Kenya Economic Review 2018, & Cytonn Weekly #45/2018

Equities

Market Performance

During the week, the equities market was on a declining trend, with NASI, NSE 20 and NSE 25 declining by 0.5%, 1.6% and 1.7%, respectively, taking their YTD performance to declines of 15.8%, 25.6% and 16.0%, for NASI, NSE 20 and NSE 25, respectively. The decline in the NASI was driven by declines in large cap stocks such as Diamond Trust Bank Kenya Ltd, Barclays Bank of Kenya, NIC and EABL, which declined by 8.8%, 5.2%, 4.3% and 3.0%, respectively.

Equities turnover declined by 16.3% during the week to USD 16.3 mn, from USD 19.5 mn the previous week, taking the YTD turnover to USD 1.7 bn. Foreign investors turned net buyers for the week, with a net buying position of USD 1.1 mn, an increase from last week's net selling position of USD 0.7 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 11.1x, 17.2% below the historical average of 13.4x, and a dividend yield of 5.0%, above the historical average of 3.8%. With the market trading at valuations below the historical average, we believe there is value in the market. The current P/E valuation of 11.1x is 14.4% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 33.7% 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

Barclays Bank of Kenya released their Q3'2018 financial results:

Barclays Bank of Kenya released their Q3'2018 financial results, with core Earnings per Share (EPS) increasing by 2.0% to Kshs 1.0, from Kshs 0.98 in Q3'2017, exceeding our expectation of a 1.5% decline to Kshs 0.97. The performance was driven by a 5.5% increase in total operating income, and was weighed down by the 8.3% increase in the total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 14.0% growth in Non-Funded Income (NFI) to Kshs 7.4 bn from Kshs 6.5 bn in Q3'2017. We expected a 0.6% decline in NFI to Kshs 6.4 bn from Kshs 6.5 bn in Q3'2017.

Highlights of the performance from Q3'2017 to Q3'2018 include:

- Total operating income increased by 5.5% to Kshs 23.9 bn in Q3'2018, from Kshs 22.6 bn over the same period to Q3'2017. This was due to a 2.1% increase in Net Interest Income (NII) to Kshs 16.5 bn, from Kshs 16.2 bn in Q3'2017, coupled with the 14.0% increase in Non-Funded Income (NFI) to Kshs 7.4 bn, from Kshs 6.5 bn in Q3'2017,

- Interest income increased by 7.7% to Kshs 21.7 bn, from Kshs 20.1 bn in Q3’2017. This was largely driven by the 34.8% growth in interest income from government securities to Kshs 5.6 bn from Kshs 4.1 bn in Q3’2017, and a 0.7% increase in interest income on loans and advances to Kshs 16.0 bn, from Kshs 15.9 bn in Q3’2017. Interest income on deposits and placements with banking institutions rose by 26.8% to Kshs 0.1 bn from Kshs 0.08 bn in Q3’2017. However, the yield on interest earning assets declined to 11.8% in Q3’2018, from 12.1% in Q3’2017, due to a faster increase of 29.5% in government securities that have relatively lower yields than loans,
- Interest expense increased by 30.1% to Kshs 5.2 bn, from Kshs 4.0 bn in Q3’2017, following a 26.9% increase in the interest expense on customer deposits to Kshs 4.5 bn, from Kshs 3.6 bn in Q3’2017. Interest expense on deposits and placements from banking institutions increased by 57.1% to Kshs 0.7 bn from Kshs 0.4 bn in Q3’2017. The cost of funds thus increased to 3.1%, from 2.8% in Q3’2017. As a consequence, the Net Interest Margin (NIM) declined to 6.8%, from 7.2% in Q3’2017,
- Non-Funded Income (NFI) increased by 14.0% to Kshs 7.4 bn, from Kshs 6.5 bn in Q3’2017. The growth in NFI was largely driven by the 16.6% growth in foreign exchange trading income to Kshs 2.5 bn from Kshs 2.2 bn in Q3’2017, coupled with a 52.2% growth in Fees and commissions on loans to Kshs 0.8 bn from Kshs 0.5 bn in Q3’2017. Furthermore, other income grew by 114.9% to Kshs 0.6 bn, from Kshs 0.3 bn in Q3’2017. However, the other fees and commission income declined by 1.7% to Kshs 3.4 bn from Kshs 3.5 bn in Q3’2017. As a result of the above performance, the current revenue mix shifted to 69:31 funded to non-funded income as compared to 71:29 in Q3’2017. The proportion of NFI to total revenue increased owing to the faster growth in NFI than in NII,
- Total operating expenses increased by 8.3% to Kshs 16.1 bn, from Kshs 14.9 bn in Q3’2017, largely driven by a 31.0% increase in other operating expenses to Kshs 5.9 bn in Q3’2018, from Kshs 4.5 bn in Q3’2017, coupled with a 21.3% increase in Loan Loss Provisions (LLP) to Kshs 2.8 bn in Q3’2018, from Kshs 2.3 bn in Q3’2017. Staff costs however declined by 7.9% to Kshs 7.5 bn from Kshs 8.1 bn in Q3’2017,
- As a result, Cost to Income Ratio (CIR) deteriorated to 67.6%, from 65.9% in Q3’2017. Without LLP, the cost to income ratio also deteriorated, albeit marginally, to 55.8%, from 55.6% in Q3’2017,
- Profit before tax increased by 0.1% to Kshs 7.72 bn, up from Kshs 7.71 bn in Q3’2017. Profit after tax however increased by 2.0% to Kshs 5.4 bn in Q3’2018, from Kshs 5.3 bn in Q3’2017, due to the Kshs 0.5 bn deferred tax in Q3’2018,
- The balance sheet recorded an expansion as total assets increased by 15.9% to Kshs 322.2 bn, from Kshs 278 bn in Q3’2017. This growth was largely driven by a 29.5% increase in government securities to Kshs 74.6 bn, from Kshs 57.6 bn in Q3’2017, coupled with a 6.7% increase in the loan book to Kshs 178.4 bn, from Kshs 167.3 bn in Q3’2017,
- Total liabilities rose by 18.7% to Kshs 279.5 bn, from Kshs 235.4 bn in Q3’2017, driven by a 9.9% increase in total deposits to Kshs 220.3 bn, from Kshs 200.4 bn in Q3’2017. Deposits per branch increased by 34.6% to Kshs 2.5 bn, from Kshs 1.8 bn in Q3’2017, with 2 branches closed in H1’2018 bringing the total number of branches to 89. Placement liabilities increased by 37.3% to Kshs 2.4 bn from Kshs 1.7 bn in Q3’2017. The bank did not have any borrowed funds,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 81.0% from 83.5% in Q3’2017. However, the proportion of government securities to deposits increased to 33.9% from 28.8% in Q3’2017,
- Gross Non-Performing Loans (NPLs) increased by 22.3% to Kshs 14.6 bn in Q3’2018 from Kshs 11.9 bn in Q3’2017. Consequently, the NPL ratio deteriorated to 7.7% in Q3’2018 from 6.8% in Q3’2017. General Loan Loss Provisions (LLPs) increased by 34.5% to Kshs 7.2 bn from Kshs 5.4 bn in Q3’2017. With the growth in NPLs outpaced by the increase in provisioning, the NPL coverage improved to 70.5% in Q3’2018, from 70.3% in Q3’2017,
- Shareholders’ funds increased marginally by 0.3% to Kshs 42.7 bn in Q3’2018 from Kshs 42.5 bn in Q3’2017, as the 231.7% increase in the revaluation reserve to Kshs 0.6 bn from Kshs 0.2 bn,

was outweighed by the 0.7% decline in retained earnings to Kshs 39.2 bn from Kshs 39.4 bn, and the 8.9% decline in the other reserves to Kshs 0.19 bn from Kshs 0.21 bn in Q3’2017,

- Barclays Bank of Kenya Ltd is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 14.8%, 4.3% points above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 16.7%, exceeding the statutory requirement by 2.2% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 15.1%, while total capital to risk weighted assets came in at 17.1%, indicating that the bank’s total capital relative to its risk-weighted assets declined by 0.4% points due to implementation of IFRS 9,
- The bank currently has a Return on Average Assets (ROaA) of 2.5%, and a Return on Average Equity (ROaE) of 16.5%.

Key Take-Outs:

a. The bank had a steep increase in its interest expense, coming in at a 30.1%, an indication that the bank mobilized deposits at higher costs, as deposits grew only by 9.9%, while interest expense on deposits grew by 26.9%. Furthermore, the bank increased its placement liabilities, which grew 37.2%, while the interest expenses on placements increased by 57.1%, an indication of expensive mobilization of funding, which compressed the bank’s top line revenue,
b. The bank’s other operating expenses increased by 31.0% y/y, with the bank indicating that the ongoing rebranding efforts to Absa Group, coupled with the upgrade and installation of IT infrastructure have increased the bank’s other operating expenses. However, staff costs declined by 7.9% y/y indicating the bank benefited from its strategy of lowering its staff number, from its retirement programs, with 323 staff leaving in H2’2017, and,
c. The bank’s asset quality deteriorated, with the NPL Ratio deteriorating to 7.7%, from 6.8% in Q3’2017. The deterioration in asset quality is likely being experienced with the trade sector clients facing delayed payments from governments, affecting their debt servicing. This, coupled with the relatively tighter macroeconomic environment, led to a deterioration in asset quality. However, with the bank employing prudence in provisioning, the coverage improved to 70.5% in Q3’2018.

For more information, see our Barclays Bank of Kenya **Q3’2018 Earnings Note**

Standard Chartered Bank Kenya Ltd released their Q3’2018 financial results:

Standard Chartered Bank Kenya Ltd released their Q3’2018 financial results with core EPS increasing by 33.9% to Kshs 18.4, from Kshs 13.7 in Q3’2017, exceeding our expectation of an 18.9% increase to Kshs 16.3. The performance was driven by a 7.1% increase in total operating income, coupled with a 7.1% decline in the total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the faster 9.7% growth in Non-Funded Income (NFI) to Kshs 7.0 bn from Kshs 6.4 bn, coupled with a faster 49.6% decline in Loan Loss Provisions (LLP) to Kshs 1.9 bn, from Kshs 3.7 bn in Q3’2017. Important to note for Standard Chartered Bank is that the decline in the specific provisions, that came despite a deterioration in asset quality, is due to banks being allowed to charge provisions through the balance sheet during the first year of the implementation of IFRS 9. We expected a slower 3.4% growth in NFI to Kshs 6.6 bn, from Kshs 6.4 bn in Q3’2017, and a slower 36.5% decline in LLP to Kshs 2.4 bn.

Highlights of the performance from Q3’2017 to Q3’2018 include:

- Total operating income increased by 7.1% to Kshs 21.6 bn year-to-date (YTD) Q3’2018, from Kshs 20.2 bn over the same period to Q3’2017. This was due to a 5.9% increase in Net Interest Income (NII) to Kshs 14.6 bn from Kshs 13.8 bn in Q3’2017, coupled with the 9.7% increase in Non-Funded Income (NFI) to Kshs 7.0 bn, from Kshs 6.4 bn in Q3’2017,
- Interest income increased by 4.8% to Kshs 20.3 bn, from Kshs 19.4 bn in Q3’2017. This was driven by a 15.2% growth in interest income from government securities to Kshs 9.5 bn, from Kshs 8.3 bn

in Q3’2017, which outpaced the 1.7% decline in interest income on loans and advances to Kshs 9.9 bn, from Kshs 10.1 bn in Q3’2017, and a 2.5% decline in interest income on deposits and placements with banking institutions, to Kshs 0.39 bn from Kshs 0.4 bn in Q3’2017. As a result of the increase in interest income, the yield on interest earning assets rose to 11.9% in Q3’2018, from 11.3% in Q3’2017,

- Interest expense increased by 2.1% to Kshs 5.8 bn, from Kshs 5.7 bn in Q3’2017, following a 5.4% increase in the interest expense on customer deposits to Kshs 4.9 bn, from Kshs 4.7 bn in Q3’2017. However, Interest expense on deposits and placements from banking institutions declined by 69.0% to Kshs 0.1 bn from Kshs 0.2 bn in Q3’2017. Furthermore, other interest expenses declined by 2.9% to Kshs 0.77 bn, from Kshs 0.79 bn in Q3’2017. As a result of the increase in interest expenses, the cost of funds increased to 3.4%, from 3.3% in Q3’2017. The Net Interest Margin (NIM) rose to 8.5%, from 8.1% in Q3’2017,
- Non-Funded Income (NFI) increased by 9.7% to Kshs 7.0 bn, from Kshs 6.4 bn in Q3’2017. Fees and commissions on loans rose by 66.7% to Kshs 0.2 bn, from Kshs 0.1 bn in Q3’2017. Other fees and commission income rose by 29.9% to Kshs 4.0 bn, from Kshs 3.1 bn in Q3’2017. Forex trading income increased by 10.9% to Kshs 2.1 bn, from Kshs 1.9 bn in Q3’2017. However, other income declined by 43.6% to Kshs 0.7 bn, from Kshs 1.3 bn in Q3’2017. As a result of the above performance, the current revenue mix shifted to 67:33 funded to non-funded income as compared to 68:32 in Q3’2017, with the NFI as proportion of total operating income slightly lower than the 34.8% industry average. The proportion of NII to total revenue decreased owing to the faster growth in NFI,
- Total operating expenses declined by 7.1% to Kshs 12.4 bn, from Kshs 13.3 bn in Q3’2017, largely driven by a 49.6% decrease in Loan Loss Provisions (LLP) to Kshs 1.9 bn in Q3’2018, from Kshs 3.7 bn in Q3’2017, coupled with a 1.9% decline in staff costs to Kshs 5.1 bn in Q3’2018, from Kshs 5.2 bn in Q3’2017. However, other operating expenses rose by 22.7% to Kshs 5.4 bn from Kshs 4.4 bn in Q3’2017,
- As a consequence, the Cost to Income Ratio (CIR) improved to 57.2%, from 66.0% in Q3’2017. However, without LLP, the cost to income ratio deteriorated to 48.5%, from 47.5% in Q3’2017,
- Profit before tax increased by 34.6% to Kshs 9.2 bn, up from Kshs 6.9 bn in Q3’2017. Profit after tax increased by 33.9% to Kshs 6.3 bn in Q3’2018, from Kshs 4.7 bn in Q3’2017,
- The balance sheet recorded a contraction as total assets decreased by 7.1% to Kshs 288.6 bn from Kshs 310.5 bn in Q3’2017. This decline was largely driven by a 6.1% decline in government securities to Kshs 107.2 bn, from Kshs 114.1 bn in Q3’2017, coupled with a 2.8% decline in the loan book to Kshs 111.0 bn, from Kshs 114.2 bn in Q3’2017,
- Total liabilities declined by 9.0% to Kshs 241.8 bn from Kshs 265.7 bn in Q3’2017, driven by an 8.0% decrease in total deposits to Kshs 219.5 bn from Kshs 238.5 bn in Q3’2017. Deposits per branch also decreased by 9.0% to Kshs 6.1 bn, from Kshs 6.6 bn in Q3’2017, with no new branches opened or closed. Placement liabilities increased by 9.8% to Kshs 4.1 bn from Kshs 3.7 bn in Q3’2017. The bank does not have any borrowed funds,
- The faster decline in deposits as compared to loans led to an increase in the loan to deposit ratio to 50.6%, from 47.9% in Q3’2017.The proportion of government securities to deposits also increased, to 48.8% from 47.8% in Q3’2017
- Gross Non-Performing Loans (NPLs) increased by 14.9% to Kshs 19.5 bn in Q3’2018, from Kshs 17.0 bn in Q3’2017. Consequently, the NPL ratio deteriorated to 15.6% in Q3’2018, from 13.4% in Q3’2017. General Loan Loss Provisions (LLPs) increased by 5.7% to Kshs 7.2 bn from Kshs 6.8 bn in Q3’2017. The NPL coverage declined marginally to 74.2% in Q3’2018 from 74.3% in Q3’2017, supported by the 25.5% increase in interest in suspense to Kshs 7.3 bn, from Kshs 5.8 bn in Q3’2017. The decline in the specific provisions despite a deterioration in asset quality, is due banks being allowed to charge provisions on equity, on the initial implementation of IFRS 9,
- Shareholders’ funds increased by 4.4% to Kshs 46.8 bn in Q3’2018 from Kshs 44.8 bn in Q3’2017, as retained earnings grew by 1.7% y/y to Kshs 31.0 bn from Kshs 30.4 bn, coupled with a 76.9% increase in the revaluation reserve to Kshs 0.7 bn from Kshs 0.4 bn in Q3’2017,

- Standard Chartered Bank Kenya Ltd remains sufficiently capitalized with a core capital to risk weighted assets ratio of 16.9%, 6.4% points above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 19.0%, exceeding the statutory requirement by 5.3% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 17.1%, while total capital to risk weighted assets came in at 20.1%, indicating that the bank's total capital relative to its risk-weighted assets declined by 0.3% points due to implementation of IFRS 9,
- The bank currently has a Return on Average Assets (ROaA) of 2.8% and a Return on Average Equity (ROaE) of 18.6%.

Key Take-Outs:

a. The bank had a deterioration in its quality, with the gross NPLs rising by 14.9% y/y, as the industry wide asset quality continues to deteriorate, sighting delayed government payments coupled with the relatively tighter macroeconomic environment, affecting borrowers' credit servicing ability,
b. The bank had a contraction in its balance sheet as the net loans and advances declined by 2.8%, and its customer deposits declined by 8.0% y/y. The decline in the bank's core funding base, coupled with the bank's stringent lending policies on asset quality concerns led to a decline in the bank's lending activities, and,
c. The bank managed to improve on its operational efficiency as the CIR improved to 57.2% from 66.0% in Q3'2017. However, this seems to have stemmed from a lower cost of risk on reduced provisioning, as the CIR without LLP deteriorated to 48.5%. This was due to a 22.7% increase in other operating expenses.

For more information, see our Standard Chartered Bank Kenya Ltd **Q3'2018 Earnings Note**

Diamond Trust Bank Limited released the Q3'2018 results:

Diamond Trust Bank Limited released the Q3'2018 results with core EPS growing by 10.0% to Kshs 20.2, from Kshs 18.3 in Q3'2017, which was in line with our projections of a 10.3% growth. Performance was driven by a 3.6% increase in total operating income to Kshs 19.0 bn, from Kshs 18.4 bn in Q3'2017, coupled with a 0.1% decline in total operating expenses to Kshs 10.8 bn, from Kshs 10.9 bn.

Highlights of the performance from Q3'2017 to Q3'2018 include:

- Total operating income increased by 3.6% to Kshs 19.0 bn, from Kshs 18.4 bn in Q3'2017. This was due to a 2.9% increase in Net-Interest Income (NII) to Kshs 14.9 bn, from Kshs 14.5 bn in Q3'2017, coupled with a 6.3% increase in Non-Funded Income (NFI) to Kshs 4.1 bn, from Kshs 3.9 bn in Q3'2017,
- Interest income increased by 3.0% to Kshs 26.5 bn from Kshs 25.7 bn in Q3'2017. This was driven by an 11.1% rise in Interest income on government securities, to Kshs 9.7 bn in Q3'2018 from Kshs 8.7 bn in Q3'2017. Interest income on loans and advances however declined by 1.5% to Kshs 16.5 bn from Kshs 16.8 bn in Q3'2017. The yield on interest earning assets declined to 10.8% in Q3'2018, from 11.4% in Q3'2017, due to the relatively faster growth in interest-earning assets by 8.7% to Kshs 341.7 bn, from Kshs 314.3 bn in Q3'2017, with the increase mainly driven by government securities that increased by 17.7% to Kshs 128.3 bn, from Kshs 109.0 bn in Q3'2017. The decline in the yield on interest earning assets also led to a decline in the Net Interest Margin to 6.1%, from 6.4% recorded in Q3'2017,
- Interest expense increased by 3.0% to Kshs 11.6 bn from Kshs 11.2 bn in Q3'2017, as interest expense on customer deposits increased by 1.2% to Kshs 10.3 bn from Kshs 10.1 bn in Q3'2017. Interest expense on deposits from other banking institutions increased by 60.2% to Kshs 628.5 mn, from Kshs 392.3 mn in Q3'2017. The cost of funds declined to 4.9% from 5.2% in Q3'2017, owing to the faster increase in interest-bearing liabilities by 8.1% to Kshs 324.1 bn, from Kshs

299.7 bn in Q3’2017, compared with the 3.0% increase in interest expense,

- Non-Funded Income increased by 6.3% to Kshs 4.1 bn from Kshs 3.9 bn in Q3’2017. The increase in NFI was driven by a 7.7% increase in fees and commissions on loans to Kshs 1.0 bn from Kshs 0.9 bn, coupled with a 7.2% increase in other fees and commission income to Kshs 1.6 bn from Kshs 1.5 bn in Q3’2017. Forex trading income also rose albeit marginally, by 2.8% to Kshs 1.19 bn from Kshs 1.16 bn in Q3’2017. The revenue mix shifted to 78:22 funded to non-funded income in Q3’2018 from 79:21 in Q3’2017, owing to the faster increase in NFI compared to NII,
- Total operating expenses declined marginally by 0.1% to Kshs 10.84 bn from Kshs 10.85 bn, largely driven by a 17.3% decline in loan loss provisions to Kshs 2.4 bn in Q3’2018 from Kshs 2.9 bn in Q3’2017, despite staff costs increasing by 4.3% to Kshs 3.1 bn in Q3’2018 from Kshs 3.0 bn in Q3’2017,
- The cost to income ratio improved to 56.9% from 59.1% in Q3’2017. Without LLP, however, the cost to income ratio deteriorated to 44.4% from 43.3% in Q3’2017,
- Profit before tax increased by 9.1% to Kshs 8.2 bn, up from Kshs 7.5 bn in Q3’2017. Profit after tax increased by 10.0% to Kshs 5.6 bn in Q3’2018 from Kshs 5.1 bn in Q3’2017,
- The balance sheet recorded an expansion with total assets recording a growth of 7.8% to Kshs 385.0 bn from Kshs 357.2 bn in Q3’2017. This growth was largely driven by a 17.7% increase in government securities to Kshs 128.3 bn in Q3’2018 from Kshs 109.0 bn in Q3’2017,
- The loan book expanded by 0.7% to Kshs 197.7 bn in Q3’2018 from 196.3 bn in Q3’2017,
- Total liabilities rose by 7.4% to Kshs 328.0 bn from Kshs 305.2 bn in Q3’2017, driven by a 6.5% increase in customer deposits to Kshs 282.2 bn from Kshs 265.1 bn in Q3’2017. Deposit per branch also grew by 6.5% to Kshs 2.0 bn from Kshs 1.9 bn, with no new branch openings/closures,
- The faster growth in deposits compared with loan growth led to a decline in the loan to deposit ratio to 70.0%, from 74.1% in Q3’2017. The proportion of government securities to deposits rose to 45.4% from 41.1% in Q3’2017,
- Gross non-performing loans declined by 1.4% to Kshs 16.3 bn in Q3’2018 from Kshs 16.6 bn in Q3’2017. Consequently, the NPL ratio improved to 7.7% in Q3’2018, from 8.0% in Q3’2017. General loan loss provisions increased by 40.8% to Kshs 9.3 bn from Kshs 6.6 bn in Q3’2017. As a result, the NPL coverage improved to 72.5% from 54.9% in Q3’2017,
- Shareholders’ funds increased by 11.0% to Kshs 51.9 bn in Q3’2018, from Kshs 46.7 bn in Q3’2017, driven by a 4.6% increase in retained earnings to Kshs 41.0 bn, from Kshs 34.6 bn in Q3’2017,
- DTB is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 17.8%, 7.3% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 19.1%, exceeding the statutory requirement by 4.6% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 18.8%, while total capital to risk-weighted assets came in at 20.1%, indicating that the bank’s total capital relative to its risk-weighted assets declined by 1.0% points due to implementation of IFRS 9,
- DTB currently has a Return on Average Assets (RoAA) of 1.8% and a Return on Average Equity (RoAE) of 13.3%.

Key Take-Outs:

a. The asset quality of DTB improved, with gross NPLs declining by 1.4% to Kshs 16.3 bn from Kshs 16.6 bn in the period under review, with the NPL ratio declining to 7.7% from 8.0% a year earlier. The 40.8% increase in the general loss provisions led to an improvement in the NPL coverage to 72.5%, due to the increase in the general loss provisions coupled with a 1.4% decline in non-performing loans.
b. The bank managed to improve on its operational efficiency as the CIR improved to 56.9% from 59.1% in Q3’2017. However, this seems to have stemmed from a lower cost of risk on reduced provisioning, as the CIR without LLP deteriorated to 44.4 from 43.3% in Q3’2017.

For more information, see our Diamond Trust Bank **Q3’2018 Earnings Note**

Stanbic Bank Kenya released their Q3’2018 results:

- Profit after tax increased by 46.7% to Kshs 4.7 bn in Q3’2018, from Kshs 3.2 bn in Q3’2017. The performance was driven by a 14.1% increase in total operating income and a 3.7% decline in operating expenses,
- Total operating income increased by 14.1% to Kshs 15.9 bn, from Kshs 14.0 bn in Q3’2017, driven by a 9.7% increase in Net Interest Income to Kshs 8.5 bn in Q3’2018, from Kshs 7.8 bn in Q3' 2017, coupled with a 19.6% increase in Non-Funded Income to Kshs 7.4 bn, from Kshs 6.2 bn in Q3’2017,
- Interest income increased by 13.3% to Kshs 13.8 bn in Q3’2018, from Kshs 12.2 bn in Q3’2017. This was largely due to the interest income on loans and advances, which increased by 15.6% to Kshs 10.3 bn in Q3’2018, from Kshs 8.9 bn in Q3’ 2017. The yield on interest-earning assets dropped to 5.1% from 5.5% in Q3’2017,
- Interest expense increased by 19.7% to Kshs 5.3 bn from Kshs 4.4 bn in Q3’2017, following a 21.8% increase in the interest expense on customer deposits to Kshs 3.3 bn from Kshs 2.7 bn in Q3’2017 as well as the Interest expense on deposits and placements from banking institutions, which increased by 12.6% to Kshs 1.5 bn from Kshs 1.3 bn in Q3’2017. The cost of funds thus rose to 3.1%, from 2.6% in Q3’2017. Net Interest Margin declined to 6.2%, from 7.0% in Q3’2017
- Non-Funded Income (NFI) increased by 19.6% to Kshs 7.4 bn in Q3’2018 from Kshs 6.2 bn in Q3’2017. The growth in NFI was driven by a 56.9% increase in other income to Kshs 2.1 bn from Kshs 1.3 bn in Q3’2017, and a 9.4% increase in foreign exchange trading income to Kshs 2.3 bn from Kshs 2.1 bn in Q3’2017. Fees and commissions grew by 9.3% to Kshs 3.0 bn from Kshs 2.7 bn in Q3’2017. The current revenue mix stands at 53:47 funded to non-funded income in Q3’2018 from the 56:42 ratio recorded in Q3’2017, owing to a faster increase in NFI,
- Total operating expenses declined by 3.7% to Kshs 9.2 bn in Q3’2018 from Kshs 9.6 bn in Q3’2017, largely driven by a 44.9% decrease in the loan loss provision to Kshs 1.2 bn from Kshs 2.3 bn in Q3’2017, given that the non-performing loans increased by 13.9%, the decline in loan loss provision could possibly be attributed to the bank passing some of the provisions through the retained earnings as IFRS 9 allows this during the first year of implementation. The staff cost increased by 17.4% to Kshs 4.2 bn from Kshs 3.6 bn in Q3’2017,
- The cost to income ratio with LLP improved to 57.9% in Q3’2018 from 68.6% in Q3’2017. Without LLP, the Cost to income ratio also improved to 50.1% in Q3’2018 from 52.4% in Q3’2017,
- Profit before tax increased by 56.5% and stood at Kshs 6.7 bn, up from Kshs 4.2 bn in Q3’2017. Profit after tax increased by 46.7% to Kshs 4.7 bn in Q3’2018 from Kshs 3.2 bn in Q3’2017,
- The balance sheet recorded an expansion as total assets increased by 21.0% to Kshs 286.3 bn from Kshs 236.56 bn in Q3’2017. This growth was largely driven by a 16.3% increase in the loan book to Kshs 141.1 bn from Kshs 121.3 bn, and balances due from the Central Bank, which increased by 116.0% to stand at Kshs 19.2 bn from Kshs 8.9 bn in Q3’2017,
- Total liabilities rose by 23.7% to Kshs 253.2 bn from Kshs 204.6 bn in Q3’2017, largely driven by a 45.5% increase in borrowings to Kshs 12.3 bn in Q3’2018 from Kshs 8.5 bn in Q3’ 2017, and deposits that grew by 20.3% to Kshs 181.5 bn from Kshs 150.9 bn in Q3’2017. Other liabilities increased by 87.7% to Kshs 13.1 bn in Q3’2018 from Kshs 7.0 bn in Q3’2017,
- The faster increase in deposits as compared to the loans lead to the decrease in the loan to deposit ratio to 77.8% in Q3’2018 from 80.4% in Q3’2017.Government securities to deposits declined to 23.1% from 23.8 % in Q3'2017
- Gross non-performing loans increased by 13.9% to Kshs 10.6 bn from Kshs 9.3 bn in Q3’2017. The NPL ratio improved to 7.5% in Q3’2018 from 7.7% in Q3’2017, owing to a faster 16.3% growth in the net loans. General Loan Loss Provisions (LLPs) increased by 51.0% to Kshs 3.9 bn from Kshs 2.6 bn in Q3’2017. The NPL coverage thus improved to 60.6% in Q3’2018 from 43.0% in Q3’2017. The decline in the specific provisions despite a deterioration in asset quality is due banks being allowed to charge provisions on equity, on the initial implementation of IFRS 9,
- Shareholders’ funds increased by 3.8% to Kshs 33.1 bn in Q3’2018 from Kshs 31.9 bn in Q3’2017,

largely due to the 7.6% increase in the retained earnings to Kshs 26.3 bn from Kshs 24.4 bn in Q3'2017,

- Stanbic Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 13.9%, 3.4% points above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 16.9%, exceeding the statutory requirement by 2.4% points. Adjusting for IFRS 9, core capital to risk weighted assets ratio was at 14.8% while total capital to risk weighted assets was 17.7%, indicating that the bank's total capital relative to its risk-weighted assets declined by 0.8% points due to the implementation of IFRS 9.

For more information, please see the **Stanbic bank Q3'2018 Earnings Update**

The summary of the performance is highlighted in the table below:

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	Return on Average Equity
Stanbic Bank	46.7%	13.3%	19.7%	9.7%	6.2%	19.6%	47.0%	9.3%	20.3%	(17.6%)	16.3%	77.8%	2.2%	14.3%
SCBK	33.9%	4.8%	2.1%	5.9%	8.5%	9.7%	32.6%	31.2%	(8.0%)	(6.1%)	(2.8%)	50.6%	3.4%	18.6%
KCB Group	19.7%	5.1%	16.0%	1.8%	8.5%	2.6%	33.1%	(7.9%)	6.2%	15.3%	3.8%	82.6%	3.2%	21.7%
DTB	10.0%	3.0%	3.0%	2.9%	6.1%	6.3%	21.7%	7.4%	6.5%	17.7%	0.7%	70.0%	4.9%	13.3%
Co-op Bank	8.2%	3.5%	0.7%	4.7%	8.3%	4.3%	32.7%	(29.7%)	2.5%	16.9%	(2.0%)	85.9%	3.8%	17.6%
Equity Group	8.1%	8.6%	13.5%	7.2%	8.5%	(6.7%)	40.0%	(1.7%)	9.1%	24.1%	8.6%	71.7%	2.7%	22.2%
Barclays Bank	2.0%	7.7%	30.1%	2.1%	9.1%	14.0%	30.8%	5.5%	9.9%	29.5%	6.7%	81.0%	3.1%	16.5%
Weighted Average Q3'2018*	**11.5%**	**6.1%**	**12.8%**	**4.3%**	**8.3%**	**2.2%**	**33.8%**	**(5.2%)**	**6.5%**	**19.5%**	**4.2%**	**77.3%**	**3.3%**	**19.6%**
Weighted Average Q3'2017**	**(7.8%)**	**(5.8%)**	**0.0%**	**(7.3%)**	**8.7%**	**11.3%**	**34.3%**	**12.5%**	**13.9%**	**10.4%**	**5.8%**	**76.0%**	**3.3%**	**18.2%**

Weighted average as at 23rd November 2018
****Weighted average as at 23rd November 2017***

Key take-outs from the table above include:

a. The listed banks that have released results for Q3'2018 have recorded an 11.5% average increase in core Earnings Per Share (EPS), compared to a decline of 7.8% in Q3'2017. None of the banks that have released their results have recorded declines in core EPS. Stanbic Bank recorded the highest growth at 46.7% y/y, with Barclays Bank recording the slowest growth in core EPS, recording a 2.0% growth y/y,
b. The sector is recording weaker deposit growth, which came in at 6.5%, slower than the 13.9% growth recorded in Q3'2017. Despite the slower deposit growth, interest expenses increased by 12.8%, indicating banks have been mobilizing expensive deposits. Thus, the cost of funds rose, albeit marginally to 3.29%, from 3.27%,
c. Average loan growth was anemic coming in at 4.2%, which was lower than 5.8% recorded in Q3'2017, indicating that there was an even slower credit extension in the economy, due to sustained effects of the interest rate cap. Government securities on the other hand recorded a growth of 19.5% y/y, which was faster compared to the loans, and faster than 10.4% recorded in Q3'2017. This indicates that banks' continued preference towards investing in government securities, which offer better risk-adjusted returns. Interest income increased by 6.1%, as banks adapted to the interest rate cap regime, with increased allocations in government securities,
d. The average Net Interest Margin in the banking sector currently stands at 8.3%, down from the 8.7% recorded in H1'2017, despite the Net Interest Income by increasing 4.3% y/y. The decline was mainly due to the faster 19.5% increase in allocation to relatively lower yielding government securities, and,
e. Non-funded Income grew by 2.2% y/y, slower than 11.3% recorded in Q3'2017. The growth in NFI was weighed down as total fee and commissions declined by 5.2%, slower than the 12.5% growth recorded in Q3'2017. The growth in fee and commission income continued to be subdued by the slow loan growth.

It is worth noting that some banks reduced their specific provisioning levels, even after experiencing a deterioration in asset quality. This is largely due to the fact that on implementation of IFRS 9, banks are allowed to charge an initial amount on their equity, hence reducing the specific provisioning demands for the quarter, even after the implementation of IFRS 9.

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Banks	Price as at 16/11/2018	Price as at 23/11/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
NIC Bank***	23.0	22.8	(1.1%)	(32.6%)	(31.4%)	48.8	4.4%	118.9%	**0.6x**
Diamond Trust Bank	160.0	146.0	(8.8%)	(24.0%)	(23.2%)	283.7	1.8%	96.1%	**0.8x**
Ghana Commercial Bank***	4.9	4.8	(2.2%)	(5.1%)	11.4%	7.7	7.9%	69.1%	**1.1x**
I&M Holdings	90.0	85.0	(5.6%)	(33.1%)	(32.5%)	138.6	4.1%	67.2%	**0.9x**
KCB Group	39.0	38.8	(0.6%)	(9.4%)	(10.4%)	61.3	7.7%	65.9%	**1.2x**
Union Bank Plc	5.1	5.1	0.0%	(35.3%)	(18.5%)	8.2	0.0%	61.4%	**0.5x**
Zenith Bank***	24.0	24.0	0.0%	(6.4%)	(4.0%)	33.3	11.3%	50.1%	**1.1x**
Equity Group	39.3	39.0	(0.6%)	(1.9%)	(9.3%)	56.2	5.1%	49.2%	**1.9x**
UBA Bank	7.8	7.8	0.0%	(24.3%)	(20.8%)	10.7	10.9%	48.1%	**0.5x**
Co-operative Bank	14.1	14.2	0.4%	(11.6%)	(14.2%)	19.9	5.7%	46.3%	**1.2x**
CAL Bank	1.0	1.0	(4.0%)	(11.1%)	3.5%	1.4	0.0%	45.8%	**0.8x**
Ecobank	7.5	7.5	0.0%	(1.3%)	9.3%	10.7	0.0%	43.1%	**1.6x**
CRDB	150.0	150.0	0.0%	(6.3%)	0.0%	207.7	0.0%	38.5%	**0.5x**
Access Bank	7.7	7.4	(3.9%)	(29.2%)	(26.0%)	9.5	5.4%	33.8%	**0.5x**
HF Group	5.5	5.4	(0.9%)	(48.1%)	(53.8%)	6.6	6.5%	28.7%	**0.2x**
Barclays	11.6	11.0	(5.2%)	14.1%	10.1%	12.5	9.1%	23.3%	**1.5x**
Stanbic Bank Uganda	32.8	32.0	(2.6%)	17.4%	17.4%	36.3	3.7%	17.0%	**2.3x**
SBM Holdings	6.2	6.1	(0.6%)	(18.4%)	(19.5%)	6.6	4.9%	12.1%	**0.9x**
Standard Chartered	190.0	188.0	(1.1%)	(9.6%)	(14.2%)	196.3	6.6%	11.1%	**1.5x**
Guaranty Trust Bank	36.9	36.4	(1.4%)	(10.7%)	(13.3%)	37.1	6.6%	8.5%	**2.3x**
Bank of Kigali	280.0	290.0	3.6%	(3.3%)	1.8%	299.9	4.8%	8.2%	**1.6x**
Bank of Baroda	125.0	126.0	0.8%	11.5%	14.5%	130.6	2.0%	5.6%	**1.1x**
Stanbic Holdings	91.0	92.5	1.6%	14.2%	13.5%	92.6	2.4%	2.5%	**0.9x**
Standard Chartered	20.2	20.2	(0.1%)	(20.1%)	(7.6%)	19.5	0.0%	(3.6%)	**2.5x**
FBN Holdings	7.5	7.6	2.0%	(13.6%)	9.4%	6.6	3.3%	(9.5%)	**0.4x**
National Bank	5.8	5.8	(0.9%)	(38.5%)	(45.2%)	4.9	0.0%	(14.8%)	**0.4x**
Stanbic IBTC Holdings	48.0	49.0	2.1%	18.1%	21.0%	37.0	1.2%	(23.3%)	**2.5x**
Ecobank Transnational	15.8	15.8	0.0%	(7.4%)	(4.5%)	9.3	0.0%	(41.1%)	**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 investment horizon. However, pockets of value exist, with a number of undervalued sectors like Financial Services, which provide an attractive entry point for medium to long-term investors, and with expectations of higher corporate earnings supported by sectors such as banking sector, we are "POSITIVE" for investors with a long-term investment horizon.

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