Consolidation in Kenya’s Banking Sector to Continue, & Cytonn Weekly #06/2019

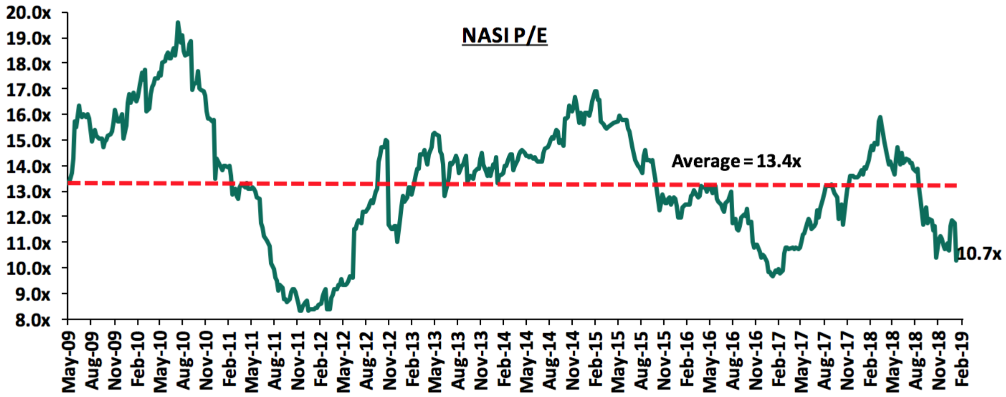
Equities

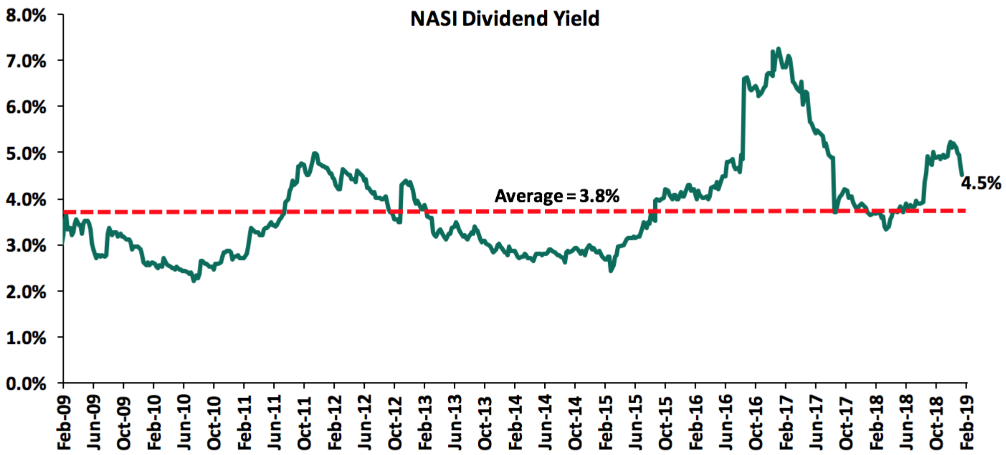
Market Performance

During the week, the equities market was on an upward trend with NASI, NSE 20 and NSE 25 gaining by 3.8%, 5.2%, and 3.5%, respectively, taking their YTD performance to 14.2%, 8.0% and 14.5%, for NASI, NSE 20 and NSE 25, respectively. The gain in NASI was mainly driven by gains in large cap banking stocks such as NIC Group, Barclays Bank, KCB Group and Standard Chartered Bank, which gained by 10.1%, 7.0%, 6.6% and 5.9%, respectively.

Equities turnover declined by 0.9% during the week to USD 59.7 mn, from USD 60.3 mn the previous week, taking the YTD turnover to USD 216.8 mn. Foreign investors remained net sellers for the week, with a net selling position of USD 3.6 mn, which is a 52.4% decrease from last week’s net selling position of USD 7.6 mn.

The market is currently trading at a price to earnings ratio (P/E) of 10.7x, 25.2% below the historical average of 13.4x, and a dividend yield of 4.5%, 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 10.7x is 10.2% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 28.6% 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

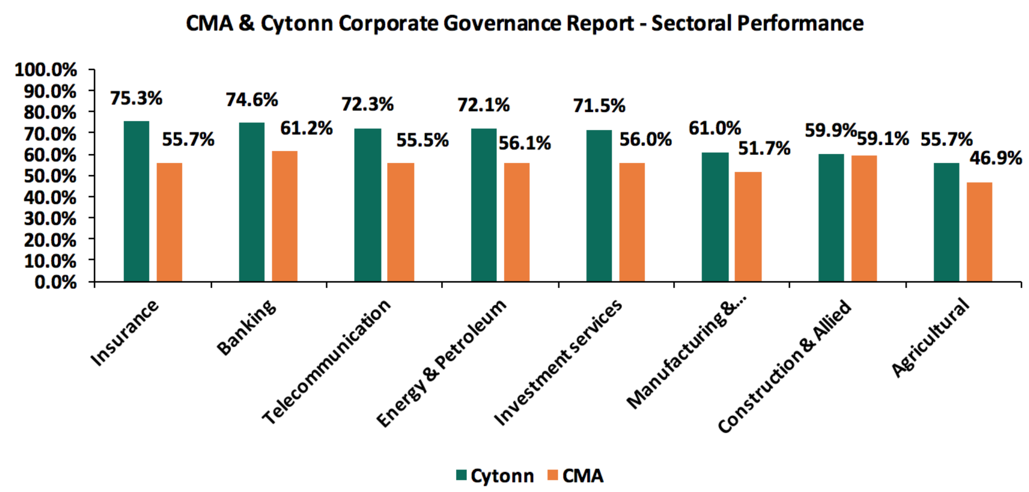
Safaricom customers have borrowed Kshs 6.2 bn in one month on the Fuliza overdraft service, revealing a huge pent-up demand for instant, micro-loans in the economy. The Fuliza overdraft facility, which was launched on 5th January 2019, is a partnership involving Safaricom, Commercial Bank of Africa (CBA) and KCB Group. The banks provide M-Pesa users with top-up loans whenever they need to make a transaction, but find they lack enough money in their mobile cash wallets. The virtual loan amounts can be used to buy goods, pay bills and is also transferrable to other mobile subscribers. The service has been used by 4.2 mn customers. The Fuliza loans attract an interest rate of 1.08% a day, which translates to 395.3% per annum. An additional administrative fee of up to Kshs 30.0 is charged for each day that the loan remains unpaid. The overdraft facility has a term of 30-days beyond which a borrower is deemed to be in default. Fuliza analyses the creditworthiness of borrowers by an analysis of their transactions and borrowing history among other factors. Borrowers can take loans of upto Kshs 70,000. Fuliza joins the growing list of digital lending platforms, such as Branch and Tala, that seek to offer small loans through the internet and mobile phones. Kenyans' rising demand for quick loans has spawned the growth of unregulated microlenders with annualised interest rates ranging from 18.0% to more than 200.0%. Micro-lending is far more lucrative than mainstream banking whose margins have been restricted by the capping of lending rates. The fast paced growth is set to boost the fees collected by Safaricom, KCB and CBA. Besides the facility and administration fees, Fuliza also attracts standard M-Pesa charges, further boosting Safaricom's earnings from the mobile money platform. For CBA and KCB, Fuliza offers an opportunity for customer acquisition and an additional high-margin revenue stream.

According to data from the Kenya National Bureau of Statistics, commercial banks in Kenya reduced their deposit rates to 5.7% in November 2018, the lowest in 15-months, from a high of 7.0% in February 2018. This comes after the removal of the 70.0% of the Central Bank Rate (CBR) floor, after the assention of the Finance Act 2018 in September 2018. The removal of the floor on deposit rates and retention of a ceiling on lending rate has failed to unlock credit to the private sector with the private sector credit growth coming in at 2.4% in the 12-months to December 2018, slower than the 3.0% recorded in the 12-months to November 2018. The reduction in deposit rates is in a bid to increase net interest margins (NIM) for banks due to reduced interest expense on deposits.

The Capital Markets Authority (CMA) released The Report on the State of Corporate Governance of Issuers of Securities To The Public in Kenya. The findings suggest a "Fair" status of 55.0% weighted overall score in the application of corporate governance practices by Kenyan issuers of securities to the public. The report analyzed 62 listed companies and 5 issuers of corporate bonds. The principles analysed were; (i) Commitment to Good Corporate Governance, (ii) Board Operations and Control, (iii) Rights of Shareholders, (iv) Stakeholders Relations, (v) Ethics and Social Responsibility, (vi) Accountability, Risk Management and Internal Control, and (vii) Transparency and Disclosure. The report used four score ratings: (i) "Leadership" compliance of 75% and above, (ii) "Good" compliance of between 74% and 65%, (iii) "Fair" compliance of between 64% and 50%, and (iv) "Needs Improvement" compliance of below 50%. The report ranked 3 companies in "Leadership", 5 companies in "Good" , 31 companies in "Fair" and 17 in "Needs Improvement". The report did not disclose the specific company ranks but noted that 3 issuers in "Leadership" were from the banking sector, while the 5 issuers in "Good" rating comprised of 2 from banking, 2 from commercial and services and 1 from manufacturing and allied sectors.

The sectoral performance is highlighed in the graph below with the best performing sector being Banking with a score of 61.2% and the worst sector being the Agricultural sector with a score of 46.9%. In the table below, we compare the CMA rankings versus our own rankings, released in the Cytonn Corporate Governance Report 2018.

(Kindly note that Cytonn did a corporate governance ranking report for listing companies to fill an existing gap in the market. With the CMA having now launched a corporate governance ranking report, we shall now cease the publication of the Cytonn Corporate Governance Ranking Report going forward.)



Universe of Coverage

Below is our banking universe of coverage table:

Universe of Coverage

Banks	Price as at 01/02/2019	Price as at 08/02/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Down side**	P/TBv Multiple
GCB Bank***	4.1	4.2	2.0%	(9.1%)	7.7	9.3%	97.6%	**1.0x**

Universe of Coverage

Banks	Price as at 01/02/2019	Price as at 08/02/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Down side**	P/TBv Multiple
Diamond Trust Bank	147.5	151.0	2.4%	(3.5%)	283.7	1.8%	94.1%	**0.8x**
Access Bank	6.0	6.7	10.8%	(2.2%)	9.5	6.7%	65.0%	**0.4x**
UBA Bank	7.2	7.7	7.0%	(0.6%)	10.7	11.9%	61.5%	**0.5x**
KCB Group	40.9	43.6	6.6%	16.4%	61.3	7.3%	57.2%	**1.3x**
Zenith Bank***	22.9	24.4	6.6%	5.9%	33.3	11.8%	57.3%	**1.0x**
CAL Bank	0.9	0.9	(1.1%)	(9.2%)	1.4	0.0%	55.6%	**0.8x**
CRDB	135.0	135.0	0.0%	(10.0%)	207.7	0.0%	53.9%	**0.5x**
I&M Holdings	95.0	95.0	0.0%	11.8%	138.6	3.7%	49.6%	**1.0x**
NIC Group	34.8	38.3	10.1%	37.6%	48.8	2.9%	43.3%	**0.9x**
Ecobank	7.5	7.5	0.0%	(0.1%)	10.7	0.0%	43.3%	**1.6x**
Equity Group	40.9	42.3	3.4%	21.4%	56.2	4.9%	42.3%	**2.0x**
Co-operative Bank	15.8	16.0	1.6%	11.9%	19.9	5.1%	31.4%	**1.4x**
Union Bank Plc	6.3	6.3	0.0%	11.6%	8.2	0.0%	30.4%	**0.7x**
Stanbic Bank Uganda	30.0	29.0	(3.3%)	(6.5%)	36.3	3.9%	24.8%	**2.1x**
Barclays Bank	11.5	12.3	7.0%	11.9%	12.5	8.7%	17.9%	**1.6x**
Guaranty Trust Bank	33.7	38.7	14.7%	12.2%	37.1	7.1%	17.2%	**2.1x**
SBM Holdings	6.0	5.9	(1.0%)	(0.3%)	6.6	5.0%	14.3%	**0.9x**
Bank of Kigali	278.0	278.0	0.0%	(7.3%)	299.9	5.0%	12.9%	**1.5x**
Standard Chartered	195.0	206.5	5.9%	6.2%	196.3	6.4%	7.1%	**1.6x**
HF Group	6.6	7.0	5.8%	25.6%	6.6	5.3%	5.6%	**0.3x**
Stanbic Holdings	91.3	90.8	(0.5%)	0.0%	92.6	2.5%	3.9%	**0.9x**
Bank of Baroda	134.0	134.2	0.1%	(4.1%)	130.6	1.9%	(0.7%)	**1.2x**
FBN Holdings	7.4	8.0	8.8%	0.6%	6.6	3.4%	(6.4%)	**0.4x**
Standard Chartered	21.1	21.0	(0.4%)	0.0%	19.5	0.0%	(7.7%)	**2.6x**
Stanbic IBTC Holdings	45.3	47.0	3.8%	(2.0%)	37.0	1.3%	(17.0%)	**2.3x**
National Bank	6.0	6.0	(0.3%)	12.4%	4.9	0.0%	(18.3%)	**0.4x**
Ecobank Transnational	14.1	13.7	(2.5%)	(19.4%)	9.3	0.0%	(34.0%)	**0.5x**

**** Target Price as per Cytonn Analyst estimates***
***** Upside/ (Downside) is adjusted for Dividend Yield***
******Banks in which Cytonn and/or its affiliates are invested in***
*******Stock prices indicated in respective country currencies***

We are "Positive" on equities for investors as the sustained price declines has seen the market P/E decline to below its historical average. We expect increased market activity, and possibly increased inflows from foreign investors, as they take advantage of the attractive valuations, to support the positive performance.