

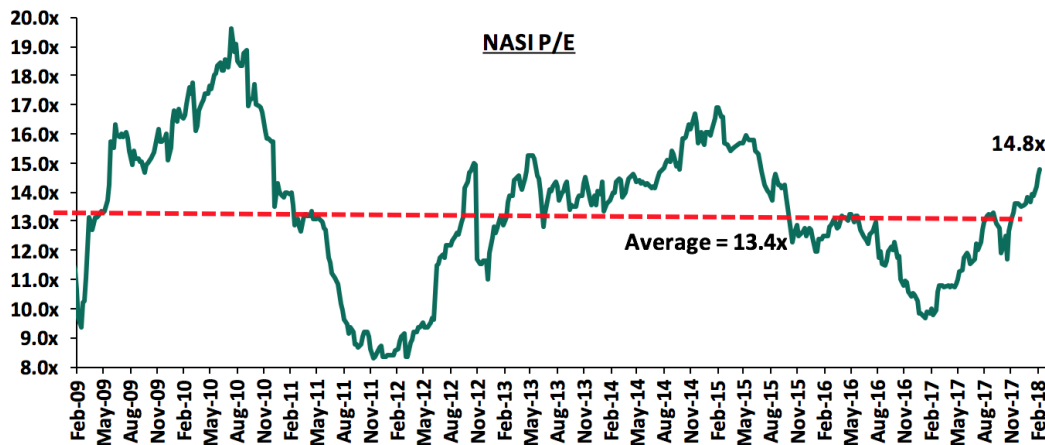
Nairobi Commercial Office Report, & Cytonn Weekly #10/2018

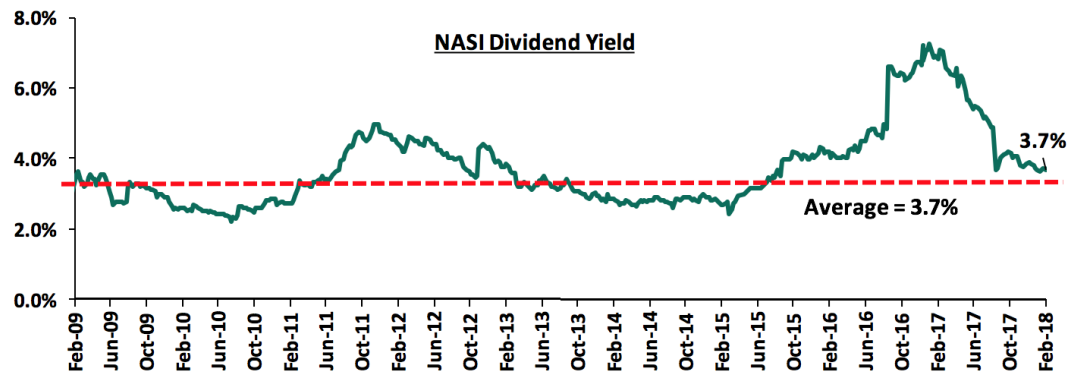
Equities

During the week, the equities market recorded mixed performance, with NASI and NSE 20 declining 0.4% and 1.0%, respectively, while NSE 25 rose 0.5% taking their YTD performance to 5.5%, 0.2% and 7.6% for NASI, NSE 20 and NSE 25, respectively. This week's performance was due to gains in Equity Group and KCB Group that rose 3.8% and 2.1%, respectively. For the last twelve months (LTM), NASI, NSE 20 and NSE 25 gained 50.7%, 26.1%, and 44.4%, respectively.

Equities turnover declined 19.0% to USD 46.2 mn from USD 57.0 mn registered last week. We expect the market to remain supported by positive investor sentiment this year, as investors take advantage of the attractive stock valuations on select counters.

The market is currently trading at a price to earnings ratio (P/E) of 14.8x, which is 10.3% above the historical average of 13.4x, and a dividend yield of 3.7%, similar to the historical average of 3.7%. The current P/E valuation of 14.8x is 52.6% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 78.1% above the previous trough valuation of 8.3x experienced in December 2011.





KCB Group released FY'2017 results during the week

KCB Group released FY'2017 results, with its core earnings per share flat at Kshs 6.4 similar to FY'2016, compared to our expectation of a slight increase to Kshs 6.5. Performance was driven by a 2.7% increase in operating income, despite a 4.7% increase in operating expenses. Highlights for the performance from FY'2016 to FY'2017 include:

- Total operating revenue grew by 2.7% y/y to Kshs 71.4 bn from Kshs 69.5 bn, driven by slight increases in both Net Interest Income (NII) and Non Funded Income (NFI). NII rose by 2.9% to Kshs 48.4 bn from Kshs 47.0 bn in FY'2016, while NFI rose 2.5% to Kshs 23.0 bn from Kshs 22.5 bn in FY'2016,
- Interest Income rose by 1.4% to Kshs 63.7 bn from Kshs 62.8 bn in FY'2016. The interest income on loans and advances alone declined by 0.8% y/y to Kshs 50.8 bn from Kshs 51.2 bn, while interest income on government securities grew by 13.8% y/y to Kshs 12.4 bn from Kshs 10.9 bn. As a result, the yield on interest-earning assets declined to 11.5% from 12.2% in FY'2016,
- Interest expense decreased by 3.1% to Kshs 15.3 bn from Kshs 15.8 bn in FY'2016, following a 6.0% decline in interest expense on customer deposits to Kshs 13.6 bn from Kshs 14.5 bn, thus bringing down the cost of funds to 3.0% from 3.3% in FY'2016. The Net Interest Income increased 2.9% to Kshs 48.4 bn from Kshs 47.0 bn. The Net Interest Margin however declined to 8.7% from 9.2% in FY'2016, owing to a faster growth in interest earning assets,
- Non-Funded Income (NFI) recorded a growth of 2.5% to Kshs 23.0 bn from Kshs 22.5 bn in FY'2016. The growth in NFI was driven by a 50.0% increase in other fees and commissions to Kshs 9.1 bn from Kshs 6.1 bn in FY'2016, despite a 14.7% decline in fees and commissions on loans to Kshs 5.6 bn from Kshs 6.6 bn in FY'2016. The current revenue mix stands at 68:32 funded to non-funded income, same as in FY'2016, owing to a similar increase in both the NII and NFI,
- The 50.0% increase in other fees and commissions was driven by growth in commissions from alternative banking channels including digital platforms and agency banking. The volume of transactions made through these alternative channels increased to 87% from 77% in FY'2016,
- Total operating expenses increased by 4.7% to Kshs 42.3 bn from Kshs 40.4 bn, driven by a 54.7% increase in Loan Loss Provisions to Kshs 5.9 bn from Kshs 3.8 bn in FY'2016, coupled with an 8.1% increase in staff costs to Kshs 19.1 bn from Kshs 17.7 bn in FY'2016. Increases in LLP and staff costs were offset by a 15.2% decline in other operating expenses to Kshs 12.6 bn from Kshs 14.9 bn in FY'2016. The growth in staff costs is attributed to the staff rationalization programme that saw 316 staff released from service (249 from KCB Bank Kenya and 67 in KCB Subsidiaries), that cost Kshs 2.0 bn to rollout, whose costs are expected to be recovered within 18-months,
- The Cost to Income ratio deteriorated to 59.2% from 58.1% in FY'2016. Without LLP, the Cost to Income ratio improved to 50.9% from 52.6% in FY'2016,
- Profit before tax remained flat at Kshs 29.1 bn. Profit after tax was also flat at Kshs 19.7 bn,

- The bank recommends a final dividend of Kshs 2.0 per share, having already paid an interim dividend of Kshs 1.0 per share, translating to a total dividend payout of Kshs 3.0 per share, unchanged from 2016, translating to a dividend yield of 4.1%.
- The total assets increased by 8.6% to Kshs 646.7 bn from Kshs 595.2 bn in FY'2016. This growth was driven by a 9.6% growth in the loan book to Kshs 422.7 bn from Kshs 385.7 bn in FY'2016. Investment in government and other securities increased by 7.4% to Kshs 110.0 bn from Kshs 102.5 bn in FY'2016,
- Total liabilities rose by 8.4% to Kshs 540.7 bn from Kshs 498.7 bn in FY'2016, driven by an 11.5% increase in deposits to Kshs 499.5 bn from Kshs 448.2 bn in FY'2016. Deposits per branch increased 10.2% to Kshs 1.9 bn from Kshs 1.7 bn in FY'2016,
- Shareholders' funds increased by 12.2% to Kshs 103.2 bn from Kshs 92.0 bn in FY'2016, due to a 14.4% y/y increase in retained earnings to Kshs 63.0 bn from Kshs 55.0 bn,
- The faster growth in deposits compared to the loan book led to a decline in the loan to deposit ratio to 84.6% from 86.1% in FY'2016,
- Gross non-performing loans increased by 17.9% to Kshs 37.5 bn from Kshs 31.8 bn. The NPL ratio thus deteriorated to 8.4% from 7.8% in FY'2016, due to the faster growth NPLs in the loan book,
- KCB Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.4%, 4.9% above the statutory requirement, with total capital to total risk weighted assets at 16.6%, exceeding statutory requirement by 2.1%

Going forward, we expect KCB's growth to be propelled by;

- i. Channel diversification to more efficient and customer convenient channels such as mobile and digital channels that allow for more transactional fee based income, thus increasing its Non Funded Income. KCB's Funded to Non Funded Income ratio of 68:32 is still below peer average of 66:34 in terms of NFI contribution to total revenue,
- ii. Improvements in asset quality, with the increase in NPLs causing KCB's Gross Non-Performing Loans ratio to deteriorate to 8.4%, which is above peer average of 8.2%.

For a comprehensive analysis, see our **KCB Group FY'2017 Earnings Note**.

Stanbic Holdings released FY'2017 results

Stanbic Holdings released FY'2017 results, registering a 2.5% decline in its core earnings per share to Kshs 10.9 from Kshs 11.2 in FY'2016, driven by a 9.6% growth in operating expenses that outpaced a 3.0% rise in operating revenue. Highlights for the performance from FY'2016 to FY'2017 include:

- Total operating revenue rose by 3.0% to Kshs 19.1 bn from Kshs 18.5 bn in FY'2016. This was supported by a 10.0% growth in Non-Funded Income, despite a 2.0% decline in Net Interest Income,
- Stanbic Bank's interest income declined by 3.0% to Kshs 16.6 bn from Kshs 17.1 bn in FY'2016, owing to an 8.9% decline in interest income on Government securities to Kshs 4.3 bn from Kshs 4.7 bn in FY'2016. Interest income on loans and advances remained relatively flat at Kshs 12.1 bn. As a result, the yield on interest-earning assets declined to 8.1% from 9.3% in FY'2016,
- Stanbic Bank's interest expense decreased by 5.3% to Kshs 6.0 bn from Kshs 6.3 bn in FY'2016. The costs of funds also declined to 3.4% from 4.0% in FY'2016. The Group's Net Interest Income (NII) declined by 2.0% to Kshs 10.6 bn from Kshs 10.9 bn in FY'2016. The Net Interest Margin thus declined to 5.2% from 5.9% in FY'2016,
- Non-Funded income (NFI) recorded an increase of 10.0% to Kshs 8.4 bn from Kshs 7.7 bn in FY'2016. The increase in NFI was driven by a 31.5% y/y rise in foreign exchange income to Kshs 4.4 bn from Kshs 3.4 bn and a 43.6% increase in other fees and commissions to Kshs 3.2 bn from Kshs 2.2 bn in FY'2016. With the NFI rising while the NII declined, the proportion of NFI to total revenue increased, with the current revenue mix at 56:44 funded to non-funded income from

59:41 in FY'2016,

- Total operating expenses grew by 9.6% to Kshs 13.7 bn from Kshs 12.5 bn in FY'2016 following a 57.6% y/y growth in Loan loss provision (LLP) to Kshs 2.8 bn from Kshs 1.8 bn. Without LLP, operating expenses increased by 1.7% to Kshs 10.9 bn from Kshs 10.7 bn registered in FY'2016,
- Cost to income ratio worsened to 71.7% from 67.3% in FY'2016. Without LLP, the cost to Income ratio improved slightly to 57.2% from 57.9% in FY'2016,
- Profit before tax declined 10.7% to Kshs 5.4 bn from Kshs 6.1 bn while profit after tax (PAT) declined by 2.5% to Kshs 4.3 bn from Kshs 4.4 bn in FY'2016, owing to a decline in the effective tax yield to 20.2% from 27%,
- The bank recommends a final dividend of Kshs 4.0 per share, having already paid an interim dividend of Kshs 1.25 per share, translating to a total dividend payout of Kshs 5.25 per share, unchanged from 2016, translating to a dividend yield of 4.9%,
- The balance sheet recorded an expansion in FY'2017, with total assets increasing by 15.9% to Kshs 248.7 bn from Kshs 214.7 bn in FY'2016, driven by a 42.6% increase in investment securities and an 8.1% rise in the loan book,
- The Loan book grew by 8.1% to Kshs 143.3 bn from Kshs 132.6 bn in FY'2016, while investment securities rose by 42.6% to Kshs 71.3 bn from Kshs 50.0 bn in FY'2016,
- Total liabilities increased by 17.9% to Kshs 205.8 bn from Kshs 174.5 bn in FY'2016, while shareholders' funds increased by 7.0% to Kshs 43.0 bn from Kshs 40.1 bn,
- Customer deposits grew by 24.1% to Kshs 193.4 bn from Kshs 155.8 bn in FY'2016. Deposits per branch increased by 28.2% to Kshs 7.4 bn from Kshs 5.8 bn per branch. The faster growth in deposits compared to loans led to a decline in the loan to deposit ratio to 74.1% from 85.1% in FY'2016,
- Gross non-performing loans grew by 47.7% to Kshs 10.4 bn from Kshs 7.0 bn in FY'2016, faster than the growth in loans, which saw the NPL ratio worsen to 7.0% from 5.2% in FY'2016,
- Stanbic Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.4%, 4.9% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 2.4% to close the period at 16.9%.

Despite the decreased profitability, going forward, we expect Stanbic's growth to be driven by;

- Cost efficiency, as the cost to income ratio of 71.7% is worse than peer average of 60.3%,
- Improvements in asset quality, with the increase in NPLs causing Stanbic's Gross Non-Performing Loans ratio to deteriorate to 7.0%, which is however still below peer average of 8.4%.

For a comprehensive analysis, see our [Stanbic Holdings FY'2017 Earnings Note](#).

Below is a summary of the FY'2017 results for the three listed banks that have released, and key take-outs from the results:

Listed Banks FY'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 & Commissions	Deposit Growth	Loan Growth	Growth in Govt. Securities
KCB Group	(0.1%)	1.4%	(3.1%)	2.9%	2.5%	32.2%	16.4%	11.5%	9.6%	7.4%
Stanbic	(2.5%)	(3.0%)	(5.3%)	(2.0%)	10.0%	44.2%	38.6%	24.1%	8.1%	42.6%
Barclays Bank	(6.4%)	(3.4%)	(7.2%)	(2.4%)	(9.5%)	27.9%	8.6%	12.5%	(0.7%)	20.1%
Weighted Average	(2.0%)	(0.4%)	(4.4%)	0.9%	0.5%	32.7%	17.4%	13.4%	6.9%	15.2%

*The weighted average is based on Market Cap as at 9th March, 2018

Key takeaways:

- None of the 3 banks has recorded a growth in core earnings per share, with the average decline in core earnings across the banking sector at 2.0%, 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 13.4%. However, despite the average deposits having grown, the interest expense paid on deposits recorded a negative growth of 4.4% 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 6.9%, however interest income has decreased by 0.4%, showing the effects of the rate caps,
- Investment in government securities has grown by 15.2% outpacing loan growth of 6.9%, showing increased lending to the government by banks as they avoid the risky borrowers,
- Non-funded income has however grown by 0.5%, which included a Fee and Commissions growth of 17.4%. This shows that banks are charging more fee income to improve their income on loans above the rate cap maximum.

The International Finance Corporation (IFC), World Bank's private sector lending arm, has advanced a Kshs 15.2 bn loan to Co-operative Bank. The loan is meant for onward lending to small firms, and its tenure is seven-years. The loan benefits Co-operative Bank as the long term funding is at attractive interest rates, while IFC will also meet its social investment goals of expanding credit to SMEs in the agricultural, manufacturing and trade sectors. IFC has invested in more than 150 local companies including Britam, KTDA, Goodlife Pharmacy and KCB Group.

The Arab Bank for Economic Development in Africa (BADEA) has opened a line of credit with HF Group for Kshs 1.5 bn, which is also meant for lending to the SME sector. The facility is meant to complement HFC's strategic initiative for its SME and retail banking segment. It will also play a pivotal role in financing the working capital and expansion of the bank's growing SME customer base. This highlights the trend that many Kenyan banks are looking for cheaper long term financing that global banks are willing and able to provide.

In an effort to keep our rankings of companies on the Cytonn Corporate Governance Ranking (Cytonn CGR) Report up-to-date, we continually update the rankings whenever there are changes on any of the 24 metrics that we track, and how this affects the company ranking. This week, Barclays Bank Kenya appointed Mr. Japheth Olende and Mr. Louis Onyango as independent Non-Executive Directors. Barclays Bank's gender diversity declined slightly to 40.0% from 50.0%, but still maintains the top score of 1.0, as it still has more than 33% gender diversity. In addition, the increase in board size to 10 members from an initial 8 members maintains the board at an even number with a score of 0.5. Barclays Bank therefore maintained its overall score at 79.2% and its ranking at position 9.

Below is our Equities Universe of Banking Coverage:

all prices in Kshs unless stated otherwise

No.	Company	Price as at 2/03/18	Price as at 9/03/18	w/w Change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/ (Downside)**
1.	NIC***	37.0	37.5	1.4%	9.6%	54.6%	61.4	3.5%	70.6%
2.	Ghana Commercial	6.1	4.8	(21.5%)	(5.9%)	(3.1%)	7.7	7.7%	70.2%
3.	DTBK	209.0	210.0	0.5%	8.9%	101.9%	281.7	1.3%	35.4%
4.	KCB Group	47.8	48.8	2.1%	11.7%	71.1%	59.7	4.1%	30.5%
5.	I&M Holdings	120.0	120.0	0.0%	(5.5%)	36.4%	150.4	2.5%	27.9%

all prices in Kshs unless stated otherwise

No.	Company	Price as at 2/03/18	Price as at 9/03/18	w/w Change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/ (Downside)**
6.	Barclays	11.1	11.1	0.0%	15.6%	23.3%	12.8	9.1%	25.5%
7.	Stanbic Uganda	29.0	29.0	0.0%	6.4%	13.7%	36.3	0.0%	25.1%
8.	HF Group***	10.9	10.5	(3.2%)	4.3%	(4.5%)	11.7	0.8%	15.2%
9.	CRDB Tanzania	190.0	190.0	0.0%	18.8%	2.7%	207.7	5.6%	14.9%
10.	Union Bank Nigeria	7.1	7.1	0.7%	(9.0%)	67.1%	8.2	0.0%	14.8%
11.	Zenith Bank Nigeria	31.6	30.9	(2.1%)	20.5%	110.9%	33.3	6.5%	14.4%
12.	Bank of Baroda -UG	120.0	116.0	(3.3%)	2.7%	5.5%	130.6	0.0%	12.6%
13.	Co-op Bank	18.6	18.8	1.1%	16.3%	79.8%	18.6	5.4%	9.0%
14.	Bank of Kigali -RW	295.0	295.0	0.0%	(1.7%)	20.4%	299.9	4.2%	5.8%
15.	Stanbic Holdings	84.0	82.0	(2.4%)	3.7%	22.4%	79.0	4.9%	1.9%
16.	Standard Chartered	210.0	209.0	(0.5%)	1.0%	3.0%	201.1	4.3%	1.0%
17.	Equity Group	46.0	47.8	3.8%	15.7%	80.2%	42.3	4.2%	0.3%
18.	Ecobank Ghana	11.7	11.6	(0.8%)	52.6%	61.8%	10.7	7.1%	(0.4%)
19.	UBA Bank Nigeria	12.8	12.9	1.2%	25.2%	157.5%	10.7	5.8%	(11.2%)
20.	SBM Holdings- MA	7.6	7.6	0.0%	1.3%	8.3%	6.6	1.3%	(12.4%)
21.	GT Bank Nigeria	48.5	47.7	(1.6%)	17.1%	77.0%	37.2	4.3%	(17.7%)
22.	Access Bank Nigeria	13.3	13.0	(2.3%)	24.4%	94.0%	9.5	5.0%	(21.9%)
23.	Stanbic IBTC Holdings	47.0	48.5	3.2%	16.9%	165.2%	37.0	1.2%	(22.5%)
24.	NBK	9.1	8.6	(5.5%)	(2.7%)	29.3%	5.6	0.0%	(29.0%)
25.	Stanchart-Ghana	34.5	34.5	0.0%	36.6%	130.0%	19.5	3.3%	(40.3%)

**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 NIC Bank, ranking as the 6th largest shareholder*

We maintain a "NEUTRAL" recommendation on equities for investors with short-term investment horizon since the market has rallied and brought the market P/E slightly above its' historical average. However, pockets of value exist, with a number of undervalued sectors like Financial Services, and with expectations of higher corporate earnings this year, the market will be cheaper for long-term investors hence we are "POSITIVE" for investors with a long-term horizon.

Liason House, StateHouse Avenue
The Chancery, Valley Road
www.cytonn.com
Generated By Cytonn Report

A product of **Cytonn Technologies**