Cytonn Weekly #15/2019

Equities

Market Performance:

During the week, the equities market was on an upward trend with NSE 20, NASI and NSE 25 gaining by 2.4%, 0.2%, and 1.3%, respectively, taking their YTD performance to gains of 2.9%, 12.4%, and 11.6%, for NSE 20, NASI and NSE 25, respectively. The performance in NASI was driven by gains in large-cap stocks such as EABL, Barclays Bank of Kenya and NIC Bank, which gained by 0.8%, 0.8% and 0.6%, respectively.

Equities turnover declined by 15.7% during the week to USD 23.2 mn, from USD 27.5 mn the previous week, taking the YTD turnover to USD 497.0 mn. Foreign investors were net sellers for the week, with the net selling position coming in at USD 2.5 mn, from last week's net buying position of USD 0.5 mn.

The market is currently trading at a price to earnings ratio (P/E) of 12.4x, 7.4% below the historical average of 13.4x, and a dividend yield of 4.7%, above the historical average of 3.8%. With the market trading at valuations below the historical average, we believe that there is still value in the market. The current P/E valuation of 12.4x is 27.7% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 49.3% 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

During the week, Standard Chartered (StanChart) Kenya launched an innovation hub lab in Nairobi dubbed Xcelerator. This is a bid to boost its revenue streams and diversify by riding on financial technology. StanChart plans to allocate Kshs 10.0 bn into supporting Financial Technology (FinTech) startups to scale up and generate innovative solutions to problems in the banking sector. StanChart views FinTech firms as partners amid their growing disruption of the local financial sector. The Nairobi hub will be run by the lender's business unit, SC Ventures Kenya, and will engage tech innovators with an eye on investing in viable FinTechs for product activation within home markets and across the world. In our view, FinTech companies are an attractive investment due to;

- High Returns - According to data collected by Crunchbase, since 2007, Fintech start-ups have raised an average of Kshs 4.1 bn (USD 41.0 mn) in Venture Capital and exited for an average value of Kshs 24.5 bn (USD 242.9 mn). This gives investors a better opportunity to invest in a sector that attracts a growing pool of new investors and in the end exit at a high price,
- Attractive Realization Periods - Many Fintech companies start showing profits by year three hence giving a chance for investors to realize their gains early, and,
- Cheaper Running Costs - They are cheaper to run since a FinTech company is not weighed down by the same burden of costly regulation that governs traditional businesses

Employees of Commercial Bank of Africa Group (CBA) are set to emerge with a 1.3% stake worth Kshs 870.0 mn in the merger between CBA Group and NIC Group. NIC, which currently has no

Employee Share Ownership Plan (ESOP), will create one to accommodate workers of CBA, which has an ESOP for the benefit of its employees that holds 2.5% of the shares of CBA. Besides CBA staff who are already entitled to shares under their current employer, the scheme is expected to admit more members including current NIC employees following the completion of the merger. NIC Group, which will remain listed on the Nairobi Securities Exchange (NSE), will be the vehicle to house the owner of the merged entity in which CBA shareholders will take a 53% stake. For existing employees of the privately-held CBA Group, the new scheme will give them an easier means of selling their shares on the stock market. Some of the benefits of ESOPs include:

i. It increases a company's competitiveness and attractiveness to employees, thus enabling them to attract and retain top talent. Especially for professional services firms, talent is the defining factor in competitiveness, hence employers must consider innovative and long-term ways of incentivizing their employees,
ii. ESOPs are also favored by small and medium-sized enterprises when developing an incentive, and, compensation structure, as they do not involve a direct cash outflow, like a bonus payment would, and,
iii. Employees are able to sell their shares on the market, usually at again, enabling them to benefit from capital appreciation when the company shares perform well.

Equity Bank Group’s share of Diaspora cash grew by 197.2% to Kshs 107.0 bn in 2018 from Kshs 36.0 bn in 2017. Diaspora banking earned the bank Kshs 751.0 mn in commissions charged for facilitating the cash transfers from abroad, in 2018, a 169.2% increase from Kshs 279.0 mn in 2017. The commission rate however declined by 0.1% points to 0.7% in 2018, from 0.8% in 2017. Diaspora remittances grew by 38.6% in 2018 to Kshs 272.0 bn from Kshs 196.3 bn in 2017, consolidating the position of Kenyans abroad as the country’s top foreign exchange earners ahead of tourism which earned, Kshs 157.4 bn in 2018, horticultural exports which earned Kshs 153.7 bn in 2018 and tea which eared Kshs 140.9 bn in 2018, according to the data from Central Bank of Kenya. The diaspora remittances data implies that Equity Bank handled 39.3% of the Diaspora remittances to Kenya. Despite this Equity Banks Non-Interest Income declined by 6.3% to Kshs 25.9 bn in 2018 from Kshs 27.6 bn in 2017 mainly attributed to a 16.6% decline in fees and commissions on loans to Kshs 4.9 bn in 2018 from Kshs 5.9 bn in 2017 and a 19.5% decline in FX trading income to Kshs 3.3 bn in 2018 from Kshs 4.1 bn in 2017. See the Equity Group FY’2018 Earnings Note.

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Kenyan banks have been excluded, as they are under review following the release of the FY’2018 results.

Banks	Price as at 5/04/2019	Price as at 12/04/2019	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
GCB Bank	3.9	4.0	0.8%	(13.7%)	4.6	7.7	9.6%	104.0%	**0.9x**	**Buy**
UBA Bank	6.2	6.5	4.8%	(15.6%)	7.7	10.7	13.1%	77.7%	**0.4x**	**Buy**
Zenith Bank	20.4	20.5	0.5%	(11.3%)	23.1	33.3	13.2%	76.1%	**0.9x**	**Buy**
Access Bank	5.7	6.0	4.4%	(12.5%)	6.8	9.5	6.7%	66.4%	**0.4x**	**Buy**
CRDB	125.0	125.0	0.0%	(16.7%)	150.0	207.7	0.0%	66.2%	**0.4x**	**Buy**
CAL Bank	1.1	1.0	(1.9%)	5.1%	1.0	1.4	0.0%	35.9%	**0.9x**	**Buy**
Ecobank	8.0	8.0	0.0%	7.1%	7.5	10.7	0.0%	33.6%	**1.8x**	**Buy**
Union Bank Plc	7.0	6.5	(7.1%)	16.1%	5.6	8.2	0.0%	25.4%	**0.7x**	**Accumulate**
SBM Holdings	6.0	5.9	(1.0%)	(1.0%)	6.0	6.6	5.1%	16.3%	**0.9x**	**Accumulate**

Banks	Price as at 5/04/2019	Price as at 12/04/2019	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
Bank of Kigali	275.0	275.0	0.0%	(8.3%)	300.0	299.9	5.0%	14.1%	**1.5x**	**Accumulate**
Guaranty Trust Bank	35.0	35.1	0.1%	1.7%	34.5	37.1	6.8%	12.7%	**2.2x**	**Accumulate**
Bank of Baroda	130.0	129.2	(0.6%)	(7.7%)	140.0	130.6	1.9%	3.0%	**1.1x**	**Lighten**
Stanbic Holdings	100.0	97.5	(2.5%)	7.4%	90.8	92.6	6.0%	1.0%	**1.0x**	**Lighten**
Standard Chartered	215.3	207.0	(3.8%)	6.4%	194.5	196.3	6.0%	0.9%	**1.7x**	**Lighten**
Standard Chartered	20.0	19.5	(2.5%)	(7.1%)	21.0	19.5	0.0%	(0.2%)	**2.5x**	**Sell**
FBN Holdings	7.4	7.5	2.0%	(5.7%)	8.0	6.6	3.3%	(8.3%)	**0.4x**	**Sell**
Ecobank Transnational	11.6	10.7	(7.8%)	(37.1%)	17.0	9.3	0.0%	(13.3%)	**0.4x**	**Sell**
Stanbic IBTC Holdings	46.3	46.0	(0.5%)	(4.1%)	48.0	37.0	1.3%	(18.3%)	**2.4x**	**Sell**

***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**
Kenyan banks are currently under review following the release of the FY'2018 results

We are "Positive" on equities since the sustained share price declines have 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.