Fintech Impact on Kenya’s Financial Services Industry, & Cytonn Weekly #07/2019

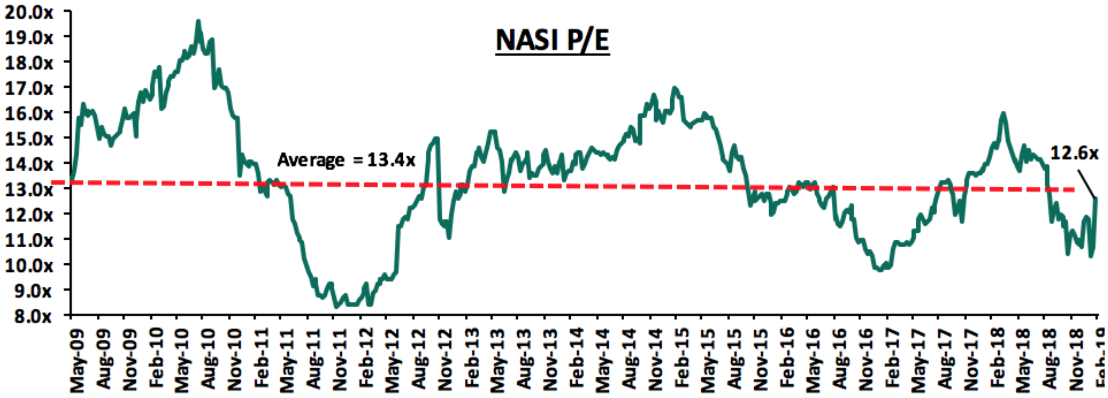
Equities

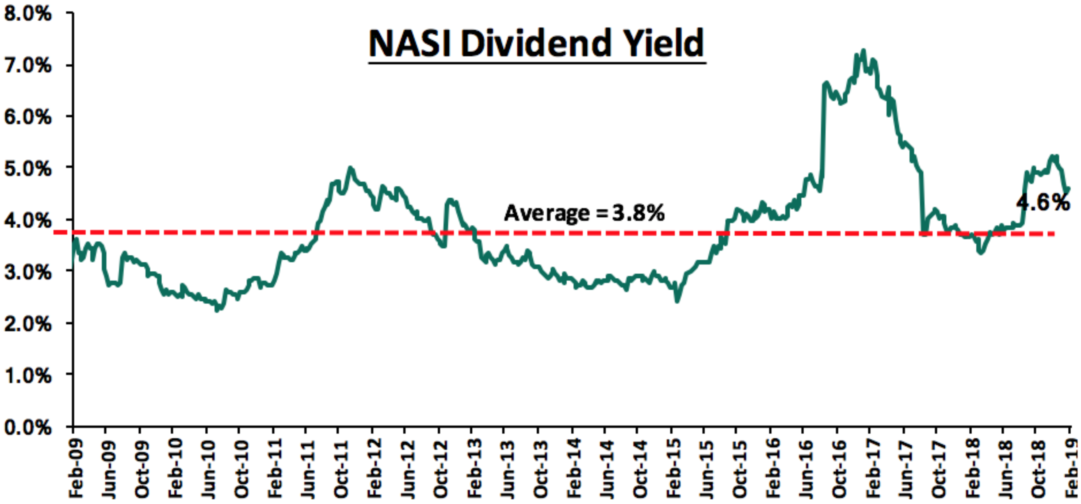
Market Performance

During the week, the equities market was on a downward trend with NASI, NSE 25, and NSE 20 declining by 2.0%, 1.6%, and 0.5%, respectively, taking their YTD performance to 11.9%, 12.7% and 7.5%, for NASI, NSE 25, and NSE 20, respectively. The decline in NASI was mainly driven by declines in large cap banking stocks such as Barclays Bank, Cooperative Bank, and Standard Chartered Bank, which declined by 3.7%, 2.8%, and 1.1%, respectively.

Equities turnover declined by 50.3% during the week to USD 29.7 mn, from USD 59.7 mn the previous week, taking the YTD turnover to USD 246.5 mn. Foreign investors turned net buyers for the week, with a net buying position of USD 1.1 mn, from last week’s net selling position of USD 3.6 mn.

The market is currently trading at a price to earnings ratio (P/E) of 12.6x, 6.3% below the historical average of 13.4x, and a dividend yield of 4.6%, 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 12.6x is 29.7% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 51.4% 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

The International Finance Corporation (IFC) has entered into a technical advisory agreement with Equity Bank to offer technical advisory services with the aim of helping the lender to better its customer base of small and meduim-sized (SME) customers. The project will see the development of new products and services tailored mainly for the SMEs. It will assist the Equity Group design and deliver an efficient SME business model, improve SME credit related processes, and train staff to effectively serve the targeted SME segments. Equity Bank is already the country's leading SME bank with the segment comprising close to 60% of the bank's loan portfolio with the lender having 10.0 mn customers in Kenya. The bank is well placed to deliver additional products and services to its SME customers given its country-wide coverage through a network of 177 branches and over 32,000 agents, and its innovative digital channels. Equity bank becomes the latest local bank to benefit from IFC's technical advisory services, after Co-op Bank which is also getting IFC's input in a Kshs 243.6 mn deal to help the lender expand its digital banking services. We note that various lenders in the local banking space such as KCB, Co-operative bank and I&M bank have been increasing focus on the SME banking segment, which was adversely affected by the implementation of the Banking (Amendment) Act 2015, as access to credit became difficult, with banks citing inability to price them within the margins set under the law. Banks have been obtaining finance from international institutions mainly for onward lending to the private sector mainly comprise of SMEs, so as to plug a funding deficit occassioned by a mismatch in their assets and liabilities by tenor, as deposits tend to be relatively short term while loans are relatively long term. The funds issues so far have been summarised in the table below:

Loans to Banks by International Organizations

Issuer	Bank	Issue Period	Amount of Loan(Kshs bn)	Term of Credit

Loans to Banks by International Organizations

	Issuer	Bank	Issue Period	Amount of Loan(Kshs bn)	Term of Credit
1	IFC	Cooperative Bank	Feb-18	15.2	7-years
2	Africa Development Bank	Kenya Commercial Bank	Oct-17	10.4	Not specified
3	14 financial Institutions (syndicated)	Stanbic Bank	May-18	10.0	2,3 years
4	Africa Development Bank	Diamond Trust bank	Mar-18	7.5	7-years
5	FMO	I&M Holdings	Oct-18	4.0	Not specified
6	IFC	I&M Holdings	Jan-18	1.0	Not specified
7	SwedFund	Victoria Commercial Bank	Apr-18	0.5	Not specified
8	East African Development Bank	Sidian Bank	Nov-18	0.2	8-years
	Total			**48.9**	

With SMEs forming 80.0% of the private sector, reduced credit extension saw the private sector credit growth remain below 5.0%, averaging 3.3% in 2018, below the 5-year average of 11.8%. With increased focus in the segment by larger banks such as Equity Group, Co-operative Bank and KCB, this would likely increase credit extension to the private sector, in addition to increasing the respective banks' interest and fee income.

Athi River Mining Plc (ARM) will remain suspended from trading at the NSE for a further 6-months. The Capital Markets Authority (CMA) opted to extend the suspension in view of the turnaround efforts led by administrators from PriceWaterhouseCoopers (PwC). The extension comes on the back of expiry of the 75 days suspension issued in October 2018. This is the fourth extension of ARM's suspension since the stock was first blocked from trading for 7 working days on August 20th 2018, after its lenders, led by UBA Bank raised concerns of insolvency hence putting it under administration. Firms interested in buying out troubled ARM Cement have until the end of this month to make final offers to the company's administrators PricewaterhouseCoopers (PwC). With the administrators currently engaged in the asset sales of the various subsidiaries, this would provide the company with a capital base to boost and streamline the core operations. We also note that the proposed move to look for a strategic investor may also provide reprieve, with several major companies such as Dangote Cement and Oman Based Raylat Limited expressing interest in acquiring the troubled company.

Universe of Coverage

Below is our banking universe of coverage table:

Universe of Coverage

Banks	Price as at 08/02/2019	Price as at 15/02/2019	w/w change	YTD Change	Target Price	Dividend Yield	Upside/Downside	P/TBv Multiple
GCB Bank***	4.2	4.2	0.0%	(9.1%)	7.7	9.3%	94.0%	**1.0x**
Diamond Trust Bank	151.0	150.0	(0.7%)	(4.2%)	283.7	1.8%	90.9%	**0.8x**
CRDB	135.0	135.0	0.0%	(10.0%)	207.7	0.0%	53.9%	**0.5x**
CAL Bank	0.9	0.9	2.2%	(7.1%)	1.4	0.0%	53.8%	**0.8x**
Access Bank	6.7	6.6	(0.8%)	(2.9%)	9.5	6.7%	50.6%	**0.4x**
I&M Holdings	95.0	95.5	0.5%	12.4%	138.6	3.7%	48.8%	**1.0x**
KCB Group***	43.6	43.5	(0.3%)	16.0%	61.3	7.3%	48.4%	**1.3x**
Zenith Bank***	24.4	24.8	1.4%	7.4%	33.3	11.8%	46.4%	**1.0x**
UBA Bank	7.7	8.0	4.6%	3.9%	10.7	11.9%	45.6%	**0.5x**
Ecobank	7.5	7.5	0.0%	(0.1%)	10.7	0.0%	43.3%	**1.6x**
Equity Group	42.3	42.5	0.5%	22.0%	56.2	4.9%	37.1%	**2.0x**
Co-operative Bank	16.0	15.6	(2.8%)	8.7%	19.9	5.1%	33.1%	**1.4x**
Stanbic Bank Uganda	29.0	29.0	(0.1%)	(6.5%)	36.3	3.9%	29.1%	**2.1x**
NIC Group	38.3	39.5	3.3%	42.1%	48.8	2.9%	26.4%	**0.9x**
Union Bank Plc	6.3	6.9	10.4%	23.2%	8.2	0.0%	18.1%	**0.7x**
Barclays Bank	12.3	11.8	(3.7%)	7.8%	12.5	8.7%	14.7%	**1.6x**
SBM Holdings	5.9	6.0	1.0%	0.7%	6.6	5.0%	14.3%	**0.9x**
Bank of Kigali	278.0	276.0	(0.7%)	(8.0%)	299.9	5.0%	13.7%	**1.5x**
HF Group	7.0	6.5	(6.3%)	17.7%	6.6	5.3%	6.5%	**0.3x**
Guaranty Trust Bank	38.7	38.0	(1.8%)	10.2%	37.1	7.1%	4.9%	**2.1x**
Standard Chartered	206.5	204.3	(1.1%)	5.0%	196.3	6.4%	2.5%	**1.6x**
Stanbic Holdings	90.8	94.3	3.9%	3.9%	92.6	2.5%	0.7%	**0.9x**
Bank of Baroda	134.2	134.0	(0.1%)	(4.3%)	130.6	1.9%	(0.7%)	**1.2x**
Standard Chartered	21.0	21.0	0.0%	0.0%	19.5	0.0%	(7.3%)	**2.6x**
National Bank	6.0	5.7	(5.0%)	6.8%	4.9	0.0%	(13.7%)	**0.4x**
FBN Holdings	8.0	8.5	5.6%	6.3%	6.6	3.4%	(18.1%)	**0.4x**
Stanbic IBTC Holdings	47.0	48.5	3.2%	1.1%	37.0	1.3%	(22.4%)	**2.3x**
Ecobank Transnational	13.7	14.4	5.1%	(15.3%)	9.3	0.0%	(35.6%)	**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.