Performance by Retirement Benefits Schemes in Kenya & Cytonn Weekly #10_2019

Private Equity

Sidian Bank, a Kenyan Tier 3 bank, has received a USD 12.0 mn (Kshs 1.2 bn) Tier II capital injection from the Investment Fund for Developing Countries (IFU), a Danish Development Finance Institution (DFI). The funds are expected to boost the bank's regulatory capital ratios as it works towards achieving its strategic objective of becoming a Tier 2 bank by 2022, as the bank's total capital to total risk-weighted assets ratio was 14.0% as at Q3'2018, which is below the minimum statutory requirement of 14.5% for banks. The details of the transaction are as follows:

- The investment by IFU is Tier II capital in the form of subordinated debt, and will likely have a minimum tenor of 5 years to maturity,
- IFU will have the option within the first three years to convert their debt investment into equity, subject to approval from the Central Bank of Kenya,
- The conversion option translates to ownership of approximately 20.0%,
- With Sidian Bank having an equity position of Kshs 3.6 bn as at Q3'2018, the transaction could be done at a price-to-book value (P/Bv) multiple of 1.6x, which is a 14.3% premium to the current listed banks trading multiple of 1.4x, and,
- IFU will have two seats on the board of the bank.

The new investment will enable the bank to be well capitalized and improve liquidity, offering ease of access to funds and fast turn-around times for its SME customers, who have been 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. In addition, the latest funding follows a series of capital raising efforts by the bank in 2018, including:

- A successful rights issue in 2018 of Kshs 1.5 bn, which saw Centum, its largest shareholder inject Kshs 1.1 bn, to defend its 72.9% shareholding, and,
- A secured loan of Kshs 235.0 mn received in November 2018, from the East African Development Bank for lending to SMEs in the agribusiness sector across the country.

Kenyan banks have, in recent years, taken on substantial loans from international financiers including International Finance Corporation (IFC), European Investment Bank and the African Development Bank (AfDB). Previously, Equity Group, Co-operative Bank, Diamond Trust Bank, Stanbic Holdings and KCB Group have borrowed from international financiers mainly to finance their onward lending businesses. This is as highlighted in the table below;

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	KCB Group	Oct-17	10.4	Not specified
3	14 financial Institutions (syndicated)	Stanbic Holdings	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	Investment Fund for Developing Countries	Sidian Bank	Mar-19	1.2	Not specified
7	IFC	I&M Holdings	Jan-18	1.0	Not specified
8	SwedFund	Victoria Commercial Bank	Apr-18	0.5	Not specified
9	East African Development Bank	Sidian Bank	Nov-18	0.2	8-years
	Total			**50.1**	

The asset-liability mismatch by tenor due to the relatively long-term nature of loans and short-term nature of deposits exposes a gap that banks have chosen to fill with credit from the international financiers.

We maintain a positive outlook on private equity investments in Africa as evidenced by the increasing investor interest, which is attributed to; (i) economic growth, which is projected to improve in Africa's most developed PE markets, (ii) attractive valuations in Sub Saharan Africa's private markets compared to its public markets, and (iii) attractive valuations in Sub Saharan Africa's markets compared to global markets. Going forward, the increasing investor interest, stable macro-economic and political environment will continue to boost deal flow into African markets.