Developing Technical Education Institutions with a Focus on Vision 2030, & Cytonn Weekly #27/2018

Equities

Market Performance:

During the week, the equities market recorded mixed performance with NASI and NSE 25 losing 1.0% and 0.7%, respectively, while NSE 20 gained by 0.6% taking their YTD performance to 0.0%, (10.2%) and 2.9%, for NASI, NSE 20 and NSE 25, respectively. This week's performance was driven by declines in large cap stocks such as Barclays Bank, Cooperative Bank, Bamburi and Safaricom that declined by 3.4%, 2.3%, 2.0% and 1.7%, respectively. For the last twelve months (LTM), NASI, NSE 20 and NSE 25 have gained 11.9%, (8.9%) and 9.2%, respectively.

Equities turnover decreased by 18.7% to USD 19.6 mn from USD 24.1 mn the previous week. We expect the market to remain supported by positive investor sentiment this year, 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 14.2x, which is 6.0% above the historical average of 13.4x, and a dividend yield of 3.9%, higher than the historical average of 3.7%. The current P/E valuation of 14.2x is 44.9% above the most recent trough valuation of 9.8x experienced in the first week of February 2017, and 71.1% 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.

Weekly highlights:

Global rating agency Moody's estimates that Non-Performing Loans (NPLs) in the banking sector are likely to increase on account of delayed impact of the various shocks experienced in the economy last year. This was mainly due to the prolonged electioneering period coupled with a prolonged drought that affected agriculture, the country's main GDP contributor. The agency estimates that the industry NPL increased to 11.0% in Q1'2018, as the effects of the economic slump experienced in 2017 spilled over to the current year. The sector's NPL has been steadily increasing since 2015, from the then average of 6.0% to the current estimated 11.0%. However, even with the current improving business environment, the agency does not expect much credit expansion, as loan growth will expand over the next 12-18 months but will remain inhibited by the interest rate cap. Thus, credit growth is expected to remain below 5.0% as banks adopt tighter lending criteria in a bid to tame the high number of NPLs, and owing to the current low risk-adjusted returns from loans as lending rates have been capped at 4.0% above the Central Bank Rate (CBR) and deposits at 70.0% of the CBR. The agency also noted that the banking sector is reaping a lot of benefits from financial technology innovation and rapid uptake of new products developed by banks. We expect credit growth to remain at the low levels of below 5.0%, below the 5-year average of 14.0%, largely due to the interest rate cap. However, with the proposal to repeal the law currently in the finance bill, a repeal would likely spur credit growth and access by the private sector. As we recommended in our focus note, Rate Cap Review Should Focus More on Stimulating Capital Markets the repeal needs to be accompanied with financial markets deepening policies and initiatives that make it easier for new and structurally unique products to be introduced in the capital and financial markets, that would promote the competing sources of financing, so as to avoid a reversion to the initial high borrowing cost regime that led to the enforcement of the cap in the first place.

According to a joint report by Financial Sector Deepening Kenya, The Central Bank of Kenya (CBK) and the Kenya National Bureau of Statistics (KNBS), Kenyans have turned to digital micro-loans. According to the report, six million people have taken digital loans, highlighting the central role mobile lending applications play. The loans are mostly taken for short-term working capital and day-to-day consumption needs, with the main preference for these loans being their convenience and ease of access. However, the report warns that while the popularity of lending apps points to a positive step towards deepening financial inclusion, more research is required to understand the real socio-economic impact of digital credit on low-income segment of the population. We are of the view that with the increased proliferation of mobile devices, micro-loan providers have been able to tap into the credit market leveraging on the convenience and ease of credit access. However, we note that digital borrowers tend to borrow frequently, and it is thus important to ensure methods are put in place to track debt profiles for individuals so as to highlight any socio-economic issues that may arise.

Barclays Africa Group Limited changed its name to Absa Group on Wednesday, as the London-based Barclays Plc exited the African market to concentrate on European and United States markets. Barclays Plc had acquired a majority stake of 56.4% in Absa Group in 2005, gradually increased its stake to 62.0% but reduced to 14.9% after selling to the large institutional investor Public Investment Corporation of South Africa (PIC). The Kenyan banking unit has however stated its intention to continue operations as Barclays Bank of Kenya until 2020, when it will complete the rebranding process. The move to separate with the London based parent company presents an opportunity for the lender to explore new business ideas and products that were initially hampered by the restrictions imposed by the parent group. This will enable the bank to quickly implement new products based on mobile and internet banking that resonate with local markets, and were constrained due to parent company’s involvement. Barclays Bank CEO Jeremy Awori noted that prior to the parent company scaling down its ownership to 14.9%, the bank experienced a lot of challenges in venturing into areas such as Small and Medium Enterprises (SMEs) and real estate asset financing. However, with localized decision-making, the bank is now able to accelerate new product development, implementation and service delivery. We are of the view that with the exit of the London- based parent company, Barclays will be able to compete more favourably with its peers, as it plans to increase its market share in the region by 5 million customers by 2020. The bank has been lagging behind in digital implementation as it launched its mobile banking platform dubbed Timiza app in March 2018, while its competitors KCB, Co-operative Bank and Equity Group had long ventured into this space. Thus, with more localized decision-making, the lender is well poised to quickly exploit any opportunities that arise as well as build on their innovative profile that has seen the bank offer efficient services to its customers.

Equities Universe of Coverage:

Below is our Equities Universe of Coverage:

Banks	Price as at 6/07/2018	Price as at 13/07/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
Ghana Commercial Bank***	5.0	5.0	0.0%	(1.0%)	(3.8%)	7.7	7.6%	62.0%	1.2x
NIC Bank***	36.5	34.8	(4.8%)	3.0%	12.4%	54.1	2.7%	51.0%	0.9x
I&M Holdings***	115.0	110.0	(4.3%)	5.8%	2.8%	169.5	3.0%	50.4%	1.2x
Zenith Bank***	24.3	24.0	(1.2%)	(6.4%)	8.6%	33.3	11.1%	48.2%	1.1x
Diamond Trust Bank***	195.0	195.0	0.0%	1.6%	15.4%	280.1	1.3%	45.0%	1.1x
Ecobank	7.6	8.0	5.3%	5.3%	25.7%	10.7	0.0%	41.2%	2.2x
KCB Group***	46.5	47.8	2.7%	11.7%	23.2%	60.9	6.5%	37.4%	1.5x
Union Bank Plc	6.0	6.0	0.0%	(23.7%)	31.1%	8.2	0.0%	37.0%	0.6x
Barclays	11.4	11.5	0.9%	19.3%	19.9%	14.0	8.8%	32.2%	1.4x
CRDB	160.0	160.0	0.0%	0.0%	(22.0%)	207.7	0.0%	29.8%	0.5x
HF Group***	8.4	8.5	1.2%	(18.3%)	(11.0%)	10.2	3.8%	25.2%	0.3x
Equity Group	47.8	48.8	2.1%	22.6%	30.0%	55.5	4.2%	20.4%	2.4x
Co-operative Bank	17.1	17.0	(0.6%)	6.3%	21.4%	19.7	4.7%	19.9%	1.5x
UBA Bank	10.4	10.0	(3.4%)	(2.9%)	11.1%	10.7	14.5%	17.9%	0.7x
Stanbic Bank Uganda	32.0	32.0	0.0%	17.4%	17.4%	36.3	3.7%	17.0%	2.0x
Bank of Kigali	288.0	290.0	0.7%	(3.3%)	17.4%	299.9	4.8%	9.0%	1.6x
CAL Bank	1.3	1.3	0.0%	20.4%	74.8%	1.4	0.0%	7.7%	1.1x
Stanbic Holdings	91.0	90.0	(1.1%)	11.1%	17.6%	85.9	5.8%	0.2%	1.1x
Standard Chartered	204.0	203.0	(0.5%)	(2.4%)	(5.6%)	184.3	6.1%	(3.5%)	1.6x
Guaranty Trust Bank	41.5	39.8	(4.2%)	(2.5%)	7.7%	37.2	5.8%	(4.5%)	2.3x
SBM Holdings	7.2	7.1	(0.8%)	(4.8%)	(5.8%)	6.6	4.2%	(4.7%)	1.0x
Access Bank	10.4	10.2	(1.9%)	(2.4%)	4.1%	9.5	3.8%	(4.8%)	0.7x
Bank of Baroda	149.0	145.0	(2.7%)	28.3%	34.3%	130.6	1.7%	(10.7%)	1.3x
Standard Chartered	26.6	26.0	(2.3%)	3.0%	58.9%	19.5	0.0%	(26.8%)	3.3x
Stanbic IBTC Holdings	52.0	51.5	(1.0%)	24.1%	64.5%	37.0	1.1%	(27.7%)	2.7x
FBN Holdings	10.5	10.4	(1.0%)	18.2%	68.3%	6.6	2.4%	(34.5%)	0.6x
Ecobank Transnational	20.5	20.4	(0.7%)	19.7%	44.3%	9.3	0.0%	(54.7%)	0.7x
National Bank	6.5	6.2	(4.7%)	(34.2%)	(39.1%)	2.8	0.0%	(56.6%)	0.4x

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***
******* Stock prices are in respective country currency***

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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