Fintech Amid COVID-19 & Cytonn Weekly #34/2020

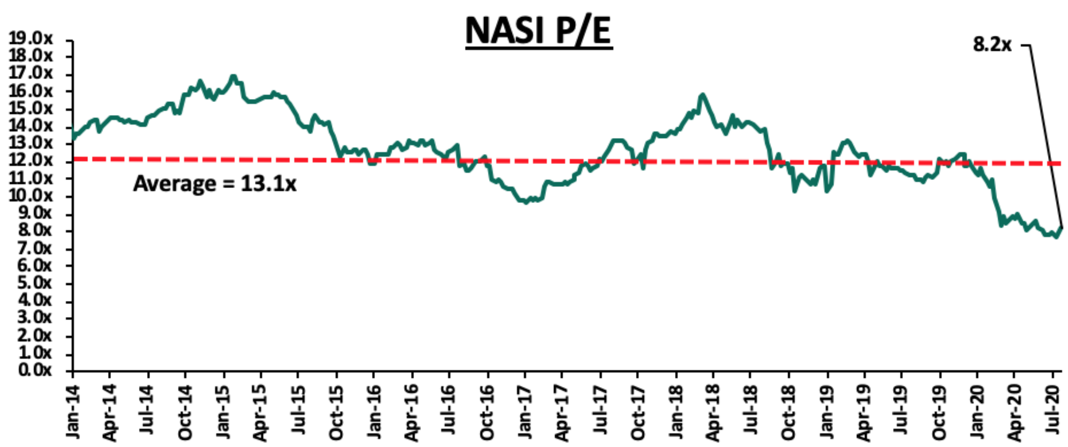
Equities

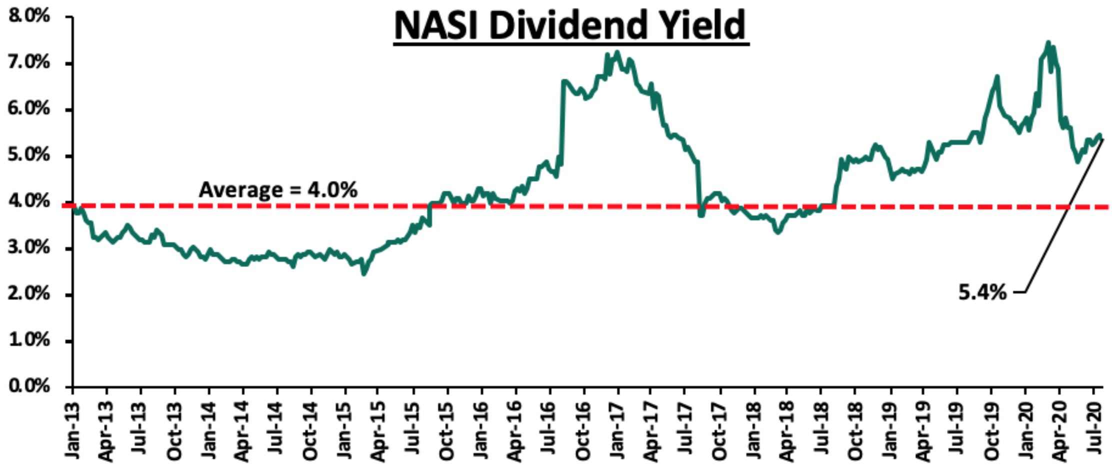
Market Performance

During the week, the equities market recorded mixed performance, with NASI and NSE 25 recording gains of 1.8% and 2.5%, respectively, while NSE 20 recorded a 1.1% loss, taking their YTD performance to losses of 20.8%, 26.5%, and 35.1%, for NASI, NSE 25 and NSE 20, respectively. The NASI performance was driven by gains recorded by large-cap stocks, with the highest gains being recorded in Equity Group, KCB and ABSA, which gained by 14.6%, 10.1%, and 7.9%, respectively. The gains were however weighed down by declines recorded by Bamburi and NCBA of 11.9% and 11.4%, respectively.

Equities turnover increased by 18.6% during the week to USD 18.1 mn, from USD 15.3 mn recorded the previous week, taking the YTD turnover to USD 994.6 mn. Foreign investors remained net sellers during the week, with a net selling position of USD 0.9 mn, from a net selling position of USD 1.1 mn recorded the previous week, taking the YTD net selling position to USD 268.9 mn.

The market is currently trading at a price to earnings ratio (P/E) of 8.2x, 37.1% below the 11-year historical average of 13.0x. The average dividend yield is currently at 5.4%, 0.1% points below the 5.5% recorded the previous week and 1.4% points above the historical average of 4.0%. The decline in dividend yield is attributable to price gains recorded by most stocks. Key to note, the dividend yield has also 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 8.2x is 5.1% above the most recent valuation trough of 7.7x experienced in the first week of August 2020. The charts below indicate the historical P/E and dividend yields of the market.





Weekly Highlight

During the week, the Nairobi Stock Exchange (NSE) reviewed the constituent counters of the NSE 20 and NSE 25, incorporating the inclusion of Stanbic Holdings and Jubilee Holdings PLC in the NSE 20 share index and NSE 25 share Index respectively, and dropping Kenya Airways, effective 14th August 2020. NSE periodically reviews the indices to ensure they give an accurate representation of the performance of the market. NSE 20 represents the top 20 performing counters listed in the NSE while NSE 25 represents the top 25 companies listed on the NSE. NSE 20 Share Index is price weighted using the mean of the top 20 best performing counters while NSE 25 Share Index uses a market capitalization weighted index that represents the performance of companies listed on NSE and as such, providing investors with a comprehensive benchmark to measure the performance of the Kenyan securities market. The table below highlights the criteria used in the selection of companies in the NSE 20 and NSE 25;

Criteria Used for selection of companies in the NSE 20 and NSE 25

#	NSE 20	NSE 25
1	The company must have a minimum Market Capitalization of Kshs 20.0 mn	The company must have a minimum Market Capitalization of Kshs 1.0 bn
2	The company should be blue chip with superior profitability and dividend record. (A blue chip is a company with a track record of superior earnings and a dividend record)	The company should be blue chip with superior profitability and dividend record. (A blue chip is a company with a track record of superior earnings and a dividend record)
3	The company must have at least 20.0% of its shares quoted on the NSE	The company must have at least 20.0% of its shares quoted on the NSE
4	The market capitalization, shares traded, deals/liquidity and turnover during the period under review are weighed in the ratio of 4:3:2:1 respectively	The company's shares must have a primary listing on the NSE
5	Must have been continuously quoted for a least 1 year	Must have been continuously quoted for a least 1 year

Earnings Releases:

During the week, Equity Group released its H1'2020 financial results. Below is a summary of their performance:

Equity Group H1’2020 Key Highlights

Balance Sheet

Balance Sheet Items	H1’2019	H1’2020	y/y change
Government Securities	145.9	181.2	24.2%
Net Loans and Advances	320.9	391.6	22.0%
Total Assets	**638.7**	**746.5**	**16.9%**
Customer Deposits	458.6	543.9	18.6%
Deposits per Branch	1.6	1.8	9.9%
Total Liabilities	535.9	623.1	16.3%
Shareholders’ Funds	**101.8**	**122.2**	**20.1%**

Income Statement

Income Statement Items	H1’2019	H1’2020	y/y change
Net Interest Income	21.1	24.6	16.9%
Net non-Interest Income	16.5	14.4	(13.0%)
Total Operating income	**37.6**	**39.0**	**3.8%**
Loan Loss provision	(0.9)	(8.0)	773.4%
Total Operating expenses	(20.6)	(27.1)	31.1%
Profit before tax	17.0	12.0	(29.5%)
Profit after tax	**12.0**	**9.1**	(24.4%)
Core EPS	**3.2**	**2.4**	(24.4%)

Key Ratios

Ratios	H1’2019	H1’2020	% point change
Yield on Interest Earning Assets	11.0%	10.8%	(0.2%)
Cost of Funding	2.6%	2.9%	0.3%
Net Interest Margin	8.5%	8.1%	(0.4%)
Non-Performing Loans (NPL) Ratio	8.8%	11.0%	2.2%
NPL Coverage	44.6%	48.5%	3.9%
Cost to Income with LLP	54.8%	69.3%	14.5%
Loan to Deposit Ratio	70.0%	72.0%	2.0%
Cost to Income Without LLP	52.4%	48.8%	(3.6%)
Return on Average Assets	3.5%	2.8%	(0.7%)
Return on Average Equity	22.1%	17.5%	(4.6%)

Key take-outs from the earnings release include;

i. Core earnings per share declined by 24.4% to Kshs 2.4, from Kshs 3.2 in H1’2019, worse than our projections of a 15.2% decline to Kshs 2.7. The performance was driven by a 31.1% increase in total operating expenses, outpacing the 3.8% growth recorded in total operating income. The variance in core earnings per share growth against our expectations was largely due to the 773.4% rise in Loan Loss Provisions (LLPs) to Kshs 8.0 bn, from Kshs 0.9 bn in H1’2019, which was higher than our expectation of a 389.3% increase to Kshs 4.5 bn,

ii. Interest income rose by 18.5% to Kshs 32.8 bn, from Kshs 27.7 bn in H1’2019. This was driven by a 20.8% increase in interest income on loans and advances to Kshs 22.5 bn, from Kshs 18.6 bn in H1’2019, coupled with a 14.8% increase in interest income on government securities to Kshs 9.8 bn, from Kshs 8.5 bn in H1’2019. The slightly stronger growth in interest income on loans as compared to interest from government securities is indicative of the benefits accruing to Equity Group Holding’s strategy to increase lending to the private sector, focusing on Small and Medium Enterprises,
iii. The yield on interest-earning assets declined marginally to 10.8%, from 11.0% in H1’2019, due to the faster 18.1% growth in average interest- earning assets, which outpaced the 16.7% growth in trailing interest income,
iv. Interest expenses rose by 23.6% to Kshs 8.2 bn from Kshs 6.6 bn in H1’2019, following the 17.7% increase in the interest expense on customer deposits to Kshs 6.1 bn, from Kshs 5.2 bn in H1’2019, coupled with a 71.4% increase in other interest expenses to Kshs 1.8 bn, from Kshs 1.0 bn in H1’2019. Cost of funds rose to 2.9%, from 2.6% in H1’2019, owing to the faster 23.6% increase in interest expense, which outpaced the 16.1% increase in average interest-bearing liabilities to Kshs 558.8 bn, from Kshs 480.4 bn in H1’2019,
v. Net Interest Margin (NIM) on the other hand, declined to 8.1% from 8.5% in H1’2019, owing to the faster 18.1% growth in average interest earning assets which outpaced the 16.9% growth in Net Interest Income (NII),
vi. Total operating expenses rose by 31.1% to Kshs 27.1 bn, from Kshs 20.6 bn in H1’2019, largely driven by a 773.4% increase in Loan Loss Provisions (LLP) to Kshs 8.0 bn, from Kshs 0.9 bn in H1’2019, on the back of the subdued business environment, coupled with a 13.0% rise in staff costs to Kshs 6.7 bn, from Kshs 6.0 bn in H1’2019,
vii. The balance sheet recorded an expansion as total assets increased by 16.9% to Kshs 746.5 bn, from Kshs 638.7 bn in H1’2019. The growth was supported by a 24.2% increase in the government securities to Kshs 181.2 bn, from Kshs 145.9 bn, coupled with a 22.0% increase in loan book to Kshs 391.6 bn from Kshs 320.9 bn in H1’2019. The growth was subdued by a 1.5% decrease in placements to Kshs 44.5 bn, from Kshs 45.2 bn in H1’2019,
viii. Total liabilities rose by 16.3% to Kshs 623.1 bn from Kshs 535.9 bn in H1’2019, driven by an 18.6% increase in customer deposits to Kshs 543.9 bn, from Kshs 458.6 bn in H1’2019. Deposits per branch increased by 9.9% to Kshs 1.8 bn, from Kshs 1.6 bn in H1’2019, with the number of branches increasing by 9 to 300 branches in H1’2020, from 291 in H1’2019. Borrowings recorded a growth of 11.3% to Kshs 57.2 bn, from Kshs 51.4 bn in H1’2019, and,
ix. Gross Non-Performing Loans (NPLs) rose by 55.8% to Kshs 45.6 bn in H1’2020, from Kshs 29.2 bn in H1’2019. Consequently, the NPL ratio deteriorated to 11.0% in H1’2020, from 8.8% in H1’2019, attributable to a faster 55.8% growth in Non-Performing Loans, which outpaced the 23.9% growth in gross loans,

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

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%
Equity	(24.4%)	18.5%	23.6%	16.9%	8.1%	(13.0%)	36.9%	(10.8%)	18.6%	24.2%	72.0%	22.0%	17.5%
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*	**(26.4%)**	**15.7%**	**16.5%**	**16.1%**	**7.7%**	**(5.7%)**	**35.1%**	**(14.1%)**	**24.2%**	**31.6%**	**73.3%**	**20.8%**	**16.6%**

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H1'19Mkt Weighted Average**	9.0%	3.7%	5.3%	3.8%	7.70%	16.5%	37.2%	12.7%	8.6%	12.1%	73.8%	9.8%	19.3%

***Market-cap-weighted as at 21/08/2020**

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

Key takeaways from the table above include:

i. Four banks have released their H1'2020 financial results, recording a (26.4%) 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 24.2%, faster than the 8.6% growth recorded in H1'2019. Interest expense, on the other hand, grew faster by 16.5%, compared to 5.3% in Q1'2019. Cost of funds, however, declined, coming in at a weighted average of 2.9% in H1'2020, owing to the faster growth in average interest-bearing liabilities, an indication that the listed banks were able to mobilize cheaper deposits,

iii. Average loan growth came in at 20.8%, which was faster than the 9.8% recorded in H1'2019, but slower than the 31.6% growth in government securities, an indication of the banks preference in investing in Government securities as opposed to lending during the COVID-19 pandemic. Government securities recorded a growth of 31.6% y/y, which was faster compared to the loans, and the 12.1% growth recorded in H1'2019,

iv. Interest income rose by 15.7%, compared to a growth of 3.7% recorded in H1'2019. The faster growth in interest income may be attributable to the 20.8% growth in loans and increased allocation to government securities. Despite the rise in interest income, the yield on interest earning assets declined to 10.1% due to the faster 21.1% growth in average interest earning assets which outpaced the 15.7% growth in interest income. Consequently, the Net Interest Margin (NIM) now stands at 7.66%, compared to the 7.70% recorded in H1'2019 for the whole listed banking sector, and,

v. Non-Funded Income declined by 5.7% y/y, slower than 16.5% growth recorded in H1'2019. The performance in NFI was on the back of declined growth in fees and commission of 14.1%, 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 14/08/2020	Price at 21/08/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank***	67.3	66.0	(1.9%)	(39.4%)	109.0	136.3	3.9%	110.4%	0.3x	Buy
NCBA***	22.8	20.2	(11.4%)	(45.2%)	36.9	32.1	1.0%	59.7%	0.6x	Buy
I&M Holdings***	44.7	43.0	(3.7%)	(20.4%)	54.0	66.4	5.1%	59.5%	0.7x	Buy
KCB Group***	30.6	33.7	10.1%	(37.7%)	54.0	46.3	9.9%	47.5%	0.8x	Buy
Co-op Bank***	10.9	10.5	(3.2%)	(35.8%)	16.4	14.3	8.4%	44.5%	0.8x	Buy
ABSA Bank***	9.1	9.8	7.9%	(26.7%)	13.4	11.7	12.0%	31.6%	1.2x	Buy
Standard Chartered***	151.0	150.0	(0.7%)	(25.9%)	202.5	177.5	7.8%	26.1%	1.2x	Buy
Equity Group***	28.8	33.0	14.6%	(38.4%)	53.5	41.1	0.0%	24.7%	0.9x	Buy
Stanbic Holdings	73.5	74.5	1.4%	(31.8%)	109.3	84.9	9.0%	23.0%	0.7x	Buy
HF Group	4.0	4.1	1.8%	(37.0%)	6.5	3.9	0.0%	(3.1%)	0.2x	Sell

***Target Price as per Cytonn Analyst estimates**
****Upside/ (Downside) is adjusted for Dividend Yield**
*****For Disclosure, these are 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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