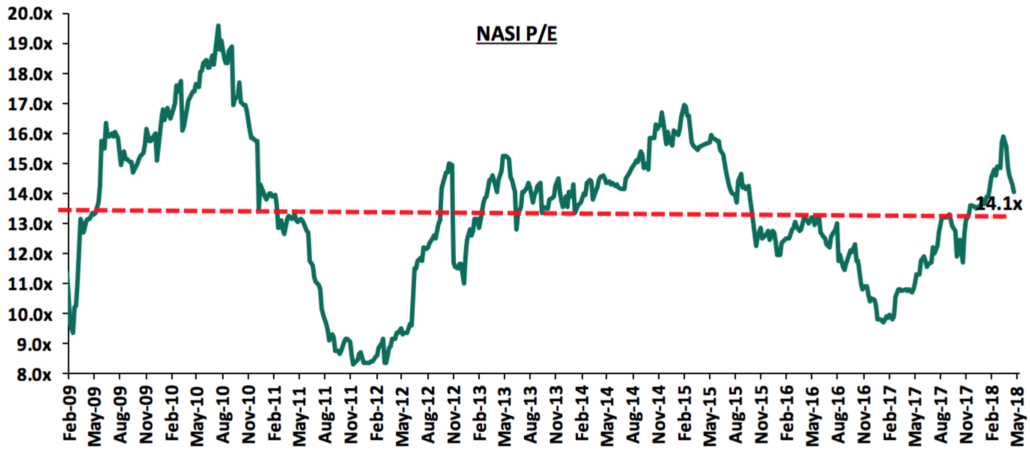
Rate Cap Review Should Focus More on Stimulating Capital Markets, & Cytonn Weekly #19/2018

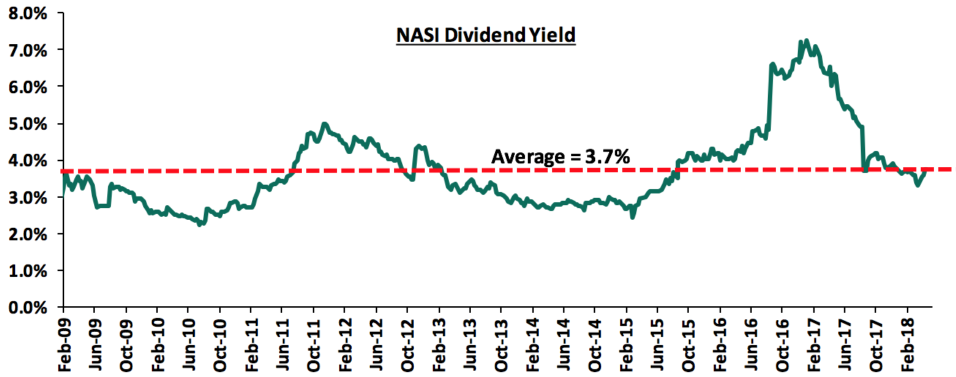
Equities

During the week, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 losing 1.5%, 2.6% and 0.8%, respectively. This takes the YTD performance of NASI, NSE 20 and NSE 25 to 4.1%, (3.0%) and 5.2%, respectively. This week's performance was driven by declines in BAT, Barclays Bank Limited and Safaricom, which declined by 7.7%, 3.3%, and 2.6%, respectively. For the last twelve months (LTM), NASI, NSE 20 and NSE 25 have gained 28.4%, 12.7% and 28.5%, respectively.

Equities turnover increased by 11.2% to USD 47.7 mn from USD 42.9 mn the previous week. We expect the market to remain resilient this year supported by positive investor sentiment, as investors take advantage of the attractive stock valuations in select counters.

The market is currently trading at a price to earnings ratio (P/E) of 14.1x, which is 4.4% above the historical average of 13.5x, and a dividend yield of 3.7%, corresponding to the historical average of 3.7%. The current P/E valuation of 14.1x is 45.4% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 69.9% 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.





Mortgage financier HF Group borrowed Kshs 800.0 mn in short-term loans from NIC Group and Co-operative Bank last year, according to their 2017 annual report. HF Group will repay the debt at close to the maximum interest rate allowed by law, an indication of its keen interest in getting the funding in order to facilitate payment to investors who participated in their Kshs 7.0 bn, 7-year Medium Term Note that matured last year. The loans, a Kshs 500.0 mn facility from NIC Group and a Kshs 300.0 mn note from Co-operative Bank, were to be serviced at interest rates of 14.0% and 13.0%, respectively over a one-year period; these rates rates similar to the 7-year Medium Term Note it had issued at 13.0%. These rates are above the 6.3% rate that prevailed last year for the interbank market, according to data from Central Bank of Kenya (CBK). The obligations had grown to Kshs 517.3 mn on the NIC loan and Kshs 309.6 mn on the Co-operative Bank loan as at December 2017. HF Group was also able to tap into the foreign markets, with the bank receiving additional funds from the European Investment Bank (EIB) and Ghana International Bank (GIB). The loan from EIB amounted to USD 22.0 mn (Kshs 2.2 bn) at an interest rate of 4.3% for 7-years, while GIB issued a 2-year loan of USD 15.0 mn (Kshs 1.5 bn) at an interest rate of 5.0% above 3-month LIBOR.

Commercial banks will be allowed to charge borrowers based on their risk profiles in a new proposed amendment to the Banking (Amendment) Act, 2015. According to the Treasury, the proposed new loan pricing model will include a flat base rate but with an additional risk component, allowing banks to differentiate rates for different customers based on individual risk assessment. The process of drafting the bill is ongoing and it will be submitted to legislators for approval in June when presenting the budget for the 2018/19 fiscal year. The proposal comes on the backdrop of dwindling access to credit by the private sector, as the intended aim of the rate cap law to help small and medium enterprises access affordable credit was not realized. Instead, lending to SMEs was deemed too risky as lenders could not properly price risk in the wake of the rate cap, opting to lend to the government instead. The proposed amendments, however, have been met with resistance from various quarters, including Members of Parliament who have vowed not to sign the bill into law. The Consumer Federation of Kenya (Cofek) said the proposed pricing model amounts to giving banks the leeway to charge high rates on loans to customers. We are of the view that despite the amendment being a positive step in addressing the slowing private sector credit growth, it may fail to mitigate the negative effects of the rate cap on the economy; we instead propose a raft of guidelines that we have highlighted in this week’s Focus note, particularly legislation that should focus on stimulating capital markets in order to reduce reliance on banks for funding and increased options for depositors.

Below is our Equities Universe of Coverage:

all prices in Kshs unless stated otherwise

No.	Company	Price as at 04/05/18	Price as at 11/05/18	w/w Change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/ (Downside)**	P/TBv Multiple
1.	NIC Group***	36.6	38.3	4.5%	5.5%	54.4%	56.0	2.6%	52.9%	**0.8x**
2.	KCB Group	48.0	50.0	4.2%	17.0%	47.1%	63.7	4.0%	31.3%	**1.5x**
3.	Zenith Bank Plc	27.5	28.9	5.1%	12.7%	59.0%	33.3	9.3%	30.7%	**1.1x**
4.	Union Bank Plc	6.7	6.8	0.7%	(13.5%)	51.0%	8.2	0.0%	30.4%	**0.7x**
5.	Diamond Trust Bank	210.0	205.0	(2.4%)	6.8%	62.7%	272.9	1.3%	28.8%	**1.1x**
6.	Ghana Commercial	6.4	6.4	0.8%	26.7%	23.1%	7.7	5.9%	28.3%	**1.5x**
7.	I&M Holdings	125.0	124.0	(0.8%)	(2.4%)	36.3%	151.2	2.8%	23.8%	**1.2x**
8.	Stanbic Bank UG	31.0	31.0	0.0%	13.8%	14.8%	36.3	3.8%	21.7%	**2.5x**
9.	CRDB	180.0	180.0	0.0%	12.5%	(2.7%)	207.7	0.0%	15.4%	**0.6x**
10.	Co-operative Bank	18.6	18.5	(0.3%)	15.6%	31.4%	20.5	4.3%	15.0%	**1.6x**
11.	Equity Group	51.0	51.0	0.0%	28.3%	59.4%	54.3	3.9%	14.3%	**2.2x**
12.	Barclays Bank	12.1	11.7	(3.3%)	21.9%	46.3%	13.7	8.5%	11.9%	**1.7x**
13.	Bank of Kigali	290.0	290.0	0.0%	(3.3%)	18.4%	299.9	4.8%	8.2%	**1.6x**
14.	National Bank	8.0	7.5	(5.7%)	(19.8%)	28.0%	8.6	0.0%	8.1%	**0.4x**
15.	UBA Bank	11.7	11.7	0.0%	13.6%	68.3%	10.7	12.8%	5.5%	**0.8x**
16.	Stanbic Holdings	91.5	90.0	(1.6%)	11.1%	46.3%	87.1	5.8%	2.7%	**1.1x**
17.	HF Group***	10.3	10.0	(2.9%)	(4.3%)	9.9%	10.0	3.2%	2.5%	**0.4x**
18.	Bank of Baroda	150.0	150.0	0.0%	32.7%	36.4%	130.6	1.7%	(0.9%)	**1.2x**
19.	StanChart KE	210.0	211.0	0.5%	1.4%	9.3%	192.6	5.9%	(1.9%)	**1.7x**
20.	Ecobank	11.6	11.7	0.9%	53.3%	58.9%	10.7	0.0%	(6.7%)	**3.3x**
21.	SBM Holdings	7.7	7.7	0.3%	2.9%	1.3%	6.6	3.9%	(10.9%)	**1.1x**
22.	Access Bank	11.3	11.3	(0.4%)	7.7%	52.0%	9.5	3.6%	(11.6%)	**0.6x**
23.	GT Bank	45.3	44.3	(2.3%)	8.6%	49.7%	37.2	5.4%	(11.9%)	**2.5x**
24.	Stanbic IBTC	49.5	49.0	(1.0%)	18.1%	81.5%	37.0	1.2%	(24.0%)	**2.7x**
25.	CAL Bank	1.9	1.8	(4.8%)	66.7%	143.2%	1.4	0.0%	(28.9%)	**1.7x**
26.	StanChart GH	34.9	34.8	(0.3%)	37.8%	117.5%	19.5	0.0%	(44.3%)	**4.4x**
27.	FBN Holdings	12.6	12.3	(2.4%)	39.2%	198.8%	6.6	2.0%	(44.9%)	**0.7x**
28.	Ecobank TN	20.6	21.1	2.4%	23.8%	123.7%	9.3	0.0%	(53.8%)	**0.7x**

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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 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.