Nairobi Metropolitan Area Mixed-Use Developments (MUDs) Report 2018, & Cytonn Weekly #44/2018

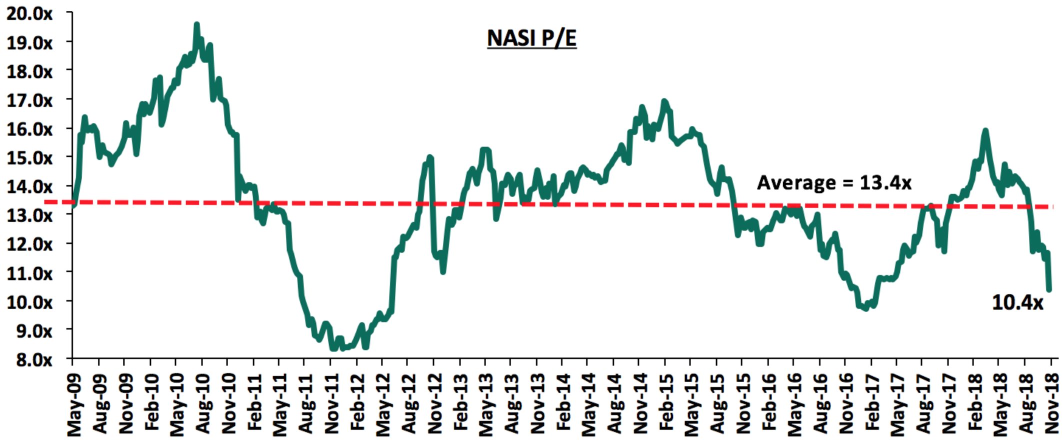
Equities

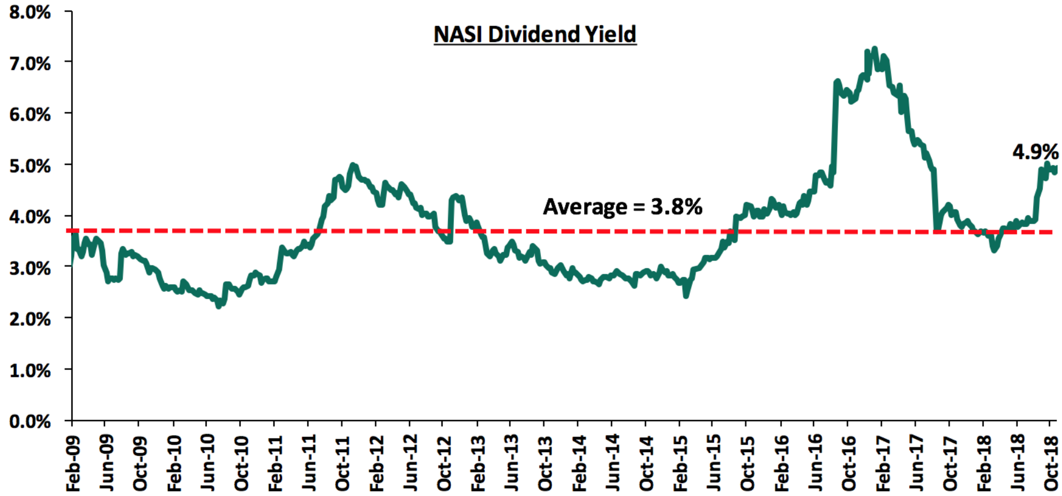
Market Performance

During the week, the equities market recorded mixed performances with NSE 20 and NASI declining by 0.9% and 1.4%, respectively, while NSE 25 gained by 0.4%, taking their YTD performance to declines of 24.4%, 15.4%, and 14.5%, for NSE 20, NASI and NSE 25, respectively. The decline in the NASI was driven by declines in large-cap stocks such as British American Tobacco (BAT) and Safaricom, which declined by 6.8% and 2.1%, respectively.

Equities turnover increased by 82.4% during the week to USD 19.5 mn from USD 10.7 mn the previous week, taking the YTD turnover to USD 1.7 bn. Foreign investors remained net sellers for the week, with a net selling position of USD 0.7 mn, a 121.3% increase from last week's net selling position of USD 0.3 mn. We expect the market to remain subdued in the near-term as international investors exit the broader emerging markets due to the expectation of rising US interest rates coupled with the strengthening of the US Dollar.

The market is currently trading at a price to earnings ratio (P/E) of 10.4x, 22.6% below the historical average of 13.4x, and a dividend yield of 4.9%, above the historical average of 3.8%. The current P/E valuation of 10.4x is 6.1% above the most recent trough valuation of 9.8x experienced in the first week of February 2017, and 25.2% 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

KCB Group released Q3'2018 results during the week;

KCB Group released their Q3'2018 results, registering core earnings per share growth of 19.7% to Kshs 5.9, from Kshs 4.9 in Q3'2017, above our expectation of a 12.4% increase to Kshs 5.5. The performance was driven by a 2.0% increase in total operating income, coupled with the 6.8% decline in the total operating expenses. However, the variance in core earnings per share growth against our expectations was largely due to the 42.6% decline in loan loss provisions to Kshs 1.8 bn from Kshs 3.1 bn. We expected a 32.1% decline in loan loss provisions to Kshs 2.1 bn from Kshs 3.1 bn recorded in Q3'2017. Highlights of the performance from Q3'2017 to Q3'2018 include:

- Total operating income increased by 2.0% to Kshs 54.2 bn from Kshs 53.2 bn in Q3'2017. This was due to a 1.8% increase in Net Interest Income (NII) to Kshs 36.3 bn from Kshs 35.7 bn in Q3'2017, coupled with a 2.6% rise in Non-Funded Income (NFI) to Kshs 17.9 bn, from Kshs 17.5 bn in Q3'2017,
- Interest income increased by 5.1% to Kshs 49.2 bn, from Kshs 46.8 bn in Q3'2017. This was driven by a 4.9% growth in interest income from government securities to Kshs 9.7 bn from Kshs 9.3 bn in Q3'2017, and a 5.2% increase in interest income on loans and advances to Kshs 39.0 bn, from Kshs 37.1 bn in Q3'2017. The yield on interest-earning assets remained unchanged at 11.4%,
- Interest expense increased by 16.0% to Kshs 12.9 bn from Kshs 11.1 bn in Q3'2017, following a 13.9% increase in the interest expense on customer deposits to Kshs 11.3 bn, from Kshs 9.9 bn in Q3'2017. Interest expense on deposits and placements from banking institutions increased by 33.0% to Kshs 1.6 bn from Kshs 1.2 bn in Q3'2017. The cost of funds thus rose to 3.2%, from 2.9% in Q3'2017. Consequently, the Net Interest Margin (NIM) declined to 8.5%, from 8.7% in Q3'2017,
- Non-Funded Income (NFI) increased by 2.6% to Kshs 17.9 bn, from Kshs 17.5 bn in Q3'2017. The increase was driven by a 2.4% increase in other fees and commission income to Kshs 6.6 bn from

Kshs 6.4 bn in Q3'2017, and a 24.1% increase in other income to Kshs 3.3 bn, from Kshs 2.6 bn in Q3'2017 outweighing the 7.9% decline in fees and commissions on loans to Kshs 4.4 bn from Kshs 4.8 bn in Q3'2017. As a result, the revenue mix remained the same at 67:33 funded to non-funded income,

- Total operating expenses declined by 6.8% to Kshs 28.6 bn, from Kshs 30.7 bn, largely driven by a 42.6% decline in Loan Loss Provisions (LLP) to Kshs 1.8 bn in Q3'2018, from Kshs 3.1 bn in Q3'2017, coupled with a 7.4% decline in staff costs to Kshs 12.8 bn in Q3'2018, from Kshs 13.8 bn in Q3'2017,
- Consequently, the Cost to Income Ratio (CIR) improved to 52.8%, from 57.8% in Q3'2017. Without LLP, the cost to income ratio also improved to 49.5%, from 51.9% in Q3'2017,
- Profit before tax increased by 14.2% to Kshs 25.6 bn, up from Kshs 22.4 bn in Q3'2017. Profit after tax increased by 19.7% to Kshs 18.0 bn in Q3'2018, from Kshs 15.1 bn in Q3'2017 as the effective tax rate declined to 32.5% from 36.4% in Q3'2017,
- The balance sheet recorded an expansion as total assets increased by 6.3% to Kshs 684.2 bn from Kshs 643.8 bn in Q3'2017. This growth was largely driven by a 15.3% increase in government securities to Kshs 119.5 bn, from Kshs 103.7 bn in Q3'2017, coupled with a 3.8% increase in their loan book to Kshs 435.3 bn from Kshs 419.5 bn in Q3'2017, which was mainly attributed to an increase in the corporate loan book,
- Total liabilities rose by 7.0% to Kshs 578.7 bn from Kshs 540.6 bn in Q3'2017, driven by a 6.2% increase in customer deposits to Kshs 526.8 bn, from Kshs 496.3 bn in Q3'2017. Deposits per branch increased by 8.6% to Kshs 2.1 bn, from Kshs 1.9 bn in Q3'2017, with the number of branches having reduced to 257 from 263 in Q3'2017. Placement liabilities increased by 20.4% to Kshs 12.6 bn from Kshs 10.5 bn in Q3'2017. Borrowings increased by 43.7% to Kshs 20.7 bn from Kshs 14.4 bn in Q3'2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 82.6% from 84.5% in Q3'2017,
- Gross Non-Performing Loans (NPLs) declined by 0.1% to Kshs 34.8 bn in Q3'2018 from Kshs 34.7 bn in Q3'2017. The NPL ratio thus improved to 7.6% in Q3'2018 from 7.8% in Q3'2017. General Loan Loss Provisions (LLPs) declined by 15.6% to Kshs 16.7 bn from Kshs 19.8 bn in Q3'2017. The NPL coverage declined to 60.4% in Q3'2018 from 67.9% in Q3'2017, as provisions declined at a faster rate than the NPLs,
- Shareholders' funds increased by 2.2% to Kshs 105.5 bn in Q3'2018 from Kshs 103.2 bn in Q3'2017, as retained earnings grew by 25.6% y/y to Kshs 79.1 bn from Kshs 63.0 bn in Q3'2017,
- KCB group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.3%, 5.8% above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 17.8%, exceeding the statutory requirement by 3.3%. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 17.6%, while total capital to risk-weighted assets came in at 19.0%, indicating that the bank's total capital relative to its risk-weighted assets declined by 1.2% due to implementation of IFRS 9,
- The bank currently has a Return on Average Assets (ROaA) of 3.5% and a Return on Average Equity (ROaE) of 21.7%.

For more information, see our KCB Group Q3'2018 Earnings Note

Co-operative Bank released Q3'2018 results during the week;

Co-operative Bank released Q3'2018 results during the week, with core earnings per share growth of 8.2% to Kshs 1.8 from Kshs 1.6 in Q3'2017, in line with our expectations of an 8.5% increase to Kshs 1.8. The performance was driven by a 4.6% increase in total operating income, despite the 3.1% increase in the total operating expenses. Highlights of the performance from Q3'2017 to Q3'2018 include:

- Total operating income increased by 4.6% to Kshs 32.3 bn from Kshs 30.9 bn over the same period in Q3’2017. This was due to a 4.7% increase in Net Interest Income (NII) to Kshs 21.7 bn from Kshs 20.8 bn in Q3’2017, coupled with 4.3% growth in Non-Funded Income (NFI) to Kshs 10.6 bn, from Kshs 10.1 bn in Q3’2017,

- Interest income increased by 3.5% to Kshs 30.9 bn from Kshs 29.9 bn in Q3’2017. This was driven by a 13.1% growth in interest income from government securities to Kshs 6.9 bn from Kshs 6.1 bn in Q3’2017, and a marginal 0.8% increase in interest income on loans and advances to Kshs 23.8 bn, from Kshs 23.5 bn in Q3’2017. Interest income on deposits and placements with banking institutions rose by 13.3% to Kshs 0.17 bn from Kshs 0.15 bn in Q3’2017. However, the yield on interest-earning assets declined to 11.9% in Q3’2018 from 12.3% in Q3’2017, given the faster growth of 16.9% in government securities that have relatively lower yields than loans,
- Interest expense remained flat at Kshs 9.1 bn in Q3’2018. Interest on customer deposits increased by 2.5% to Kshs 8.2 mn from Kshs 8.0 mn, while other interest charges decreased by 3.4% to Kshs 0.88 bn from Kshs 0.91 bn in Q3’2017. The cost of funds decreased to 3.8% from 3.9% in Q3’2017. Consequently, net interest margin decreased to 8.3% from 8.6% in Q3’2017,
- Non-Funded Income (NFI) increased by 4.3% to Kshs 10.6 bn, from Kshs 10.1 bn in Q3’2017. The increase in NFI was realized across all NFI segments apart from fees and commissions on loans which declined by 29.7 % to Kshs 1.3 bn from Kshs 1.9 bn in Q3’2017, with management indicating that the appraisal fees declined by 51.0%, while negotiation fees declined by 16.0%. The values were however undisclosed. Other fees and commission income increased by 9.9% to Kshs 6.6 bn, from Kshs 6.0 bn in Q3’2017. Forex trading income increased by 13.6% to Kshs 1.8 bn, from Kshs 1.5 bn in Q3’2017. Other income increased by 24.1% to Kshs 0.9 bn, from Kshs 0.8 bn in Q3’2017, with management citing recoveries from loans and revenue from the custody business as the key drivers for the growth in the other income segment. As a result, the current revenue mix remained at 67:33 funded to non-funded income,
- Total operating expenses increased by 3.1% to Kshs 17.8 bn, from Kshs 17.3 bn, largely driven by a 12.5% increase in other operating expenses to Kshs 8.4 bn in Q3’2018, from Kshs 7.5 bn in Q3’2017, as the bank improved its Information Technology (IT) infrastructure, as it pushes for further automation of its processes, together with improving its data analytics function. Staff costs increased by 12.3% to Kshs 8.1 bn from Kshs 7.2 bn in Q3’2017, attributed to recruitment by the bank for the IT department, with management indicating the expertize was hired at a premium. Loan Loss Provisions (LLP) however declined by 50.3% to Kshs 1.3 bn in Q3’2018, from Kshs 2.6 bn in Q3’2017,
- The Cost to Income Ratio (CIR) improved to 55.1%, from 55.9% in Q3’2017. Without LLP, the cost to income ratio deteriorated to 51.2%, from 47.6% in Q3’2017,
- Profit before tax increased by 6.6% to Kshs 14.6 bn, up from Kshs 13.7 bn in Q3’2017. Profit after tax increased by 8.2% to Kshs 10.3 bn in Q3’2018, from Kshs 9.5 bn in Q3’2017,
- The balance sheet recorded an expansion as total assets increased by 4.1% to Kshs 404.2 bn from Kshs 388.3 bn in Q3’2017. This growth was largely driven by a 16.9% increase in government securities to Kshs 83.3 bn, from Kshs 71.2 bn in Q3’2017. This was despite the 2.0% decrease in their loan book to Kshs 254.2 bn from Kshs 259.4 bn in Q3’2017,
- Total liabilities rose by 3.5% to Kshs 332.5 bn from Kshs 321.1 bn in Q3’2017, driven by a 2.5% increase in customer deposits to Kshs 296.1 bn from Kshs 289.0.8 bn in Q3’2017. In terms of distribution, transaction accounts, current accounts and fixed deposits accounted for the highest proportion at 29.5%, 28.9% and 22.6% respectively. Deposits per branch decreased by 1.5% to Kshs 1.91 bn from Kshs 1.94 bn in Q3’2017, with six branches opened to bring the total to 155 from 149 in Q3’2017. Placement liabilities increased by 24.0% to Kshs 1.5 bn from Kshs 1.2 bn in Q3’2017. Borrowings decreased by 7.2% to Kshs 26.0 bn from Kshs 28.0 bn in Q3’2017,
- The growth in deposits as compared to decline in loans led to a slight decline in the loan to deposit ratio to 85.9% from 89.8% in Q3’2017,
- Gross Non-Performing Loans (NPLs) increased by 75.3% to Kshs 29.7 bn in Q3’2018 from Kshs 16.9 bn in Q3’2017. Consequently, the NPL ratio increased to 11.2% in Q3’2018 from 6.4% in Q3’2017. The Loan Loss Provisions (LLPs) due to IFRS 9 increased by 78.4% to Kshs 9.9 bn from

Kshs 5.6 bn in Q3'2017, however, the specific LLPs for the quarter decreased by 50.3% to Kshs 1.3 bn from Kshs 2.6 bn in Q3’2017. With the growth in NPLs partially matched with a similar increase in provisioning, the NPL coverage decreased to 36.8% in Q3’2018 from 38.1% in Q3’2017. The increase in the non-performing loans was attributed to challenges experienced in the manufacturing, trade, real estate, and consumer loans sectors,

- Shareholders’ funds increased by 5.3 % to Kshs 70.9 bn in Q3’2018 from Kshs 67.3 bn in Q3’2017, as retained earnings grew by 6.5% y/y to Kshs 62.5 bn, from Kshs 58.7 bn in Q3’2017,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.5%, 6.0% above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 16.6%, exceeding the statutory requirement by 2.1%. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 17.3%, while total capital to risk-weighted assets came in at 17.4%, indicating that the bank’s total capital relative to its risk-weighted assets declined by 0.8% due to implementation of IFRS 9. This is because the banks are allowed to add back amounts used in provisioning to capital for capital computation purposes, as they implement IFRS 9,
- The bank currently has a Return on Average Assets (ROaA) of 3.1% and a Return on Average Equity (ROaE) of 17.6%.

For more information, see our Co-operative Bank Q3’2018 Earnings Note

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Equities Universe of Coverage

Banks	Price as at 9/11/2018	Price as at 16/11/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield**	Upside/Downside	P/TBv Multiple
NIC Bank***	22.8	23.0	1.1%	(31.9%)	(30.7%)	48.8	4.3%	116.5%	**0.6x**
Diamond Trust Bank	158.0	160.0	1.3%	(16.7%)	(15.8%)	283.7	1.6%	78.9%	**0.9x**
KCB Group***	39.0	38.0	(2.6%)	(11.1%)	(6.7%)	61.3	7.9%	69.2%	**1.2x**
Union Bank Plc	5.1	4.9	(4.0%)	(37.8%)	(20.8%)	8.2	0.0%	68.0%	**0.5x**
Ghana Commercial Bank***	4.9	5.1	3.9%	0.8%	19.2%	7.7	7.5%	59.1%	**1.2x**
I&M Holdings***	90.0	90.0	0.0%	(29.1%)	(25.0%)	138.6	3.9%	57.9%	**0.9x**
Ecobank	7.5	7.0	(6.7%)	(7.9%)	2.0%	10.7	0.0%	53.3%	**1.5x**
Equity Group	39.3	39.0	(0.6%)	(1.9%)	(3.1%)	56.2	5.1%	49.2%	**1.9x**
Zenith Bank***	24.0	24.4	1.7%	(4.8%)	1.5%	33.3	11.1%	47.6%	**1.1x**
Co-operative Bank	14.1	14.2	0.7%	(11.3%)	(11.5%)	19.9	5.6%	45.8%	**1.2x**
UBA Bank	7.8	8.0	1.9%	(22.8%)	(16.3%)	10.7	10.7%	45.3%	**0.5x**
CRDB	150.0	145.0	(3.3%)	(9.4%)	(3.3%)	207.7	0.0%	43.2%	**0.5x**
CAL Bank	1.0	1.0	2.0%	(5.6%)	10.0%	1.4	0.0%	37.3%	**0.9x**
HF Group	5.5	5.4	(1.8%)	(48.6%)	(51.6%)	6.6	6.5%	29.9%	**0.2x**
Access Bank	7.7	7.7	0.0%	(26.3%)	(21.9%)	9.5	5.2%	28.6%	**0.5x**
Barclays	11.6	11.2	(3.0%)	16.7%	12.6%	12.5	8.9%	20.5%	**1.5x**
Stanbic Bank Uganda	32.8	33.0	0.5%	21.1%	21.1%	36.3	3.5%	13.5%	**2.3x**
SBM Holdings	6.2	6.1	(0.3%)	(18.1%)	(19.2%)	6.6	4.9%	11.7%	**0.9x**

Equities Universe of Coverage

Banks	Price as at 9/11/2018	Price as at 16/11/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield**	Upside/Downside	P/TBv Multiple
Standard Chartered	190.0	192.0	1.1%	(7.7%)	(12.7%)	196.3	6.5%	8.8%	**1.5x**
Bank of Kigali	280.0	289.0	3.2%	(3.7%)	1.4%	299.9	4.8%	8.6%	**1.6x**
Bank of Baroda	125.0	125.0	0.0%	10.6%	13.6%	130.6	2.0%	6.5%	**1.1x**
Guaranty Trust Bank	36.9	37.2	0.7%	(8.8%)	(13.8%)	37.1	6.5%	6.3%	**2.3x**
Stanbic Holdings	91.0	91.5	0.5%	13.0%	14.4%	92.6	2.5%	3.7%	**0.9x**
FBN Holdings	7.5	7.5	0.0%	(15.3%)	12.5%	6.6	3.4%	(7.7%)	**0.4x**
Standard Chartered	20.2	21.8	7.9%	(13.7%)	(0.3%)	19.5	0.0%	(10.7%)	**2.7x**
National Bank	5.8	5.8	(0.9%)	(38.5%)	(39.8%)	4.9	0.0%	(14.8%)	**0.4x**
Stanbic IBTC Holdings	48.0	47.1	(1.9%)	13.5%	10.6%	37.0	1.3%	(20.2%)	**2.4x**
Ecobank Transnational	15.8	15.6	(1.3%)	(8.5%)	(8.5%)	9.3	0.0%	(40.3%)	**0.6x**

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.***
******Stock prices indicated in respective country currencies***

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.