Kenya's IMF Standby Facility, & Cytonn Weekly #31/2018

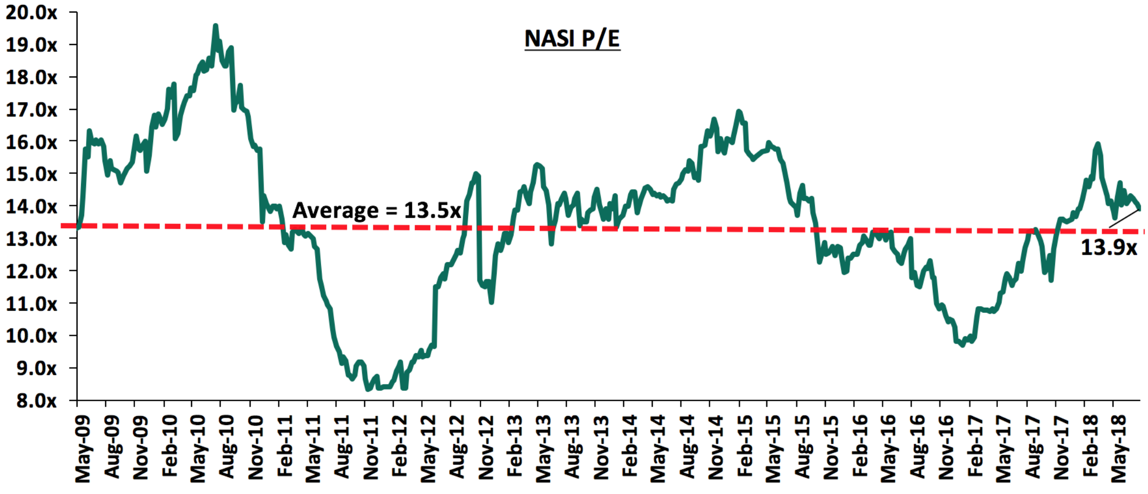
Equities

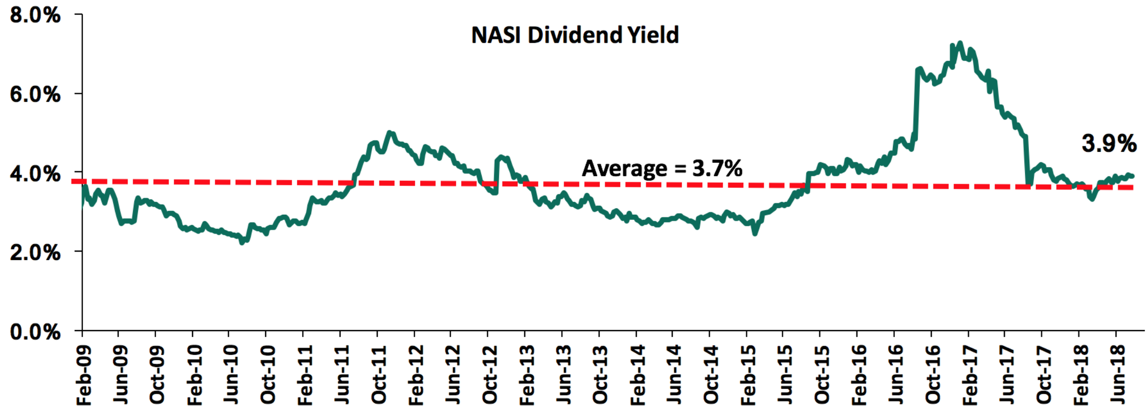
Market Performance:

During the week, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining 1.0%, 0.6% and 0.1%, respectively, taking their YTD performance to 2.0%, (10.1%) and 3.0%, respectively. This week's performance was driven by gains in large cap stocks such as Safaricom, BAT and Bamburi Cement that gained by 2.7%, 1.3% and 0.6%, respectively. For the last twelve months (LTM), NASI, NSE 20 and NSE 25 have gained 5.1%, (17.5%) and 2.1%, respectively.

Equities turnover increased by 55.6% to USD 26.9 mn, from USD 17.3 mn the previous week. This takes the YTD turnover to USD 1.2 bn. Foreign investors remained net sellers, with a net foreign outflow of USD 5.5 mn during the week. On a YTD basis, foreign investors have remained net sellers, recording a net outflow of USD 194.2 mn as they exit the market at relatively expensive valuations so as to realize capital gains earned from the bullish rally witnessed from Q2'2017 to March 2018, for possible re-entry at cheaper valuations. 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 13.9x, which is 3.0% above the historical average of 13.5x, and a dividend yield of 3.9%, higher than the historical average of 3.7%. The current P/E valuation of 13.9x is 41.8% above the most recent trough valuation of 9.8x experienced in the first week of February 2017, and 67.5% 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:

Equity Group Holdings released H1'2018 results during the week;

Equity Group Holdings released H1'2018 results, with core earnings per share increasing by 17.6% to Kshs 2.9 from Kshs 2.5 in H1'2017, below our expectation of a 20.7% increase to Kshs 3.0. Performance was driven by a 5.9% increase in total operating income, coupled with a 1.9% decrease in the total operating expenses. The variance in core earnings per share growth against our expectations was largely due to a slower growth in Non-Funded Income (NFI), which grew by 1.5% to Kshs 13.2 bn, against our expectation of an 8.3% growth to Kshs 14.1 bn. Highlights of the performance from H1'2017 to H1'2018 include:

- Total operating income increased by 5.9% to Kshs 32.8 bn in H1'2018, from Kshs 30.9 bn in H1'2017. This was due to a 9.1% increase in Net Interest Income (NII) to Kshs 19.6 bn from Kshs 17.9 bn in H1'2017, coupled with a 1.5% increase in Non-Funded Income (NFI) to Kshs 13.2 bn from Kshs 13.0 bn in H1'2017. The anemic NFI growth is concerning given that Equity Group has positioned itself as a transactions bank, hence we expected a stronger NFI growth,
- Interest income increased by 10.2% to Kshs 25.4 bn from Kshs 23.0 bn in H1'2017 bn. The interest income on loans and advances increased by 4.5% to Kshs 17.1 bn from Kshs 16.4 bn in H1'2017. Interest income on government securities increased by 26.8% to Kshs 7.9 bn in H1'2018 from Kshs 6.2 bn in H1'2017. The strong growth in government securities income relative to growth in loans should be a concern to policy makers as it indicates that government borrowing is crowding out the private sector. The yield on interest earning assets however declined to 11.4% in H1'2018 from 12.2% in H1'2017, due to a faster increase in allocation to government securities, that have a lower yield than loans,
- Interest expense increased by 14.0% to Kshs 5.8 bn from Kshs 5.1 bn in H1'2017, following an 11.6% increase in the interest expense on customer deposits to Kshs 4.7 bn from Kshs 4.2 bn in H1'2017. Interest expense on deposits and placements from banking institutions increased by 87.7% to Kshs 0.2 bn from Kshs 0.1 bn in H1'2017. Other interest expenses increased by 17.5% to Kshs 0.9 bn in H1'2018, from Kshs 0.8 bn in H1'2017. The cost of funds thus increased to 2.7% from 2.6% in H1'2017. Net Interest Margin declined to 8.8% from 9.7% in H1'2017,
- Non-Funded Income (NFI) increased by 1.5% to Kshs 13.2 bn from Kshs 13.0 bn in H1'2017. The growth in NFI was driven by a 21.9% increase in other income to Kshs 2.6 bn, from Kshs 2.1 bn in H1'2017. The growth in NFI was weighed down by a 2.5% decrease in fee and commission income on loans and advances to Kshs 2.8 bn from Kshs 2.9 bn in H1'2017, coupled with a 10.2% decline in foreign exchange trading income to Kshs 1.5 bn, from Kshs 1.7 bn in H1'2017. The current revenue mix stands at 60:40 funded to non-funded income as compared to 58:42 in H1'2017. The proportion of non-funded income to total revenue declined owing to the faster growth in NII as compared to NFI,
- Total operating expenses declined by 1.9% to Kshs 17.3 bn from Kshs 17.6 bn, largely driven by a 57.7% decrease in loan loss provisions to Kshs 0.8 bn in H1'2018 from Kshs 1.9 bn in H1'2017, coupled with a 12.3% decrease in depreciation on property and equipment to Kshs 1.6 bn in

H1’2018 from Kshs 1.9 bn in H1’2017. Staff costs however increased by 1.3% to Kshs 5.23 bn from Kshs 5.16 bn in H1’2017.
- The cost to income ratio improved to 52.8% from 57.0% in H1’2017. Without LLP, the Cost to income ratio also improved, albeit marginally, to 50.4% from 51.0% in H1’2017,
- Profit before tax increased by 16.4% to Kshs 15.5 bn, up from Kshs 13.3 bn in H1’2017. Profit after tax increased by 17.6% to Kshs 11.0 bn in H1’2018, from Kshs 9.4 bn in H1’2017,
- The balance sheet recorded an expansion as total assets increased by 7.3% to Kshs 542.0 bn from Kshs 504.9 bn in H1’2017. This growth was largely driven by a 37.5% increase in government securities to Kshs 158.9 bn from Kshs 115.6 bn in H1’2017,
- The loan book increased by 3.8% to Kshs 275.0 bn in H1’2018 from Kshs 265.1 bn in H1’2017,
- Total liabilities rose by 8.7% to Kshs 455.7 bn from Kshs 419.1 bn in H1’2017, driven by an 8.5% increase in total deposits to Kshs 393.7 bn from Kshs 362.8 bn in H1’2017. Deposits per branch increased by 10.8% to Kshs 1.4 bn from Kshs 1.3 bn in H1’2017, with the growth attributed to the bank’s closure of 6 branches in H2’2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 69.9% from 73.1% in H1’2017,
- Gross non-performing loans increased by 20.1% to Kshs 24.5 bn in H1’2018 from Kshs 20.4 bn in H1’2017. Consequently, the NPL ratio deteriorated to 8.5% in H1’2018 from 7.4% in H1’2017. General Loan Loss Provisions (LLPs) increased by 23.2% to Kshs 9.6 bn from Kshs 7.8 bn in H1’2017. Thus, the NPL coverage improved to 79.9% in H1’2018 from 69.5% in H1’2017, due to the relatively faster increase in the loan loss provisions. The increase in the non-performing loans was attributed to three major corporate clients. Large enterprises contributed the largest proportion of NLPs at 17.0%, with micro enterprises and agriculture contributing 14.9% and 8.1%, respectively,
- Shareholders’ funds increased marginally by 0.5% to Kshs 86.3 bn in H1’2018, from Kshs 85.9 bn in H1’2017.
- Equity Group Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 18.3%, 7.8% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 18.4%, exceeding the statutory requirement by 3.9%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 19.1%, while total capital to risk weighted assets came in at 19.2%, indicating that the bank’s total capital relative to its risk-weighted assets declined by 0.8% due to implementation of IFRS 9,

Equity Group Holdings currently has a return on average assets of 3.9% and a return on average equity of 23.9%.

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

i. Channeled diversification, which is likely to further improve on efficiency, with emphasis on alternative channels of transactions, as the bank rides on the digital revolution wave, thereby further improving the cost to income ratio by cost rationalization and revenue expansion. This will likely propel the bank’s prospects of achieving sustainable growth, as it replicates its successful business model across its various regional subsidiaries, and,
ii. The bank’s operating model of enhancing balance sheet agility, which is likely to place the bank in a prime position to take advantage of any opportunities that may arise, such as attractive inorganic growth via acquisitions or fast lending in the event of a repeal of the interest rate cap. The bank’s balance sheet agility is seen given the bank’s high liquidity ratio of 57.1%.

For a comprehensive analysis, see our Equity Group Holdings H1’2018 Earnings Note

KCB Group PLC released H1’2018 results during the week;

KCB Group PLC released H1’2018 results, with core earnings per share increasing by 18.0% to Kshs 7.9 from Kshs 6.7 in H1’2017, exceeding our expectation of a 9.4% increase to Kshs 7.3.

Performance was driven by a 2.9% increase in total operating income, coupled with a 6.8% decline in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to a 58.9% decline in Loan Loss Provisions (LLP) to Kshs 0.8 bn. We had expected a 9.5% decline in LLP to Kshs 1.8 bn from Kshs 2.0 bn in H1'2017. Highlights of the performance from H1'2017 to H1'2018 include:

- Total operating income increased by 2.9% to Kshs 35.6 bn in H1'2018 from Kshs 34.6 bn in H1'2017. This was due to a 4.3% increase in Net Interest Income (NII) to Kshs 24.1 bn from Kshs 23.1 bn in H1'2017, despite Non-Funded Income (NFI) remaining flat at Kshs 11.5 bn,
- Interest income increased by 6.1% to Kshs 32.2 bn from Kshs 30.4 bn in H1'2017, driven by a 7.1% increase in interest income on loans and advances to Kshs 25.6 bn from Kshs 23.9 bn, and a 3.6% increase in interest on government securities to Kshs 6.3 bn from Kshs 6.1 bn in H1'2017. As a result, the yield on interest-earning assets increased slightly to 11.4%, from 11.2% in H1'2017,
- Interest expense increased by 11.9% to Kshs 8.1 bn from Kshs 7.2 bn in H1'2017, following a 12.0% increase in the interest expense on customer deposits to Kshs 7.3 bn from Kshs 6.5 bn in H1'2017.Interest expense on deposits and placements from banking institutions increased by 11.4% to Kshs 0.8 bn from Kshs 0.7 bn in H1'2017. Consequently, the cost of funds increased to 3.0% from 2.7% in H1'2017, while the Net Interest Margin declined to 8.6% from 8.7% in H1'2017,
- Non-Funded Income remained flat at Kshs 11.5 bn. This was due to a 1.2% decline in fees and commissions on loans to Kshs 3.08 bn from Kshs 3.11 bn in H1'2017, and a 9.7% decline in other fees and commissions to Kshs 3.7 bn from Kshs 4.1 bn in H1'2017, which offset a 7.0% rise in forex income to Kshs 2.8 bn from Kshs 2.6 bn in H1'2017, and a 15.0% rise in other income to Kshs 1.9 bn from Kshs 1.6 bn in H1'2017. The current revenue mix stands at 68:32 funded to non-funded income as compared to 67:33 in H1'2017. The proportion of funded income to total revenue increased slightly owing to the growth in NII while NFI remained flat,
- Total operating expenses declined by 6.8% to Kshs 18.5 bn from Kshs 19.9 bn in H1'2017, largely driven by a 58.9% decline in loan loss provisions to Kshs 0.8 bn in H1'2018 from Kshs 2.0 bn in H1'2017, coupled with a 5.0% decline in staff costs to Kshs 8.6 bn from Kshs 9.1 bn in H1'2017. Depreciation charge on property and equipment however increased by 10.1% to Kshs 0.9 bn from Kshs 0.8 bn in H1'2017,
- The cost to income ratio improved to 52.0% from 57.0% in H1'2017. Without LLP, the cost to income ratio also improved to 49.7% from 51.6% in H1'2017,
- Profit before tax increased by 15.9% to Kshs 17.1 bn, up from Kshs 14.8 bn in H1'2017. Profit after tax increased by 18.0% to Kshs 12.1 bn from Kshs 10.3 bn in H1'2017,
- KCB declared an interim dividend of Kshs 1.0 per share, payable on 30th November 2018 to shareholder's registered at the close of business on 3rd September 2018. We expect a final dividend per share of Kshs 2.0, taking the total dividend for 2018 to Kshs 3.0 per share, translating to a dividend yield of 6.1%,
- The balance sheet recorded an expansion as total assets increased by 5.9% to Kshs 667.7 bn from Kshs 630.6 bn in H1'2017. This growth was driven by a 35.8% growth in other assets to Kshs 22.0 bn from Kshs 16.2 bn in H1'2017, and a loan book growth of 3.6% to Kshs 421.5 bn from Kshs 407.0 bn in H1'2017. Government securities declined by 2.8% to Kshs 112.5 bn from Kshs 115.8 bn in H1'2017,
- Total liabilities rose by 6.8% to Kshs 568.7 bn from Kshs 532.3 bn in H1'2017, driven by an 8.7% increase in customer deposits to Kshs 524.9 bn from Kshs 482.8 bn in H1'2017. Deposits per branch increased by 11.1% to Kshs 2.0 bn from Kshs 1.8 bn in H1'2017. The bank highlighted the closure of 3 branches in H1'2018. The faster growth in deposits compared to loans led to a decline in the loan to deposit ratio to 80.3% from 84.3% in H1'2017,
- Gross non-performing loans increased by 13.2% to Kshs 37.6 bn in H1'2018 from Kshs 33.2 bn in H1'2017. As a consequence, the NPL ratio deteriorated to 8.4% in H1'2018 from 7.7% in H1'2017. General Loan Loss Provisions increased by 1.4% to Kshs 19.4 bn from Kshs 19.1 bn in

H1’2017.Thus, the NPL coverage declined marginally to 75.0% in H1’2018 from 75.4% in H1’2017, due to the relatively faster growth in gross non-performing loans compared to growth in loan loss provisions,

- Total shareholders’ funds increased by 6.8% to Kshs 99.0 bn in H1’2018 from Kshs 98.3 bn in H1’2017,
- KCB Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.7%, 5.2% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 17.2%, exceeding the statutory requirement by 2.7%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.6%, while total capital to risk weighted assets came in at 18.3%, indicating that the bank’s total capital relative to its risky assets declined by 1.0%, due to implementation of IFRS 9,
- KCB Bank currently has a return on average assets of 3.5% and a return on average equity of 21.9%.

Going forward, we expect the bank’s growth to be driven by:

a. 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,
b. 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 – this remains the biggest source of potential growth for KCB Group. KCB’s NFI ratio currently stands at 32.0%, a decline from 33% in H1’2017. Just moving to an NFI ratio of 40% would mean Kshs 4.5 bn of additional revenue. KCB should diversify its sources of revenue in order to sustain profitability in the interest rate cap environment.

For a comprehensive analysis, see our KCB Group PLC H1’2018 Earnings Note

Co-operative Bank Kenya released H1’2018 results during the week;

Co-operative Bank released H1’2018 results, with core earnings per share increasing by 7.6% to Kshs 2.0 from Kshs 1.9 in H1’2017, in line with our expectation of a 6.1% increase to Kshs 2.0. Performance was driven by a 6.3% increase in total operating income, despite a 5.5% increase in total operating expenses. Highlights of the performance from H1’2017 to H1’2018 include:

- Total operating income increased by 6.3% to Kshs 21.8 bn in H1’2018 from Kshs 20.5 bn in H1’2017. This was due to a 10.4% increase in Net Interest Income (NII) to Kshs 14.8 bn from Kshs 13.4 bn in H1’2017, despite a 1.6% decline in Non-Funded Income (NFI) to Kshs 7.0 bn from Kshs 7.1 bn in H1’2017,
- Interest income increased by 7.9% to Kshs 20.8 bn from Kshs 19.3 bn in H1’2017. The interest income on loans and advances increased by 5.7% to Kshs 16.1 bn from Kshs 15.3 bn in H1’2017. Interest income on government securities increased by 17.5% to Kshs 4.5 bn from Kshs 3.9 bn in H1’2017. The yield on interest earning assets however declined to 12.2% in H1’2018 from 12.4% in H1’2017, due to the increase in interest earning assets mainly being government securities that have a lower yield than loans,
- Interest expense increased by 2.2% to Kshs 6.0 bn from Kshs 5.8 bn in H1’2017, following a 2.9% increase in the interest expense on customer deposits to Kshs 5.4 bn from Kshs 5.2 bn in H1’2017. Other interest expenses declined by 5.0% to Kshs 572.8 mn in H1’2018 from Kshs 602.7 mn in H1’2017. The cost of funds increased slightly to 3.9% from 3.8% in H1’2017. Consequently, the Net Interest Margin declined to 8.6% from 8.8% in H1’2017,
- Non-Funded Income decreased by 1.6% to Kshs 7.0 bn from Kshs 7.1 bn in H1’2017. The decline

in NFI was caused by a 41.4% decrease in fees and commissions on loans to Kshs 0.8 bn from Kshs 1.4 bn in H1’2017. The decline in fees is attributable to a contracting loan book, and growth in loans extended to corporates, which the bank charged minimal fees and commissions. Other fees and commissions income rose 11.0% to Kshs 4.3 bn from Kshs 3.9 bn in H1’2017, while foreign exchange trading income declined by 1.7% to Kshs 0.8 bn from Kshs 0.6 bn in H1’2017. The current revenue mix stands at 68:32 funded to non-funded income as compared to 65:35 in H1’2017. The proportion of non-funded income to total revenue declined owing to the faster growth in NII, coupled with the decrease in NFI,

- Total operating expenses increased by 5.5% to Kshs 12.0 bn from Kshs 11.3 bn in H1’2017, largely driven by a 13.0% increase in staff costs to Kshs 5.3 bn in H1’2018 from Kshs 4.7 bn in H1’2017, coupled with an 8.4% increase in other operating expenses to Kshs 5.5 bn from Kshs 5.1 bn in H1’2017. Staff costs rose faster than industry average, in part due to specialized hires made by the bank in the IT department to be used for big data analytics and credit pre-scoring purposes, with the bank indicating the hires were being paid at a premium to average market rates. The additional staff costs are equivalent to an additional Kshs 51.3 mn monthly amount. The Loan Loss Provisions (LLP) declined by 27.6% to Kshs 1.1 bn from Kshs 1.5 bn in H1’2017,
- The cost to income ratio improved albeit marginally to 54.9% from 55.3% in H1’2017. Without LLP, the Cost to income ratio deteriorated to 49.9% from 47.9% in H1’2017,
- Profit before tax increased by 7.6% to Kshs 10.0 bn up from Kshs 9.3 bn in H1’2017. Profit after tax also increased by 7.6% to Kshs 7.1 bn in H1’2018 from Kshs 6.6 bn in H1’2017,
- The balance sheet recorded an expansion as total assets increased by 3.9% to Kshs 398.4 bn from Kshs 383.3 bn in H1’2017. This growth was largely driven by a 12.0% increase in government securities to Kshs 83.1 bn from Kshs 74.2 bn in H1’2017,
- The loan book contracted marginally by 0.6% to Kshs 251.1 bn from Kshs 252.6 bn in H1’2017. The proportion of the loans extended to SMEs and Personal banking increased during the period to 8.9% and 32.2%, up from 6.7% and 31.5%, respectively in H1’2017, while Corporate loans declined to 25.0% from 26.3% in H1’2017,
- Total liabilities rose by 3.3% to Kshs 329.6 bn from Kshs 319.0 bn in H1’2017, driven by a 3.9% increase in total deposits to Kshs 297.0 bn from Kshs 285.8 bn in H1’2017. Deposits per branch remained at Kshs 1.92 bn, similar to H1’2017 despite the number of branch outlets increasing by 2 branches to 155 during the quarter,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 84.6% from 88.4% in H1’2017,
- Gross non-performing loans increased by 130.8% to Kshs 28.2 bn in H1’2018 from Kshs 12.2 bn in H1’2017. As a consequence, the NPL ratio deteriorated to 10.9% in H1’2018 from 4.7% in H1’2017. Loan loss provisions increased by 75.6% to Kshs 7.9 bn from Kshs 4.5 bn in H1’2017.The NPL coverage decreased to 31.0% in H1’2018 from 44.7% in H1’2017, due to the relatively faster increase in the gross non-performing loans. The increase in the non-performing loans was attributed to major clients in the trade and manufacturing sectors,
- Shareholders’ funds increased by 5.5% to Kshs 68.0 bn in H1’2018 from Kshs 64.5 bn in H1’2017,
- Cooperative Bank Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.9%, 5.4% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 16.0%, exceeding the statutory requirement by 1.5%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.8%, 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 0.9% due to implementation of IFRS 9,
- Cooperative Bank currently has a return on average assets of 3.0% and a return on average equity of 18.0%.

Going forward, we expect the bank’s growth to be driven by:

1. Non-Funded Income growth initiatives – Co-operative Bank’s NFI is below the industry average,

coming in at 32.1%, which is lower than the industry average of 36.0%. The bank needs to focus on increasing fee income and transactional income. To this effect, the bank is taking advantage of its alternative channels such as the mobile wallet platform, MCoop Cash mobile app, and agency banking to increase its transactional income, as more customers increase the usage of these platforms,
2. Increased adoption of alternative channels by customers will improve operational efficiency in addition to increasing the bank's transactional income. The bank is planning to aggressively grow its number of agents to 20,000 agents from the current 10,000. Agency outlets will be transformed such that basic banking services such as account opening will be done by agents in a bid to migrate transactions from the bank's branches. Such initiatives will see the bank's cost-to-income ratio improve significantly from the current 54.9%.

For a comprehensive analysis, see our Cooperative Bank H1'2018 Earnings Note

Barclays Bank Kenya released H1'2018 results during the week;

Barclays Bank released H1'2018 results, with core earnings per share increasing by 6.2% to Kshs 0.69 from Kshs 0.65 in H1'2017, which was lower than our expectation of a 12.7% increase to Kshs 0.73. Performance was driven by a 4.8% increase in total operating income, despite a 6.0% increase in the total operating expenses. Variance in core earnings per share growth against our expectation was due to a 26.9% increase y/y in Loan Loss Provisions (LLPs). We had expected a 20.9% decrease in LLPs to Kshs 1.1 bn, but came in at Kshs 1.7 bn. Highlights of the performance from H1'2017 to H1'2018 include:

- Total operating income increased by 4.8% to Kshs 15.7 bn from Kshs 14.9 bn in H1'2017. This was due to a 4.1% increase in Net Interest Income (NII) to Kshs 11.0 bn from Kshs 10.5 bn in H1'2017, and a 6.9% increase in Non-Funded Income (NFI) to Kshs 4.7 bn from Kshs 4.4 bn in H1'2017,
- Interest income increased by 7.6% to Kshs 14.1 bn from Kshs 13.1 bn in H1'2017. The interest income on loans and advances increased marginally by 0.6% to Kshs 10.6 bn from Kshs 10.5 bn in H1'2017. Interest income on government securities increased by 36.1% to Kshs 3.5 bn from Kshs 2.6 bn in H1'2017. The yield on interest earning assets however declined to 11.7% in H1'2018 from 12.7% in H1'2017, due to the relatively faster increase in the interest earning assets by 13.2% to Kshs 256.4 bn from Kshs 226.4 bn in H1'2017, with the increase mainly being government securities that had lower yield than loans,
- Interest expense increased by 22.4% to Kshs 3.2 bn from Kshs 2.6 bn in H1'2017, as interest expense on customer deposits increased by 19.0% to Kshs 2.8 bn from Kshs 2.3 bn in H1'2017. Interest expense on deposits from other banking institutions rose by 50.6% to Kshs 416.1 mn from Kshs 276.4 mn in H1'2017. Consequently, the cost of funds increased to 2.6% from 2.5% in H1'2017. Thus, the Net Interest Margin declined to 9.0% from 9.8% in H1'2017,
- Non-Funded Income increased by 6.9% to Kshs 4.7 bn from Kshs 4.4 bn in H1'2017. The increase in NFI was driven by a 47.1% increase in fees and commissions income from loans and advances to Kshs 474.3 mn from Kshs 322.5 mn in H1'2017, coupled with a 10.9% increase in forex trading income to Kshs 1.6 bn from Kshs 1.5 bn in H1'2017. Other fees and commissions decreased by 4.2% to Kshs 2.3 bn from Kshs 2.4 bn in H1'2017. The revenue mix shifted to 70:30 funded to non-funded income in H1'2018 from 71:29 in H1'2017, due to the faster growth in NFI,
- Total operating expenses increased by 6.0% to Kshs 5.0 bn from Kshs 4.9 bn, largely driven by a 26.9% increase in loan loss provision (LLP) to Kshs 1.7 bn in H1'2018 from Kshs 1.4 bn in H1'2017, coupled with a 7.6% increase in other operating expenses to Kshs 3.6 bn from Kshs 3.3 bn in H1'2017. Staff costs decreased marginally by 0.4% to Kshs 5.10 bn in H1'2018 from 5.12 bn in H1'2017,
- The cost to income ratio deteriorated to 66.3% from 65.5% in H1'2017. Without LLP, however, the cost to income ratio improved to 55.3% from 56.5% in H1'2017,
- Profit before tax increased by 2.6% to Kshs 5.3 bn, up from Kshs 5.2 bn in H1'2017. Profit after

tax increased 6.2% to Kshs 3.8 bn from Kshs 3.5 bn in H1’2017, with the effective tax rate being 33.6%,

- Barclays Bank declared an interim dividend of Kshs 0.2 per share, which is similar to H1’2017 interim dividend payout of Kshs 0.2 per share. We expect a final dividend per share of Kshs 0.8 per share, taking the total dividend for 2018 to Kshs 1.0 per share, translating to a dividend yield of 8.3%
- The balance sheet recorded an expansion with total assets increasing by 18.1% to Kshs 316.6 bn from Kshs 268.2 bn in H1’2017. This growth was largely driven by a 33.6% increase in government securities to Kshs 70.3 bn from Kshs 52.7 bn in H1’2017 and a loan book growth of 7.5% to Kshs 176.1 bn from Kshs 163.8 bn in H1’2017,
- Total liabilities rose by 21.3% to Kshs 275.8 bn from Kshs 227.4 bn in H1’2017, driven by a 14.9% increase in total deposits to Kshs 216.8 bn from Kshs 188.7 bn in H1’2017. Deposits per branch increased by 14.3% to Kshs 2.4 bn from Kshs 2.1 bn in H1’2017, as the bank closed 2 branches in H2’2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 81.2% from 86.8% in H1’2017,
- Gross non-performing loans increased by 19.7% to Kshs 14.4 bn in H1’2018 from Kshs 12.0 bn in H1’2017. Consequently, the NPL ratio deteriorated to 7.7% in H1’2018 from 7.0% in H1’2017. General Loan loss provisions increased by 27.9% to Kshs 6.4 bn from Kshs 5.0 bn in H1’2017. The NPL coverage increased to 63.0% from 58.0% in H1’2017. The increase in the non-performing loans was attributed to large loan defaults by clients mainly in the retail business segment,
- Shareholders’ funds increased marginally by 0.5% to Kshs 40.81 bn from Kshs 40.79 bn in H1’2017,
- Barclays Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 14.7%, 4.2%above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 16.7%, exceeding the statutory requirement by 2.2%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 15.0%, 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 decreased by 0.2% due to the impact of IFRS 9,
- Barclays Bank currently has a return on average assets of 2.6% and a return on average equity of 17.5%.

Going forward, we expect the bank’s growth to be further driven by:

a. Non-Funded Income Growth Initiatives - Barclays’ NFI is improving as the bank focuses on digital innovation and alternative banking channels in the wake of the rebranding move. These will go a long way to grow the bank’s fee income, and,
b. Cost Control – Barclays’ cost to income ratio currently stands at 66.3%. The bank needs to manage any rising costs, such as those that may arise from poor asset qualities, leading to increasing provisioning, and other operational expenses, which strain its revenue. Emphasis on operational efficiency by, for example, adopting alternative channels will likely boost profitability.

For a comprehensive analysis, see our Barclays Bank H1’2018 Earnings Note

Below is a summary of the H1’2018 results for the five listed banks that have released,

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-Funded Income (NFI) Growth	NFI to Total Operating Income	Growth in Total Fees & Commissions	Deposit Growth	Growth in Govt. Securities	Loan Growth	LDR	Cost of Funds	IFRS 9 Impact on Capital	Return on Average Equity
Stanbic Holdings	104.5%	15.4%	21.7%	11.9%	4.9%	34.0%	50.0%	(4.2%)	21.3%	26.9%	15.4%	71.4%	3.1%	(0.9%)	14.8%
KCB Group	18.0%	6.1%	11.9%	4.3%	8.6%	(0.1%)	32.2%	(6.0%)	8.7%	(2.8%)	3.6%	80.3%	3.0%	(1.0%)	21.9%
Equity Group	17.6%	10.2%	14.0%	9.1%	8.8%	1.5%	40.2%	(1.0%)	8.5%	18.7%	3.8%	69.9%	2.7%	(0.8%)	23.9%
Co-op Bank	7.6%	7.9%	2.2%	10.4%	8.6%	(1.6%)	32.1%	(3.0%)	3.9%	12.0%	(0.6%)	84.6%	3.9%	(0.9%)	18.0%

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-Funded Income (NFI) Growth	NFI to Total Operating Income	Growth in Total Fees & Commissions	Deposit Growth	Growth in Govt. Securities	Loan Growth	LDR	Cost of Funds	IFRS 9 Impact on Capital	Return on Average Equity
Barclays Bank	6.2%	7.6%	22.4%	4.0%	9.0%	6.9%	30.0%	1.9%	14.9%	33.6%	7.5%	81.2%	2.6%	(0.2%)	17.5%
Weighted Average H1'2018*	**21.2%**	**8.7%**	**12.9%**	**7.6%**	**8.4%**	**3.6%**	**36.0%**	**(2.6%)**	**9.5%**	**13.9%**	**4.2%**	**76.9%**	**3.0%**	**(0.8%)**	**20.8%**
Weighted Average H1’2017*	**(13.8%)**	**(8.3%)**	**(9.3%)**	**(6.9%)**	**7.1%**	**(6.9%)**	**36.1%**	**16.9%**	**6.0%**	**17.2%**	**6.8%**	**77.9%**	**2.9%**	**-**	**21.0%**

Market Cap weighted average as per 17-8-2018 & 17-8-2017

Key takeaways from the table include:

- All listed banks recorded an increase in core EPS growth, with the weighted average increase coming in at 21.2% compared to a decrease of 13.8% for the same period last year. Growth is driven by an increase in the Net Interest Income (NII), which came in at 7.6%, and a 3.6% growth in NFI. This indicates that the banking industry has adjusted to the new operating environment;
- Average deposit growth came in at 9.5%. Interest expense paid on deposits recorded a faster growth of 12.9% on average, indicating that more interest earning accounts have been opened;
- Average loan growth came in at 4.2%, while investment in government securities has grown by 17.1%, outpacing the loan growth, showing increased lending to the government by banks as they avoid the risky borrowers. The loan to deposit ratio thus declined marginally to 76.9% from 77.9% in H1’2017; and,
- The average Net Interest Margin in the banking sector currently stands at 8.4%, an increase from the 7.1% recorded in H1’2017.

Corporate Governance Changes:

ARM Cement PLC, which has been put under administration, issued a press release with the following highlights:

a. The retirement of Mr. Wilfred Murungi as Chairman and Director, and will be replaced by Mr. Linus Gitahi, former CEO of Nation Media Group, as Chairman,
b. The retirement of Mr. Surendra Bhatia as Deputy Managing Director and from the Board. The appointment of Mr. Thierry Metro, former Board Director at Lafarge Africa Plc, as his replacement,
c. Pradeep Paunrana (Ms. Navishka Paunrana is his alternate), Mr. John Ngumi (Non-Executive) and Ms. Aliya Shariff (Non-Executive) will remain on the Board. Mr. Paunrana will become a Non-Executive Director with the appointment of the new CEO.

Following the changes:

i. The board size remains unchanged with 9 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 22.2% female composition; hence the metric score also remains the same at 0.5 since it’s less than 30.0%;
iii. The proportion of Non-Executive Directors improves to 100.0% since the incoming Director is Non-Executive, while Pradeep Paunrana who was the Executive director, transitioned to a Non-Executive Director, pending the appointment of a new CEO, 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 remained unchanged at Position 25 in Cytonn’s Corporate Governance Index.

Equities Universe of Coverage:

Below is our Equities Universe of Coverage:

Banks	Price as at 10/08/2018	Price as at 17/08/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple
NIC Bank***	34.8	34.8	0.0%	3.0%	5.5%	54.1	2.9%	58.6%	0.8x
Zenith Bank***	22.9	23.6	3.3%	(8.0%)	2.6%	33.3	11.4%	57.3%	1.0x
Ghana Commercial Bank***	5.2	5.3	2.5%	5.0%	3.1%	7.7	7.2%	56.5%	1.3x
I&M Holdings***	116.0	115.0	(0.9%)	10.6%	(7.3%)	169.5	3.0%	49.2%	1.2x
Union Bank Plc	5.6	5.9	5.4%	(25.0%)	12.3%	8.2	0.0%	46.8%	0.6x
Diamond Trust Bank***	194.0	197.0	1.5%	2.6%	3.7%	280.1	1.3%	45.7%	1.1x
HF Group***	8.0	7.9	(1.3%)	(24.0%)	(27.0%)	10.2	4.1%	31.6%	0.3x
UBA Bank	9.5	8.4	(11.6%)	(18.9%)	(10.2%)	10.7	18.0%	31.2%	0.6x
CRDB	160.0	160.0	0.0%	0.0%	(20.0%)	207.7	0.0%	29.8%	0.5x
Ecobank	8.3	9.0	8.0%	17.9%	40.8%	10.7	0.0%	29.3%	2.4x
KCB Group***	49.5	49.5	0.0%	15.8%	12.5%	60.9	6.1%	29.1%	1.6x
Barclays	12.6	12.0	(4.4%)	25.0%	11.6%	14.0	8.3%	19.9%	1.6x
Co-operative Bank	17.2	17.1	(0.6%)	6.9%	(2.0%)	19.7	4.7%	19.2%	1.5x
CAL Bank	1.2	1.3	3.3%	17.6%	59.5%	1.4	0.0%	13.8%	1.0x
Stanbic Bank Uganda	33.0	33.0	0.0%	21.1%	21.1%	36.3	3.5%	13.5%	2.1x
Equity Group	51.5	50.0	(2.9%)	25.8%	15.6%	55.5	4.0%	11.8%	2.6x
Bank of Kigali	290.0	290.0	0.0%	(3.3%)	15.1%	299.9	4.8%	8.2%	1.6x
Guaranty Trust Bank	39.0	38.0	(2.6%)	(6.7%)	(5.1%)	37.1	6.3%	1.4%	2.2x
Access Bank	10.0	9.6	(4.0%)	(8.1%)	(1.3%)	9.5	4.2%	(0.8%)	0.7x
SBM Holdings	7.0	6.7	(4.0%)	(10.7%)	(15.0%)	6.6	4.5%	(1.5%)	1.0x
Standard Chartered	205.0	206.0	0.5%	(1.0%)	(12.0%)	184.3	6.1%	(4.0%)	1.6x
Bank of Baroda	140.0	120.0	(14.3%)	6.2%	9.1%	130.6	2.1%	(4.6%)	1.2x
Stanbic Holdings	98.0	106.0	8.2%	30.9%	28.5%	85.9	2.1%	(10.2%)	1.2x
Stanbic IBTC Holdings	49.4	50.1	1.4%	20.6%	35.3%	37.0	1.2%	(23.8%)	2.5x
Standard Chartered	26.1	26.1	(0.0%)	3.2%	15.2%	19.5	0.0%	(25.3%)	3.3x
FBN Holdings	9.6	9.8	2.1%	11.4%	63.3%	6.6	2.6%	(28.4%)	0.5x
National Bank	6.0	6.1	0.8%	(35.3%)	(48.7%)	2.8	0.0%	(53.3%)	0.4x
Ecobank Transnational	21.2	21.1	(0.5%)	23.8%	16.9%	9.3	0.0%	(56.1%)	0.8x

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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