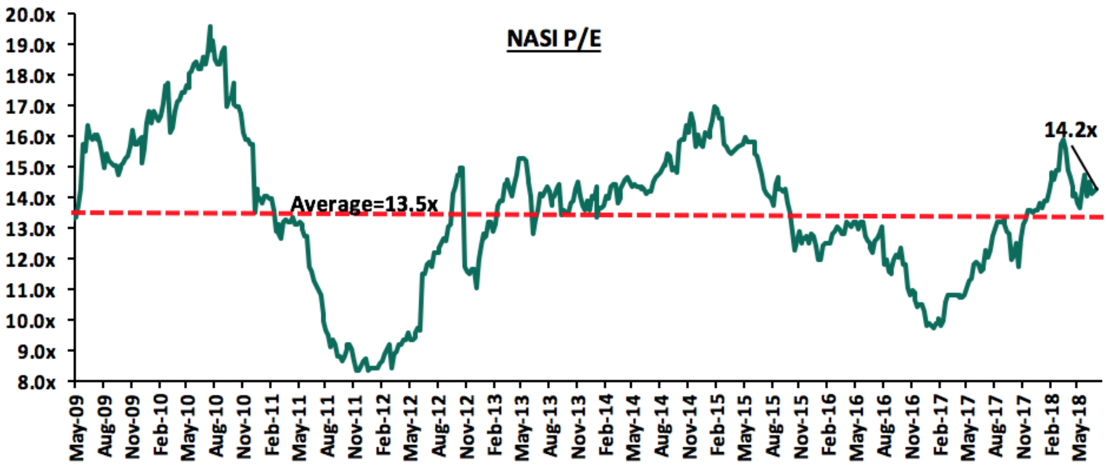
The Fight Against Corruption in Kenya…Yet Another Chapter, & Cytonn Weekly #29/2018

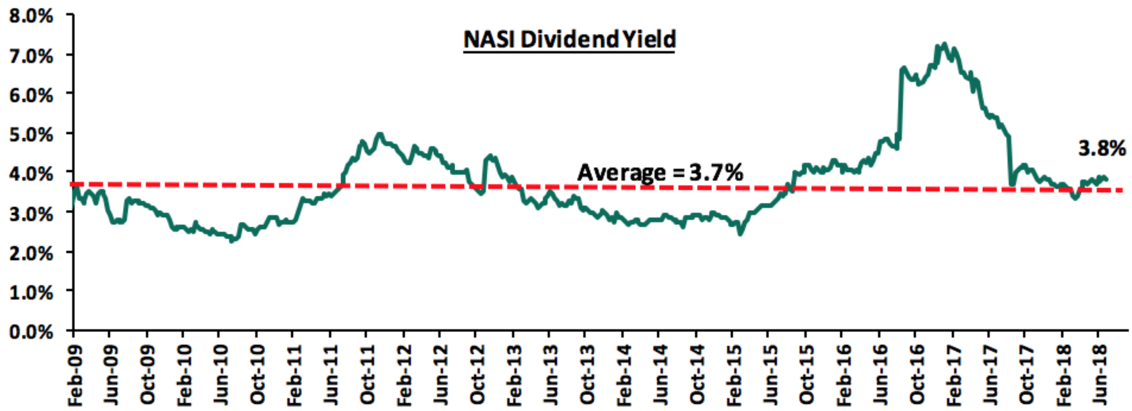
Equities

Market Performance:

During the week, the equities market recorded mixed performance with NASI and NSE 20 gaining 0.1% and 0.2%, respectively, while NSE 25 remained flat at 0.0%, taking their YTD performance to 0.7%, (10.5%) and 2.0%, for NASI, NSE 20 and NSE 25, respectively. This week's performance was driven by gains in large cap stocks such as BAT, Safaricom, EABL and Diamond Trust Bank (DTB) that gained by 3.3%, 2.7%, 2.7% and 2.0%, respectively. For the last twelve months (LTM), NASI and NSE 25 have gained 8.9% and 6.3%, respectively, while NSE 20 has declined by 11.8%. Equities turnover decreased by 13.2% to USD 17.7 mn from USD 20.4 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 5.2% above the historical average of 13.5x, and a dividend yield of 3.8%, slightly 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:

Banks have been venturing into the digital lending space, in a bid to take advantage of the increased adoption of digital banking, whose main selling point is the convenience it provides for customers. New initiatives include:

i. Listed lender HF Group has ventured into the increasingly popular mobile-based lending segment via an app dubbed HF Whizz, which will enable their customers to borrow between Kshs 1,000 and Kshs 50,000 at a monthly interest rate of 1.1%, and a facilitation fee of 6.6%, which is above average, with most institutions charging between 1.5% and 3.0%. The bank's customers will also be able to transfer up to Kshs 200,000 daily, in addition to making deposits directly to their bank accounts. The bank tailored the mobile app for smartphone users as opposed to using USSD code, due to the smartphone-based app's superior value-added options such as expense tracking and budget management,
ii. Commercial Bank of Africa (CBA) also launched a digital banking platform that allows the bank's customers to borrow up to Kshs 3.0 mn, which is currently the highest among all digital platforms. The payment period of the maximum borrowable amount has been capped at 3-years. Customers also have access to an overdraft facility of up to Kshs 100,000, which is contingent on their financial track record. The loan service has been appended to the bank's platform called "Loop", which was launched in March 2017. Customers will be able to perform Loop to Loop transfers for free while payments done via the Safaricom Paybill and Buy Goods services will attract no additional bank charges. Furthermore, the transaction charges for Loop to M-pesa have been reduced by 44.0% while charges for Loop to ATM have been reduced by 40.0%, and,
iii. UBA Kenya also released an interactive chat banker platform that enables the bank's customers to make use of social media platforms to conduct bank transactions. Through the app dubbed "Leo", Facebook users can open accounts, transfer money to other accounts, top up airtime and request for mini statements via the platform. The creation of the social-media based platform was informed by smartphone users spending 80.0% of their time on three apps: WhatsApp, Facebook and YouTube. Since its launch in the Nigerian market, the app has had over 35.0 mn conversations, with over 500,000 transactions carried out. The Pan African bank has launched the service in 15 countries.

We note that competition in the digital banking space has become rife, with several players launching innovative products to tap into the market. The biggest selling point for these products has been the convenience provided. This has created a new revenue source for banks, who earn both transactional income and interest income from the mobile lending space, which is currently unregulated. This improves banks' overall efficiency as well as diversifies their revenue sources, thereby providing sustainable growth.

Six government agencies have issued a warning to members of the public about engaging with rogue digital credit providers, citing that many of the providers are operating illegally. The joint statement by the Capital Markets Authority (CMA), Central Bank of Kenya (CBK), Insurance Regulatory

Authority (IRA), Ministry of Trade, Industry and Cooperatives, Retirement Benefits Authority (RBA), and Sacco Societies Regulatory Authority (SASRA), has warned that these services, which are available online, include online pyramid schemes, credit and savings schemes, as well as mobile loan applications, which are available in Google Play and the Apple App Store. The agencies advised members of the public to deal only with genuine and licensed institutions. The notice highlighted that some of the institutions require individuals to save first before qualifying for the loans, promising to deliver unusually high returns in the process. Some of the institutions rely on investment strategies that may require the institutions to recruit more members in order to earn benefits. Some have no registered premises, websites and addresses. We note that it is the high time that regulation is enacted to regulate the activities of the digital lending space, given the exponential growth in the segment's uptake by the public. Information of legitimate and licensed digital loan providers needs to be readily available to the members of the public, which will go a long way to ensure they engage with credible entities. In addition to this, it is vital that the government comes up with a regulatory framework tailored for the mobile lending segment, so as to protect the consumers of these products, whose prominence keeps on growing.

KCB Group offered its second bid to acquire a stake in the troubled lender Imperial Bank Limited (IBL), which is under receivership. Diamond Trust Bank (DTB), which had also expressed interest, pulled out of the deal, putting KCB in pole position to acquire a stake in the troubled lender. IBL was put under receivership in August 2015, with a loan book of Kshs 41.0 bn and deposits of Kshs 58.0 bn. KCB Group had submitted an offer in April, whose details were not disclosed, but both banks were tasked with revising their offers, with DTB declining to participate further. Kenya Deposit Insurance Corporation (KDIC) highlighted that it had received the revised proposal from KCB, while the other bidder had withdrawn from the process. The Central Bank of Kenya (CBK) and KDIC will engage KCB in discussions with the aim of maximizing the value for depositors. In April, the bidders were tasked to disclose the oversight frameworks they planned to implement, the type of transaction they intended to proceed with, and the financial resources that could be deployed to compete the transaction. The impending resolution of the matter, which could possibly result in the bank's removal from receivership, will be welcomed by customers, whose deposits have been locked in the bank since August 2015. We note that the process needs to be expedited, as the transaction falls way behind the expected timelines shared by the CBK, who, in September 2017, had scheduled to have a winning bidder by February 2018. If successful, this would mark the second instance a bank is brought out of receivership, after the recently concluded deal that saw SBM Kenya complete the acquisition of certain assets and Liabilities of Chase Bank Limited (under Receivership).

Equities Universe of Coverage:

Below is our Equities Universe of Coverage:

Banks	Price as at 20/07/2018	Price as at 27/07/2018	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/(Downside)**	P/TBv Multiple
Ghana Commercial Bank***	5.0	5.1	1.0%	0.2%	7.7	7.6%	61.7%	**1.2x**
NIC Bank***	34.8	34.8	0.0%	3.0%	54.1	2.9%	58.6%	**0.8x**
Zenith Bank***	23.0	23.7	3.0%	(7.6%)	33.3	11.7%	56.6%	**1.0x**
I&M Holdings***	114.0	106.0	(7.0%)	1.9%	169.5	3.1%	51.8%	**1.1x**
Diamond Trust Bank***	196.0	200.0	2.0%	4.2%	280.1	1.3%	44.2%	**1.1x**
Union Bank Plc	5.8	5.6	(3.4%)	(28.2%)	8.2	0.0%	40.5%	**0.6x**
KCB Group***	48.3	47.5	(1.6%)	11.1%	60.9	6.2%	32.4%	**1.5x**

Banks	Price as at 20/07/2018	Price as at 27/07/2018	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/(Downside)**	P/TBv Multiple
Ecobank Ghana	8.2	8.2	0.5%	8.0%	10.7	0.0%	31.3%	**2.3x**
Barclays	11.5	11.6	0.4%	20.3%	14.0	8.7%	30.4%	**1.4x**
CRDB	160.0	160.0	0.0%	0.0%	207.7	0.0%	29.8%	**0.5x**
UBA Bank	9.6	9.7	1.6%	(5.8%)	10.7	15.7%	27.7%	**0.6x**
HF Group***	8.5	8.5	0.0%	(18.3%)	10.2	3.8%	23.8%	**0.3x**
Co-operative Bank	16.8	17.0	1.2%	6.3%	19.7	4.8%	22.0%	**1.5x**
Equity Group	49.5	50.0	1.0%	25.8%	55.5	4.0%	16.2%	**2.5x**
Stanbic Bank Uganda	33.0	33.0	0.0%	21.1%	36.3	3.5%	13.5%	**2.1x**
CAL Bank	1.3	1.3	(2.3%)	16.7%	1.4	0.0%	8.5%	**1.1x**
Bank of Kigali	290.0	290.0	0.0%	(3.3%)	299.9	4.8%	8.2%	**1.6x**
Guaranty Trust Bank	38.0	39.6	4.2%	(2.8%)	37.2	6.3%	4.3%	**2.1x**
Stanbic Holdings	92.0	90.5	(1.6%)	11.7%	85.9	5.7%	(0.9%)	**1.1x**
Access Bank	10.1	10.1	(0.5%)	(3.8%)	9.5	4.0%	(2.0%)	**0.7x**
Standard Chartered	204.0	204.0	0.0%	(1.9%)	184.3	6.1%	(3.5%)	**1.6x**
Bank of Baroda	140.0	140.0	0.0%	23.9%	130.6	1.8%	(4.9%)	**1.2x**
SBM Holdings	7.3	7.3	0.0%	(2.1%)	6.6	4.1%	(6.5%)	**1.0x**
Stanbic IBTC Holdings	48.8	48.7	(0.3%)	17.2%	37.0	1.2%	(23.0%)	**2.5x**
FBN Holdings	9.1	10.0	10.5%	13.6%	6.6	2.8%	(24.0%)	**0.5x**
Standard Chartered	26.0	26.0	0.0%	3.0%	19.5	0.0%	(25.2%)	**3.3x**
National Bank	5.6	5.8	4.5%	(38.0%)	2.8	0.0%	(49.5%)	**0.4x**
Ecobank Transnational	20.7	20.6	(0.5%)	20.9%	9.3	0.0%	(55.1%)	**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***
******* 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.