

Cytonn Monthly – July 2018

Equities

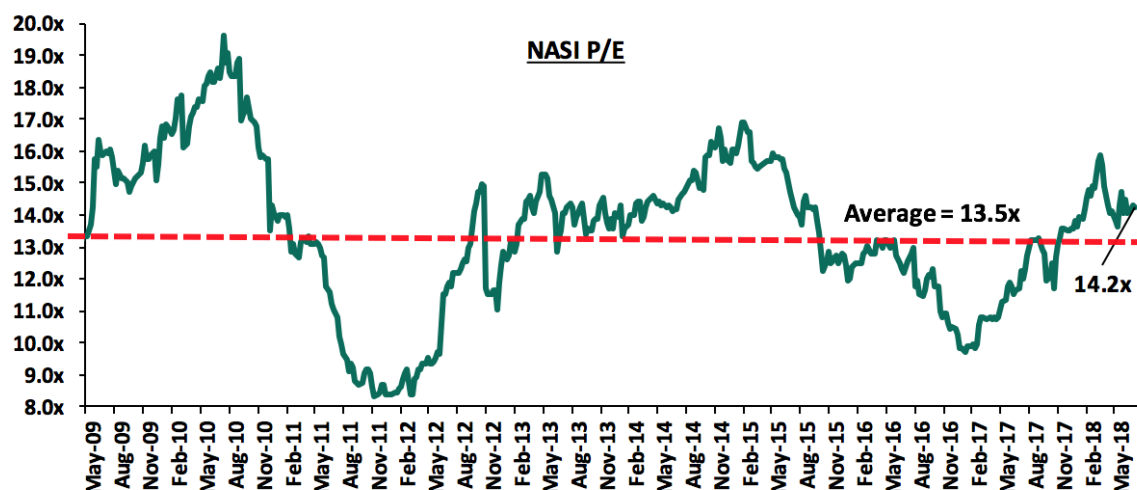
Market Performance:

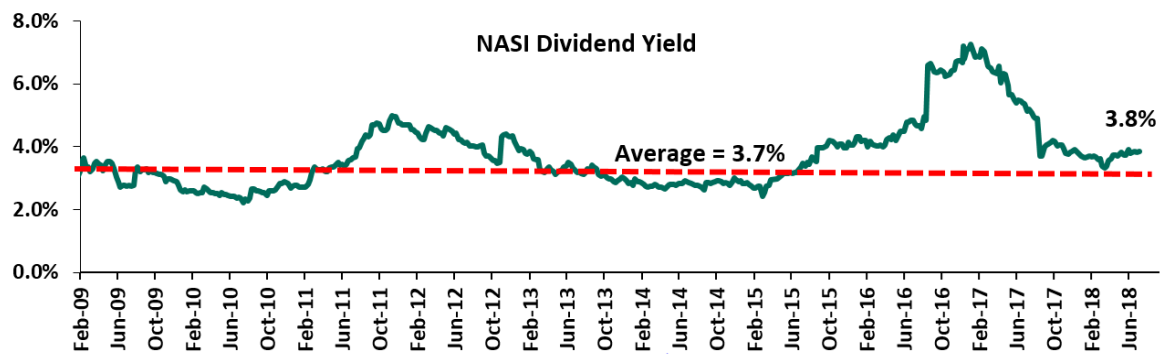
During the month of July, the equities market recorded mixed performance, with NASI and NSE 25 declining by 2.2% and 0.6%, respectively; while NSE 20 gained by 0.3%, taking their YTD performance as at the end of July to (0.4%), (11.2%) and 3.4% for NASI, NSE 20 and NSE 25, respectively. The equities market performance during the month was shaped by gains in large caps such as Equity Group, BAT, Standard Chartered and EABL of 3.8%, 3.3%, 2.5% and 2.3%, respectively, which were offset by declines in other large caps such as NIC Group, Safaricom, Bamburi and Co-operative bank of 2.8%, 4.3%, 2.2% and 3.1%, respectively.

During the week, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 declining by 0.8%, 0.3% and 0.8%, respectively, due to declines in large cap stocks such as Safaricom, Standard Chartered Bank and Equity Group, which declined by 3.4%, 2.0% and 1.5%, respectively.

Equities turnover declined by 29.8% during the month to USD 96.7 mn from USD 137.7 mn in June, taking the YTD turnover to USD 1.2 bn. Foreign investors remained net sellers during the month. 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 14.2x, 5.2% 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 14.2x is 46.4% above the most recent trough valuation of 9.7x 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.





Monthly Highlights:

During the month, KCB Group emerged as the only bidder for a stake in Imperial Bank Limited (IBL), which is under receivership, after Diamond Trust Bank (DTB), having also expressed interest, pulled out of the deal. IBL was put under receivership in August 2015, with a loan book of Kshs 41.0 bn and deposits of Kshs 58.0 bn. The Central Bank of Kenya (CBK) and KDIC is to 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 coming out of 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). For more information, see our **Cytonn Weekly #29/2018**

Commercial banks began implementing Treasury's new Robin Hood tax of 0.05% on bank transfers of above Kshs 0.5 mn that was proposed in the 2018/19 Budget presented to Parliament. Lenders communicated to customers notifying them of the new fee adjustment that took effect from 1st July 2018. However, the implementation of the tax was suspended by the High Court following a move by the Kenya Bankers Association (KBA) seeking to suspend its implementation. It was noted that the petition raised fundamental constitutional concerns, among them being the principle of public participation, given KBA's claims that there was no stakeholder engagement prior to the operationalization of the law as required by the Constitution. The Attorney-General, Mr. Kihara Kariuki, had termed the quest to suspend the Robin Hood tax premature as Parliament has not passed the relevant Bill into law, arguing that Parliament had already invited public participation on the Finance Bill 2018, according banks an opportunity to present their views on the Bill. For more information, see our **Cytonn Weekly #28/2018**

Barclays Africa Group Limited changed its name to Absa Group following the London-based Barclays Plc's exit from 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). Its Kenyan subsidiary, however, is looking to complete the rebranding process in 2020 and will continue operating as Barclays Bank Kenya till then. The move to separate with the London based parent company presents an opportunity for the local lender to explore new business areas and products that were initially hampered by the restrictions imposed by the parent group, hence enabling the bank to quickly implement new products based on mobile and internet banking that resonate with local markets. 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. Thus, with more localized decision-making, the lender is well positioned 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. For more information, see our [Cytonn Weekly #27/2018](#)

During the month, capital markets stakeholders agreed to collaborate on a joint strategy that aims to ensure proper packaging of investment products that meet issuers and investors' expectations, in a bid to enhance both listing and uptake of products. The strategy incorporates agencies such as the Treasury, the Nairobi Securities Exchange, the Central Depository and Settlement Corporation (CDSC), as well as the Fund Managers Association (FMA), alongside the Kenya Association of Stockbrokers and Investment Banks (KASIB), licensed market intermediaries, and the East African Venture Capital Association (EAVCA). The initiative was informed by a recent study conducted by Capital Markets Authority (CMA) that raised concern over the low number of listings and low uptake of capital markets products such as the Barclays Gold ETF and the Fahari I-REIT. We are of the view that this initiative will not only help investors better evaluate and understand capital market products, thereby increasing uptake of investment products; but will also assist issuers take advantage of capital-raising opportunities by tailoring investment products to meet investors' expectations. For more information, see our [Cytonn Weekly #26/2018](#)

Bank M Tanzania Plc has been placed under administration by the Bank of Tanzania (BoT) after the bank ran into critical liquidity problems that have rendered it unable to meet its maturing obligations. This means the lender will not resume normal business for up to 90 days effective 2nd August 2018, until the regulator determines an appropriate course of action. The move is expected to affect the operations of the Kenyan lender M-Oriental, formerly Oriental Commercial Bank, where Bank M acquired a 51.0% stake in 2016 through transfer of 42.3 mn shares valued at Kshs 30.0 per share, with the total transaction being valued at Kshs 1.3 bn translating to a P/B of 1.4x. Bank of Tanzania has appointed a statutory manager to manage the bank's operations after suspending its board of directors and management team. Bank M of Tanzania entered the Kenyan market in 2016, with a deposit base of Kshs 31.8 bn and a loan book of Kshs 33.5 bn.

The Bank of Ghana (BoG) has issued a universal banking licence to government-owned Consolidated Bank Ghana Limited, after revoking the licences of five banks namely UniBank Ghana Limited, The Royal Bank Limited, Beige Bank Limited, Sovereign Bank Limited, and Construction Bank Limited. The BoG appointed Mr. Nii Amanor Dodoo of KPMG as the Receiver for the five banks. All deposit liabilities of the five banks have been transferred to the Consolidated Bank. Operations will run as usual at the respective banks, which will now become branches of the Consolidated Bank, and the staff of these banks will also be absorbed by Consolidated Bank. Boards of Directors and shareholders of these banks will no longer have any roles. An asset quality review conducted by the BoG in 2016 revealed vulnerabilities in the five mentioned banks, namely:

- i. UniBank and Royal Bank were both found to be significantly undercapitalized,
- ii. Royal Bank was found to have a high non-performing loans ratio of 78.9% owing to poor credit and liquidity risk management frameworks,
- iii. Sovereign Bank has been unable to publish its financial statements for December 2017, and it emerged that the bank's licence was obtained by false pretences through the use of suspicious and non-existent capital, and,
- iv. Beige Bank and Construction Bank were each granted provisional licences in 2016 and launched in 2017. Subsequent investigations revealed that, similar to Sovereign Bank, both banks obtained their banking licences under false pretences through the use of suspicious and non-existent capital, which resulted in a situation where their reported capital is inaccessible to them for their operations.

The Bank of Ghana also approved a Purchase and Assumption Agreement between Consolidated

Bank and the Receiver for the five banks, under which Consolidated Bank has acquired all deposits and other specified liabilities, and good assets of the five banks. The Government has issued a bond of up to GH¢ 5.8 bn to finance the shortfall between the liabilities and good assets assumed by Consolidated Bank. The Bank of Ghana aims to promote a strong and resilient banking sector to drive economic growth, and needs a strong and stable banking sector to drive the process of economic transformation. To this effect, the BoG recently raised the minimum capital threshold for lenders by more than threefold to GHS 400.0 mn (USD 84.0 mn) from GHS 120.0 mn (USD 25.0) mn, in a move aimed at strengthening the banking sector and encourage lending. At least 15 lenders in the country, including Ghana Commercial Bank, have met or are close to meeting the new capital requirements ahead of the December 2018 deadline.

Corporate Governance Changes:

East African Breweries Limited announced the retirement of Dr. Alan Shonubi from the Board after completing 9 years (3 terms) as an independent non-executive director, effective 26th July 2018. The company also gave notice of the appointment of Mr. Jimmy D. Mugerwa as an independent non-executive director, effective 27th July 2018. Following the changes:

- i. The board size remains unchanged with 11 members, an odd number, hence the score remains the same at 1.0 since 11 is the optimal number of board members;
- ii. Gender diversity also remains unchanged at 18.2% female composition, hence the metric score also remains the same at 0.5 since it's less than 30.0%,
- iii. Ethnic diversity also remains unchanged since the incoming director, a Ugandan, replaces the outgoing who is also Ugandan; hence the score remains the same at 1.0 since less than 30.0% are from one ethnicity,
- iv. The proportion of non-executive members also remains unchanged at 72.7% since the incoming director is also non-executive, hence the score remains unchanged at 1.0 as it is still greater than 50.0%;

Overall, the comprehensive score has therefore remained unchanged at 77.1%, and the rank remained unchanged at position 8 in Cytonn Corporate Governance Index.

WPP Scangroup Plc also announced changes in its Board of Directors. The company gave notice of the appointment of Mr. Richard Omwela as the Chairman of the Board, in addition to appointments of Mr. Pratul Shah and Mr. Dominic Grainger, both as directors of the company, effective 26th July 2018. Following the changes:

- i. The board size has increased to 11, an odd number, from 10 hence an improvement of the metric score to 1.0 from 0.5,
- ii. Gender diversity remains unchanged at 10.0%, hence the metric score remains unchanged at 0.5 as it is less than 33.0%,
- iii. Ethnic diversity also remains unchanged at 55.6%, hence the score remains the same at 0.0 since more than 30.0% are from one ethnicity,
- iv. The proportion of non-executive members has remained unchanged at 90.0%, hence the score remains unchanged at 1.0 as it is still greater than 50.0%;

Overall, the comprehensive score has therefore remained unchanged at 66.7%, and the rank also remained unchanged at position 25 in the Cytonn Corporate Governance Index.

Equities Universe of Coverage:

Below is our equities universe of coverage:

Banks	Price as at 29/06/2018	Price as at 31/07/2018	m/m change	YTD Change	LTM Change	Dividend Yield	Upside/Downside**	P/TBv Multiple
Ghana Commercial Bank***	5.15	5.08	(1.4%)	0.6%	(1.4%)	7.6%	61.7%	1.2x
NIC Bank***	35.50	34.50	(2.8%)	2.2%	12.5%	2.9%	58.6%	0.8x
Zenith Bank***	25.00	23.00	(8.0%)	(10.3%)	(6.5%)	11.7%	56.6%	1.0x
I&M Holdings***	115.00	110.00	(4.3%)	5.8%	(3.5%)	3.1%	51.8%	1.1x
Diamond Trust Bank***	199.00	200.00	0.5%	4.2%	8.7%	1.3%	44.2%	1.1x
Union Bank Plc	6.10	5.90	(3.3%)	(24.4%)	29.7%	0.0%	40.5%	0.6x
KCB Group***	46.25	47.00	1.6%	9.9%	15.3%	6.2%	32.4%	1.5x
Ecobank	8.45	8.23	(2.6%)	8.3%	29.3%	0.0%	31.3%	2.3x
Barclays	11.75	11.55	(1.7%)	20.3%	17.3%	8.7%	30.4%	1.4x
CRDB	160.00	160.00	0.0%	0.0%	(23.8%)	0.0%	29.8%	0.5x
UBA Bank	10.50	9.55	(9.0%)	(7.3%)	(1.5%)	15.7%	27.7%	0.6x
HF Group***	8.50	8.00	(5.9%)	(23.1%)	(15.8%)	3.8%	23.8%	0.3x
Co-operative Bank	17.50	16.95	(3.1%)	5.9%	8.3%	4.8%	22.0%	1.5x
Equity Group	46.25	48.00	3.8%	20.8%	17.8%	4.0%	16.2%	2.5x
Stanbic Bank Uganda	32.00	33.00	3.1%	21.1%	22.2%	3.5%	13.5%	2.1x
CAL Bank	1.28	1.27	(0.8%)	17.6%	61.3%	0.0%	8.5%	1.1x
Bank of Kigali	286.00	290.00	1.4%	(3.3%)	16.0%	4.8%	8.2%	1.6x
Guaranty Trust Bank	40.50	40.05	(1.1%)	(1.7%)	2.6%	6.3%	4.3%	2.1x
Stanbic Holdings	91.50	93.50	2.2%	15.4%	16.9%	5.7%	(0.9%)	1.1x
Access Bank	10.35	10.00	(3.4%)	(4.3%)	(0.5%)	4.0%	(2.0%)	0.7x
Standard Chartered	198.00	203.00	2.5%	(2.4%)	(8.1%)	6.1%	(3.5%)	1.6x
Bank of Baroda	150.00	140.00	(6.7%)	23.9%	29.6%	1.8%	(4.9%)	1.2x
SBM Holdings	7.28	7.40	1.6%	(1.3%)	(3.4%)	4.1%	(6.5%)	1.0x
Stanbic IBTC Holdings	52.00	49.75	(4.3%)	19.9%	38.6%	1.2%	(23.0%)	2.5x
FBN Holdings	10.60	10.10	(4.7%)	14.8%	68.3%	2.8%	(24.0%)	0.5x
Standard Chartered	23.14	26.00	12.3%	3.0%	15.7%	0.0%	(25.2%)	3.3x
National Bank	6.25	5.80	(7.2%)	(38.0%)	(39.3%)	0.0%	(49.5%)	0.4x
Ecobank Transnational	20.00	20.60	3.0%	21.2%	24.8%	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.

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