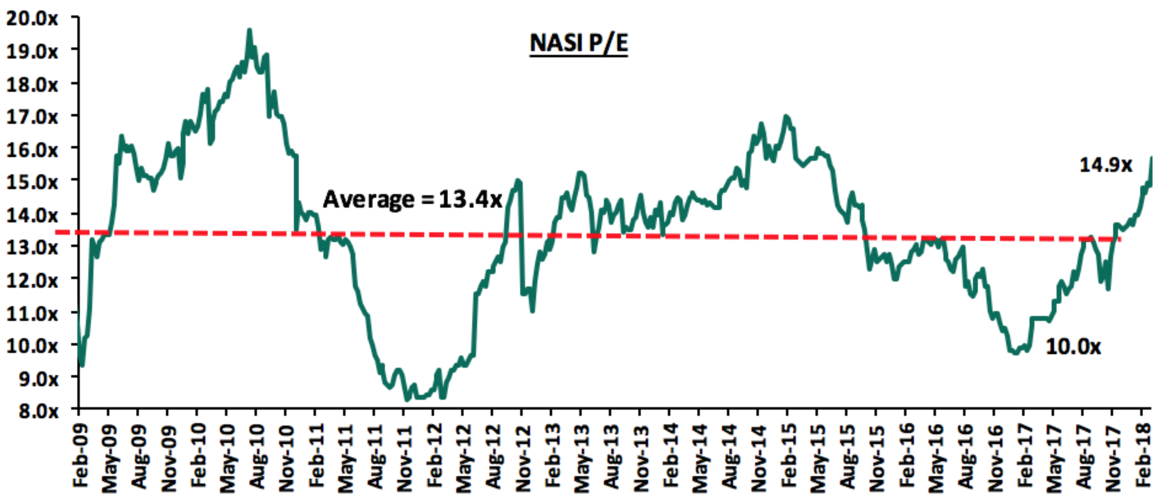
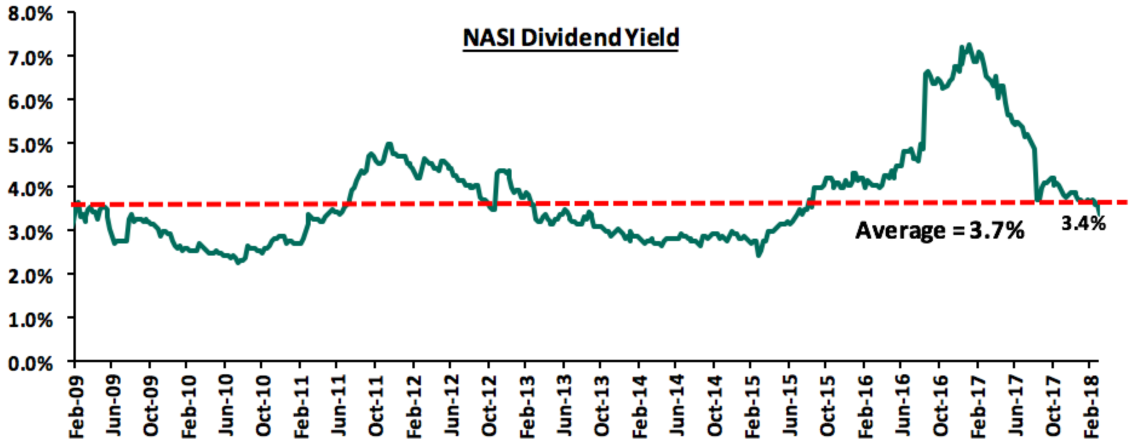
Cytonn Q1'2018 Markets Review

Equities

During Q1'2018, the Kenyan equities market was on an upward trend, with NASI, NSE 20 and NSE 25 gaining by 11.7%, 3.6% and 9.6%, respectively, as a result of gains in prices of large cap stocks. Top gainers for the quarter were Equity Group, Barclays, KCB Group, Cooperative Bank and Safaricom, which were up by 38.4%, 31.8%, 24.0%, 22.5% and 15.0%, respectively. NASI, NSE 20 and NSE 25 gained by 46.5%, 23.5% and 35.4%, over the last 12 months (LTM) respectively. During the week, the market had mixed performance, as NASI declined by 0.5%, NSE 20 was flat, while NSE 25 gained by 0.2%, with the decline in NASI due to a 2.4% decline in Safaricom.

Equity turnover during Q1'2018 rose by 73% to USD 600.0 mn from USD 347.2 mn in Q4'2017. This can be attributed to improved investor sentiment, as a result of improved political stability after the election period, which saw investors take profit following a rally in the stock market. The market is currently trading at a price to earnings ratio (P/E) of 14.9x, versus a historical average of 13.4x, and a dividend yield of 3.4%, compared to a historical average of 3.7%. The valuation is above the historical average but we believe there still exist pockets of value in the market, with the current P/E valuation being 7.1% below the most recent peak in February 2015. The current P/E valuation of 14.9x is 54% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 80% 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.





During the quarter, the Treasury issued a gazette notice authorizing stock lending and short selling (Securities Lending, Borrowing and Short-Selling) Regulations, 2017 as highlighted in our Cytonn Weekly #03/2018. This is set to enhance liquidity in the capital markets since bulk of the shares are held by pension funds who do not trade as often, thus reducing the levels of activity and liquidity in the market. Short selling provides an opportunity for investors to gain from a stock they do not own by borrowing it with an agreement of buying it back driven by the conviction that the stock's price will drop in future. The CMA has set up some of these measures in a bid to minimize risks associated with short selling:

- Short selling will be limited to a number of listed securities which is yet to be determined,
- Market intermediaries involved with short selling will also be required to submit a report of the transactions they have conducted once every month or in any other determined frequency by CMA, and,
- The stock borrower will also be required to submit collateral in cash or Government paper to the lender that covers at least 100% the value of the stocks borrowed.

During the quarter, 3 of the largest Kenyan Banks by market cap- Equity Bank, Cooperative Bank and KCB group were downgraded by the Moody's investor service to "B2" from "B1" previously. This was driven by the weakening credit rating of the Kenyan Government to B2 from B1 previously following the rising debt levels. The 3 Banks credit rating was linked to the Government rating due to their high sovereign exposure in form of Government securities held as part of liquid assets in their Balance sheets. A downgrade in the credit rating for a corporate might make it difficult for it to negotiate for lower rates on corporate debt financing. We maintain our view that the 3 banks are still fundamentally strong with their capital adequacy ratios currently above the minimum statutory requirements.

A number of Banks released results during the week:

- Diamond Trust Bank released FY'2017 results, registering a decline in its core earnings per share (EPS) by 10.3% to Kshs 24.8 from Kshs 27.6 in FY'2016, lower than our expectations for an EPS of Kshs 26.8. The decline in performance was driven by a 10.4% increase in operating expenses, despite operating income increasing by 2.0%. For more information, see our DTBK FY'2017 Earnings Note
- I&M Holdings Limited released FY'2017 results, registering a decline in core earnings per share by 7.1% to Kshs 16.5 from Kshs 17.7 in FY'2016, higher than our expectations for an EPS of Kshs 16.0. The decline in performance was driven by a 15.9% increase in operating expenses, despite operating income increasing by 4.0%. For more information, see our I&M Holdings FY'2017 Earnings Note.
- HF Group released FY'2017 results, registering a decline in its core earnings per share by 86.1% to Kshs 0.4 from Kshs 2.5 in FY'2016, lower than our expectations for an EPS of Kshs 0.5. The decline in performance was driven by a 19.3% increase in operating expenses, coupled with a

7.8% decline in operating income. For more information, see our HF Group FY'2017 Earnings Note
- NBK released FY'2017 results, registering an increase in its core earnings per share by 479.0% to Kshs 1.2 from Kshs 0.2 in FY'2016, higher than our expectations for an EPS of Kshs 0.3. The improvement in performance was driven by a 20.8% decline in operating expenses, despite operating income also declining by 14.0%. For more information, see our NBK FY'2017 Earnings Note

During the quarter, listed banks released their 2017 full year results, recording an average decline in core earnings per share of 0.8% compared to a 4.4% gain in 2016, weighed down by the enactment of the Banking Act (Amendment) 2015, which placed regulations on banks' loan and deposit pricing framework. Below is a summary of some of the metrics that we track:

Listed Banks FY'2017 Earnings and Growth Metrics

Bank	Core EPS Growth (%)	Interest Income Growth (%)	Interest Expense Growth (%)	Net Interest Income Growth (%)	Net Interest Margin (%)	Non-Funded Income (NFI) Growth (%)	NFI to Total Operating Income (%)	Growth in Total Fees& Commissions (%)	Deposit Growth (%)	Loan Growth (%)	Growth in Govt. Securities (%)
NBK	479.0	(17.7)	(24.9)	(13.7)	7.4	(15.0)	26.5	(1.2)	91.4	0.4	(4.8)
Equity Group	14.0	(6.6)	8.1	(10.2)	9.0	24.2	42.0	22.0	10.7	4.9	27.3
KCB Group	(0.1)	1.4	(3.1)	2.9	8.7	2.5	32.2	16.4	11.5	9.6	7.4
Stanbic	(2.5)	(3.0)	(5.3)	(2.0)	5.2	10.0	44.2	38.6	24.1	8.1	42.6
NIC Group	(4.3)	(3.2)	11.5	(11.5)	6.3	3.6	27.9	14.2	24.2	4.6	77.9
Barclays Bank	(6.4)	(3.4)	(7.2)	(2.4)	9.7	(9.5)	27.9	8.6	12.5	(0.7)	20.1
I&M Holdings	(7.1)	(0.1)	0.0	0.6	7.8	15.9	27.0	22.0	15.5	13.6	10.9
Co-op Bank	(10.0)	(4.5)	(3.9)	(4.7)	9.2	5.6	32.4	0.3	9.2	7.1	19.7
DTBK	(10.3)	2.4	3.6	1.5	6.5	4.1	21.1	5.3	11.8	5.2	23.3
Stanchart	(24.0)	1.9	20.3	(4.1)	8.4	2.3	32.1	(0.4)	14.3	2.9	26.7
HF Group	(86.1)	(17.1)	(11.1)	(24.3)	5.2	78.2	31.1	(37.6)	(3.7)	(8.9)	(44.0)
Weighted Average**	**(0.8%)**	**(2.4%)**	**2.5%**	**(3.8%)**	**8.4%**	**9.0%**	**33.6%**	**13.3%**	**12.5%**	**6.1%**	**22.2%**
Weighted 2016 Average	**4.4%**	**15.5%**	**6.2%**	**20.3%**	**9.2%**	**2.4%**	**31.0%**	**12.6%**	**6.4%**	**6.3%**	**45.8%**

**- Market cap weighted as at 29th March, 2018

Key take-outs from the Kenya Listed Banks performance in 2017 include:

- The listed banks recorded a 0.8% decline in core EPS, compared to a growth of 4.4% in 2016. Only National Bank and Equity Group recorded a growth in core EPS, registering at 457%, and 14% growth in earnings, respectively. National Bank restated their 2016 results, and benefitted from a decline in loan loss provisioning, while Equity Group gained on the back of a 24.3% growth in Non-Funded income (NFI). HF Group recorded the biggest decline at 86.1%, on the back of a 24.3% decline in Net Interest Income (NII),
- Average deposit growth came in at 12.5%. However, despite the average deposits having grown, the interest expense paid on deposits recorded a slower growth of 2.5% 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 6.1%, however interest income has decreased by 2.4%, showing the effects of the rate cap,
- Investment in government securities has grown by 22.2%, outpacing loan growth of 6.1%, showing increased lending to the government by banks as they avoid the risky borrowers,
- The average Net Interest Margin in the banking sector currently stands at 8.4%, and

- Non-funded income has grown by 9.0%, which included a Fee and Commissions growth of 13.3%. This shows that banks are charging more fee income to improve their income 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 23/03/18	Price as at 29/03/18	w/w Change	YTD/Q/Q Change	LTM Change	Target Price*	Dividend Yield	Upside/ (Downside)**	P/TBv Multiple
1.	NIC Bank***	41.3	41.3	0.0%	22.2%	66.7%	61.4	3.0%	51.9%	0.8x
2.	Ghana Commercial	6.0	6.1	1.3%	20.6%	19.6%	7.7	6.2%	33.0%	1.7x
3.	Diamond Trust Bank	218.0	219.0	0.5%	14.1%	76.6%	281.7	1.2%	29.8%	1.2x
4.	CRDB	170.0	170.0	0.0%	6.3%	(8.1%)	207.7	5.6%	27.7%	0.7x
5.	Zenith Bank	30.2	29.3	(3.0%)	14.3%	109.3%	33.3	10.1%	23.8%	1.4x
6.	I&M Holdings	125.0	125.0	0.0%	(1.6%)	35.1%	150.4	2.8%	23.1%	1.4x
7.	Union Bank Plc	6.7	6.7	0.0%	(14.1%)	54.4%	8.2	0.0%	21.6%	0.7x
8.	Stanbic Bank Uganda	30.0	30.0	0.0%	10.1%	15.4%	36.3	0.0%	20.9%	2.0x
9.	KCB Group	51.5	52.0	1.0%	21.6%	57.6%	59.7	5.8%	20.6%	1.6x
10.	Barclays	12.7	12.6	(0.8%)	30.7%	40.2%	12.8	8.0%	10.0%	1.6x
11.	Bank of Baroda	120.0	120.0	0.0%	6.2%	9.1%	130.6	0.0%	8.8%	1.1x
12.	Bank of Kigali	295.0	290.0	(1.7%)	(3.3%)	18.9%	299.9	4.2%	7.7%	1.7x
13.	Ecobank	11.2	11.2	(0.4%)	46.7%	52.7%	10.7	7.4%	3.6%	4.0x
14.	HF Group***	10.8	11.7	8.4%	12.0%	14.8%	11.7	3.0%	3.4%	0.4x
15.	Co-operative Bank	19.5	19.6	0.5%	22.5%	71.1%	18.6	4.1%	(1.0%)	1.7x
16.	UBA Bank	11.5	11.8	2.2%	14.1%	104.0%	10.7	7.2%	(1.7%)	1.0x
17.	Standard Chartered KE	234.0	228.0	(2.6%)	9.6%	3.2%	201.1	7.5%	(4.3%)	1.8x
18.	Access Bank	11.3	11.1	(2.2%)	5.7%	78.2%	9.5	5.9%	(8.1%)	0.8x
19.	CAL Bank	1.3	1.5	16.8%	41.7%	212.2%	1.4	0.0%	(8.5%)	1.2x
20.	Stanbic Holdings	91.5	92.5	1.1%	14.2%	46.8%	79.0	5.7%	(8.9%)	1.2x
21.	SBM Holdings	7.6	7.7	0.5%	2.4%	8.2%	6.6	5.2%	(9.4%)	0.9x
22.	Guaranty Trust Bank	46.9	44.7	(4.7%)	9.7%	76.3%	37.2	6.0%	(10.7%)	2.7x
23.	Equity Group	52.5	54.0	2.9%	35.8%	66.2%	42.3	3.7%	(18.0%)	2.4x
24.	Stanbic IBTC Holdings	45.7	48.5	6.2%	13.3%	169.4%	37.0	1.0%	(22.7%)	2.9x
25.	National Bank	8.5	9.2	7.6%	(2.1%)	52.5%	5.6	0.0%	(38.8%)	0.5x
26.	Ecobank Transnational	17.8	16.4	(8.1%)	(3.8%)	87.9%	9.3	3.7%	(39.5%)	0.9x
27.	Standard Chartered GH	34.8	35.1	1.0%	39.0%	127.2%	19.5	3.2%	(41.4%)	5.0x
28.	FBN Holdings	12.3	12.5	2.0%	42.0%	311.2%	6.6	1.6%	(45.4%)	0.7x

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 5th largest shareholder***

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