Unit Trust Funds Performance, Q2’2020, & Cytonn Weekly #46/2020

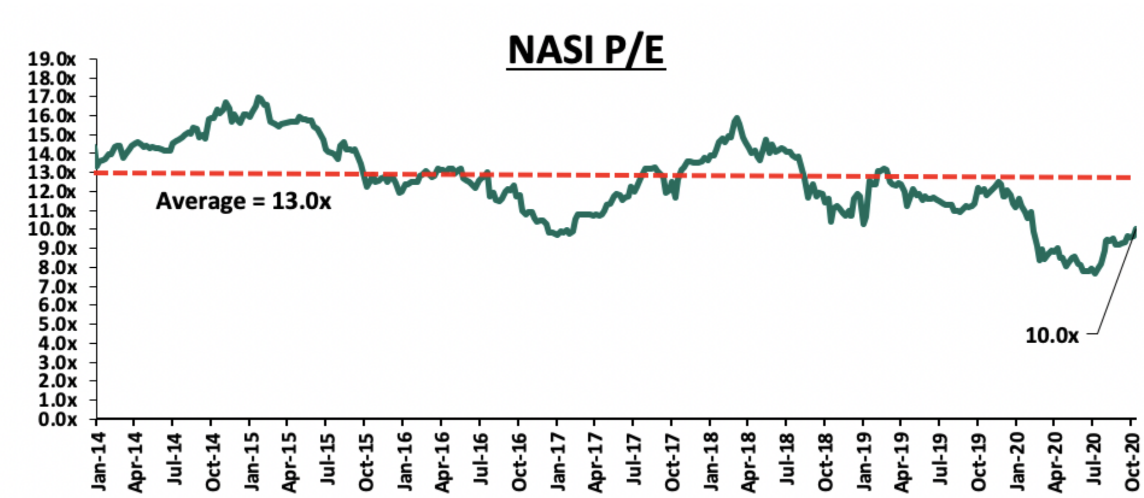
Equities

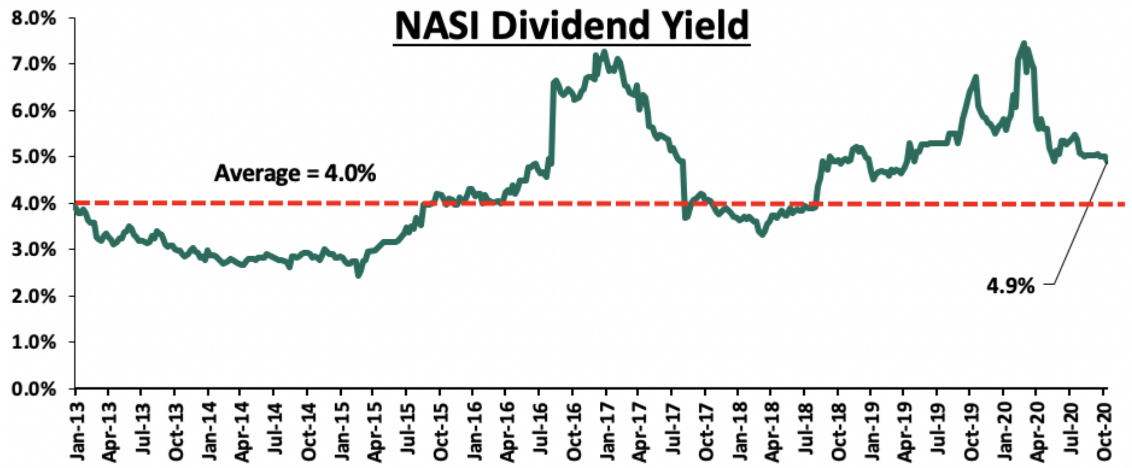
During the week, the equities market was on an upward trajectory, with NASI, NSE 20 and NSE 25 recording gains of 1.9%, 1.1% and 2.5% respectively, taking their YTD performance to losses of 13.5%, 20.0% and 32.6%, for NASI, NSE 25 and NSE 20 respectively. The equities market performance was driven by gains recorded by EABL, KCB Group, Equity Group and BAT of 5.5%, 5.3%, 5.1% and 4.3%, respectively. The gains were however weighed down by losses being recorded by Cooperative Bank and Standard Chartered Bank of 1.7% and 0.5%, respectively.

Equities turnover declined by 33.9% during the week to USD 19.0 mn, from USD 28.8 mn recorded the previous week, taking the YTD turnover to USD 1.3 bn. Foreign investors remained net sellers during the week, with a net selling position of USD 0.1 mn, from a net selling position of USD 11.1 mn recorded the previous week, taking the YTD net selling position to USD 278.0 mn.

The market is currently trading at a price to earnings ratio (P/E) of 10.0x, 22.8% below the 11-year historical average of 13.0x. The average dividend yield is currently at 4.9%, 0.9% points above the historical average of 4.0%.

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 10.0x is 30.0% 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.





Earnings Releases:

During the week, KCB Group and Equity Group Holdings released their Q3'2020 financial results. Below is a summary of their performance

I. KCB Group

KCB Group Q3'2020 Key Highlights

Balance Sheet

Balance Sheet Items	Q3'2019 (Kshs bn)	Q3'2020 (Kshs bn)	y/y change
Government Securities	128.5	236.2	83.9%
Net Loans and Advances	486.4	577.5	18.7%
Total Assets	764.3	972.0	27.2%
Customer Deposits	586.7	772.7	31.7%
Deposits per Branch	2.3	2.2	(5.6%)
Total Liabilities	643.1	836.1	30.0%
Shareholders' Funds	121.2	135.9	12.1%

Income Statement

Income Statement Items	Q3'2019 (Kshs bn)	Q3'2020 (Kshs bn)	y/y change
Net Interest Income	38.7	47.9	23.7%
Net non-Interest Income	21.0	21.3	1.5%
Total Operating income	59.7	69.1	15.9%
Loan Loss provision	(5.8)	(20.0)	242.5%
Total Operating expenses	(32.5)	(52.0)	60.1%
Profit before tax	27.2	17.1	(36.9%)
Profit after tax	19.2	10.9	(43.2%)
Core EPS	6.0	3.4	(43.2%)

Key Ratios

Ratios	Q3'2019	Q3'2020	% point change

i. Core earnings per share declined by 43.2% to Kshs 3.4, from Kshs 6.0 in Q3’2019, driven by a 60.1% growth in total operating expenses to Kshs 52.0 bn, from Kshs 32.5 bn in Q3’2019 which outweighed the 15.9% growth in total operating income to Kshs 69.1 bn, from Kshs 59.7 bn. The decline in core earnings per share was higher than our projected decline of 29.5% as the company had a much faster growth of 60.1% in the total operating expenses compared to our projection of 23.6% increase,
ii. Interest income grew by 23.0% to Kshs 63.3 bn, from Kshs 51.4 bn in Q3’2019. This was driven by a 65.7% rise in interest income on government securities to Kshs 16.8 bn, from Kshs 10.2 bn in Q3’2019, coupled with a 12.9% rise in interest income on loans and advances to Kshs 45.8 bn, from Kshs 40.5 bn in Q3’2019.
iii. Yields on interest-earning assets declined to 10.3% from 10.5% in Q3’2019 attributable to a faster 13.7% growth in average interest-earning assets, outpacing the 4.9% growth in trailing interest income,
iv. Interest expense rose by 20.8% to Kshs 15.4 bn, from Kshs 12.8 bn in Q3’2019, following a 23.6% rise in interest expense on customer deposits to Kshs 14.0 bn from Kshs 11.3 bn in Q3’2019. Interest expense on deposits and placement from banking institutions, declined by 1.1% to Kshs 1.4 bn, from Kshs 1.5 bn in Q3’2019. The cost of funds, on the other hand, declined to 2.6% from 2.9% in Q3’2019 owing to a faster 30.1% growth in average interest-bearing liabilities, which outpaced the 20.3% rise in the trailing interest expense,
v. Net Interest Margin (NIM) remained unchanged at 7.8% from what was recorded in Q3’2019,
vi. Total operating expenses grew by 60.1% to Kshs 52.0 bn, from Kshs 32.5 bn, largely driven by a 242.5% spike in Loan Loss Provisions (LLP) to Kshs 20.0 bn in Q3’2020, from Kshs 5.8 bn in Q3’2019, coupled with a 12.2% rise in Staff costs to Kshs 15.2 bn in Q3’2020, from Kshs 13.6 bn in Q3’2019. 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,
vii. The balance sheet recorded an expansion as total assets grew by 27.2% to Kshs 972.0 bn, from Kshs 764.3 bn in Q3’2019. This growth was driven by an 83.9% rise in investment in government and other securities to Kshs 236.2 bn, from Kshs 128.5 bn in Q3’2019. 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 an 18.7% growth to Kshs 577.5 bn, from Kshs 486.6 bn in Q3’2019,
viii. Total liabilities rose by 30.0% to Kshs 836.1 bn, from Kshs 643.1 bn in Q3’2019, driven by a 31.7% increase in customer deposits to Kshs 772.7 bn, from Kshs 586.7 bn in Q3’2019, with customer deposits from NBK amounting to Kshs 102.6 bn in Q3’2020. Key to note, NBK was amalgamated into the group in Q4’2019 and as such, the groups Q3’2019 results were exclusive of NBKs customer deposits. Deposits per branch declined by 5.6% to Kshs 2.2 bn from Kshs 2.3 bn in Q3’2019, with the number of branches having increased to 360 as at Q3’2020, from 258 in Q3’2019, and,
ix. Gross Non-Performing Loans (NPLs) rose by 127.8% to Kshs 97.0 bn in Q3’2020, from Kshs 42.6 bn in Q3’2019. Consequently, the NPL ratio deteriorated to 15.3%, from 8.3% in Q3’2019, due to the faster growth in Gross Non-Performing Loans (NPLs), which outpaced the growth in loans.

For a comprehensive analysis, please see our KCB Group Q3’2020 Earnings Note

II. Equity Group Holdings

Equity Group Q3’2020 Key Highlights

Balance Sheet

Balance Sheet Items	Q3’2019 (Kshs bn)	Q3’2020 (Kshs bn)	y/y change
Government Securities	135.1	185.3	37.2%
Net Loans and Advances	348.9	453.9	30.1%
Total Assets	677.1	933.9	37.9%
Customer Deposits	478.1	691.0	44.5%
Deposits per Branch	1.6	2.3	43.8%
Total Liabilities	568.4	796.3	40.1%
Shareholders’ Funds	107.7	130.7	21.4%

Income Statement

Income Statement Items	Q3’2019 (Kshs bn)	Q3’2020 (Kshs bn)	y/y change
Net Interest Income	32.3	39.3	21.8%
Net non-Interest Income	22.5	24.8	10.1%
Total Operating income	54.8	64.1	17.0%
Loan Loss provision	(1.9)	(14.8)	686.1%
Total Operating expenses	(30.0)	(45.3)	50.7%
Profit before tax	24.8	19.8	(20.3%)
Profit after tax	17.5	15.0	(13.9%)
Core EPS	4.6	4.0	(13.9%)

Key Ratios

Ratios	Q3’2019	Q3’2020	% point change
Yield on Interest Earning Assets	10.9%	10.1%	(0.8%)
Cost of Funding	2.7%	2.6%	(0.1%)
Net Interest Margin	8.4%	7.6%	(0.8%)
Non-Performing Loans (NPL) Ratio	8.4%	10.8%	2.4%
NPL Coverage	45.8%	52.0%	6.2%
Cost to Income with LLP	54.8%	70.6%	15.8%
Loan to Deposit Ratio	73.0%	65.7%	(7.3%)
Cost to Income Without LLP	51.4%	47.6%	(3.8%)
Return on Average Assets	3.5%	2.5%	(1.0%)
Return on Average Equity	21.7%	16.9%	(4.8%)

Key take-outs from the earnings release include;

i. Core earnings per share declined by 13.9% to Kshs 4.0, from Kshs 4.6 in Q3’2019, better than our projections of a 41.7% decline to Kshs 2.7. The performance was driven by a 50.7% increase in total operating expenses, outpacing the 17.0% growth recorded in total operating income. The variance in core earnings per share growth against our expectations was due to the 17.0% growth in total operating income to Kshs 64.1 bn, from Kshs 54.8 bn in Q3’2019, against our expectation of a 27.3% decline to Kshs 39.8 bn,

ii. Interest income rose by 21.7% to Kshs 52.1 bn, from Kshs 42.8 bn in Q3’2019. This was driven by a 24.4% increase in interest income on loans and advances to Kshs 36.0 bn, from Kshs 29.0 bn in Q3’2019, coupled with a 21.9% increase in interest income on government securities to Kshs 15.4 bn, from Kshs 12.6 bn in Q3’2019,
iii. Yield on interest-earning assets declined to 10.1%, from 10.9% in Q3’2019, due to a faster 29.2% growth in average interest- earning assets, which outpaced the 19.9% growth in trailing interest income
iv. Interest expense rose by 21.6% to Kshs 12.8 bn from Kshs 10.5 bn in Q3’2019, following a 17.9% increase in interest expense on customer deposits to Kshs 9.6 bn, from Kshs 8.1 bn in Q3’2019, coupled with a 36.8% increase in other interest expenses to Kshs 2.6 bn from Kshs 1.9 bn in Q3’2019. Interest expenses on deposits and placements grew by 5.1% to Kshs 0.6 bn, from Kshs 0.5 bn in Q3’2019. Cost of funds declined marginally to 2.6%, from 2.7% recorded in Q3’2019, owing to the faster 30.2% growth in average interest-bearing liabilities to Kshs 653.0 bn, from Kshs 501.4 bn recorded in Q3’2019, outpacing the 21.6% increase in interest expense,
v. Net Interest Margin (NIM) declined to 7.6% from 8.4% in Q3’2019, owing to the faster 29.2% growth in average interest earning assets which outpaced the 21.8% growth in Net Interest Income (NII),
vi. Total operating expenses rose by 50.7% to Kshs 45.3 bn, from Kshs 30.0 bn in Q3’2019, largely driven by a 686.1% increase in Loan Loss Provisions (LLP) to Kshs 14.8 bn, from Kshs 1.9 bn in Q3’2019, on the back of the subdued business environment, coupled with a 16.2% rise in staff costs to Kshs 10.8 bn, from Kshs 9.3 bn in Q3’2019,
vii. The balance sheet recorded an expansion as total assets increased by 37.9% to Kshs 933.9 bn, from Kshs 677.1 bn in Q3’2019. The growth was supported by a 37.2% increase in the government securities to Kshs 185.3 bn, from Kshs 135.1 bn, coupled with a 30.1% increase in loan book to Kshs 453.9 bn from Kshs 348.9 bn in Q3’2019,
viii. Total liabilities rose by 40.1% to Kshs 796.3 bn from Kshs 568.4 bn in Q3’2019, driven by a 44.5% increase in customer deposits to Kshs 691.0 bn, from Kshs 478.1 bn in Q3’2019. Key to note, the strong growth in customer deposits is mainly attributable to the acquisition of BCDC, with the subsidiary contributing Kshs 130.0 bn to the total deposits. Deposits per branch increased by 43.8% to Kshs 2.3 bn, from Kshs 1.6 bn in Q3’2019, with the number of branches increasing by 6 to 300 branches in Q3’2020, from 294 in Q3’2019. Borrowings recorded a growth of 19.0% to Kshs 68.5 bn, from Kshs 57.6 bn in Q3’2019, and,
ix. Gross Non-Performing Loans (NPLs) rose by 69.4% to Kshs 51.8 bn in Q3’2020, from Kshs 30.5 bn in Q3’2019. Consequently, the NPL ratio deteriorated to 10.8% in Q3’2020, from 8.4% in Q3’2019, attributable to a faster 69.4% growth in Non-Performing Loans, which outpaced the 32.5% growth in gross loans,

For a comprehensive analysis, please see our Equity Group Q3’2020 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	(43.2%)	23.0%	20.8%	23.7%	7.8%	1.5%	30.8%	(14.2%)	31.7%	83.9%	74.7%	18.7%	13.1%
Equity	(13.9%)	21.7%	21.6%	21.8%	7.6%	10.1%	38.7%	2.1%	44.5%	37.2%	65.7%	30.1%	16.9%
Q3'20 Mkt Weighted Average*	(27.5%)	22.3%	21.2%	22.7%	7.7%	6.1%	35.0%	(5.5%)	38.6%	58.9%	69.9%	24.8%	15.1%

i. Two banks have released their Q3'2020 financial results, recording a (27.5%) weighted average decline in core Earnings Per Share (EPS), compared to a weighted average growth of 8.7% in Q3'2019 for the entire listed banking sector,
ii. The banks that have released results have recorded a deposit growth of 38.6%, faster than the 11.0% growth recorded in Q3'2019. Interest expense, on the other hand, grew faster by 21.2%, compared to 4.3% in Q3'2019. Cost of funds, however, declined, coming in at a weighted average of 2.6% in Q3'2020, from 3.2% in Q3'2019, 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 24.8%, slightly slower than the 11.6% recorded in Q3'2019, and slower than the 58.9% growth in government securities, an indication of the banks preference of investing in Government securities as opposed to lending,
iv. Interest income rose by 22.3%, compared to a growth of 4.5% recorded in Q3'2019. The faster growth in interest income may be attributable to the increased allocation to government securities. Despite the rise in interest income, the Yield on Interest Earning Assets (YIEA) declined to 10.2% from the 10.5% recorded in Q3'2019, an indication of the increased allocation to lower-yielding government securities by the sector. The decline in the YIEA can also be attributed to the reduced lending rates for customers by the sector, in line with the Central Bank Rate cuts. Consequently, the Net Interest Margin (NIM) now stands at 7.7%, unchanged from what was recorded in Q3'2019 for the whole listed banking sector, and,
v. Non-Funded Income grew by 6.1% y/y, slower than 15.8% growth recorded in Q3'2019. The performance in NFI was on the back of declined growth in fees and commission of 5.5%, which was slower than the 22.6% growth recorded in Q3'2019. The poor performance of the growth in fees and commission can be attributed to the 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:

Company	Price at 06/11/2020	Price at 13/11/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank***	61.0	63.0	3.3%	(42.2%)	109.0	119.4	4.3%	93.8%	0.3x	Buy
Kenya Reinsurance	2.0	2.2	7.4%	(28.4%)	3.0	4.0	5.1%	89.4%	0.2x	Buy
Sanlam	12.8	12.0	(5.9%)	(30.2%)	17.2	18.4	0.0%	53.3%	1.2x	Buy
NCBA***	22.0	22.0	0.2%	(40.3%)	36.9	30.7	1.1%	40.7%	0.6x	Buy
I&M Holdings***	43.2	43.7	1.2%	(19.1%)	54.0	57.8	5.8%	38.1%	0.7x	Buy
Liberty Holdings	7.5	7.2	(3.5%)	(30.0%)	10.4	9.8	0.0%	35.4%	0.6x	Buy
Standard Chartered***	157.0	156.3	(0.5%)	(22.8%)	202.5	197.2	8.0%	34.2%	1.2x	Buy
Co-op Bank***	11.6	11.4	(1.7%)	(30.3%)	16.4	14.2	8.8%	33.3%	0.8x	Buy
KCB Group***	35.6	37.5	5.3%	(30.6%)	54.0	46.4	9.3%	33.1%	0.8x	Buy
Equity Group***	35.0	36.8	5.1%	(31.2%)	53.5	44.5	5.4%	26.4%	0.9x	Buy
ABSA Bank***	9.5	9.9	4.2%	(25.8%)	13.4	10.8	11.1%	20.2%	1.2x	Buy
Jubilee Holdings	269.0	270.0	0.4%	(23.1%)	351.0	313.8	3.3%	19.5%	0.5x	Accumulate
HF Group	3.7	3.5	(6.5%)	(46.6%)	6.5	4.1	0.0%	18.8%	0.2x	Accumulate
Britam	7.5	7.6	1.3%	(15.6%)	9.0	8.6	3.3%	16.4%	0.8x	Accumulate
Stanbic Holdings	80.0	80.0	0.0%	(26.8%)	109.3	84.9	8.8%	14.9%	0.6x	Accumulate
CIC Group	2.2	2.1	(5.5%)	(23.1%)	2.7	2.1	0.0%	1.9%	0.7x	Lighten

*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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