Cytonn INVESTMENTS

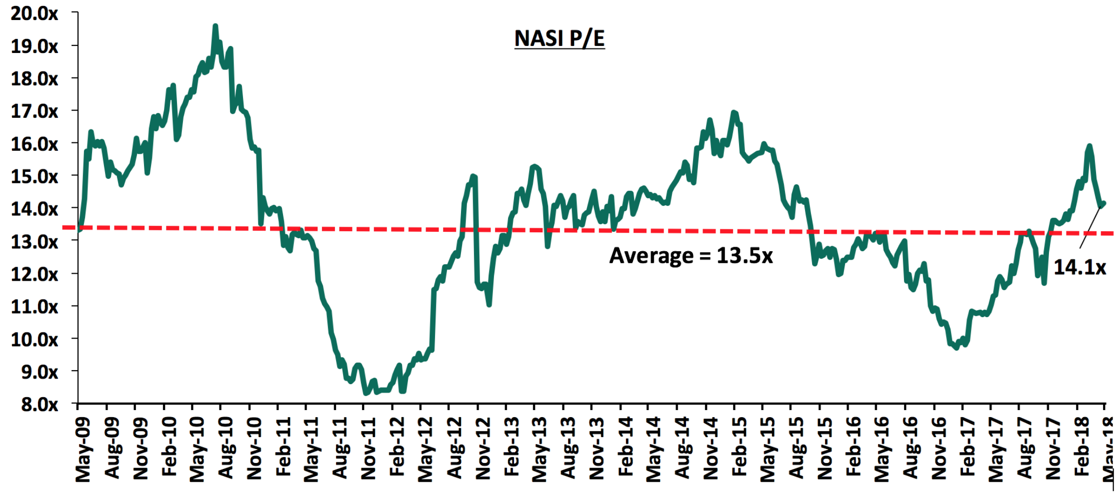
Cytonn Weekly #20/2018

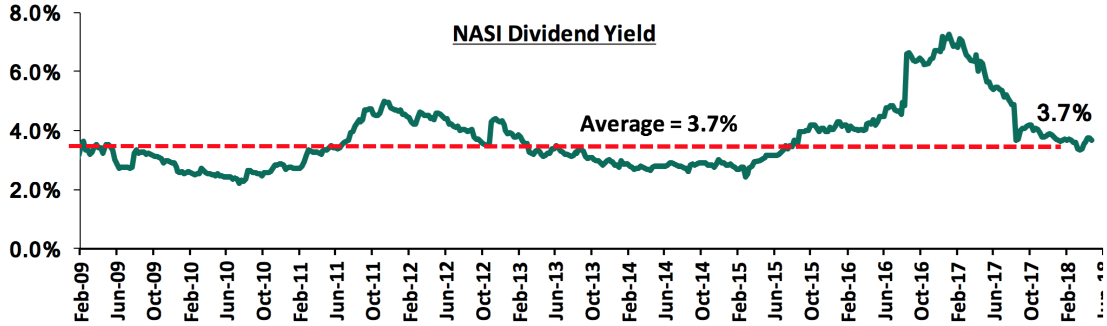
Equities

During the week, the equities market recorded mixed performance with NASI and NSE 25 gaining by 0.6% and 0.7%, respectively, while the NSE 20 declined by 3.0%, taking their YTD performance to 4.7%, (5.9%) and 5.9% for NASI, NSE 20 and NSE 25, respectively. This week's performance of the NASI was due to gains in Safaricom, BAT and Cooperative Bank that gained by 5.4%, 2.7% and 1.1%, respectively. For the last twelve months (LTM), NASI, NSE 20 and NSE 25 have gained 29.1%, 7.7%, and 28.1%, respectively.

Equities turnover declined by 33.1% to USD 33.1 mn, from USD 47.7 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 14.1x, which is 4.4% above the historical average of 13.5x, and a dividend yield of 3.7%, which is similar 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. Below are the P/E and dividend yield charts of the NASI:





KCB Group released Q1'2018 results during the week;

KCB Group released Q1'2018 results, with its core earnings per share increasing by 14.0% to Kshs

6.8 from Kshs 5.9 in Q1’2017, compared to our expectation of a 2.2% increase to Kshs 6.0. The performance was driven by a 6.7% increase in total operating income, which outpaced the 1.8% increase in total operating expenses, to Kshs 9.5 bn in Q1’2018 from Kshs 9.3 bn in Q1’2017. The variance in core earnings per share growth against our expectations was largely due to a 37.0% decline in KCB’s provisioning levels despite the compliance with IFRS 9 that adopts a forward-looking approach to credit risk assessment. We expected provisioning levels of Kshs 1.0 bn, that came in at Kshs 0.6 bn. Highlights of the performance from Q1’2017 to Q1’2018 include:

- Total operating income increased by 6.7% to Kshs 17.0 bn, from Kshs 15.9 bn in Q1’2017, driven by an increase in Net Interest Income (NII) that rose by 10.0% to Kshs 11.4 bn, from Kshs 10.3 bn in Q1’2017. Non-Funded Income (NFI) declined marginally by 0.4% to Kshs 5.5 bn, from Kshs 5.6 bn in Q1’2017,
- Interest income increased by 11.0% to Kshs 15.7 bn from Kshs 14.1 bn in Q1’2017. The interest income on loans and advances increased by 10.9% y/y to Kshs 12.6 bn from 11.3 bn, while interest income on government securities increased by 17.2% y/y to Kshs 3.0 bn from Kshs 2.6 bn. As a result, the yield on interest-earning assets increased slightly to 12.0%, from 11.9% in Q1’2017,
- Interest expense increased 13.0% to Kshs 4.2 bn, from Kshs 3.8 bn in Q1’2017, following an 18.9% increase in the interest expense on customer deposits to Kshs 3.8 bn in Q1’2018, from Kshs 3.1 bn in Q1’2017, increasing the cost of funds to 3.1% from 3.0% in Q1’2017. The Net Interest Margin remained stable at 8.2%, as the rate of change in yield on interest income and cost of interest expense was the same,
- Non-Funded Income (NFI) declined marginally by 0.4% to Kshs 5.5 bn, from Kshs 5.6 bn in Q1’2017, due to a decline in total fees and commissions, which declined by 2.3% to Kshs 1.4 bn from Kshs 1.43 bn in Q1’2017, and forex trading income declined 19.7% to Kshs 1.0 bn from Kshs 1.3 bn in Q1’2017. However, other income rose 7.6% to Kshs 0.9 bn from Kshs 0.8 bn,
- The current revenue mix stands at about 67:33 funded to non-funded income, from 65:35 recorded in Q1’2017. The decline in the proportion of NFI to total income is due to a faster growth in NII coupled with a 0.4% decline in NFI,
- Total operating expenses increased by 1.8% to Kshs 9.5 bn from Kshs 9.3 bn in Q1’2017, largely driven by an increase in other operating expenses, which rose by 13.9% to Kshs 3.3 bn from Kshs 2.9 bn in Q1’2017. Rental charges rose 8.0% to Kshs 337.5 mn from Kshs 312.5 mn. Staff costs rose by 0.2% to Kshs 4.5 bn in Q1’2018 from Kshs 4.4 bn in Q1’2017. However, loan loss provisions (LLP) decreased by 37.0% to Kshs 0.6 bn from Kshs 1.0 bn in Q1’2017,
- The cost to income ratio improved to 55.9% from 58.6% in Q1’2017. Without LLP, the Cost to income ratio also improved, albeit marginally to 52.4% in Q1’2018 from 52.5% in Q1’2017,
- Profit before tax increased by 14.0% and to stand at Kshs 7.5 bn, up from Kshs 6.6 bn in Q1’2017. Profit after tax also increased 14.0% to Kshs 5.2 bn from Kshs 4.5 bn in Q1’2017,
- The balance sheet recorded an expansion in Q1’2018. Total assets increased by 7.0% to Kshs 647.5 bn from Kshs 605.8 bn in Q1’2017. The loan book increased by 6.0% to stand at Kshs 418.6 bn from Kshs 395.5 bn in Q1’2017. Government securities increased by 5.8% to Kshs 112.1 bn from Kshs 106.0 bn in Q1’2017 while fixed assets increased by 5.1% to Kshs 11.0 bn from Kshs 9.5 bn,
- Total liabilities rose by 8.6% to Kshs 547.8 bn from Kshs 504.5 bn in Q1’2017, driven by an 8.7% increase in customer deposits to Kshs 496.4 bn from Kshs 456.8 bn in Q1’2017. Deposits per branch closed the quarter at Kshs 1.9 bn, up by 11.8% from Kshs 1.7 bn in Q1’2017,
- The faster growth in deposits compared to loans led to a decline in the loan to deposit ratio to 84.3% in Q1’2018 from 86.6% in Q1’2017,
- Shareholders’ funds declined by 4.4% from Kshs 101.2 bn in Q1’2017 to Kshs 99.6 bn in Q1’2018, mainly due to the 92.7% decline in the statutory loan loss reserve to Kshs 0.9 bn from Kshs 11.7 bn in Q1’2017,
- Gross non-performing loans (NPLs) increased by 36.2% to Kshs 43.8 bn from Kshs 32.2 bn in Q1’2017. The NPL ratio as a consequence deteriorated to 9.9% in Q1’2018 from 7.7% in Q1’2017,

as NPLs increased at a faster rate than the loan book,
- KCB Group Plc is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.1%, 4.6% above the statutory requirement of 10.5%. The total capital to risk weighted assets ratio is 15.3%, exceeding the statutory requirement of 14.5% by just 0.8%, an indication that the bank may seek to raise additional Tier II capital this year. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 15.9%, while total capital to risk weighted assets came in at 16.9%, indicating that the bank's total capital relative to its risk-weighted assets declined by 0.8% owing to IFRS 9 implementation,
- KCB Group currently has a return on average assets of 3.2% and a return on average equity of 20.3%.

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

i. Non-Funded Income Growth Initiatives - This includes increasing other fees and commission income by leveraging on mobile and internet banking to increase the transaction income. Additionally, the brand is underutilized in fee income businesses such as investment banking, brokerage, asset and investment management, and advisory, and it does not seem like the current management has the ability to diversify the revenue streams. KCB's NFI ratio currently stands at 33.0%, slightly lower than the industry average of 33.6%. KCB should diversify its sources of revenue in order to compete favorably in the interest rate cap environment,
ii. Alternative Distribution Channels – By leveraging on alternative distribution channels for the bank's products and services, such as agency banking, internet and mobile banking platforms, would address the stagnating growth in non-funded sources of income for the bank thereby creating efficiencies and improving overall profitability for the bank, and,
iii. Furthermore, the bank hopes to reduce the non-performing loans by aiding in reinstating of collapsed businesses, which will enable them to service their loans, and thus improve the bank's asset quality.

For a comprehensive analysis, see our KCB Group Q1'2018 Earnings Note.

Equity Group Holding released Q1'2018 financial results;

Equity Group Holdings released Q1'2018 results, with its core earnings per share increasing by 21.7% to Kshs 5.9 from Kshs 4.9 in Q1'2017, compared to our expectation of a 17.5% increase to Kshs 5.7. Performance was driven by an 8.6% increase in total operating income, coupled with a 1.2% decrease in the total operating expenses. The variance in core earnings per share growth against our expectations was largely due to a 55.0% decline in Equity's provisioning levels despite the compliance with IFRS 9 that adopts a prospective approach to credit risk assessment. We expected provisioning levels of Kshs 0.9 bn, that came in at Kshs 0.4 bn. Highlights of the performance from Q1'2017 to Q1'2018 include:

- Total operating income increased by 8.6% to Kshs 16.5 bn in Q1'2018, from Kshs 15.2 bn in Q1'2017. This was due to a 10.5% increase in Net Interest Income (NII) to Kshs 9.8 bn in Q1'2018 from Kshs 8.9 bn in Q1'2017, coupled with a 6.3% increase in Non-Funded Income (NFI) to Kshs 6.7 bn in Q1'2018 from Kshs 6.3 bn in Q1'2017,
- Interest income increased by 10.5% to Kshs 12.7 bn in Q1'2018 from Kshs 11.5 bn in Q1'2017 bn. The interest income on loans and advances increased by 7.0% to Kshs 8.8 bn in Q1'2018 from Kshs 8.2 bn in Q1'2017. Interest income on government securities increased by 21.9% to Kshs 3.9 bn in Q1'2018 from Kshs 3.2 bn in Q1'2017. The yield on interest earning assets however declined to 11.3% in Q1'2018 from 13.0% in Q1'2017, due to the relatively faster increase in the interest earning assets to Kshs 458.3 bn from Kshs 407.1 bn in Q1'2017,
- Interest expense increased by 10.5% to Kshs 2.9 bn in Q1'2018 from Kshs 2.6 bn in Q1'2017, following a 16.8% increase in the interest expense on customer deposits to Kshs 2.4 bn in Q1'2018 from Kshs 2.0 bn in Q1'2017. Other interest expenses declined by 18.7% to Kshs 0.4 bn in

Q1’2018 from Kshs 0.5 bn in Q1’2017. The cost of funds remained unchanged at 2.7%. Net Interest Margin declined to 8.4% from 8.5% in Q1’2017,

- Non-Funded Income increased by 6.3% to Kshs 6.7 bn from Kshs 6.3 bn in Q1’2017. The growth in NFI was driven by a 7.2% increase in Fees and commissions on loans to Kshs 1.5 bn from Kshs 1.4 bn in Q1’2017, and a 3.2% increase in other fees and commission income to Kshs 3.2 bn from Kshs 3.1 bn in Q1’2017. Foreign exchange income however declined by 26.9% to Kshs 0.7 bn from Kshs 0.9 bn in Q1’2017. The current revenue mix stands at 59:41 funded to non-funded income as compared to 58:42 in Q1’2017. The proportion of non-funded income to total revenue declined slightly owing to the faster growth in NII as compared to NFI,
- Total operating expenses declined by 1.2% to Kshs 8.2 bn from Kshs 8.3 bn, largely driven by a 55% decrease in the loan loss provision to Kshs 0.4 bn in Q1’2018 from Kshs 0.8 bn in Q1’2017, coupled with a 9.5% decline in the depreciation charge on property and equipment to Kshs 0.8 bn in Q1’2018 from Kshs 0.9 bn in Q1’2017. Staff costs however rose by 6.0% to Kshs 2.6 bn in Q1’2018 from Kshs 2.5 bn in Q1’2017, owing to increased staff reorganization costs as 400 employees were laid off,
- The cost to income ratio improved to 49.6% from 54.7% in Q1’2017. Without LLP, the Cost to income ratio also improved to 47.5% from 49.4% in Q1’2017,
- Profit before tax increased by 21.0% to Kshs 8.3 bn, up from Kshs 6.9 bn in Q1’2017. Profit after tax increased 21.7% to Kshs 5.9 bn in Q1’2018 from Kshs 4.9 bn in Q1’2017,
- The balance sheet recorded an expansion as total assets increased by 2.0% to Kshs 402.2 bn from Kshs 393.9 bn in Q1’2017. This growth was largely driven by a 32.9% increase in the government securities to Kshs 150.2 bn from Kshs 113.0 bn. Net loans and advances increased by 3.5% to Kshs 271.1 bn in Q1’2018 from Kshs 261.9 bn in Q1’2017,
- Total liabilities rose by 8.0% to Kshs 445.7 bn from Kshs 412.7 bn in Q1’2017, driven by a 10.0% increase in total deposits to Kshs 382.4 bn in Q1’2018 from Kshs 349.3 bn in Q1’2017. Deposits per branch increased by 9.5% to Kshs 1.4 bn from Kshs 1.2 bn in Q1’2017,
- The faster growth in deposits as compared to loans led to the decline in the loan to deposit ratio to 70.9% from 75.0% in Q1’2017,
- Gross non-performing loans decreased by 7.2% to Kshs 18.1 bn in Q1’2018 from Kshs 19.5 bn in Q1’2017. Consequently, the NPL ratio improved to 6.3% in Q1’2018 from 7.1% in Q1’2017. The NPL coverage increased to 105.1% in Q1’2018 from 64.9% in Q1’2017, as the group implemented provisioning under the IFRS 9 reporting standard,
- Shareholders’ funds increased by 3.0% to Kshs 82.1 bn in Q1’2018 from Kshs 79.4 bn in Q1’2017.
- Equity Group Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 19.3%, 8.8% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 20.2%, exceeding the statutory requirement by 5.7%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 20.2%, while total capital to risk weighted assets came in at 20.3%, indicating that the bank had its capital position decline by 0.5% due to implementation of IFRS 9,
- Equity Group currently has a return on average assets of 3.9% and a return on average equity of 24.7%.

Going forward, we expect the bank’s growth to be further propelled by;

i. Increased focus on alternative distribution channels, as the bank rides on the digital revolution wave, as evidenced by the increase in the number of transactions done via the Equity Eazzy Banking app, which had the number of transactions increase by 239.0% to 48.7 mn transactions from 14.4 mn transactions in Q1’2017. This consequently saw the value of transactions done via the channel increase by 146.0% to Kshs 26.7 bn from Kshs 10.9 bn in Q1’2017. Equitel on the other hand had the number of transactions decline by 16.0% to 60.1 mn transactions from 71.4 mn transactions in Q1’2017. However, the value of transactions done via Equitel increased by 17.0% to Kshs 138.5 bn from 118.0 bn in Q1’2017. Thus, the adoption of these alternative channels will help in improving the cost to income ratio by cost rationalization and revenue expansion, thereby aiding the group in achieving a sustainable growth,

ii. The bank's operating model of enhancing balance sheet agility is likely to place the bank in a prime position to take advantage of any opportunities that may arise, such as attractive inorganic growth opportunities via acquisitions or fast lending in the event of a repeal of the interest rate cap, and,
iii. Increased focus on regional expansion as the bank focuses on increasing its footprint in regions it has already established itself as it aims to diversify across geographies.

For a comprehensive analysis, see our Equity Group Q1'2018 Earnings Note.

NIC Group Holding released Q1'2018 financial results;

NIC Group released Q1'2018 results, recording core earnings per share (Core EPS) growth of 2.2% to Kshs 1.38 from Kshs 1.35 in Q1'2017, compared to our expectation of a 3.4% growth in core EPS to Kshs 1.4. The performance was driven by a faster decline in total operating expenses by 8.1% outpacing the decline in total operating revenue, which declined by 4.6%. The variance in core earnings per share growth against our expectations was largely due to a 36.6% decline in NIC's provisioning levels despite the compliance with IFRS 9 that adopts a forward-looking approach to credit risk assessment. We expected provisioning levels of Kshs 0.9 bn, that came in at Kshs 0.6 bn. Highlights of the performance from Q1'2017 to Q1'2018 include:

- Total operating revenue declined by 4.6% to Kshs 3.5 bn from Kshs 3.7 bn in Q1'2017. This was due to an 8.3% decline in Net Interest Income (NII) to Kshs 2.5 bn from Kshs 2.7 bn, despite a 5.5% increase in Non - Funded Income (NFI) to Kshs 1.0 bn from Kshs 988.9 mn in Q1'2017,
- Interest Income increased by 8.2% to Kshs 4.7 bn from Kshs 4.3 bn in Q1'2017, driven by a 66.1% increase in interest income on government securities to Kshs 1.6 bn from Kshs 962.8 mn in Q1'2017. Interest income on loans and advances declined by 8.9% to Kshs 3.0 bn from Kshs 3.3 bn in Q1'2017. The yield on interest earning assets decreased to 11.2% from 12.2% in Q1'2017,
- Interest expense increased by 35.9% to Kshs 2.2 bn, from Kshs 1.6 bn in Q1'2017, driven by a 43.7% increase in interest expense on customer deposits to Kshs 1.8 bn, from Kshs 1.2 bn in Q1'2017. The cost of funds came in at 5.2%, from 4.8% in Q1'2017. The Net Interest Margin thus declined to 6.3% from 7.9% in Q1'2017, as a result of a faster increase in interest expense as compared to the increase in interest income,
- Non-funded income recorded a growth of 5.5% to Kshs 1.0 bn from Kshs 988.9 mn in Q1'2017. The growth in NFI was driven by a 33.1% increase in other income to Kshs 178.6 mn, from Kshs 134.2 mn in Q1'2017. Components of other income include rental income, gains/losses on disposal of motor vehicles & equipment, bad debt recoveries and trust & other fiduciary fees and it is not clear which component drove the 33.1% growth, and it appears a one-time increase as opposed to a sustainable fundamental increase. Total fees and commissions also increased by 1.8% to Kshs 564.0 mn from Kshs 554.0 mn in Q1'2017,
- Owing to the increase in NFI coupled with the decline in NII, the current revenue mix came in at 70:30 funded to non-funded income from 73:27 in Q1'2017,

- Total operating expenses declined by 8.1% to Kshs 2.1 bn from Kshs 2.3 bn in Q1'2017, following a 36.6% y/y decline in Loan loss provisions (LLP) to Kshs 0.6 bn from Kshs 0.9 bn in Q1'2017. Without LLP, operating expenses grew by 9.2% to Kshs 1.6 bn from Kshs 1.5 bn registered in Q1'2017. Staff costs grew by 12.0% to Kshs 0.8 bn from Kshs 0.7 bn in Q1'2017,
- The Cost to Income ratio improved to 60.7% from 63.0% in Q1'2017. Without LLP, cost to Income ratio deteriorated to 45.0% from 39.3% in Q1'2017,

- Profit before tax increased by 1.3% to Kshs 1.39 bn from Kshs 1.37 bn. Profit after tax increased by 2.2% to Kshs 972.7 mn from Kshs 952.0 mn in Q1'2017,

- The balance sheet recorded an expansion in Q1’2018, with total assets increasing by 14.9% to Kshs 199.8 bn from Kshs 173.8 bn in Q1’2017. This expansion was driven by an 81.2% increase in government security holdings to Kshs 54.7 bn from Kshs 30.2 bn in Q1’2017,
- The Loan book declined by 0.4% to Kshs 115.9 bn from Kshs 116.3 bn in Q1’2017,
- Total liabilities increased by 17.5% to Kshs 167.8 bn from Kshs 142.8 bn in Q1’2017, driven by a 22.1% increase in customer deposits to Kshs 143.9 bn from Kshs 117.8 bn in Q1’2017,
- Deposits per branch increased by 14.8% to Kshs 2.9 bn from Kshs 2.5 bn in Q1’2017, with the bank’s branch network increasing by four branches that opened in 2018. The bank’s efforts to strengthen its network channels through 4 new branches at the Coast in 2018 are aimed at boosting its deposit mobilization capabilities,
- The faster growth in deposits compared to loans resulted in a decline in the loan to deposit ratio to 80.5% from 98.7% in Q1’2017,
- Gross non-performing loans (NPLs) increased by 15.5% to Kshs 15.9 bn from Kshs 13.8 bn in Q1’2017. The faster growth in NPLs coupled with a contraction in the loan book resulted in the NPL ratio deteriorating to 12.9% from 11.3% in Q1’2017. Gross NPL coverage ratio increased to 48.0% from 43.3% in Q1’2017,
- Shareholders’ funds increased by 3.4% to Kshs 31.6 bn from Kshs 30.5 bn in Q1’2017,
- NIC Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 18.2%, 7.7% above the statutory requirement of 10.5%, with total capital to total risk weighted assets exceeding statutory requirement by 6.3% to close the period at 20.8%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 19.0%, while total capital to risk weighted assets came in at 21.6%, indicating the bank took a capital hit of 0.8% owing to IFRS 9 compliance,
- NIC Group currently has a return on average assets of 2.2% and a return on average equity of 13.4%. The ROAE of 13.4% is way below industry average of 17.6%, an indicator that the franchise is underperforming

Going forward NIC Group has an opportunity to address its poor performance by targeting the following areas**:**

a. NIC Group’s NFI is still below industry average, coming in at 30.0% while the industry is at 33.6%; yet it has fee income businesses such as NIC Securities and NIC Capital. NIC Group is really performing below its potential on fee income businesses, with total fees rising a mere 1.8%, and this should be a key area of focus to improve profitability,
b. Better deployment of deposits, which grew strongly by 22.1%, leading to a 35.9% growth in interest expense, but the bank was not able to deploy the strong deposit growth into yielding assets, leading to an 8.3% drop in Net Interest Income.
c. Bring down the cost of funds, as it’s not clear why the bank is aggressive in mobilizing expensive deposits that it is not able to deploy, as the loan book actually declined even as deposits grew aggressively at 22.1%, leading to cost of money at 5.2%, which is too high, above Tier 1 and 2 averages of 3.1%, and almost double the cost of other players such as Equity Group at 2.7%. The bank needs to urgently address its cost of funding,
d. Focusing on improving their asset quality, with the establishment of the Credit Risk Advisory Group (CRAG) division expected to improve the credit appraisal process and loan recovery efforts. This in turn should reduce NIC Group’s NPLs. NIC Group’s Gross Non-Performing Loans ratio came in at 12.9%, which is way above industry average of 8.3%,
e. NIC should strive to manage its rising staff costs, which increased by 12.0%, which is way higher than the average industry increase of 3.6%. Increased adoption of alternative distribution channels such as mobile and internet banking will aid in increasing the bank’s operation efficiency, by cost reduction, as well as increase the bank’s transaction income, thereby achieving sustainable growth.

For a comprehensive analysis, see our NIC Group Q1’2018 Earnings Note.

Below is a summary of the Q1'2018 results for the four listed banks that have released:

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Cost of Funds	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	IFRS 9 Capital Ratios Effect
Stanbic	79.0%	17.7%	17.4%	3.3%	17.9%	7.0%	55.4%	49.0%	73.7%	13.2%	11.4%	83.5%	(0.6%)
Equity Group	21.7%	10.5%	10.5%	2.7%	10.5%	8.4%	6.3%	41.0%	7.2%	10.0%	3.5%	32.9%	(0.5%)
KCB Group	14.1%	11.0%	13.0%	3.1%	10.0%	8.2%	(0.4%)	32.8%	(2.3%)	8.7%	5.8%	(10.7%)	(0.8%)
NIC Group	2.2%	8.2%	35.9%	5.2%	(8.3%)	6.3%	(5.5%)	29.6%	1.8%	22.1%	(0.4%)	81.2%	(0.8%)
Weighted Average Q1' 2018	**22.7%**	**11.1%**	**13.7%**	**3.1%**	**9.8%**	**8.1%**	**7.8%**	**41.6%**	**9.1%**	**10.5%**	**4.8%**	**29.6%**	**(0.6%)**
Weighted Average Q1'2017	**(8.6%)**	**(11.6%)**	**(10.3%)**	**3.0%**	**(10.1%)**	**9.2%**	**18.6%**	**37.8%**	**8.7%**	**11.7%**	**7.1%**	**43.1%**	**-**

Weighted Average is market cap weighted*

Key takeaways from the table include:

- All listed banks recorded an increase in core EPS growth, with the average increase coming in at 22.7%. Growth is driven by an increase in the Net Interest Income (NII), which came in at 9.8%;
- Average deposit growth came in at 10.5%. Interest expense paid on deposits recorded a faster growth of 13.7% on average, indicating that more interest earning accounts have been opened, which increased the cost of funds;
- Average loan growth came in at 4.8%, while investment in government securities has grown by 29.6%, outpacing the loan growth, 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 8.1%, a decline from the 9.2% recorded in Q1'2017, and,
- Non-funded income has grown by 7.8%, which included a Fee and Commissions growth of 9.1%. This shows that banks are charging more fee income to improve their income on loans above the rate cap maximum.

During the week, the Nairobi Securities Exchange (NSE) announced plans to roll out a test launch of the derivatives market segment, within 6-months. The exchange has obtained the required approval from the Central Bank of Kenya (CBK). Stanbic Bank of Kenya and Cooperative Bank of Kenya have been granted approval to participate as clearing and settlement houses during the pilot testing phase. Initially, six banks were to participate in the pilot phase, including NIC Group, Commercial Bank of Africa (CBA), Barclays and Chase Bank (under receivership), however only Cooperative and Stanbic were granted approval to participate in the test. The establishment of the derivatives market will aid in enhancing the depth of the financial market as it would (i) enable trading and clearing of multi-asset classes, and (ii) create synthetic structured products, thus ultimately providing investors with new investing channels and thereby diversifying their portfolios.

Below is our equities universe of coverage:

all prices in Kshs unless stated otherwise									
Banks	**Price as at 11/05/2018**	**Price as at 18/05/2018**	**w/w change**	**YTD Change**	**LTM Change**	**Target Price***	**Dividend Yield**	**Upside/(Downside)****	**P/TBv Multiple**
NIC Bank***	38.3	36.0	(5.9%)	(0.7%)	40.2%	56.0	2.8%	53.0%	**0.9x**
KCB Group	50.0	49.8	(0.5%)	16.4%	31.8%	63.7	4.0%	31.4%	**1.6x**
Zenith Bank	28.9	28.0	(3.1%)	9.2%	55.8%	33.3	9.6%	31.0%	**1.1x**
Union Bank Plc	6.8	6.1	(9.6%)	(21.8%)	40.6%	8.2	0.0%	30.4%	**0.7x**
Diamond Trust Bank	205.0	202.0	(1.5%)	5.2%	50.7%	272.9	1.3%	28.8%	**1.1x**

all prices in Kshs unless stated otherwise									
Banks	**Price as at 11/05/2018**	**Price as at 18/05/2018**	**w/w change**	**YTD Change**	**LTM Change**	**Target Price***	**Dividend Yield**	**Upside/(Downside)****	**P/TBv Multiple**
Ghana Commercial Bank	6.4	6.5	1.6%	28.7%	24.8%	7.7	5.8%	28.2%	**1.5x**
I&M Holdings	124.0	118.0	(4.8%)	(7.1%)	29.7%	151.2	3.0%	23.9%	**1.2x**
Stanbic Bank Uganda	31.0	31.0	0.0%	13.8%	14.8%	36.3	3.8%	21.7%	**2.5x**
CRDB	180.0	160.0	(11.1%)	0.0%	-13.5%	207.7	0.0%	15.4%	**0.6x**
Co-operative Bank	18.5	18.7	1.1%	16.9%	32.3%	20.5	4.3%	14.9%	**1.6x**
Equity Group	51.0	49.8	(2.5%)	25.2%	44.2%	54.3	4.0%	14.4%	**2.5x**
Barclays	11.7	11.8	0.4%	22.4%	47.8%	13.7	8.5%	11.9%	**1.7x**
Bank of Kigali	290.0	290.00	0.0%	(3.3%)	18.4%	299.9	4.8%	8.2%	**1.6x**
National Bank	7.5	6.5	(14.0%)	(31.0%)	-11.9%	8.6	0.0%	8.1%	**0.4x**
UBA Bank	11.7	11.5	(2.1%)	11.2%	63.3%	10.7	13.1%	5.7%	**0.8x**
HF Group***	10.0	9.7	(3.0%)	(7.2%)	6.2%	10.0	3.3%	2.6%	**0.4x**
Stanbic Holdings	90.0	92.0	2.2%	13.6%	42.6%	87.1	5.7%	2.5%	**1.6x**
Bank of Baroda	150.0	150.0	0.0%	32.7%	36.4%	130.6	1.7%	(0.9%)	**1.2x**
Standard Chartered	211.0	209.0	(0.9%)	0.5%	5.6%	192.6	6.0%	(1.9%)	**1.7x**
Ecobank	11.7	11.7	0.0%	53.3%	60.7%	10.7	0.0%	(6.7%)	**3.3x**
SBM Holdings	7.7	7.9	2.1%	5.1%	4.0%	6.6	3.8%	(11.0%)	**1.1x**
Access Bank	11.3	10.9	(3.1%)	4.3%	49.7%	9.5	3.7%	(11.5%)	**0.6x**
Guaranty Trust Bank	44.3	44.0	(0.6%)	8.0%	39.2%	37.2	5.5%	(11.8%)	**2.5x**
Stanbic IBTC Holdings	49.0	50.0	(0.1%)	18.0%	88.3%	37.0	1.2%	(24.0%)	**2.7x**
CAL Bank	1.8	1.7	(5.6%)	57.4%	120.8%	1.4	0.0%	(28.9%)	**1.7x**
Standard Chartered GH	34.8	32.5	(6.8%)	28.5%	105.0%	19.5	0.0%	(44.3%)	**4.4x**
FBN Holdings	12.3	11.1	(9.8%)	25.6%	176.3%	6.6	2.3%	(44.7%)	**0.7x**
Ecobank Transnational	21.1	20.6	(2.1%)	21.2%	108.1%	9.3	0.0%	(53.8%)	**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 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.

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