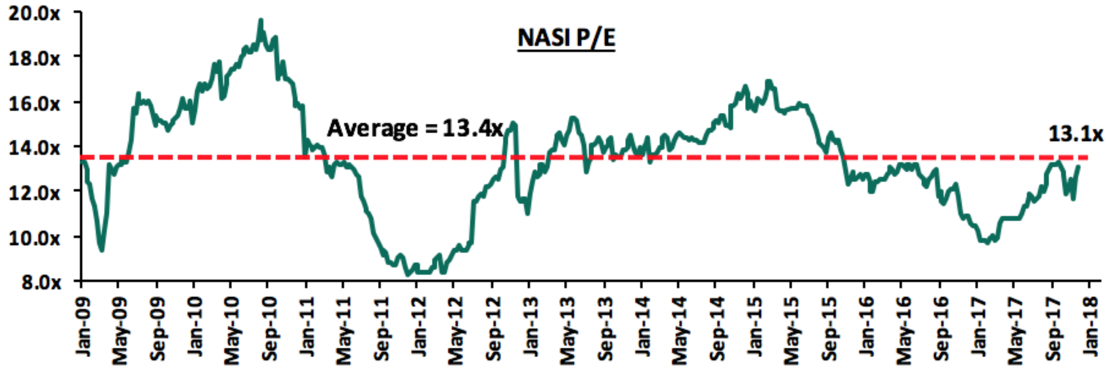
Accra, Ghana Real Estate Investment Opportunity, & Cytonn Weekly #47

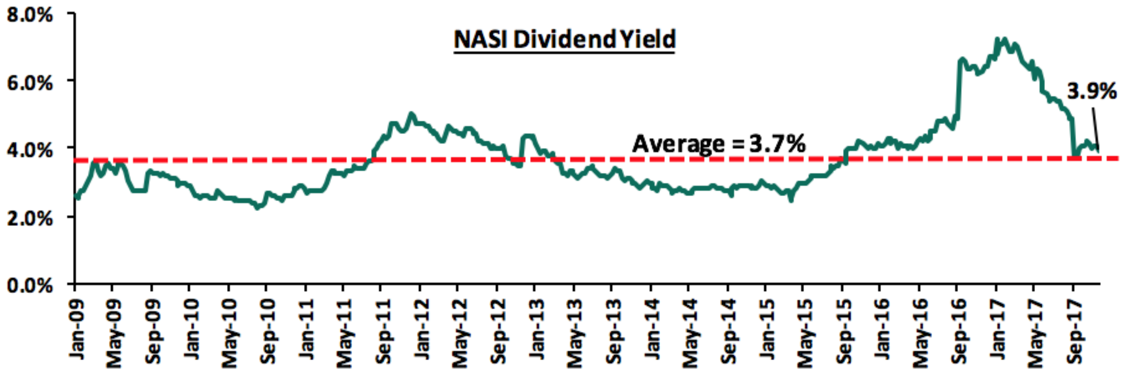
Equities

During the week, the equities market was on an upward trend with NSE 25, NASI and NSE 20 recording gains of 3.3%, 3.2% and 2.8%, respectively, taking their YTD performance to 26.3%, 24.4% and 20.3% for NASI, NSE 25 and NSE 20, respectively. This week's performance was driven by gains in select large cap stocks such as Equity Group, Safaricom and KCB Group, which gained 5.5%, 4.9% and 4.3%, respectively. Safaricom rallied during the week, touching a 12-month high of Kshs 28.5 per share. It however eased back to close the week at Kshs 26.8 per share. Since the February 2015 peak, the market has lost 5.1% and 30.3% for NASI and NSE 20, respectively.

Equities turnover declined slightly by 0.4% to USD 33.4 mn from USD 33.5 mn the previous week. Foreign investors turned net buyers with a net inflow of USD 4.7 mn compared to a net outflow of USD 1.3 mn recorded the previous week. We expect the market to remain supported by improved investor sentiment once uncertainty dissipates, as investors take advantage of the attractive stock valuations.

The market is currently trading at a price to earnings ratio (P/E) of 13.1x, versus a historical average of 13.4x, and a dividend yield of 3.9%, compared to a historical average of 3.7%. In our view, there still exist pockets of value in the market, with the current P/E valuation being 22.5% below the most recent peak in February 2015. The current P/E valuation of 13.1x is 35.2% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 57.8% 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.





The Kenya Deposit Insurance Corporation (KDIC) and the Central Bank of Kenya (CBK) are set to jointly monitor corporate governance and financial performance of banks, in order to identify early warning signs and discuss resolutions with the owners and directors of any troubled institutions. KDIC plays the role of protecting depositors against loss of all their deposits in case of a bank failure, by providing payments of insured deposits. This move is expected to curb runs on deposits and safeguard depositors as regulators will ensure revival of institutions, with liquidation being a last resort. This serves as relief for depositors as they could soon be spared the distress of having their money locked up in failed banks. These measures come after the collapse of Chase Bank, which has since been acquired, Imperial Bank (which is in the process of reopening) and Dubai Bank, which shook depositors' confidence in the banking sector, leading to flight to safety of deposits from small banks to large banks. This is a good move by the regulators as it will ensure bank failures are minimised, and reduce disruptions and the negative impact on financial stability in the banking sector resulting from banks being put under receivership.

During the week, we had a number of earnings releases. Below is the detailed analysis of the earnings' releases:

NIC Bank released Q3'2017 results

NIC Bank released Q3'2017 results, recording a 2.5% decline in core earnings per share to Kshs 3.3 from Kshs 3.4 in Q3'2016, attributable to an 18.8% decline in total operating income, despite a 24.8% decrease in operating expenses. Key highlights for the performance from Q3'2016 to Q3'2017 include:

- Total operating income declined by 18.8% to Kshs 10.1 bn from Kshs 12.5 bn in Q3'2016, driven by a 21.8% decline in Net Interest Income (NII) to Kshs 7.4 bn from Kshs 9.4 bn in Q3'2016, and a 9.6% decline in Non-Funded income to Kshs 2.8 bn from Kshs 3.1 bn in Q3'2016,
- Interest Income decreased by 15.7% to Kshs 12.4 bn from Kshs 14.7 bn in Q3'2016. The decline is attributable to a 16.1% decline in interest income on loans & advances to Kshs 9.2 bn from Kshs 11.1 bn, despite an increase in interest income on government securities by 14.3% to Kshs 3.2 bn from Kshs 2.8 bn in Q3'2016,
- Interest expense increased by 3.8% to Kshs 5.5 bn from Kshs 5.3 bn in Q3'2016, attributed to a 2.4% increase in interest expense on customer deposits to Kshs 4.3 bn from Kshs 4.2 bn in Q3'2016 and an 11.1% in other interest expenses to Kshs 1.0 bn from Kshs 0.9 bn in Q3'2016. This coupled with a 15.7% decline in interest income led to a 21.8% decline in the Net Interest Income to Kshs 7.4 bn from Kshs 9.4 bn. The Net Interest Margin thus declined to 6.4% from 8.3% in Q3'2016,
- Non-Funded Income (NFI) recorded a decline of 9.6% to Kshs 2.8 bn from Kshs 3.1 bn in Q3'2016. The decline in NFI was driven by a decrease in other income that shed 47.0% to Kshs 0.4 bn from Kshs 0.7 bn in Q3'2016 despite the 2.4% increase in fees & commissions on loans to Kshs 0.97 bn from Kshs 0.95 bn in Q3'2016. The decline in NFI is however against the performance of majority of the other banks which have recorded a weighted average growth of 10.8%,

- The current revenue mix came in at 73:27 funded to non-funded income from 75:25 in Q3’2016,
- Total operating expenses decreased by 24.8% to Kshs 5.8 bn from Kshs 7.7 bn, driven by a 34.6% decrease in Loan Loss Provisions (LLP) to Kshs 2.1 bn from Kshs 3.2 bn, coupled with a 15.0% decline in staff costs to Kshs 1.9 bn from Kshs 2.3 bn in Q3'2016. The decline in staff costs is attributable to job cuts that saw the bank retrench senior level employees in a move to cut on operational costs. Staff costs account for 32.9% of operating expenses while LLPs account for 36.0% of operating expenses,
- The Cost to Income ratio improved to 57.4% from 62.0% in Q3'2016, following the 24.8% decrease in total operating expenses that outpaced the 18.8% decline in total operating income. Without LLP, the Cost to Income ratio deteriorated to 36.7% from 36.4% in Q3'2016,
- Profit before tax decreased by 8.9% to Kshs 4.3 bn from Kshs 4.7 bn, while profit after tax decreased by 2.5% to Kshs 3.3 bn from Kshs 3.4 bn in Q3’2016, due to the one-off deferred tax asset of Kshs 0.8 bn recorded in Q3’2017.
- The balance sheet recorded an expansion in Q3’2017, with total assets increasing by 10.0% to Kshs 181.9 bn from Kshs 165.3 bn in Q3'2016. This growth was driven by a 42.4% increase in investment in government securities to Kshs 49.3 bn from Kshs 34.6 bn in Q3'2016, despite a 0.2% decrease in the loan book, which is 60.6% of the bank’s total assets, to Kshs 110.3 bn from Kshs 110.5 bn in Q3’2016. Contribution of government securities to the total interest earning assets increased to 30.0% from 23.1% in Q3’2016,
- Total liabilities rose by 13.3% to Kshs 153.8 bn from Kshs 135.7 bn in Q3'2016, driven by a 13.6% increase in deposits to Kshs 123.1 bn from Kshs 108.4 bn in Q3'2016. Shareholders’ funds decreased by 3.3% to Kshs 28.1 bn from Kshs 29.1 bn in Q3’2016,
- The increase in deposits and decline in loans led to a decline in the loan to deposit ratio to 89.6% from 101.9% in Q3'2016,
- NIC Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 16.3%, 5.8% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 5.1%,
- NIC Group currently has a return on average assets of 2.4% and a return on average equity of 14.9%, against an industry average return on average assets of 2.9% and a return on average equity of 18.1%.

Key Take outs:

i. Resilience through improved efficiency and coverage. NIC Group’s cost to income ratio improved by 4.6 percentage points to 57.4% from 62.0% in Q3’2016, due to a faster decline in operating expenses by 24.8%, compared to the 18.8% decline in operating income. This was driven by a 15.0% decline in staff costs to Kshs 1.9 bn from Kshs 2.3 bn in Q3’2015, with staff costs constituting 32.9% of operating expenses,
ii. Prudence through improved coverage. The lender’s largest cost component, LLPs at 36.0%, declined by 34.6% to Kshs 2.1 bn from Kshs 3.2 bn, as NPLs and loans declined by 2.5% and 0.2%, respectively. With the declining gross NPL ratio due to this, we notice that the NPL coverage ratio improved to 50.9% from 22.4% in Q3’2016,
iii. Going forward, we expect NIC Group to reap the benefits expected from the newly concluded restructuring, which include improved capital use, strategic and risk management. This is expected to result in further gradual improvement of efficiency and asset quality, observed through improving cost to income and gross NPL ratios, respectively.

For a more comprehensive analysis, see our NIC Bank Q3’2017 Earnings Note.

Barclays Bank released Q3’2017 results

Barclays Bank released Q3’2017 results, recording a 12.0% decline in core earnings per share to Kshs 1.0 from Kshs 1.1 in Q3’2016, attributable to a 7.5% decline in operating revenue outpacing a 5.3% decline in operating expenses. Key highlights for the performance from Q3’2016 to Q3’2017 include:

- Total operating revenue declined by 7.5% y/y to Kshs 22.6 bn from Kshs 24.4 bn, driven by a 14.8% decline in Non-Funded Income (NFI) to Kshs 6.5 bn from Kshs 7.6 bn in Q3'2016, and a 4.2% decline in Net Interest Income (NII) to Kshs 16.1 bn from Kshs 16.9 bn,
- Interest Income declined by 4.6% to Kshs 20.1 bn from Kshs 21.1 bn in Q3’2016, despite the loan book recording a 5.3% growth, implying that the decline was an effect of the interest rate cap. The decline in interest income is attributable to 97.9% y/y decline in other interest income to Kshs 0.03 bn from Kshs 1.31 bn, and a 2.2% y/y decline on loans and advances to Kshs 15.9 bn from Kshs 15.6 bn, while interest income on government securities grew by a marginal 0.5% y/y to Kshs 4.1 bn from Kshs 4.0 bn. As a result, the yield on interest-earning assets declined to 12.1% from 13.8% in Q3’2016,
- Interest expense decreased by 6.3% to Kshs 4.0 bn from Kshs 4.2 bn in Q3’2016, following a 100.0% decline in other interest expenses to Kshs 0.0 bn from Kshs 0.5 bn in Q3’2016. The Net Interest Income declined by 4.2% to Kshs 16.1 bn from Kshs 16.9 bn in Q3’2016. The Net Interest Margin thus declined to 9.7% from 10.9% in Q3'2016,
- Non-Funded Income (NFI) recorded a drop of 14.8% to Kshs 6.5 bn from Kshs 7.6 bn in Q3'2016. The decline in NFI was driven by a 54.5% drop in fees and commissions on loans to Kshs 0.5 bn from Kshs 1.1 bn in Q3’2016, and an 8.7% decline in other fees and commissions to Kshs 3.5 bn from Kshs 3.8 bn. With the decline in NFI faster than the decline in NII, the proportion of NFI to total revenue also declined, with the current revenue mix at 71:29 funded to non-funded income from 69:31 in Q3’2016,
- Total operating expenses declined by 5.3% to Kshs 14.8 bn from Kshs 15.7 bn, attributable to a 25.6% drop in loan loss provisions (LLP) to Kshs 2.3 bn from Kshs 3.1 bn in Q3’2016 despite a 9.8% growth in staff costs to Kshs 8.1 bn from Kshs 7.4 bn in Q3’2016. The growth in staff costs is attributed to the voluntary employee buyout programme that the bank rolled out and saw 145 employees leave the firm as at October this year,
- Following a faster decline in operating revenue than in operating expenses, the Cost to Income ratio worsened to 65.9% from 64.3% in Q3'2016. Without LLP, the Cost to Income ratio worsened to 55.6% from 51.5% in Q3'2016,
- Profit before tax declined by 11.5% to Kshs 7.7 bn from Kshs 8.7 bn. Profit after tax declined by 12.0% to Kshs 5.3 bn from Kshs 6.1 bn in Q3’2016.
- Total assets increased by 5.3% to Kshs 278.0 bn from Kshs 264.0 bn in Q3'2016. This growth was driven by a 5.3% growth in the loan book to Kshs 167.2 bn from Kshs 158.8 bn in Q3’2016. Investment in government increased marginally by 1.6% to Kshs 57.6 bn from Kshs 56.7 bn in Q3'2016. The 5.3% loan book growth was supported by strong performance in lending to the consumer and SME segments of the business,
- Total liabilities rose by 5.8% to Kshs 235.4 bn from Kshs 222.5 bn in Q3'2016, driven by a 10.8% increase in deposits to Kshs 200.4 bn from Kshs 180.9 bn in Q3'2016. The increase in deposits was driven by an increase in transactional accounts following the launch of new products such as the Twin Account
- Shareholders’ funds increased by 2.6% to Kshs 42.5 bn from Kshs 41.5 bn in Q3’2016, due to a 2.8% y/y increase in retained earnings to Kshs 39.4 bn from Kshs 38.3 bn in Q3’2016,
- The faster growth in deposits compared to the loan book led to a drop in the loan to deposit ratio to 83.5% from 87.8% in Q3'2016,
- Barclays Bank Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.9%, 5.4% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 3.5%,
- Barclays Bank Kenya currently has a return on average assets of 2.6% and a return on average equity of 15.9%, against an industry average return on average assets of 2.9% and a return on average equity of 18.1%.

Going forward, we expect BBK’s growth to be propelled by their investments in innovation, technology, introduction of new products, review of their existing products, their Customer Life-cycle Management (CLM) analysis and diversification of their revenue streams to increase their non-funded income contribution to total operating income, which currently standing at 28.6%.

For a more comprehensive analysis, see our Barclays Bank Q3’2017 Earnings Note.

Stanbic Bank released Q3’2017 results

Stanbic Bank released Q3’2017 results, recording a 19.7% rise in EPS to Kshs 18.9 from Kshs 15.8 in Q3'2016, largely on account of an improvement in the hyper-inflationary environment in South Sudan that saw an improvement in the expensing of the exceptional items by 91.0% to Kshs 0.1 bn from Kshs 1.1 bn in Q3’2016. Profit before tax decreased by 17.4% to Kshs 4.4 bn from Kshs 5.3 bn in Q3’2016 driven by the 1.7% decline in operating income and the 7.6% increase in operating expenses. Key highlights for the performance from Q3’2016 to Q3’2017 include:

- Total operating income declined by 1.7% to Kshs 14.0 bn from Kshs 14.2 bn in Q3'2016, attributed to a 6.5% decline in Net Interest Income (NII) to Kshs 7.8 bn from Kshs 8.3 bn in Q3'2016, despite a 5.1% increase in Non-Funded income to Kshs 6.2 bn from Kshs 5.9 bn in Q3’2016,
- Interest Income decreased by 7.3% to Kshs 12.2 bn from Kshs 13.2 bn in Q3’2016. This is attributable to a 3.6% decline in interest income on loans & advances to Kshs 8.9 bn from Kshs 9.3 bn and a 15.4% decline in interest income on government securities to Kshs 3.0 bn from Kshs 3.6 bn in Q3’2016,
- Interest expense declined by 8.8% to Kshs 4.4 bn from Kshs 4.9 bn in Q3’2016, following a 3.2% and 29.6% decline in interest expense on customer deposits and other interest expenses, respectively,
- Non-Funded Income (NFI) recorded a growth of 5.1% to Kshs 6.2 bn from Kshs 5.9 bn in Q3'2016. The growth in NFI was driven by a 29.0% increase in fees & commissions on loans to Kshs 0.3 bn from Kshs 0.2 bn in Q3’2016,
- The current revenue mix came in at 56:44 funded to non-funded income from 58:42 in Q3’2016,
- Total operating expenses increased by 7.6% to Kshs 9.6 bn from Kshs 8.9 bn, attributed to an 88.5% increase in Loan Loss Provisions (LLP) to Kshs 2.3 bn from Kshs 1.2 bn, despite a 1.5% decline in staff costs to Kshs 3.61 bn from Kshs 3.67 bn in Q3'2016. Staff costs account for 37.7% of operating expenses while LLPs account for 23.6% of operating expenses,
- The Cost to Income ratio deteriorated to 68.6% from 62.7% in Q3'2016, following the 7.6% increase in total operating expenses coupled with the 1.7% decline in total operating income. Without LLP, the Cost to Income ratio improved to 52.4% from 54.2% in Q3'2016,
- Profit before tax decreased by 17.4% to Kshs 4.4 bn from Kshs 5.3 bn, while profit after tax increased by 19.7% to Kshs 3.2 bn from Kshs 2.7 bn in Q3’2016, largely on account of a decline in exceptional items that declined by 91.0% to Kshs 0.1 bn from Kshs 1.1 bn in Q3’2016, brought about by an adjustment related to the hyper-inflationary environment in South Sudan,
- The balance sheet recorded an expansion, with total assets increasing by 2.9% to Kshs 236.5 bn from Kshs 229.9 bn in Q3'2016. This growth was driven by a 13.8% increase in the loan book to Kshs 121.3 bn from Kshs 106.7 bn in Q3'2016,
- Total liabilities rose by 1.6% to Kshs 204.6 bn from Kshs 201.3 bn in Q3'2016, driven by an 8.2% increase in deposits to Kshs 150.9 bn from Kshs 139.4 bn in Q3'2016.
- Shareholders’ funds increased by 11.6% to Kshs 31.9 bn from Kshs 28.6 bn in Q3’2016,
- The faster increase in loans than deposits led to an increase in the loan to deposit ratio to 80.4% from 76.5% in Q3'2016,

- Stanbic Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.2%, 4.7% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 2.5%.

Going forward, we expect Stanbic Bank's growth to be propelled by their diversified and clearly defined business strategy, enabling the bank to respond effectively to shifting market dynamics, with their non-funded income at 44.4% of total operating income, coupled with the roll out of their new digital platform and support systems.

Below is a summary of the Q3'2017 results for the eight listed banks that have released thus far and key take-outs from the results:

Listed Banks Q3'2017 Earnings and Growth Metrics

Bank	Core EPS Growth		Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Non Funded Income (NFI) Growth	NFI to Total Operating Income	Growth in total fees and commissions	Loan Growth		Deposits Growth		Growth in Govt Securities
	Q3'2017	Q3'2016	Q3'2017	Q3'2017	Q3'2017	Q3'2017	Q3'2017	Q3'2017	Q3'2017	Q3'2016	Q3'2017	Q3'2016	Q3'2017
Stanbic	19.7%	(2.1%)	(7.3%)	(8.8%)	(6.5%)	5.1%	44.4%	45.3%	13.8%	1.9%	8.2%	22.8%	40.0%
KCB	5.0%	16.1%	(3.6%)	(10.9%)	(1.0%)	18.4%	32.9%	25.5%	15.1%	4.9%	13.6%	(7.3%)	2.8%
NIC Bank	(2.5%)	(6.4%)	(15.7%)	3.8%	(21.8%)	(9.6%)	27.4%	1.8%	(0.2%)	(0.7%)	13.6%	2.4%	40.0%
Equity	(2.7%)	17.7%	(11.1%)	5.9%	(15.0%)	28.3%	43.6%	24.9%	(2.2%)	3.0%	11.3%	4.8%	17.7%
DTB	(3.5%)	11.4%	0.8%	3.7%	(1.4%)	4.7%	21.2%	8.6%	8.1%	5.4%	16.5%	29.9%	18.2%
Co-op	(9.5%)	22.3%	(7.7%)	(8.5%)	(7.3%)	2.7%	32.8%	5.9%	14.2%	6.9%	12.1%	1.7%	0.8%
Barclays	(12.0%)	(5.4%)	(4.6%)	(6.3%)	(4.2%)	(14.8%)	31.0%	(17.6%)	5.3%	14.3%	10.8%	13.4%	28.8%
StanChart	(39.1%)	24.5%	(1.4%)	19.1%	(8.0%)	(3.2%)	31.8%	(4.0%)	(5.4%)	14.1%	19.5%	19.8%	19.9%
Weighted Average*	(6.5%)	15.2%	(6.6%)	(0.7%)	(8.2%)	10.8%	36.7%	14.6%	6.3%	6.6%	13.9%	7.6%	16.0%

** The weighted average is based on Market Cap as at 24th November, 2017*

Key takeaways:

- Of the 8 banks that have released their Q3'2017 results, only Stanbic Bank and KCB Group have recorded a growth in core earnings per share, with the average decline in core earnings across the banking sector at 6.5%, owing to the tough operating environment as a result of the interest rate caps and political uncertainty in the country that affected the business environment,
- Average deposit growth came in at 13.9%. However, despite the average deposits having grown, the interest expense paid on deposits recorded a negative growth of 0.7% on average, indicating that banks are growing deposits but opening less interest earning accounts and possibly transferring some existing interest earning accounts to transaction accounts,
- Average loan growth has been recorded at 6.3%, however interest income has decreased by 6.6%, showing the effects of the rate caps,
- Investment in government securities has grown by 16.0% outpacing loan growth of 6.3%, showing increased lending to the government by banks as they avoid the risky borrowers,
- Non-funded income has however grown by 10.8%, which included a Fee and Commissions growth of 14.6%. This shows that banks are charging more fee income to improve their total yield on loans above the rate cap maximum.

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise

No.	Company	Price as at 17/11/17	Price as at 24/11/17	w/w Change	YTD Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	NIC***	36.3	36.8	1.4%	41.3%	58.2	3.3%	61.7%
2.	KCB Group***	41.0	42.8	4.3%	48.7%	57.1	4.9%	38.5%
3.	Barclays	9.8	9.9	1.5%	16.7%	12.5	10.0%	36.2%
4.	DTBK	187.0	190.0	1.6%	61.0%	234.1	1.3%	24.5%
5.	Kenya Re	19.9	20.3	1.8%	(10.0%)	24.4	3.8%	24.3%
6.	I&M Holdings	120.0	126.0	5.0%	40.0%	149.6	2.5%	21.2%
7.	Liberty	12.5	13.7	9.2%	3.4%	16.4	0.0%	20.1%
8.	Jubilee	494.0	490.0	(0.8%)	0.0%	575.4	1.8%	19.2%
9.	Sanlam Kenya	27.0	27.8	2.8%	0.9%	31.4	1.0%	14.1%
10.	Co-op Bank	16.1	16.2	0.9%	22.7%	17.5	5.7%	13.7%
11.	HF Group***	12.2	12.7	4.1%	(9.3%)	14.2	1.8%	13.6%
12.	CIC Group	5.6	5.9	6.3%	55.3%	6.2	1.8%	6.9%
13.	Britam	14.5	15.0	3.4%	50.0%	15.2	1.6%	3.0%
14.	Stanbic Holdings	80.0	81.5	1.9%	15.6%	79.1	5.2%	2.2%
15.	Equity Group	40.8	43.0	5.5%	43.3%	40.5	5.0%	(0.8%)
16.	StanChart	218.0	219.0	0.5%	15.9%	199.8	4.5%	(4.2%)
17.	NBK	10.1	10.5	4.5%	45.8%	5.2	0.0%	(50.7%)

**Target Price as per Cytonn Analyst estimates*

***Upside / (Downside) is adjusted for Dividend Yield*

****Banks in which Cytonn and/or its affiliates holds a stake*

For full disclosure, Cytonn and/or its affiliates holds a significant stake in KCB Group and NIC Bank, ranking as the 5th largest local institutional investor and the 9th largest shareholder, respectively

We maintain a "NEUTRAL" view on equities for investors with short-term investment horizon since, despite the lower earnings growth prospects for this year, the market has rallied and brought the market P/E closer to its' historical average. Pockets of value exist, with a number of undervalued sectors like Financial Services, which provide an attractive entry point for long-term investors and thus we are positive for investors with a long-term investment horizon.