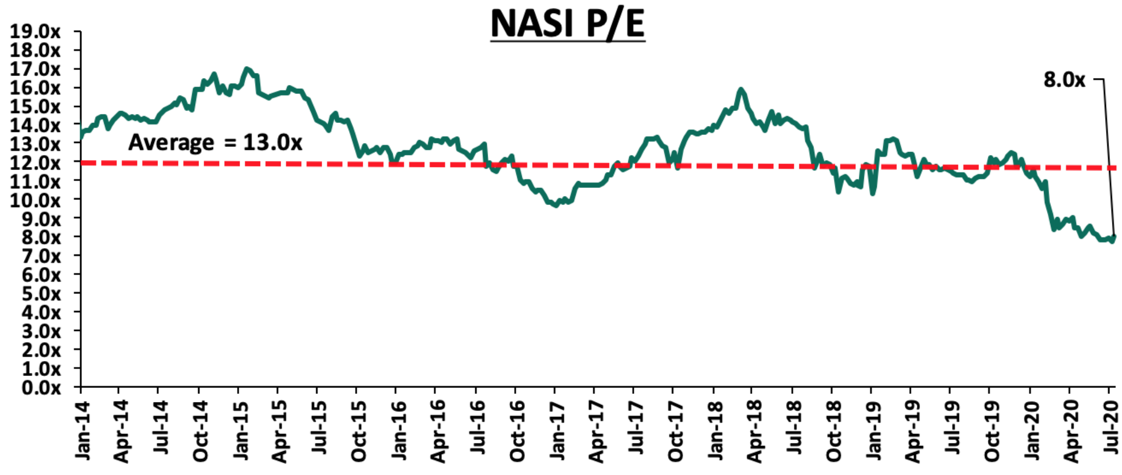
Equities

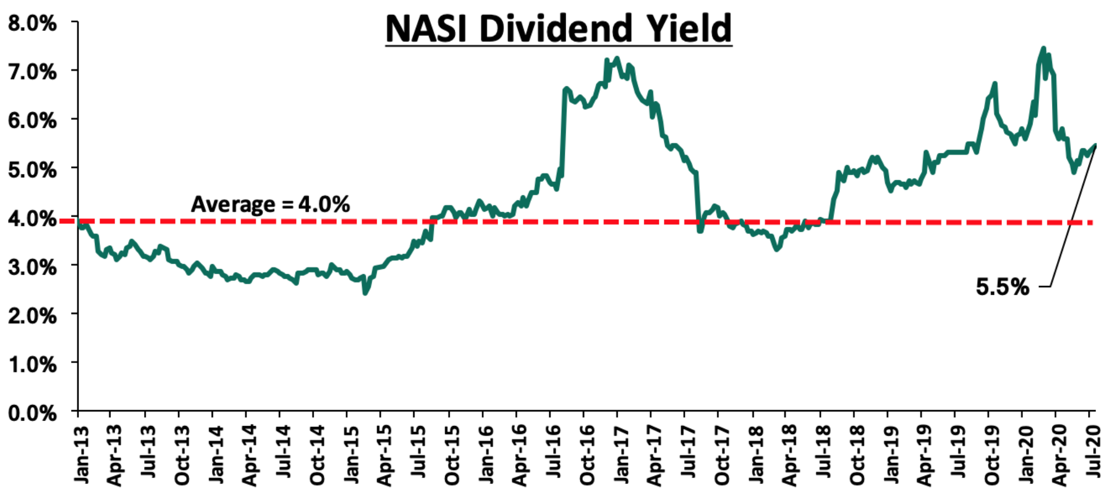
Market Performance

During the week, the equities market was on a downward trend, with NSE 20, NASI and NSE 25 recording declines of 0.8%, 0.9% and 1.7%, respectively, taking their YTD performance to losses of 22.2%, 34.3%, and 28.3%, for NASI, NSE 20 and NSE 25, respectively. The NASI performance was driven by declines recorded by large-cap stocks, with the highest declines being recorded in Equity Group, KCB and Diamond Trust Bank, which lost by 8.7%, 7.3%, and 2.5%, respectively.

Equities turnover declined by 43.2% during the week to USD 15.3 mn, from USD 26.9 mn recorded the previous week, taking the YTD turnover to USD 976.5 mn. Foreign investors remained net sellers during the week, with a net selling position of USD 1.1 mn, from a net selling position of USD 1.3 mn recorded the previous week, taking the YTD net selling position to USD 268.0 mn.

The market is currently trading at a price to earnings ratio (P/E) of 8.0x, 38.8% below the 11-year historical average of 13.0x. The average dividend yield is currently at 5.5%, 0.1% points above the 5.4% recorded the previous week and 1.5% points above the historical average of 4.0%. The rise in dividend yield is attributable to price declines recorded by most stocks, however, the dividend yield has been weighed down by the decision by most companies to withhold dividend payments. 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 8.0x is 2.3% above the most recent valuation trough of 7.8x experienced in the second week of July 2020. The charts below indicate the historical P/E and dividend yields of the market.





Weekly Highlight

During the week, Equity Group Holdings completed the 66.5% stake acquisition of the Banque Commerciale Du Congo (BCDC) at a cost of USD 95.0 mn (Kshs 10.3 bn). The acquisition was first announced by the group on 18th November 2019 and was subject to approvals from the Central Bank of Kenya (CBK), Democratic Republic of Congo's Central Bank, the COMESA Competition Commission. Initially, the deal was to cost USD 105.0 mn (Kshs 11.4 bn), however factoring in the adverse effects of the COVID-19 pandemic on the two economies, the two parties agreed to reduce the amount to USD 95.0 mn (Kshs 10.3 bn). Following the change in the pricing, the trading multiple for the transaction will now be at a Price to Book value of 1.2x from the earlier 1.3x. Following the acquisition, BCDC will become Equity Groups subsidiary increasing Equity's subsidiaries in the DRC to two. We believe that the bank's geographical diversification strategy will continue to emerge as a net positive, with the bank's various subsidiaries in Uganda, DRC, Rwanda, Tanzania, and South Sudan cumulatively contributing 25.0% of the bank's total profitability and 28.0% of the group's total asset base as at Q1'2020.

Earnings Releases:

During the week, KCB Group, Co-operative Bank and Stanbic Holdings released their H1'2020 financial results. Below is a summary of their earnings:

KCB Group

Income Statement

- Core earnings per share declined by 40.4% to Kshs 2.4, from Kshs 4.0 in H1'2019, despite a 16.7% growth in total operating income to Kshs 45.0 bn, from Kshs 38.6 bn, as the total operating expenses grew by 56.0% to Kshs 32.2 bn, from Kshs 20.6 bn in H1'2019. The decline in the core earnings per share was lower than our projected decline of 44.8% as the company had a much faster growth of 7% in the total operating income compared to our projection of 3.9% decline,
- Total operating income rose by 16.7% to Kshs 45.0 bn, from Kshs 38.6 bn in H1'2019. This was driven by a 22.3% rise in Net Interest Income (NII) to Kshs 31.1 bn, from Kshs 25.4 bn in H1'2019, coupled with a 6.0% rise in Non-Funded Income (NFI) to Kshs 14.0 bn, from Kshs 13.2 bn in H1'2019,
- Interest income grew by 23.2% to Kshs 41.4 bn, from Kshs 33.6 bn in H1'2019. This was driven by a 63.6% rise in interest income on government securities to Kshs 10.8 bn, from Kshs 6.6 bn in H1'2019, which outpaced the 11.9% rise in interest income on loans and advances to Kshs 30.0 bn, from Kshs 26.8 bn in H1'2019. The yield on interest-earning assets declined to 10.1% from 11.0% in H1'2019 attributable to faster growth in the average interest-earning assets of 32.0%

which outpaced the 21.4% growth in trailing interest income. Trailing interest income, refers to the performance of the interest income for the past 12 consecutive months,

- Interest expense rose by 25.7% to Kshs 10.3 bn, from Kshs 8.2 bn in H1'2019, following a 29.2% rise in interest expense on customer deposits to Kshs 9.3 bn from Kshs 7.2 bn in H1'2019. Interest expense on deposits and placement from banking institutions, rose by 3.1% to Kshs 0.99 bn, from Kshs 0.96 bn in H1'2019. The cost of funds, on the other hand, declined marginally to 2.6% from 3.0% in H1'2019 owing to a faster 31.2% growth in average interest-bearing liabilities, which outpaced the 25.7% rise in the trailing interest expense. Trailing interest expense, refers to the performance of the interest expense for the past 12 consecutive months. The Net Interest Margin (NIM) declined to 7.6% from 8.1% in H1'2019, owing to the faster 32.0% growth in average interest-earning assets, which outpaced the 22.3% growth in Net Interest Income (NII),
- Non-Funded Income (NFI) rose by 6.0% to Kshs 14.0 bn, from Kshs 13.2 bn in H1'2019. The increase was mainly driven by a 14.3% rise in Foreign Exchange trading Income to Kshs 2.4 bn, from Kshs 2.1 bn in H1'2019, coupled with a 4.3% increase in Fees and Commissions from loans and advances to Kshs 4.9 bn, from Kshs 4.7bn in H1'2019. As a result, the revenue mix shifted to 69:31 from 66:34 funded to non-funded income, due to the faster growth in NII compared to NFI,
- Total operating expenses grew by 56.0% to Kshs 32.2 bn, from Kshs 20.6 bn, largely driven by a 263.8% spike in Loan Loss Provisions (LLP) to Kshs 11.0 bn in H1'2020, from Kshs 3.0 bn in H1'2019, coupled with a 12.3% rise in Staff costs to Kshs 10.1 bn in H1'2020, from Kshs 9.0 bn in H1'2019. The increased provisioning levels were witnessed as the Group covered for downgraded facilities, with the expectation of an increase in defaults across sectors, brought about by the COVID-19 pandemic,
- Cost to Income Ratio (CIR) deteriorated to 71.5%, from 53.5% in H1'2019 owing to the faster 56.0% rise in Total Operating Expenses to Kshs 32.2 bn from Kshs 20.6 bn in H1'2019 which outpaced the 16.7% rise in Total Operating Income to Kshs 45.0 bn, from Kshs 38.6 bn in H1'2019. Without LLP however, the cost to income ratio rose to 47.0% from 45.7% in H1'2019, and,
- Profit before tax declined by 28.5% to Kshs 12.8 bn, down from Kshs 17.9 bn in H1'2019 owing to the 263.8% rise in Loan Loss Provisions (LLP) to Kshs 11.0 bn from Kshs 3.0 bn given the poor operating environment due to COVID-19. Profit after tax declined by 40.4% to Kshs 7.6 bn in H1'2020, from Kshs 12.7 bn in H1'2019 with the effective tax rate increasing to 40.9% from 29.1% in H1'2019. The growth in the effective tax rate can be attributed to the 28.5% decline in the profit before tax and the 1.9% increase in total tax to Kshs 5.3 bn from Kshs 5.2 bn in H1'2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 27.7% to Kshs 953.1 bn, from Kshs 746.5 bn in H1'2019. This growth was driven by a 54.5% rise in investment in government and other securities to Kshs 208.5 bn, from Kshs 135.0 bn in H1'2019. The rise in the investments in government securities is mainly due to the bank's cautious stance with regards to lending. The loan book also recorded a 17.0% growth to Kshs 559.9 bn, from Kshs 478.7 bn in H1'2019. The strong balance sheet growth is also partly attributable to KCB consolidating assets following the acquisition of NBK as first published in the Q1'2020 results,
- Total liabilities rose by 30.5% to Kshs 820.9 bn, from Kshs 629.0 bn in H1'2019, driven by a 34.6% increase in customer deposits to Kshs 758.2 bn, from Kshs 563.2 bn in H1'2019, with customer deposits from NBK amounting to Kshs 99.6 bn in H1'2020. Deposits per branch declined by 4.5% to Kshs 2.1 bn from Kshs 2.2 bn in H1'2019, with the number of branches having increased to 359 as at H1'2020, from 258 in H1'2019,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 73.8%, from 85.0% in H1'2019,
- Gross Non-Performing Loans (NPLs) rose by 114.5% to Kshs 83.9 bn in H1'2020, from Kshs 39.1

bn in H1’2019. Consequently, the NPL ratio deteriorated to 13.8%, from 7.8% in H1’2019, due to the faster growth in Gross Non-Performing Loans (NPLs), which outpaced the growth in loans. The rise in non-performing loans was mainly attributable to the poor performance from the MSMEs segment, Corporate Segment, Mortgage segment and Check-off Loans recording NPL Ratios of 14.9%, 12.0%, 10.3% and 2.9%, respectively,

- General Loan Loss Provisions rose by 124.5% to Kshs 36.1 bn, from Kshs 16.1 bn in H1’2019. The NPL coverage thus increased to 56.9%, from 52.7% in H1’2019, due to the faster growth in General Loan Loss Provisions, which outpaced the growth in Gross Non-Performing Loans (NPLs),
- Shareholders’ funds increased by 12.4% to Kshs 132.1 bn in H1’2020, from Kshs 117.5 bn in H1’2019, as retained earnings rose by 11.0% y/y to Kshs 105.2 bn, from Kshs 94.8 bn in H1’2019,
- KCB Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 17.9%, 7.4% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 19.5%, exceeding the statutory requirement by 5.0% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 18.3% while total capital to risk-weighted assets came in at 19.8%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.4%, and a Return on Average Equity (ROaE) of 16.0%.

Key Take-Outs:

1. The group’s Profit after Tax (PAT) declined by 40.4% y/y to Kshs 7.6 bn from Kshs 12.7 bn in H1’2019 attributable to the 56.0% growth in Total Operating expenses to Kshs 32.2 bn from Kshs 20.6 bn. The growth in the Total Operating expenses was mainly attributable to the 263.8% growth in Loan Loss Provisions as the group provisioned for potential loan losses that may arise from the COVID-19 pandemic,
2. The group’s asset quality remains under threat as seen in the increase of the group's Non-Performing Loans (NPL) ratio to 13.8% from 7.8% in H1’2019. The significant rise is attributable to KCB’s acquisition of National Banks’ non-performing loans portfolio of Kshs 28.7 bn. Additionally, given the effects emanating from the pandemic, the rise in non-performing loans was also driven by the poor performance from the MSMEs segment, Corporate Segment Mortgage segment and Check-off Loans recording NPL Ratios of 14.9%, 12.0%, 10.3% and 2.9%, respectively,
3. Loan Loss Provisions increased by 263.8% to Kshs 11.0 bn from Kshs 3.0 bn. The increased provisioning levels were witnessed as the Group provided cover for downgraded facilities, with the expectation of an increase in defaults across sectors, brought about by the COVID-19 pandemic, and,
4. The group has been able to leverage on digital and innovation as seen in the robust growth in the number of transactions performed outside the branch comprising of 79.0% on mobile, 16.0% on agency, Internet and POS and 3.0% on ATMs. This growth can also be attributed to the push to digital transactions and the transaction fee waivers seen during the COVID-19 period.

For a comprehensive analysis, please see our KCB Group H1’2020 Earnings Note

Co-operative Bank

Income Statement

- Core earnings per share (EPS) declined by 3.6% to Kshs 1.05 in H1’2020, from Kshs 1.09 in H1’2019, which was much better than our projections of Kshs 0.8. The decline in the EPS was driven by a 15.7% increase in total operating expenses to Kshs 14.6 bn in H1’2020 from Kshs 12.6 in H1’2019, outweighing the 5.3% increase in total operating income,
- Total operating income increased by 5.3% to Kshs 24.2 bn in H1’2020, from Kshs 23.0 bn in H1’2019. This was mainly due to an 11.6% increase in Net Interest Income (NII) to Kshs 15.9 bn from Kshs 14.3 bn in H1’2019, which was weighed down by the 5.1% decline in Non-Funded

Income (NFI) to Kshs 8.3 bn from Kshs 8.8 bn in H1’2019,

- Interest income rose by 6.8% to Kshs 21.8 bn in H1’2020, from Kshs 20.4 bn in H1’2019. The growth recorded was as a result of a 12.1% increase in interest income from government securities to Kshs 6.2 bn, from Kshs 5.5 bn in H1’2019, as well as a 2.4% rise in interest income from loans and advances to Kshs 15.0 bn from Kshs 14.7 bn in H1’2019. The yield on interest-earning assets, however, declined to 11.5%, from 11.9% in H1’2019 due to the faster 11.6% growth in the average interest-earning assets that outpaced the 6.8% growth in interest income,
- Interest expense declined by 4.4% to Kshs 5.9 bn in H1’2020, from Kshs 6.2 bn in H1’2019, largely due to a 4.7% decline in interest expense from customer deposits to Kshs 5.1 bn from Kshs 5.4 bn in H1’2019. Other interest expenses also declined by 2.1% to Kshs 778.1 mn from Kshs 794.9 mn in H1’2019. Consequently, the cost of funds declined to 3.2%, from 3.7% in H1’2019, owing to a 19.9% rise in interest-bearing liabilities which outpaced the 4.4% decline in interest expenses,
- Non-Funded Income fell by 5.1% to Kshs 8.3 bn in H1’2020, from Kshs 8.8 bn in H1’2019. The decline was mainly driven by a 42.5% drop in fees and commissions on loans to Kshs 0.6 bn, from Kshs 1.1 bn in H1’2019, as well as a 67.5% decline in other income to 0.2 bn from 0.7 bn in H1’2019. The decline in NFI was however mitigated by a 37.2% increase in forex trading income to Kshs 1.3 bn, from Kshs 1.0 bn in H1’2019 as well as other fees and commissions which increased by 2.4% to Kshs 6.2 bn from Kshs 6.0 in H1’2019. As a consequence, the revenue mix shifted to 66:34, from 62:38 in H1’2019 owing to the faster growth in NII,
- Total operating expenses rose by 15.7% to Kshs 14.6 bn in H1’2020, from Kshs 12.6 bn in H1’2019, largely driven by the 57.9% rise in Loan Loss Provisions (LLP) to Kshs 1.9 bn from Kshs 1.2 bn in H1’2019, coupled with a 15.5% rise in staff costs to Kshs 6.6 bn in H1’2020 from Kshs 5.7 bn in H1’2019,
- The Cost to Income Ratio (CIR) deteriorated to 60.1%, from 54.8% in H1’2019, following the faster rise in total operating expenses that outpaced total operating income. Without LLP, the cost to income ratio also deteriorated to 52.4% from 49.6% in H1’2019, and indication of reduced efficiency levels,
- The bank registered a 3.6% decline in profit after tax to Kshs 7.2 bn in H1’2020 from Kshs 7.5 bn in H1’2019. Profit before tax and exceptional items declined by 8.0% to Kshs 9.6 bn from Kshs 10.4 bn in H1’2019, with the effective tax rate declining to 25.0% in H1’2020 from 28.4% seen in H1’2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 19.6% to Kshs 513.9 bn in H1’2020 from Kshs 429.6 bn in H1’2019, mainly attributable to the 28.8% growth in government securities to Kshs 122.4 bn from Kshs 95.0 bn, coupled with a 5.7% growth in net loans and advances to Kshs 272.2 bn in H1’2020 from Kshs 257.6 bn in H1’2019. Placements also rose by 5.8% to Kshs 17.7 bn in H1’2020, from Kshs 16.8 bn,
- Total liabilities grew by 21.0% to Kshs 432.2 bn in H1’2020 from Kshs 357.2 bn in H1’2019 which was largely attributable to a 247.1% rise in placements from banking institutions to Kshs 5.2 bn in H1’2020, from Kshs 1.5 bn, coupled with the 18.9% rise in customer deposits to Kshs 384.6 bn in H1’2020 from Kshs 323.6 bn in H1’2019. Borrowings also recorded a 19.4% increase to Kshs 25.6 bn from Kshs 21.5 bn in H1’2019,
- The slower 5.7% growth in net loans and advances compared to the 18.9% growth in deposits, led to a decline in the loan to deposit ratio to 70.8%, from 79.6% in H1’2019. Deposits per branch remained unchanged at Kshs 2.1 bn as the number of branches remained unchanged at 159 branches,
- Gross Non-Performing Loans (NPLs) increased by 12.3% to Kshs 34.3 bn in H1’2020, from Kshs 30.6 bn in H1’2020. The NPL ratio deteriorated to 11.8% in H1’2020, from 11.2% in H1’2019 owing to slower growth in gross loans by 6.4% compared to the 12.3% growth in gross non-

performing loans,

- General Loan Loss Provisions increased by 20.2% to Kshs 13.1 bn, from Kshs 10.9 bn in H1’2019. The NPL coverage ratio thus improved to 54.6% in H1’2020 from 51.4% in H1’2019, due to the faster growth in General Loan Loss Provisions which outpaced the growth in Gross Non-Performing Loans (NPLs),
- Shareholders’ funds increased by 12.8% to Kshs 80.1 bn in H1’2020 from Kshs 71.0 bn in H1’2019, mainly driven by a 13.0% increase in the retained earnings to Kshs 62.2 bn, from Kshs 70.3 bn in H1’2019,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.3%, 5.8% points above the statutory requirement of 10.5%. Also, the total capital to risk-weighted assets ratio came in at 16.8%, exceeding the statutory requirement of 14.5% by 2.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.9%, while total capital to risk-weighted assets came in at 16.4%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.0%, and a Return on Average Equity (ROaE) of 18.6%.

Key Take-Outs:

1. Total operating expenses grew by 15.7% mainly due to the increase in loan loss provisions by 57.9%, coupled with the 15.5% increase in staff costs. Consequently, the cost to income ratio deteriorated to 60.1% from 54.8% seen in H1’2019. The increase in provisioning levels was expected considering the current situation surrounding the spread of COVID-19. The movement restrictions put in place to curb the virus led to subdued activity in the business environment and loss of jobs came about as a result of the same. Consequently, households and businesses haven’t been able to keep up with their debt obligations and that has resulted in an increase in Non-performing loans, and,
2. The bank’s asset quality deteriorated, with the NPL ratio coming in at 11.8% in H1’2020, from 11.2% in H1’2019, H1’2019 owing to slower growth in gross loans by 6.4% compared to the 12.3% growth in gross non-performing loans. Generally, banks have had to go back to the drawing board to come up with new strategies to manage the worsening asset quality in the wake of the ongoing global pandemic.

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

I. Lending to SMEs: Putting into consideration the current state of affairs in the banking sector, it is evident that the risk factor when lending to businesses has increased significantly. It is, however, key to note that through loan restructurings and increasing their loan book exposure to MSMEs will help support the bank during this period of uncertainty, and,
II. Focus on diversification: The bank’s continued focus on channel diversification will likely continue to help the bank in generating profitability, as they continue to record increased usage and traffic. The focus on branch transformation and innovation centred on alternative channels will continue to drive NFI growth as well as transform braches to handle advisory, wealth management and advisory services,

For a comprehensive analysis, please see our Co-operative Bank H1’2020 Earnings Note

Stanbic Holdings

Income Statement

- Core earnings per share declined by 31.2% to Kshs 6.5, from Kshs 9.4 in H1’2019, which was a larger decline compared to our projections of a decline to Kshs 7.5. The performance was mainly driven by a 60.5% rise in loan loss provisions which came in at Kshs 2.0 bn, from Kshs 1.2 bn recorded in H1’2019, in a move to cater for the increasing loan defaults,
- Total operating income declined by 12.0% to Kshs 10.7 bn in H1’2020, from Kshs 12.2 bn in

H1’2019. This was driven by an 18.8% decline in Non-Funded Income (NFI) to Kshs 4.7 bn, from Kshs 5.8 bn in H1’2019, coupled with a 5.9% decline in Net Interest Income (NII) to Kshs 6.0 bn, from Kshs 6.4 bn in H1’2019,

- Interest income declined by 4.8% to Kshs 9.6 bn, from Kshs 10.1 bn recorded in H1’2019, driven by a 15.5% decline in interest income from government securities to Kshs 2.0 bn, from Kshs 2.3 bn in H1’2019, coupled with the 6.3% decline in interest income from loans and advances to Kshs 7.1 bn, from Kshs 7.6 bn in H1’2019. There was however a 240.2% increase in interest income from other deposits to Kshs 0.5 bn, from Kshs 0.1 bn in H1’2019. The yield on interest-earning assets declined to 4.5% from 4.9% in H1’2019, this is attributable to the 16.8% growth in interest-earning assets compared to the 4.8% decline in Interest Income,
- Interest expense declined by 3.1% to 3.6 bn, from 3.7 bn in H1’2019 mainly due to the 63.1% decline in interest expense from deposits and placements from other banking institutions to Kshs 0.3 bn, from Kshs 0.8 bn in H1’2019, which was distracted by a 12.9% increase in interest expense from deposits to Kshs 2.8 bn, from Kshs 2.5 bn in H1’2019. The Net Interest Margin (NIM) declined to 4.5% from 4.9% in H1’2019. This is attributable to the faster growth in average interest-earning assets by 13.8% compared to the 3.3% growth in the bank’s trailing net interest income,
- Non-Funded Income (NFI) declined by 18.8% to Kshs 4.7 bn, from Kshs 5.8 bn in H1’2019, mainly driven by a 36.7% decline in fees and commissions on loans to Kshs 0.1 bn, from Kshs 0.2 bn in H1’2019, coupled with a 33.1% decline in other fees and commissions to Kshs 1.7 bn, from Kshs 2.5 bn in H1’2019, and a 13.1% decline in other income to Kshs 0.3 bn, from Kshs 0.4 bn in H1’2019. The revenue mix for H1’2020 shifted to 56:44, from 51:49, mainly due to the decline in non-funded income,
- Total operating expenses increased marginally by 1.3% to Kshs 6.8 bn, largely driven by an 83.6% increase in Loan Loss Provisions (LLP) to Kshs 1.7 bn in H1’2020, from Kshs 0.9 bn in H1’2019, which outweighed the 11.7% decline in staff costs to Kshs 5.2 bn, from Kshs 5.8 bn, in H1’2019,
- The cost to income ratio improved to 45.7%, from 58.3% in H1’2019. Without LLP, the Cost to income ratio improved to 28.1% from 48.0% in H1’2019, highlighting the increase in the cost of risk to 17.6%, from 9.9% in H1’2019 as a result of the increase in loan loss provisions, and,
- Profit before tax declined by 20.7% to Kshs 4.1 bn, down from Kshs 5.2 bn in H1’2019. Profit after tax declined by 31.2% to Kshs 2.6 bn in H1’2020, from Kshs 3.7 bn in H1’2019, highlighting the decline in the effective tax rate to 16.1%, from 28.7% in H1’2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 15.4% to Kshs 361.5 bn, from Kshs 313.3 bn in H1’2019. This growth was largely driven by a 32.8% increase in net loans and advances to Kshs 235.1 bn, from Kshs 177.1 bn in H1’2019, coupled with a 20.7% increase in derivative assets to Kshs 2.5 bn, from Kshs 2.0 bn in H1’2019. These increments we’re however weighed down by a 29.1% decline in property and equipment to Kshs 2.3 bn, from Kshs 3.3 bn in H1’2019 attributable to depreciation relating to Stanbic South Sudan based on restated amounts for the effects of hyperinflation, and, a 13.4% decline in investment securities to Kshs 81.5 bn in H1’2020, from Kshs 94.1 bn,
- Total liabilities rose by 17.1% to Kshs 312.2 bn, from Kshs 266.5 bn in H1’2019, driven by a 20.6% increase in total deposits to Kshs 287.0 bn, from Kshs 238.0 bn in H1’2019. On the other hand, borrowings declined by 41.3% to Kshs 5.4 bn, from Kshs 9.2 bn in H1’2019, which include payments to the parent company on syndicated borrowings,
- The faster growth in loans as compared to deposits led to an increase in the loan to deposit ratio to 81.9%, from 74.4% in H1’2018,
- Gross Non Performing Loans (NPLs) increased by 20.2% to Kshs 21.2 bn from Kshs 17.6 bn recorded in H1’2019. The Gross NPL ratio fell to 8.5%, from 9.4% in H1’2019, owing to a faster 32.4% growth in gross loans, compared to the 20.2% growth in gross non-performing loans.

General provisions rose by 20.8% to Kshs 8.6 bn, from Kshs 7.1 bn in H1’2019. As a result, the NPL Coverage increased to 64.8% from 61.7% in H1’2019,
- Shareholders’ funds increased by 5.4% to Kshs 49.3 bn in H1’2020, from Kshs 46.8 bn in H1’2019, mainly driven by the 12.1% increase in retained earnings to Kshs 33.4 bn, from Kshs 29.8 bn in H1’2019,
- Stanbic Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.4%, 4.9% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio stood at 17.9%, exceeding the statutory requirement by 3.4% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.9%, while total capital to risk-weighted assets came in at 18.4%,
- Stanbic Holdings currently has a return on average assets of 1.4% and a return on average equity of 10.0%.

Key Take-Outs:

i. The bank recorded relatively poor performance in both funded and NFI segments evidenced by the 12.0% decline in total operating income to Kshs 10.7 bn in H1’2020, from Kshs 12.2 bn in H1’2019. Non-funded income declined by 18.8% to Kshs 4.7 bn, from Kshs 5.8 bn in H1’2019, while net interest income declined by 5.9% to Kshs 6.0 bn, from Kshs 6.4 bn in H1’2019. This poor performance can be attributed to the current ongoing pandemic which led to the enforcement of movement restrictions which have adversely affected both businesses and households,
ii. The bank’s asset quality has deteriorated significantly with the gross non-performing loans (NPLs) increasing by 20.2% to Kshs 21.2 bn from Kshs 17.6 bn recorded in H1’2019. To curb this, the bank has had to increase its provisioning where general provisions rose by 20.8% to Kshs 8.6 bn, from Kshs 7.1 bn in H1’2019.

Going forward:

i. The bank has put in place plans to promote digitization on the bank’s functions which we believe will improve efficiencies in the bank's activities in a cost-effective manner. They also intend to use the digital platforms to push their ecosystem and help increase adoption in their customer base,

For a comprehensive analysis, please see our Stanbic Holdings H1’2020 Earnings

The table below highlights the performance of the banks that have released so far, showing the performance using several metrics, and the key take-outs of the performance.

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
KCB	(40.4%)	23.2%	25.7%	22.3%	7.6%	6.0%	31.0%	4.3%	34.6%	54.5%	73.8%	17.0%	16.0%
Stanbic	(31.2%)	(4.8%)	(3.1%)	(0.7%)	4.5%	(18.8%)	44.0%	(36.7%)	20.6%	(13.4%)	81.9%	32.8%	10.9%
Co-op	(3.6%)	6.8%	(4.4%)	11.6%	8.4%	(5.1%)	34.3%	(42.5%)	18.9%	28.0%	70.8%	19.4%	18.6%
H1'20 Mkt Weighted Average*	**(26.7%)**	**13.5%**	**11.3%**	**15.2%**	**7.4%**	**(1.5%)**	**34.1%**	**(17.5%)**	**27.2%**	**35.3%**	**74.0%**	**20.2%**	**16.1%**
H1'19Mkt Weighted Average**	**9.0%**	**3.7%**	**5.3%**	**3.8%**	**7.7%**	**16.5%**	**37.2%**	**12.7%**	**8.6%**	**12.1%**	**73.8%**	**9.8%**	**19.3%**

***Market-cap-weighted as at 14/08/2020**

****Market-cap-weighted as at 06/09/2019**

Key takeaways from the table above include:

I. Three banks have released their H1’2020 financial results, recording a (26.7%) average decline in core Earnings Per Share (EPS), compared to a growth of 9.0% in H1’2019 for the entire listed banking sector,
II. The banks that have released results have recorded a deposit growth of 27.2%, faster than the 8.6% growth recorded in H1’2019. Interest expense grew faster by 11.3%, compared to 5.3% in

Q1’2019, indicating that banks struggled to mobilize relatively cheaper deposits amid the ongoing pandemic as most customers prefer liquidity,

III. Average loan growth came in at 20.2%, which was faster than the 9.8% recorded in H1’2019, with the growth in loans being accelerated following the repeal of interest rate cap in November 2019, coupled with increased demand in funding as businesses demand working capital to operate in the tough operating environment as a result of the pandemic. Government securities recorded a growth of 35.3% y/y, which was faster compared to the loans, and the 12.1% growth recorded in H1’2019. This highlights banks’ continued preference towards investing in government securities, which offer better risk-adjusted returns,

IV. Interest income rose by 13.5%, compared to a growth of 3.7% recorded in H1’2019. The faster growth in interest income may be attributable to the 20.2% growth in loans and increased allocation to government securities. Consequently, the Net Interest Margin (NIM) now stands at 7.4%, compared to the 7.7% recorded in H1’2019 for the whole listed banking sector, and,

V. Non-Funded Income declined by 1.5% y/y, slower than 16.5% recorded in H1’2019. The performance in NFI was on the back of declined growth in fees and commission of 17.5%, which was slower than the 12.7% growth recorded in H1’2019. The poor performance of the growth in fees and commission can be attributed to the recent waiver on fees on mobile transactions below Kshs 1,000 and the free bank-mobile money transfer. Banks with a large customer base who rely heavily on mobile money transactions are likely to take the biggest hit.

Universe of Coverage:

Banks	Price at 07/08/2020	Price at 14/08/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank* **	69.0	67.3	(2.5%)	(38.3%)	109.0	136.3	3.9%	106.6%	**0.3x**	Buy
KCB Group* **	33.0	30.6	(7.3%)	(43.4%)	54.0	46.3	9.9%	61.5%	**0.8x**	Buy
I&M Holdings* **	46.3	44.7	(3.5%)	(17.3%)	54.0	66.4	5.1%	53.8%	**0.7x**	Buy
Equity Group* **	31.5	28.8	(8.7%)	(46.3%)	53.5	41.1	0.0%	42.9%	**1.0x**	Buy
NCBA* **	23.2	22.8	(1.7%)	(38.1%)	36.9	32.1	1.0%	41.6%	**0.6x**	Buy
ABSA Bank* **	8.6	9.1	5.1%	(32.1%)	13.4	11.7	12.0%	41.1%	**1.2x**	Buy
Co-op Bank* **	10.3	10.9	5.3%	(33.6%)	16.4	14.3	8.4%	40.1%	**0.8x**	Buy
Standard Chartered* **	151.8	151.0	(0.5%)	(25.4%)	202.5	177.5	7.8%	25.4%	**1.2x**	Buy
Stanbic Holdings	74.5	73.5	(1.3%)	(32.7%)	109.3	84.9	9.0%	24.5%	**0.7x**	Buy
HF Group	3.7	4.0	7.5%	(38.1%)	6.5	3.9	0.0%	(1.4%)	**0.2x**	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 “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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