

Cytonn Monthly – May 2018

Equities

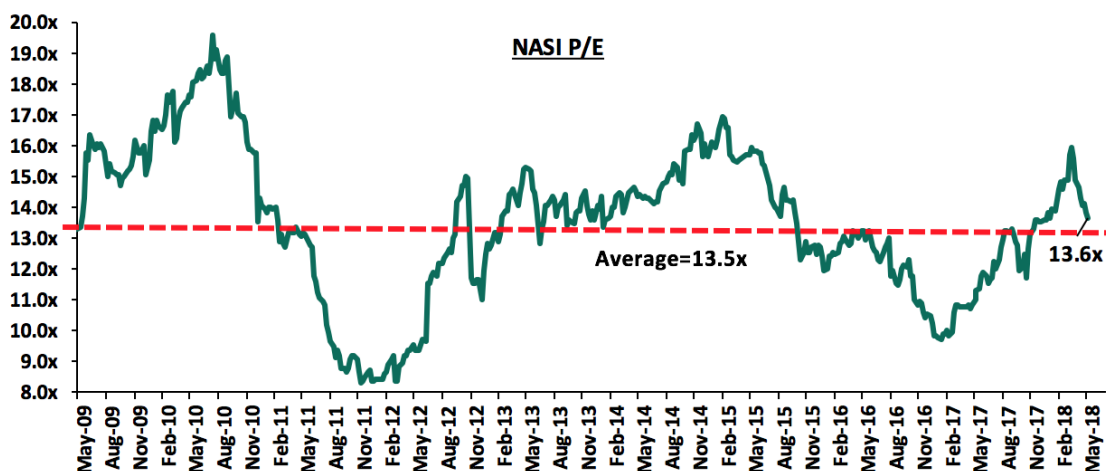
Market Performance:

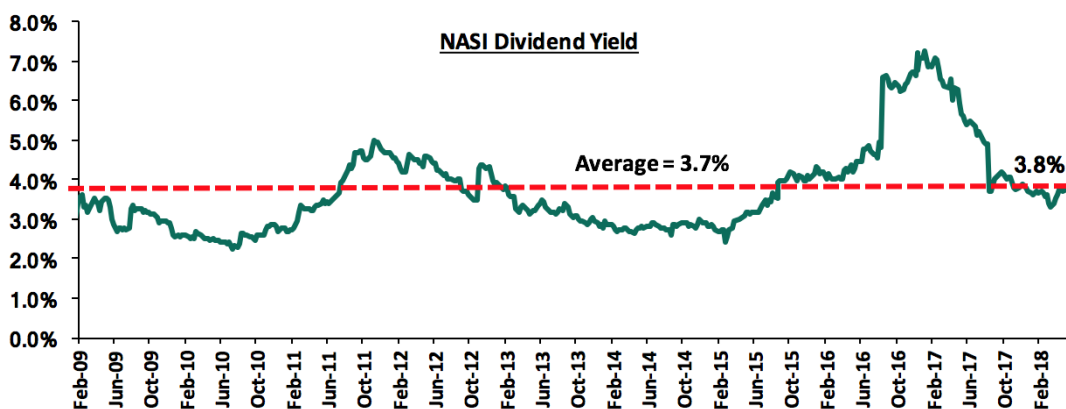
During the month of May, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 declining by 3.9%, 10.8% and 3.7%, respectively, taking their YTD performance as at the end of May to 0.8%, (10.2%) and 1.9% for NASI, NSE 20 and NSE 25, respectively. The equities market performance during the month was driven by declines in large caps such as Diamond Trust Bank (DTB), Barclays Bank, Cooperative Bank and KCB Group, which declined by 11.2%, 10.9%, 8.4% and 8.0%, respectively, owing to the bank's closing their books for dividend during the month.

During the week, the equities market was also on a downward trend with NASI, NSE 20 and NSE 25 declining by 1.6%, 0.9% and 1.5%, respectively, due to declines in counters such as Standard Chartered, Cooperative Bank and Safaricom, which declined by 3.8%, 3.1% and 2.6%, respectively.

Equities turnover rose by 22.0% during the month to USD 182.5 mn from USD 149.6 mn in April, taking the YTD turnover to USD 0.9 bn. Foreign investors remained net sellers for this month, as they sought to realize the capital gains on various counters, in addition to receiving dividend income. Most investors exited the market at the relatively healthy valuation, with possible re-entry at cheaper valuations in the future. We expect the market to remain supported by improved investor sentiment as the economy recovers from shocks experienced last year.

The market is currently trading at a price to earnings ratio (P/E) of 13.6x, 0.7% above the historical average of 13.5x, and a dividend yield of 3.8%, slightly above the historical average of 3.7%. Despite the valuations nearing the historical average, we believe there still exist pockets of value in the market. The current P/E valuation of 13.5x is 39.2% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 62.7% 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.





Earnings Releases:

During the week, there were various earnings releases.

Barclays Bank of Kenya released Q1'2018 results

Barclays Bank of Kenya released Q1'2018 financial results, with its core earnings per share increasing by 7.7% to Kshs 0.35 from Kshs 0.32 in Q1'2017, in line with our expectation of a 7.1% increase to Kshs 0.34. Performance was driven by a 4.2% increase in total operating income, outpacing a 2.4% increase in the total operating expenses. The bank reported a profit after tax of Kshs 1.9 bn from Kshs 1.7 bn in Q1'2017.

For more information, see our Barclays Bank Q1'2018 earnings note.

I & M Holdings released Q1' 2018 results

I&M Holdings released Q1'2018 results, with its core earnings per share increasing by 1.8% to Kshs 18.5 from Kshs 18.1 in Q1'2017, which was below our expectation of a 6.7% increase to Kshs 19.4. The variance in core earnings per share growth was largely due to (i) the higher than expected rise in loan loss provisions due to a spike in Non-Performing Loans (NPLs), and (ii) the slower than expected growth in NFI. Performance was driven by a 10.4% increase in total operating income, despite an 18.6% increase in the total operating expenses. The bank reported a profit after tax of Kshs 1.81 bn from Kshs 1.78 in Q1'2017.

For more information, see our I&M holdings Q1'2018 earnings note.

Standard Chartered Bank released Q1'2018 results

Standard Chartered Bank released Q1'2018 results, with its core earnings per share declining by 12.5% to Kshs 5.2 from Kshs 6.0 in Q1'2017 compared to our expectation of a 6.4% increase to Kshs 6.4. Performance was driven by a 15.4% increase in total operating expenses that outpaced the 5.4% increase in total operating income. The variance in core earnings per share growth was due to the faster increase in operating expenses, which was driven by an increase in loan loss provisioning by 37.9% to Kshs 1.1 bn from Kshs 0.8 bn in Q1'2017. The bank reported a profit after tax of Kshs 1.8 bn from Kshs 2.1 bn in Q1'2017.

For more information, see our Standard Chartered Q1'2018 earnings note.

National Bank of Kenya released Q1'2018 results

National Bank of Kenya released Q1'2018 results, with its core earnings per share increasing by 348.0% to Kshs 0.8 from Kshs 0.2 in Q1'2017, compared to our expectation of a 13.2% increase to Kshs 0.2. However, this growth in core EPS was realised after stripping out of an exceptional expense of Kshs 0.5 bn, which the bank incurred in Q1'2018. The bank registered a loss after tax of

Kshs 0.3 bn in Q1'2018 from a profit of Kshs 0.1 bn in Q1'2017. Performance was driven by a 14.7% decrease in total operating income, despite a 14.9% decrease in the total operating expenses. The variance in core earnings per share growth against our expectations was largely due to (i) the unexpected exceptional expense item of Kshs 0.5 bn that the bank incurred in Q1'2018, (ii) the unexpected one-off deferred tax item of Kshs 0.2 bn.

For more information, see our National Bank of Kenya Q1'2018 earnings note

HF Group released Q1'2018 results

Housing Finance Group limited released their Q1'2018 financial results, with core earnings per share declining by 58.4% to Kshs 0.4 from Kshs 1.0 in Q1'2017. The bank recorded a profit after tax of Kshs 37.1 mn, compared to our expectation of a loss of Kshs 15.4 mn in Q1'2017. Performance was driven by a 1.1% increase in total operating income to Kshs 980.1 mn from Kshs 970.4 mn in Q1'2017, coupled with a 10.3% increase in total operating expenses to Kshs 928.0 mn from 841.1 mn in Q1'2017. The variance in performance compared to our expectation was largely due to a larger than expected decline in loan loss provisions, which declined by 43.9% to Kshs 112.7 mn from Kshs 200.7 mn in Q1'2017, despite the adoption of the IFRS 9 reporting standard that requires a forward looking approach to credit risk assessment.

For more information, see our Housing Finance Group Q1'2018 earnings note.

Below is a summary of the listed banks' performance.

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
National Bank	348.0%	(14.2%)	(11.7%)	3.3%	(15.8%)	7.1%	(12.3%)	31.0%	91.3%	(6.3%)	(12.0%)	(9.8%)	(0.6%)
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%	49.0%	7.2%	10.0%	3.5%	45.5%	(0.5%)
KCB Group	14.0%	10.9%	13.0%	3.1%	10.0%	8.2%	(1.1%)	32.8%	(2.3%)	8.7%	5.8%	(10.7%)	(0.8%)
Barclays	7.7%	8.1%	6.8%	2.9%	8.5%	9.6%	5.0%	29.2%	(6.7%)	8.4%	(1.9%)	35.3%	1.00%
Co-op Bank	6.8%	9.1%	5.0%	4.0%	10.8%	8.6%	3.8%	32.0%	9.6%	5.7%	2.8%	21.3%	(0.9%)
DTBK	3.0%	4.9%	4.2%	5.1%	5.4%	6.4%	4.4%	22.0%	8.3%	11.6%	3.0%	16.0%	(1.6%)
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%)
I&M Holdings	1.8%	2.5%	10.9%	4.8%	(2.7%)	7.4%	43.9%	37.0%	45.9%	3.5%	7.6%	(1.7%)	(0.2%)
Stanchart	(12.5%)	7.7%	16.4%	3.6%	4.5%	7.8%	6.5%	32.0%	27.0%	13.2%	(2.6%)	12.4%	(0.5%)
HF Group	(58.4%)	(12.8%)	(13.0%)	7.2%	(12.6%)	5.1%	64.2%	28.9%	(62.7%)	(6.1%)	(12.5%)	(41.4%)	0.0%
Weighted Average Q1'2018	14.4%	9.3%	11.4%	3.4%	8.1%	8.1%	9.5%	37.1%	12.2%	9.4%	3.2%	25.0%	(0.3%)
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%	-

Key takeaways from the table include:

- The listed banking sector recorded growth in core EPS, with the average increase coming in at 14.4%. Growth was driven by an increase in both the Net Interest Income (NII) and Non-Funded Income (NFI), which came in at 8.1%, and 9.5%, respectively;
- Average deposit growth came in at 9.4%. Interest expense paid on deposits recorded a faster growth of 11.4% on average, indicating that more interest earning accounts have been opened, which increased the cost of funds;
- Average loan growth came in at 3.2%, while investment in government securities has grown by 25.0%, 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 9.5%, which included a Fee and Commissions growth of 12.2%. This shows that banks are charging more fee income to improve their income on loans above the rate cap maximum.

We shall be releasing our Q1'2018 Banking Sector report on 17th June 2018

Monthly Highlights:

During the month, 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 enabling them to diversifying their portfolios.

Equities Universe of Coverage:

Below is our equities universe of coverage:

all prices in Kshs unless stated otherwise

Banks	Price as at 30/04/2018	Price as at 31/05/2018	m/m change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/(Downside)**	P/T Bv Multiple
NIC Group***	37.3	34.8	(6.8%)	3.0%	24.3%	56.0	2.9%	64.0%	0.8x
HF Group***	10.1	8.0	(20.9%)	(23.6%)	(10.8%)	11.7	4.0%	51.2%	0.3x
Union Bank	6.3	5.6	(11.2%)	(28.8%)	26.1%	8.2	0.0%	46.8%	0.6x
Diamond Trust Bank	214.0	190.0	(11.2%)	(1.0%)	35.7%	272.9	1.4%	45.0%	1.0x
I&M Holdings	125.0	108.0	(13.6%)	(15.0%)	16.8%	151.2	3.2%	43.2%	1.0x
KCB Group	50.0	46.0	(8.0%)	7.6%	15.7%	63.7	4.3%	42.8%	1.5x
Zenith Bank	27.5	25.5	(7.1%)	(0.5%)	34.6%	33.3	10.6%	41.3%	1.1x
National Bank	7.9	6.6	(17.0%)	(29.4%)	(0.8%)	8.6	0.0%	30.2%	0.4x
CRDB	180.0	160.0	(11.1%)	0.0%	(15.8%)	207.7	0.0%	29.8%	0.5x
GCB	6.3	6.4	1.1%	26.3%	22.0%	7.7	6.0%	27.0%	1.5x
Co-op Bank	18.6	17.0	(8.4%)	6.3%	22.9%	20.5	4.7%	25.4%	1.5x
Barclays	13.3	11.8	(10.9%)	22.9%	31.8%	13.7	8.5%	24.6%	1.5x
Equity Group	49.3	47.3	(4.1%)	18.9%	24.3%	54.3	4.2%	19.3%	2.4x
Stanbic UG	30.8	31.5	2.4%	15.6%	16.7%	36.3	3.7%	18.9%	2.0x

all prices in Kshs unless stated otherwise

Banks	Price as at 30/04/2018	Price as at 31/05/2018	m/m change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/(Downside)**	P/T Bv Multiple
UBA Bank	11.6	10.8	(6.5%)	4.9%	44.0%	10.7	13.9%	13.0%	0.7x
Bank of Kigali	290.0	289.0	(0.3%)	(3.7%)	18.0%	299.9	4.8%	8.6%	1.6x
Stanchart KE	209.0	202.0	(3.3%)	(2.9%)	0.0%	192.6	6.2%	1.5%	1.6x
Guaranty Trust	45.0	40.5	(10.0%)	(0.6%)	19.1%	37.2	5.9%	(2.2%)	2.3x
Stanbic Holdings	90.0	95.5	6.1%	17.9%	35.5%	87.1	5.5%	(3.3%)	1.2x
CAL Bank	2.0	1.5	(26.4%)	34.3%	88.3%	1.4	0.0%	(3.4%)	1.2x
Access Bank	11.2	10.4	(7.1%)	(0.5%)	30.7%	9.5	3.8%	(4.8%)	0.7x
Ecobank	11.5	11.6	1.1%	53.0%	60.4%	10.7	0.0%	(7.7%)	3.3x
SBM Holdings	7.7	7.7	(0.5%)	2.1%	3.5%	6.6	3.9%	(10.4%)	1.1x
Bank of Baroda	134.0	160.0	19.4%	41.6%	45.5%	130.6	1.6%	(16.8%)	1.4x
Stanbic IBTC Holdings	49.5	46.1	(6.9%)	11.1%	77.3%	37.0	1.3%	(18.4%)	2.4x
Standard Chartered	35.0	26.0	(25.6%)	3.0%	61.7%	19.5	0.0%	(25.2%)	3.3x
FBN Holdings	12.5	10.2	(18.8%)	15.3%	91.5%	6.6	2.5%	(32.2%)	0.6x
Ecobank Transnational	20.1	19.5	(3.0%)	14.7%	84.0%	9.3	0.0%	(52.4%)	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 exist, with a number of undervalued sectors such as 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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