The Role of the Capital Markets in Economic Development & Cytonn Weekly #12 2019

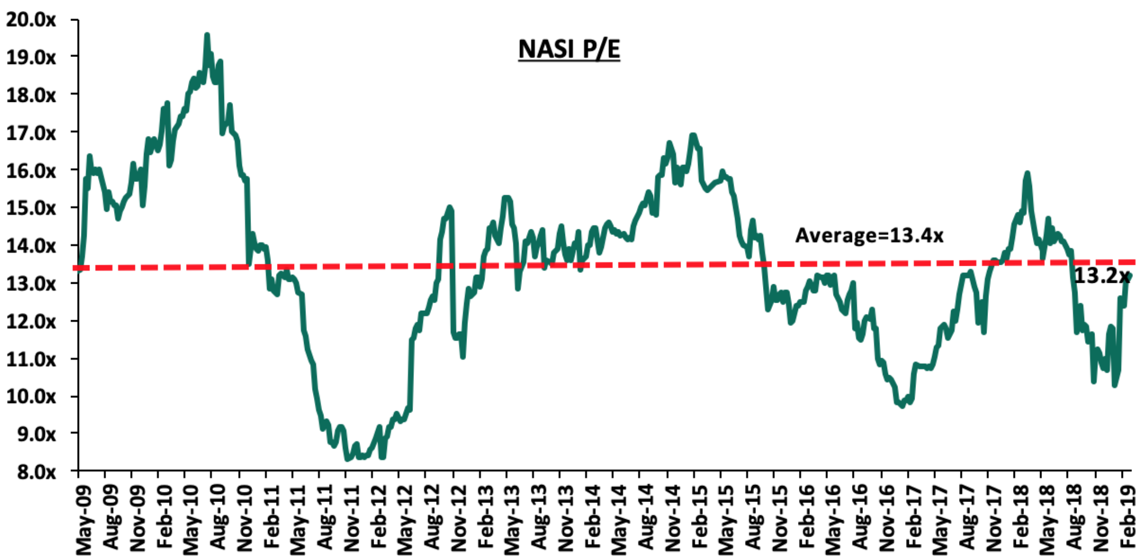
Equities

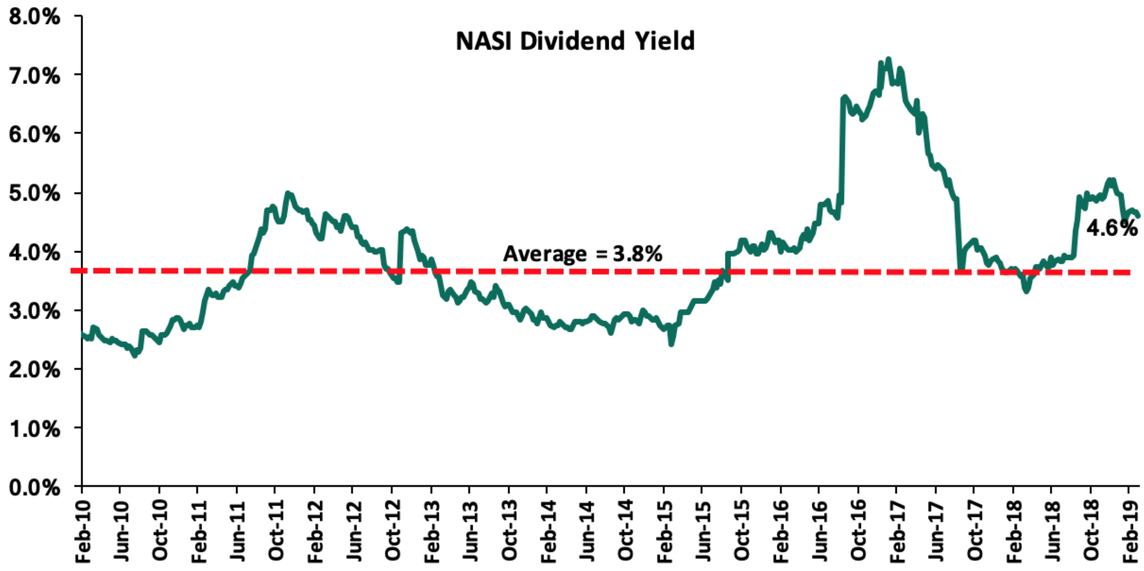
Market Performance:

During the week, the equities market recorded mixed performances with NASI and NSE 25 gaining by 1.2% and 1.0%, respectively, while NSE 20 declined by 0.3%, taking their YTD performance to gains of 13.9%, 1.9%, and 12.0%, for NASI, NSE 20 and NSE 25, respectively. The performance in NASI was driven by gains in large-cap stocks such as Standard Chartered Bank Kenya, Co-operative Bank of Kenya, EABL and Safaricom, which gained by 10.0%, 4.0%, 2.9%, and 1.4%, respectively.

Equities turnover rose by 12.2% during the week to USD 34.3 mn, from USD 30.7 mn the previous week, taking the YTD turnover to USD 415.6 mn. Foreign investors remained net buyers for the week, with a net buying position of USD 2.7 mn, an 18.2% decline from last week's net buying position of USD 3.3 mn.

The market is currently trading at a price to earnings ratio (P/E) of 13.2x, 1.2% 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 13.2x is 36.2% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 59.2% 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

Standard Chartered Bank Kenya released their FY'2018 financial results:

Standard Chartered Bank Kenya released their FY'2018 financial results, with core earnings per share increasing by 17.1% to Kshs 23.6, from Kshs 20.1 in FY'2017, in line with our expectation of a 16.0% increase to Kshs 23.3. The performance was driven by a 4.6% increase in total operating income, coupled with a 3.0% decline in total operating expenses. The variance in core earnings per share growth against our expectations was due to the 3.0% decline in total operating expenses to Kshs 16.8 bn, from Kshs 17.3 bn in FY'2017, which slightly exceeded our expectation of a 2.0% decline. Highlights of the performance from FY'2017 to FY'2018 include:

- Total operating income increased by 4.6% to Kshs 28.6 bn from Kshs 27.3 bn in FY'2017. The rise was due to a 4.9% increase in Non-Funded Income (NFI) to Kshs 9.2 bn from Kshs 8.8 bn in FY'2017, coupled with a 4.5% increase in Net Interest Income (NII) to Kshs 19.4 bn, from Kshs 18.6 bn in FY'2017,
- Interest income rose by 2.3% to Kshs 26.9 bn, from Kshs 26.3 bn in FY'2017. This was driven by a 9.9% growth in interest income from government securities to Kshs 12.5 bn, from Kshs 11.3 bn in FY'2017. There was however a 3.2% decline in interest income on loans and advances to Kshs 13.1 bn, from Kshs 13.6 bn in FY'2017, attributable to the 6.7% decline in the loan book, coupled with the decline in yields on loans due to the two Central Bank Rate (CBR) cuts in 2018. The yield on interest-earning assets however declined to 10.5%, from 11.2% in FY'2017, attributed to a decline in yields on government securities as well as the decline in lending rates,
- Interest expense declined by 3.0% to Kshs 7.5 bn, from Kshs 7.7 bn in FY'2017, following a 10.0% decline in other interest expenses to Kshs 976.3 mn from Kshs 1.1 bn in FY'2017. Interest expense on customer deposits however rose marginally by 0.4% to Kshs 6.44 bn from Kshs 6.41 bn in FY'2017. Consequently, cost of funds declined to 3.3% from 3.7% in FY'2017, with the Net Interest Margin (NIM) declining to 7.5%, from 7.9% in FY'2017,
- Non-Funded Income (NFI) increased by 4.9% to Kshs 9.2 bn, from Kshs 8.8 bn in FY'2017. The increase was mainly driven by a 16.4% rise in other fees and commissions to Kshs 5.1 bn, from Kshs 4.4 bn in FY'2017, coupled with a 6.9% rise in forex trading income to Kshs 2.8 bn, from Kshs 2.7 bn. The revenue mix remained unchanged at 68:32 funded to non-funded income, owing to a comparable increase in NII and NFI,
- Total operating expenses declined by 3.0% to Kshs 16.8 bn, from Kshs 17.3 bn, largely driven by a 53.9% decline in loan loss provisions to Kshs 1.9 bn from Kshs 4.2 bn. The large decline in loan loss provisions was however offset by a 9.5% rise in staff costs to Kshs 7.4 bn from Kshs 6.7 bn in FY'2017, and a 17.3% rise in other operating expenses to Kshs 7.5 bn from Kshs 6.4 bn,
- The Cost to Income Ratio (CIR) improved to 58.6%, from 63.2% in FY'2017. Without LLP, the cost

to income deteriorated to 51.8%, from 47.9% in FY'2017,

- Profit before tax increased by 17.6% to Kshs 11.9 bn, from Kshs 10.1 bn in FY'2017. Profit after tax grew by 17.1% to Kshs 8.1 bn in FY'2018, from Kshs 6.9 bn in FY'2017, as the effective tax rate increased marginally to 31.6% from 31.3% in FY'2017,
- The bank recommends a first and final dividend of Kshs 19.0 per share; this is an 11.8% rise from the Kshs 17.0 per share paid in FY'2017, which translates to a dividend yield of 9.4%, and a payout ratio of 80.6%,
- The balance sheet recorded a slight contraction as total assets declined by 0.1% to Kshs 285.4 bn, from Kshs 285.7 bn in FY'2017. This decline was largely driven by a 10.7% decline in government securities to Kshs 98.7 bn, from Kshs 110.5 bn in FY'2017, coupled with a 6.1% decline in net loans and advances to customers to Kshs 118.7 bn from Kshs 126.3 bn in FY'2017. The decline was however mitigated by a 74.8% increase in placements to Kshs 37.5 bn, from Kshs 21.5 bn in FY'2017,
- Total liabilities declined marginally by 0.5% to Kshs 238.8 bn from Kshs 240.1 bn in FY'2017. This was driven by a 98.8% decline in placements to Kshs 0.2 bn, from Kshs 12.7 bn in FY'2017, possibly due to the bank opting to reduce placement liabilities and consequently the associated interest expenses, on the back of a removal of the floor of interest payable on deposits, as they seek to utilize the relatively cheaper deposit funding. This was however mitigated by a 5.1% rise in deposits to Kshs 224.2 bn, from Kshs 213.4 bn in FY'2017. Deposits per branch increased by 11.1% to Kshs 6.6 bn, from Kshs 4.9 bn previously, with the number of branches as at the end of 2018 being 34, a decline from 36 as at end of 2017,
- The rise in deposits coupled with the decline in loans led to a decline in the loan to deposit ratio to 52.9%, from 59.2% in FY'2017,
- Gross Non-Performing Loans (NPLs) increased by 22.9% to Kshs 21.7 bn in FY'2018, from Kshs 17.6 bn in FY'2017. Consequently, the NPL ratio deteriorated to 16.3% in FY'2018 from 12.6% in FY'2017. The NPL coverage declined to 67.0% in FY'2018, from 74.4% in FY'2017, as provisions declined despite the rise in NPLs, as the bank utilized the shareholder's equity for the impairments, as allowed in the initial year of implementation of the new IFRS 9 accounting framework,
- Shareholders' funds increased by 2.1% to Kshs 46.6 bn in FY'2018 from Kshs 45.7 bn in FY'2017, attributable to a 2.3% rise in capital grants to Kshs 1.93 bn, from Kshs 1.89 bn in FY'2017,
- Standard Chartered Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.5%, 6.0% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio was 19.5%, exceeding the statutory requirement of 14.5% by 5.0% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.6%, while total capital to risk-weighted assets came in at 19.7%,
- The bank currently has a Return on Average Assets (ROaA) of 2.8%, and a Return on Average Equity (ROaE) of 17.5%.

Key Take-Outs:

1. There was a decline in efficiency levels as the cost to income ratio without LLP worsened to 51.8% from 47.9% in FY'2017. The deterioration was largely attributable to a 9.5% rise in staff costs coupled with a 17.3% rise in other operating expenses, which depressed the bottom line. The rising inefficiency was largely due to the bank's investment in the development of robust ICT systems so as to enhance service delivery to clients,
2. The bank's asset quality deteriorated, with the NPL ratio rising to 16.3%, from 12.6% in FY'2017. The deteriorating NPL ratio is attributable to a 22.9% rise in gross non-performing loans to Kshs 21.7 bn, from Kshs 17.6 bn in FY'2017m due to recovery problems of loans made to key troubled sectors such as real estate and manufacturing, and,
3. There was an 11.4% rise in NFI to Kshs 9.2 bn, from Kshs 8.8 bn in FY'2017, despite the implementation of the Effective Interest Rate (EIR) under IFRS 9, which has seen the bank

amortize fees charged on loans over future period of a loan's tenor leading to a decline in NFI's in FY'2018. Fees and commissions on loans and advances recorded a 112.5% rise to Kshs 326.1 mn from Kshs 153.4 mn in FY'2017.

For more information, please see our Standard Chartered Bank FY'2018 Earnings Note

Co-operative Bank of Kenya released their FY'2018 financial results:

Co-operative Bank of Kenya released their FY'2018 financial results, with core earnings per share increasing by 11.6% to Kshs 2.2 from Kshs 1.9 in FY'2017, in line with our projections. The performance was driven by a 5.0% increase in total operating income, which outpaced the 1.4% increase in total operating expenses. Highlights of the performance from FY'2017 to FY'2018 include:

- Total operating income increased by 5.0% to Kshs 43.7 bn, from Kshs 41.6 bn in FY'2017. This was due to a 9.5% increase in Net Interest Income (NII) to Kshs 30.8 bn, from Kshs 28.1 bn in FY'2017, which outweighed the 4.4% decline in Non-Funded Income (NFI) to Kshs 12.9 bn, from Kshs 13.5 bn in FY'2017,
- Interest income increased by 6.6% to Kshs 43.0 bn, from Kshs 40.4 bn in FY'2017. This was driven by a 19.2% growth in interest income from government securities to Kshs 9.8 bn, from Kshs 8.2 bn in FY'2017, a 3.1% increase in interest income from loans to Kshs 33.0 bn from Kshs 31.9 bn, and a 32.8% increase in interest income on placement assets to Kshs 0.3 bn, from Kshs 0.2 bn in FY'2017. Consequently, the yield on interest-earning assets rose marginally to 12.70%, from 12.65% in FY'2017,
- Interest expenses declined marginally by 0.2% to Kshs 12.2 bn from Kshs 12.3 bn in FY'2017, following a 40.8% decrease in the interest expense on placement liabilities to Kshs 0.1 bn from Kshs 0.2 bn in FY'2017. The decline in interest expense was however weighed down by the 1.6% increase in other interest expenses to Kshs 1.22 bn, from Kshs 1.20 bn in FY'2017, and the 0.4% increase in interest expense on customer deposits to Kshs 10.9 bn from Kshs 10.85 bn in FY'2017. Consequently, the cost of funds declined to 3.8% from 4.1% in FY'2017. Thus, the Net Interest Margin (NIM) improved to 9.5%, from 8.8% in FY'2017,
- Non-Funded Income (NFI) declined by 4.4% to Kshs 12.9 bn, from Kshs 13.5 bn in FY'2017. The decline was mainly caused by the 77.8% decline in fees and commissions on loans to Kshs 0.6 bn from Kshs 2.6 bn in FY'2017, which management attributed to the implementation of the Effective Interest Rate (EIR) model under IFRS 9, which requires banks to amortize the fees and commissions on loans, throughout the tenor of a loan. The decline in NFI was also caused by the 24.5% decline in other income, to Kshs 1.1 bn from Kshs 1.5 bn in FY'2017, which management attributed to reduced recoveries in 2018, compared to 2017. The decline in NFI was however mitigated by the 23.9% increase in other fees and commissions to Kshs 8.9 bn, from Kshs 7.2 bn in FY'2017, attributable to increased transactional revenue from agency banking, and the digital channels, coupled with the 2.4% increase in forex trading income to Kshs 2.3 bn, from Kshs 2.2 bn in FY'2017. The revenue mix shifted to 70:30 funded to non-funded income, from 68:22, owing to the decline in NFI coupled with the growth in NII,
- Total operating expenses rose by 1.4% to Kshs 25.7 bn, from Kshs 25.3 bn in FY'2017, largely driven by a 13.4% increase in staff costs to Kshs 11.4 bn in FY'2018, from Kshs 10.1 bn in FY'2017. The jump in staff costs was attributed to new specialized hires in data & big data analytics, machine learning and artificial intelligence from major IT firms such as IBM. In addition, other operating expenses also rose by 6.7% to Kshs 12.4 bn in FY'2018, from Kshs 11.6 bn in FY'2017. The increase in total operating expenses was however mitigated by the 48.9% decline in Loan Loss Provisions (LLP) to Kshs 1.8 bn from Kshs 3.6 bn in FY'2017,
- The Cost to Income Ratio (CIR) improved to 58.8%, from 60.9% in FY'2017. However, without LLP, the cost to income ratio deteriorated to 54.6%, from 52.2% in FY'2017, highlighting the significant decline in the cost of risk to 4.2% from 8.7% in FY'2017,

- Profit before tax increased by 10.7% to Kshs 18.2 bn, up from Kshs 16.4 bn in FY'2017. Profit after tax grew by 11.6% to Kshs 12.7 bn in FY'2018, from Kshs 11.4 bn in FY'2017, with the difference in growth attributable to the decline in the effective tax rate to 29.9% from 31.3% in FY'2017,
- The bank recommended a first and final dividend of Kshs 1.0 per share, a 25.0% increase from the Kshs 0.8 paid in FY'2017, which translates to a dividend yield of 6.5%, and a payout ratio of 46.1%,
- The balance sheet recorded an expansion as total assets increased by 6.9% to Kshs 413.4 bn from Kshs 386.9 bn in FY'2017. This growth was largely driven by a 10.4% increase in government securities to Kshs 80.3 bn from Kshs 72.7 bn in FY'2017, coupled with a 53.0% increase in other assets to Kshs 25.5 bn from Kshs 16.7 bn in FY'2017,
- However, the loan book contracted by 3.3% to Kshs 245.4 bn from Kshs 253.9 bn in FY'2017, which management attributed to repayment of approximately Kshs 8.0 bn by a single client in the real estate sector,
- Total liabilities rose by 8.1% to Kshs 342.2 bn from Kshs 316.6 bn in FY'2017, driven by a 6.5% increase in customer deposits to Kshs 306.1 bn from Kshs 287.4 bn in FY'2017, coupled with the 13.2% growth in borrowings to Kshs 24.0 bn, from Kshs 21.2 bn in FY'2017, as management highlighted that the bank drew Kshs 7.5 bn from the IMF facility of Kshs 15.0 bn in June 2018. The growth was however weighed down by the 89.8% decline in placement liabilities to Kshs 0.4 bn from Kshs 4.4 bn in FY'2017. Deposits per branch increased by 6.5% to Kshs 2.0 bn from Kshs 1.9 bn in FY'2017, as the number of branches remained the same at 155,
- The faster growth in deposits as compared to the decline in loans led to a decline in the loan to deposit ratio to 80.2% from 88.3% in FY'2017,
- Gross Non-Performing Loans (NPLs) increased by 56.7% to Kshs 29.4 bn in FY'2018 from Kshs 18.8 bn in FY'2017. The NPL ratio thus deteriorated to 11.3% in FY'2018 from 7.2% in FY'2017. General Loan Loss Provisions increased by 63.0% to Kshs 9.9 bn from Kshs 6.1 bn in FY'2017, and as a consequence, the NPL coverage improved to 48.1% in FY'2018 from 37.6% in FY'2017,
- Shareholders' funds increased marginally by 0.4% to Kshs 69.9 bn in FY'2018 from Kshs 48.4 bn in FY'2017, as the 41.0% increase in the statutory loan loss reserve to Kshs 1.0 bn, from Kshs 0.7 bn in FY'2017, was weighed down by the 2.4% decline in the retained earnings to Kshs 54.0 bn from Kshs 55.3 bn in FY'2017,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.0%, 5.5% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 16.4%, exceeding the statutory requirement by 1.9% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.8%, while total capital to risk-weighted assets came in at 17.2%,
- The bank currently has a Return on Average Assets (ROaA) of 3.3%, and a Return on Average Equity (ROaE) of 18.3%.

Key Take-Outs:

1. The bank's asset quality deteriorated significantly, with the NPL ratio deteriorating to 11.3% from 7.2% in FY'2017, as the gross NPLs rose by 56.7%. According to management, the deterioration was largely due to major clients in the manufacturing, trade and real estate sectors. According to management, the increase in NPLs was mitigated by repayment of a Kshs 10.4 bn loan, which was almost non-performing, which highlights the relatively tougher operating environment of 2018,
2. The bank's Non-Funded Income shrunk by 4.4% y/y, with the decline attributed to the significant 77.8% decline in fees and commissions on loans. This, as earlier highlighted was largely due to the implementation of the EIR model under IFRS 9, which requires the amortization of the fees over the tenor of the loan. However, the bank's alternative channels aided in NFI generation via transactional revenue, as alternative channels contributed to more than 88.0% of all transactions. With the banks NFI contribution to total income currently at 29.5%, this has shifted to below the

current industry average of 33.8%, highlighting the existence of a headroom for the bank to grow its income this segment, and,

3. The bank's efficiency reduced as the CIR deteriorated to 54.6%, from 52.2% in FY'2017, which was mainly driven by the steep 13.4% increase in staff costs, coupled with the 6.7% increase in other operating expenses, which management attributed to increased hires especially in data analytics, machine learning and artificial intelligence, coupled with the payment of specialized licenses for the digital software and technology. Management advised that the bank would begin to reap the benefits of the digital investments from June 2019.

For more information, please see our Co-operative Bank FY'2018 Earnings Note

Diamond Trust Bank Kenya released their FY'2018 financial results:

Diamond Trust Bank Kenya released their FY'2018 financial results, with core earnings per share increasing by 2.3% to Kshs 25.3, from Kshs 24.8 in FY'2017, slower than our expectation of a 6.3% increase to Kshs 26.3 per share. The performance was driven by a 2.0% increase in total operating income, coupled with the 2.5% decline in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the slower than expected growth in total operating income, that expanded by 2.0%, against the expected 2.9%, coupled with the 4.2% points increase in the effective tax rate to 35.6% from 31.4% in FY'2017. Highlights of the performance from FY'2017 to FY'2018 include:

- Total operating income increased by 2.0% to Kshs 25.5 bn from Kshs 25.0 bn in FY'2017. This was due to a 1.8% increase in Net Interest Income (NII) to Kshs 20.0 bn, from Kshs 19.7 bn in FY'2017, coupled with the 3.0% increase in Non-Funded Income (NFI) to Kshs 5.4 bn, from Kshs 5.3 bn in FY'2017,
- Interest income increased by 1.8% to Kshs 35.3 bn from Kshs 34.6 bn in FY'2017. This was driven by a 10.8% growth in interest income from government securities to Kshs 13.0 bn, from Kshs 11.7 bn in FY'2017, coupled with a 29.8% increase in interest income from placement assets to Kshs 0.3 bn from Kshs 0.2 bn in FY'2017. The growth in interest income was however weighed down by the 3.1% decline in interest income from loans to Kshs 22.0 bn from Kshs 22.7 bn in FY'2017. However, the yield on interest-earning assets declined to 10.9% from 11.4% in FY'2017, largely due to the decline in yields on government securities, and the decline in yields on loans owing to the 100 bps cut in the Central Bank Rate (CBR),
- Interest expense rose by 2.0% to Kshs 15.3 bn from Kshs 15.0 bn in FY'2017, following a 62.1% increase in the interest expense on placement liabilities to Kshs 0.8 bn from Kshs 0.5 bn in FY'2017, coupled with the 2.4% increase in other interest expenses to Kshs 0.99 bn from Kshs 0.97 bn in FY'2017. The increase in interest expense was mitigated by the 0.3% decline in interest expense on customer deposits to Kshs 13.46 bn, from Kshs 13.50 bn in FY'2017. However, the cost of funds declined to 4.9% from 5.1% in FY'2017, due to the faster 3.5% increase in interest-bearing liabilities to Kshs 314.7 bn from Kshs 303.9 bn in FY'2017. The Net Interest Margin (NIM) declined to 6.2%, from 6.5% in FY'2017,
- Non-Funded Income (NFI) rose by 3.0% to Kshs 5.4 bn, from Kshs 5.3 bn in FY'2017. The increase was mainly driven by the 5.7% growth in the total fees and commissions to Kshs 3.4 bn from Kshs 3.2 bn in FY'2017. The growth in NFI was however weighed down by the 1.6% decline in forex trading income, to Kshs 1.57 bn from Kshs 1.6 bn in FY'2017. Owing to the comparable movement in both NII and NFI, the revenue mix remained 79:21, funded to non-funded income,
- Total operating expenses declined by 2.5% to Kshs 14.5 bn from Kshs 14.9 bn in FY'2017, largely driven by the 30.7% decline in Loan Loss Provisions (LLP) to Kshs 3.0 bn from Kshs 4.3 bn in FY'2017. Other operating expenses rose, with staff costs rising by 5.5% to Kshs 4.2 bn from Kshs 4.0 bn in FY'2017, coupled with an 11.0% increase in other operating expenses to Kshs 7.3 bn from Kshs 6.6 bn in FY'2017,
- The Cost to Income Ratio (CIR) improved to 56.9%, from 59.6% in FY'2017. However, without

LLP, the cost to income ratio deteriorated to 45.2%, from 42.3% in FY’2017, highlighting the significant decline in the cost of risk to 11.7% from 17.2% in FY’2017,

- Profit before tax increased by 8.9% to Kshs 11.0 bn, up from Kshs 10.1 bn in FY’2017. Profit after tax grew by 2.3% to Kshs 7.1 bn in FY’2018, from Kshs 6.9 bn in FY’2017, with the effective tax rate rising to 35.6% from 31.4% in FY’2017,
- The bank recommended a first and final dividend of Kshs 2.6 per share, similar to that paid in FY’2017, which translates to a dividend yield of 1.9%, and a payout ratio of 10.9%,
- The balance sheet recorded an expansion as total assets increased by 4.0% to Kshs 377.7 bn from Kshs 363.3 bn in FY’2017. This growth was largely driven by a 2.6% increase in government securities to Kshs 117.3 bn from Kshs 114.4 bn in FY’2017, coupled with a 4.2% increase in other assets to Kshs 9.0 bn from Kshs 8.7 bn in FY’2017,
- However, the loan book contracted by 1.5% to Kshs 193.1 bn from Kshs 196.1 bn in FY’2017,
- Total liabilities rose by 2.9% to Kshs 318.8 bn from Kshs 309.7 bn in FY’2017, driven by a 6.2% increase in customer deposits to Kshs 282.9 bn from Kshs 266.3 bn in FY’2017. The growth was however weighed down by the 16.4% decline in placement liabilities to Kshs 17.1 bn from Kshs 20.5 bn in FY’2017, coupled with the 14.4% decline in borrowings to Kshs 14.7 bn from Kshs 17.2 bn in FY’2017. Deposits per branch increased by 4.0% to Kshs 2.0 bn from Kshs 1.9 bn in FY’2017, as the number of branches increased by 3 to 140 in 2018, from 137 in FY’2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 68.3% from 73.6% in FY’2017,
- Gross Non-Performing Loans (NPLs) declined by 8.2% to Kshs 13.6 bn in FY’2018 from Kshs 14.8 bn in FY’2017. As a consequence, the NPL ratio improved to 6.7% in FY’2018 from 7.1% in FY’2017. General Loan Loss Provisions declined by 34.2% to Kshs 5.4 bn from Kshs 8.2 bn in FY’2017. Thus, the NPL coverage declined to 50.6% in FY’2018 from 67.5% in FY’2017,
- Shareholders’ funds increased by 10.9% to Kshs 53.7 bn in FY’2018 from Kshs 48.4 bn in FY’2017, largely due to the 17.1% increase in the retained earnings to Kshs 42.1 bn, from Kshs 35.9 bn in FY’2017,
- Diamond Trust Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.7%, 8.2% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 21.1%, exceeding the statutory requirement by 6.6% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 19.6%, while total capital to risk-weighted assets came in at 22.0%,
- The bank currently has a Return on Average Assets (ROaA) of 1.8%, and a Return on Average Equity (ROaE) of 13.1%.

Key Take-Outs:

1. The bank’s asset quality improved, with the NPL ratio improving to 6.7% from 7.1% in FY’2017, as the gross NPLs declined by 8.2%. This, coupled with the implementation of IFRS 9, which allowed the bank to charge a one-off provision on the equity, lead to an improved cost of risk to 11.7% from 17.2%, which was the key contributing factor to a decline in the bank’s total operating expenses, and consequently an improved bottom line,
2. The bank’s Non-Funded Income expanded by 3.0% y/y, with the growth being derived largely from fees and commissions. However, the bank’s revenue remains skewed towards funded income, with NFI accounting for only 21.0% of total revenue, way below the industry average of 31.4% as at FY’2018, indicating there’s more room for the bank to exploit this income stream, and,
3. The bank’s loan book shrunk by 1.5%, as the bank tightened its credit standards, opting to invest in government securities instead, which increased by 2.6%. Declining yields on government securities coupled with the 100 bps cut of the CBR have seen interest income remain compressed, as it grew by only 1.8%. This was further exacerbated by the 2.0% rise in interest expenses. Thus the bank growth may be hindered by continued preference to funded income, especially if the rate cap remains in place.

For more information, please see our Diamond Trust Bank FY'2018 Earnings Note

NIC Group released FY'2018 financial results:

NIC Group released its financial results, with core earnings per share increasing by 2.0% to Kshs 6.0 from Kshs 5.9 in FY'2017, below our expectation of a 3.9% increase to Kshs 6.1 per share. The performance was driven by a 1.9% increase in total operating income, which outweighed the 0.6% increase in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 0.6% rise in total operating expenses to Kshs 9.4 bn, from Kshs 9.3 bn in FY'2017, which was not in line with our expectation of a 2.1% decline. Highlights of the performance from FY'2017 to FY'2018 include:

- Total operating income increased by 1.9% to Kshs 15.2 bn from Kshs 14.9 bn in FY'2017. The marginal rise was due to an 11.4% increase in Non-Funded Income (NFI), coupled with a 1.8% decline in Net Interest Income (NII) to Kshs 10.6 bn, from Kshs 10.8 bn in FY'2017,
- Interest income rose by 4.8% to Kshs 19.3 bn, from Kshs 18.4 bn in FY'2017. This was driven by a 31.2% growth in interest income from government securities to Kshs 6.8 bn, from Kshs 5.2 bn in FY'2017. The growth, however, was subdued by the 6.1% decline in interest income on loans and advances to Kshs 12.3 bn, from Kshs 13.1 bn in FY'2017. The yield on interest-earning assets, however, declined to 10.4%, from 10.8% in FY'2017, attributed to a decline in yields on government securities as well as a decline in lending rates due to the two Central Bank Rate (CBR) cuts in 2018,
- Interest expense increased by 14.1% to Kshs 17.5 bn, from Kshs 15.3 bn in FY'2017, following a 20.6% increase in the interest expense on customer deposits to Kshs 7.2 bn from Kshs 6.0 bn in FY'2017, significantly faster than the 4.0% increase in customer deposits, indicating that the bank may be paying relatively higher interest on deposits, as a strategy to attract deposits. Interest expense on deposits and placements from banking institutions however declined by 31.8% to Kshs 217.8 mn, from Kshs 319.1 mn in FY'2017. Consequently, cost of funds rose to 5.2% from 4.7% in FY'2017, with the Net Interest Margin (NIM) declining to 5.7%, from 6.3% in FY'2017,
- Non-Funded Income (NFI) increased by 11.4% to Kshs 4.6 bn, from Kshs 4.2 bn in FY'2017. The rise was mainly driven by a 10.2% rise in forex trading income to Kshs 1.3 bn from Kshs 1.2 bn, coupled with an 8.0% increase in fees and commissions on loans. Other incomes also rose by 20.2% to Kshs 853.9 mn from Kshs 710.3 mn in FY'2017. The revenue mix shifted to 70:30 funded to non-funded income, from 72:28 in FY'2017, owing to the faster growth in NFI, coupled with the decline in NII,
- Total operating expenses increased by 0.6% to Kshs 9.4 bn, from Kshs 9.3 bn, largely driven by a 13.6% rise in staff costs to Kshs 3.6 bn from Kshs 3.2 bn in FY'2017, and a 7.9% rise in other operating expenses to Kshs 3.4 bn from Kshs 3.2 bn. This offset the 21.0% decline in Loan Loss Provisions (LLP) to Kshs 2.4 bn in FY'2018, from Kshs 3.0 bn in FY'2017,
- Consequently, the Cost to Income Ratio (CIR) improved to 61.7%, from 62.5% in FY'2017. Without LLP, the cost to income however deteriorated to 46.3%, from 42.6% in FY'2017,
- Profit before tax increased by 4.0% to Kshs 5.8 bn, from Kshs 5.6 bn in FY'2017. Profit after tax grew by 2.0% to Kshs 4.2 bn in FY'2018, from Kshs 4.1 bn in FY'2017, as the effective tax rate increased to 27.4% from 26.0% in FY'2017,
- The bank recommended a first and final dividend of Kshs 1.25 per share; similar to that paid in FY'2017, which translates to a dividend yield of 3.4%, and a payout ratio of 20.8%,
- The balance sheet recorded an expansion as total assets increased by 1.1% to Kshs 208.5 bn from Kshs 206.2 bn in FY'2017. This growth was largely driven by a 12.9% increase in government securities to Kshs 61.2 bn, from Kshs 54.2 bn in FY'2017, coupled with a 25.8% increase in cash and cash balances to Kshs 12.0 bn from Kshs 9.5 bn in FY'2017. This growth was however offset by the 57.7% decline in placements to Kshs 5.3 bn from Kshs 12.4 bn in FY'2017 and a 1.4% decline in the loan book to Kshs 118.1 bn from Kshs 119.8 bn in FY'2017,
- Total liabilities rose marginally by 0.7% to Kshs 172.7 bn from Kshs 171.5 bn in FY'2017. This was

driven by a 4.0% increase in deposits to Kshs 144.5 bn from Kshs 138.9 bn in FY’2017, coupled with an 18.4% decline in placements and a 12.7% decline in borrowings to Kshs 9.9 bn, and Kshs 14.9 bn from Kshs 12.1 bn, and Kshs 17.0 bn in FY’2017, respectively. Deposits per branch increased by 6.4% to Kshs 3.4 bn from Kshs 3.2bn with the number of branches as at the close of 2018 at 43 from 44 at the close of FY’2017,

- The rise in deposits coupled with the decline in loans led to a decline in the loan to deposit ratio to 81.7% from 86.2% in FY’2017,
- Gross Non-Performing Loans (NPLs) increased by 17.6% to Kshs 16.8 bn in FY’2018 from Kshs 14.3 bn in FY’2017. Consequently, the NPL ratio deteriorated to 13.4% in FY’2018 from 11.3% in FY’2017. The NPL coverage declined to 43.5% in FY’2018 from 45.7% in FY’2017, as provisions declined despite the rise in NPLs,
- Shareholders’ funds increased by 3.4% to Kshs 35.4 bn in FY’2018 from Kshs 34.3 bn in FY’2017, as retained earnings grew by 3.9% to Kshs 28.9 bn from Kshs 27.8 bn in FY’2017,
- NIC Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 19.5%, 9.0% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio was 21.2%, exceeding the statutory requirement of 14.5% by 6.7% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 19.3%, while total capital to risk-weighted assets came in at 20.9%,
- The bank currently has a Return on Average Assets (ROaA) of 2.0%, and a Return on Average Equity (ROaE) of 12.1%.

Key Take-Outs:

1. There was an 11.4% rise in NFI’s, which is way ahead of most banks that have reported so far. This was despite the implementation of the Effective Interest Rate (EIR) under IFRS 9, which has seen the bank amortize fees charged on loans over future period of a loan’s tenor leading to a decline in NFI’s in FY’2018. NFI contribution to total operating income is slightly below the industrial average of 31.4% indicating room for growth of the income segment exists,
2. The bank’s asset quality deteriorated, with the NPL ratio rising to 13.4% from 11.3% in FY’2017. The deteriorating NPL ratio is attributable to a 17.6% rise in gross non-performing loans to Kshs 16.8 bn from Kshs 14.3 bn in FY’2017, and,
3. The Bank’s cost of funds continued to rise coming in at 5.2% from 4.7% in FY’2017, while the Net Interest Margin (NIM) declined to 5.7%, from 6.3% in FY’2017. This is mainly attributable to the bank accepting costly customer deposits, which saw interest in customer deposits increasing by 20.6% to Kshs 7.2 bn from Kshs 6.0% in FY’2017. It remains unclear why the bank continues to pay high cost on deposits – now at 5.2% compared to an industry average of 3.7%; and despite paying the highest cost of deposits, NIC Group is still registering the weakest deposit growth of 4.0% relative to the industry average of 7.7% deposit growth.

For more information, please see our NIC Group FY’2018 Earnings Note

A summary of the banking sector performance is highlighted in the table below:

Listed Banks Operating Metrics

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-funded income Growth	NFI to Total Operating Income	Growth in Total Fee and Commissions	Deposit Growth	Growth in Govt Securities	Cost to Income	Loan to Deposit ratio	Loan Growth	Cost of Funds	Return on average equity
Stanbic	45.7%	13.8%	19.2%	14.0%	5.0%	18.3%	45.1%	15.5%	13.5%	3.7%	59.5%	79.7%	22.1%	3.5%	14.3%
KCB Group	21.8%	4.1%	14.1%	0.9%	8.2%	(0.1%)	32.0%	(25.3%)	7.6%	9.1%	52.8%	84.8%	7.9%	3.2%	21.9%
SCBK	17.1%	2.3%	(3.0%)	4.5%	7.5%	4.9%	32.2%	19.7%	5.1%	(10.7%)	58.6%	52.9%	(6.1%)	3.3%	17.5%
Co-op Bank	11.6%	6.6%	(0.2%)	9.5%	9.5%	(4.4%)	29.5%	(3.0%)	6.5%	10.4%	58.8%	80.2%	(3.3%)	3.8%	18.3%
Barclays Bank	7.1%	7.0%	31.6%	0.9%	8.6%	14.7%	30.6%	6.7%	11.5%	58.9%	66.4%	85.5%	5.3%	3.5%	16.8%
DTBK	2.3%	1.8%	2.0%	1.8%	6.2%	3.0%	21.3%	5.7%	6.2%	2.6%	56.9%	68.3%	(1.5%)	4.9%	13.1%
NIC Group	2.0%	4.8%	14.1%	(1.8%)	5.7%	11.4%	30.5%	9.2%	4.0%	12.9%	61.7%	81.7%	(1.4%)	5.2%	12.1%

Listed Banks Operating Metrics

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-funded income Growth	NFI to Total Operating Income	Growth in Total Fee and Commissions	Deposit Growth	Growth in Govt Securities	Cost to Income	Loan to Deposit ratio	Loan Growth	Cost of Funds	Return on average equity
2018 Mkt cap Weighted Average	16.0%	5.4%	10.1%	4.3%	7.8%	4.3%	31.4%	(0.9%)	7.7%	12.3%	58.3%	76.8%	2.8%	3.7%	17.8%
2017 Mkt cap Weighted Average	(1.0%)	(2.4%)	2.6%	(3.8%)	8.4%	9.1%	33.6%	13.4%	12.5%	22.2%	61.1%	80.0%	6.1%	3.6%	17.6%

Key take-outs from the table above include:

a. 7 banks have released results for FY'2018, and have recorded a 16.0% average increase in core Earnings Per Share (EPS), compared to a decline of 1.0% in FY'2017, and consequently, the Return on Average Equity (RoAE) rose to 17.8%, from 17.6% in FY'2017. All the banks that have released so far have recorded growths in their core EPS, with Stanbic Holdings recording the highest growth of 45.7%, and the lowest being NIC Group, which recorded a 2.0% growth y/y,
b. The sector recorded weaker deposit growth, which came in at 7.7%, slower than the 12.5% growth recorded in FY'2017. Despite the slower deposit growth, interest expenses increased by 10.1%, indicating banks have been mobilizing expensive deposits, since placement liabilities declined by an average of 5.1% y/y from a 73.8% growth in FY'2017, indicating banks'preference of deposit funding, as opposed to placements, possibly due to the relatively lower cost, especially given the removal of the floor of interest payable on deposits. However, with the removal of the limit of interest payable on deposits, the associated interest expenses on deposits is expected to improve in 2019, and possibly improve the cost of funds,
c. Average loan growth was anemic coming in at 2.8%, which was lower than 6.1% recorded in FY'2017, indicating that there was an even slower credit extension to the economy, due to sustained effects of the interest rate cap. Government securities on the other hand recorded a growth of 12.3% y/y, which was faster compared to the loans, albeit slower than 22.2% recorded in FY'2017. This indicates that banks' continued preference towards investing in government securities, which offer better risk-adjusted returns. Interest income increased by 5.4%, compared to a decline of 2.4% recorded in FY'2017, as banks adapted to the interest rate cap regime, with increased allocations in government securities. The Net Interest Income (NII) thus grew by 4.3% compared to a decline of 3.8% in FY'2017,
d. The average Net Interest Margin in the banking sector currently stands at 7.8%, down from the 8.0% recorded in FY'2017, despite the Net Interest Income increasing by 4.3% y/y. The decline was mainly due to the faster 12.3% increase in allocation to relatively lower yielding government securities, coupled with the decline in yields on loans due to the 100 bps Central Bank Rate (CBR) decline, and,
e. Non-funded Income grew by 4.3% y/y, slower than 9.8% recorded in FY'2017. The growth in NFI was weighed down as total fee and commission growth declined marginally by 0.9%, slower than the 13.5% growth recorded in FY'2017. The growth in fee and commission income continued to be subdued by the slow loan growth, coupled with the implementation of the Effective Interest Rate (EIR) model under IFRS 9, which requires banks to amortize the fees and commissions on loans, over the tenor of the loan.

Weekly Highlights

KCB Group has highlighted its intention to set up subsidiaries in Somalia and DRC Congo, as the bank aims to increase its regional footprint to 10 countries in the Eastern African region. This comes on the back of highlighting its intention to venture into Ethiopia, with the Ethiopian market becoming increasingly liberalized due to the reforms being implemented by the government. The bank's entry into the Somali market will however be hindered by the lack of proper government structures on the registration of persons, which makes the implementation of international regulations on anti-money laundering and terror financing prevention difficult. KCB Group plans to complete its entry into the DRC Market inorganically within 3 years via an acquisition; similar to the method used by Equity Group to venture into the market, where Equity Group acquired 79.8% of Pro Credit Bank, before raising the stake to 86.0% in April 2017. We view KCB Group's increased focus on geographical diversification as a possible significant growth driver for the bank going forward, given the vast untapped markets such as Ethiopia, which is the fastest growing economy in Africa, averaging 10.3% over the last 10 years, and has a rapidly growing population, currently at more than 105.0 mn, presenting a huge market for the bank to drive its retail banking strategy. Furthermore, given the lack of price controls on loan pricing in these markets, this should see the bank expand it topline interest revenue, whose growth has slowed down owing to the implementation of the interest rate cap in Kenya, which is the bank's largest market.

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Banks	Price as at 15/03/2019	Price as at 22/03/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
Diamond Trust Bank	138.0	135.5	(1.8%)	(13.4%)	283.7	1.9%	111.3%	**0.7x**
GCB Bank	4.0	4.0	0.0%	(13.0%)	7.7	9.5%	102.5%	**0.9x**
CRDB	125.0	125.0	0.0%	(16.7%)	207.7	0.0%	66.2%	**0.4x**
Zenith Bank	22.2	22.1	(0.7%)	(4.3%)	33.3	12.2%	63.4%	**1.0x**
I&M Holdings	90.0	94.3	4.7%	10.9%	138.6	3.7%	50.8%	**0.9x**
UBA Bank	7.7	7.8	2.0%	1.3%	10.7	10.9%	48.1%	**0.5x**
KCB Group***	44.3	44.7	0.9%	19.4%	61.3	7.8%	45.0%	**1.4x**
Access Bank	6.0	6.9	15.1%	0.7%	9.5	5.8%	44.5%	**0.4x**
Ecobank	7.7	7.7	(0.1%)	3.1%	10.7	0.0%	38.8%	**1.7x**
CAL Bank	1.0	1.0	1.0%	6.1%	1.4	0.0%	34.6%	**0.9x**
NIC Group	37.1	37.0	(0.1%)	33.1%	48.8	2.7%	34.6%	**1.0x**
Co-operative Bank	15.0	15.6	4.0%	8.7%	19.9	6.4%	34.4%	**1.3x**
Equity Group	43.0	43.5	1.2%	24.8%	56.2	4.6%	33.8%	**2.1x**
HF Group	5.4	5.2	(4.4%)	(6.1%)	6.6	6.7%	33.7%	**0.2x**
Stanbic Bank Uganda	29.0	29.0	(0.1%)	(6.5%)	36.3	4.0%	29.2%	**2.1x**
Union Bank Plc	7.0	6.9	(2.1%)	22.3%	8.2	0.0%	19.0%	**0.7x**
Bank of Kigali	265.0	265.0	0.0%	(11.7%)	299.9	5.2%	18.4%	**1.5x**
SBM Holdings	6.0	6.0	0.0%	0.7%	6.6	5.0%	14.3%	**0.9x**
Barclays Bank	11.9	12.0	0.8%	9.1%	12.5	8.4%	13.0%	**1.6x**
Guaranty Trust Bank	35.4	37.5	5.9%	8.9%	37.1	6.4%	5.3%	**2.2x**
Bank of Baroda	130.0	130.0	0.0%	(7.1%)	130.6	1.9%	2.4%	**1.1x**
Stanbic Holdings	100.0	97.8	(2.3%)	7.7%	92.6	6.0%	0.7%	**1.0x**

Banks	Price as at 15/03/2019	Price as at 22/03/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
National Bank	5.0	5.0	(1.4%)	(7.0%)	4.9	0.0%	(1.0%)	**0.4x**
Standard Chartered	21.0	20.0	(4.8%)	(4.8%)	19.5	0.0%	(2.7%)	**2.6x**
Standard Chartered	197.5	217.3	10.0%	11.7%	196.3	5.8%	(3.9%)	**1.6x**
FBN Holdings	8.2	8.3	0.6%	3.8%	6.6	3.0%	(16.6%)	**0.5x**
Stanbic IBTC Holdings	48.1	45.5	(5.4%)	(5.1%)	37.0	1.3%	(17.4%)	**2.5x**
Ecobank Transnational	13.5	13.4	(0.7%)	(21.2%)	9.3	0.0%	(30.7%)	**0.5x**

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 "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.

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