



Kenya Listed Banks FY'2018 Report & Cytonn Weekly #16/2019

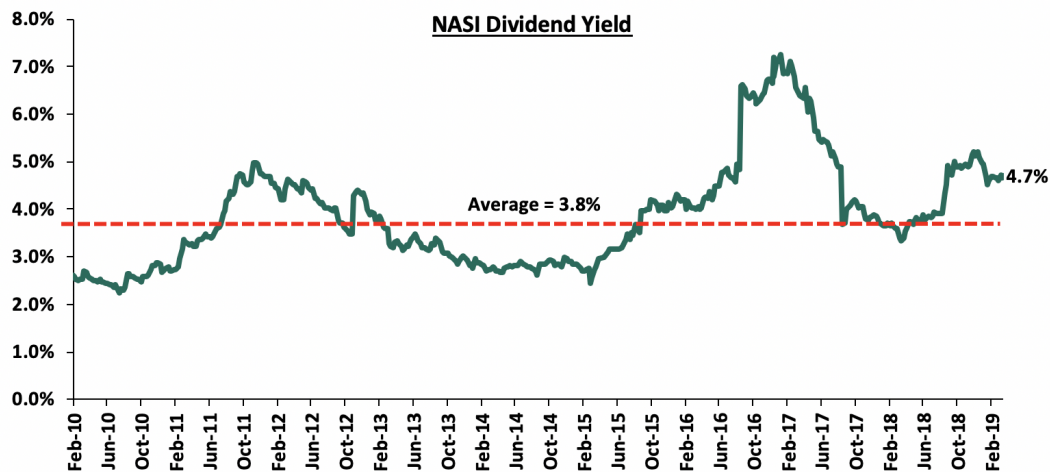
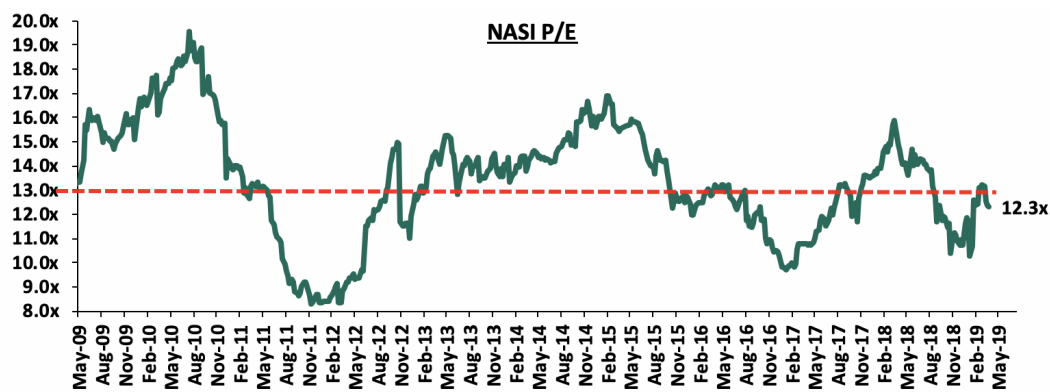
Equities

Market Performance:

During the week, the equities market recorded mixed performance with NSE 20 and NSE 25 declining by 1.5% and 0.2%, respectively, while NASI gained by 0.2%, taking their YTD performance to gains of 1.3%, 12.6% and 11.4%, for NSE 20, NASI and NSE 25, respectively. The performance of NASI was driven by gains in large cap stocks such as EABL, Safaricom and NIC Bank, which gained by 2.1%, 1.3% and 1.0%, respectively.

Equities turnover declined by 48.3% during the week to USD 12.0 mn, from USD 23.2 mn the previous week, taking the YTD turnover to USD 509.0 mn. Foreign investors were net sellers for the week, with the net selling position coming in at USD 0.9 mn, a 63.6% decline from last week's net selling position of USD 2.5 mn.

The market is currently trading at a price to earnings ratio (P/E) of 12.3x, 7.8% 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 12.3x is 27.1% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 48.6% 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

During the week, KCB Group announced its intention to acquire a 100% stake in the National Bank of Kenya (NBK). The transaction is in line with our expectation of increased consolidation in the Kenya banking sector, as players with depleted capital positions become acquired by their larger counterparts or merge together to form well capitalized entities capable of navigating the relatively tough operating environment induced by price controls on lending rates, and exacerbated by the stiff competition. The summary of the transaction is as below:

1. The offer will be by way of a share swap at a ratio of 10:1, 10 ordinary shares of NBK for 1 ordinary share of KCB, whose shares are currently trading at Kshs 4.7 and Kshs 45.0, respectively as at 18th April 2019,
2. NBK, which has both ordinary and preference shareholders, will have the preference shareholders convert their preference shares into new ordinary shares. The conversion ratio will be 1:1, i.e. 1 preference share for 1 ordinary share. With the number of preference shares at 1.13 bn, and the number of ordinary shares at 338.7 mn, this will imply a total of 1.47 bn ordinary shares post conversion, and a dilution of 77.0% to the ordinary shareholders of NBK,
3. Thus using the share swap ratio of 10:1, NBK's 1.47 bn ordinary shares will be swapped for 147.3 mn KCB shares,
4. KCB will thus have to issue an additional 147.3 mn ordinary shares to complete the share swap. This will increase KCB's total shares outstanding to 3.21 bn shares from the current 3.06 bn shares, and current shareholders will be diluted by 4.6%,
5. The implied transaction value will therefore be Kshs 6.6 bn, being the offer of 147.3 mn KCB shares at a price of Kshs 45.0, which was the market share price for KCB Group as at 18th April, 2019, and,
6. As at FY'2018, NBK had a book value of Kshs 7.0 bn. As such the transaction is being carried out at a price-to-book value (P/Bv) of 0.9x, which is a 35.7% discount to the current listed banks trading book value of 1.4x, and 38.6% below the historical average P/Bv of 1.5x for the Kenyan Bank Transactions in the last 5 years;

The table below indicates previous banking acquisition deals and their transaction multiples in the Kenyan banking industry;

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date
KCB Group	National Bank of Kenya	7.0	100.0%	6.6	0.9x	19-Apr*
CBA Group	Jamii Bora Bank	3.4	100.0%	1.4	0.4x	19-Jan*
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	1.0x	19-Jan
NIC Group	CBA Group	30.5**	47:53***	18.0	0.6x	19-Jan*
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	N/A	18-Dec
SBM Bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	N/A	18-Aug
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	0.8x	17-Mar
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	1.6x	16-Nov
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	1.4x	16-Jun
I&M Holdings	Giro Commercial Bank	3	100.0%	5	1.7x	16-Jun
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	2.3x	15-Mar
Centum	K-Rep Bank	2.1	66.0%	2.5	1.8x	14-Jul
GT Bank	Fina Bank Group	3.9	70.0%	8.6	3.2x	13-Nov
Average			78.3%		1.4x	

* **Announcement date**

** **Book Value as of the announcement date**

*** **Shareholder swap ratio between NIC and CBA, respectively**

From the table, we can see that Kenyan bank acquisition P/Bv average is at 1.4x, down from the previous 1.5x, as a result of the KCB-NBK Acquisition that was carried out at a lower P/Bv multiple. The average stake acquired is at 78.3%, up from 76.1%. Previously, transactions have taken place at a premium, (i) SBM and Fidelity at 57.0% above market, (ii) I&M Holdings and Giro at 30.8% above market, and (iii) M Bank and Oriental at 9.0% above market. Thus going forward, we expect acquisition transactions to take place at cheaper valuations. For NBK, the discount to the book value may be due to the bank's high Non-Performing Loans ratio of 47.6% as at FY'2018, and NBK's deteriorating top line revenue, with the bank's core lending activities constrained by its significantly low capitalization, with the banks total capital to risk weighted assets coming in at 3.7% as at FY'2018.

In our view, Kenya's banking sector consolidation will continue to happen and it will lead to a more stable, safer banking sector. Smaller banks constrained in capital, and struggling in their operations are likely to continue receiving take-over offers, which would present the best case scenario to navigate the current competitive banking sector landscape. Transactions are happening at significantly cheaper valuations, perhaps due to the smaller banks' relatively poor performance, leading to liquidity constraints, which may warrant even further capital injections, hence the cheaper acquisition costs. For more information on the Banking Sector Performance see our Cytonn FY'2018 Banking Sector Review.

Shareholders of NIC Group and CBA Group have approved the merger of the two banks in their

respective Annual General Meetings, which were held during the week. The approval paves the way for completion of the merger. The merger still needs approval from local and regional regulators including Bank of Tanzania, the Central Bank of Kenya, Capital Markets Authority and Competition Authority of Kenya. The banks expect that all the requisite approvals will be obtained by June, allowing shares of the merged entity to commence trading on the Nairobi Securities Exchange (NSE) on 17th July 2019. For more information on the merger please see our NIC Group and Commercial Bank of Africa (CBA) Merger Note.

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Banks	Price as at 12/04/2019	Price as at 18/04/2019	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
GCB Bank	4.0	4.0	(0.3%)	(13.9%)	4.6	7.7	9.6%	104.5%	0.9x	Buy
Diamond Trust Bank	130.0	130.0	0.0%	(16.9%)	156.5	241.5	2.0%	87.8%	0.7x	Buy
UBA Bank	6.5	6.7	2.3%	(13.6%)	7.7	10.7	12.8%	73.7%	0.4x	Buy
Zenith Bank	20.5	20.9	2.2%	(9.3%)	23.1	33.3	12.9%	72.3%	0.9x	Buy
CRDB	125.0	125.0	0.0%	(16.7%)	150.0	207.7	0.0%	66.2%	0.4x	Buy
I&M Holdings	113.0	112.8	(0.2%)	32.6%	85.0	167.7	3.1%	51.8%	1.1x	Buy
Access Bank	6.0	6.9	15.1%	0.7%	6.8	9.5	5.8%	44.5%	0.4x	Buy
Equity Group	42.5	41.9	(1.3%)	20.2%	34.9	58.1	4.8%	43.4%	2.0x	Buy
KCB Group***	44.8	45.0	0.4%	20.2%	37.5	60.0	7.8%	41.1%	1.4x	Buy
Co-operative Bank	14.7	14.2	(3.7%)	(1.0%)	14.3	18.5	7.1%	37.8%	1.3x	Buy
Ecobank	8.0	7.8	(2.5%)	4.0%	7.5	10.7	0.0%	37.6%	1.8x	Buy
CAL Bank	1.0	1.0	6.2%	5.1%	1.0	1.4	0.0%	35.9%	0.8x	Buy
NIC Group	36.5	36.8	1.0%	32.4%	27.8	48.8	2.7%	35.3%	1.0x	Buy
Stanbic Bank Uganda	30.0	29.0	(3.3%)	(6.5%)	31.0	36.3	4.0%	29.1%	2.1x	Buy
Stanbic Holdings	97.5	99.0	1.5%	9.1%	90.8	115.6	5.9%	22.7%	0.9x	Buy
Union Bank Plc	6.5	6.8	4.6%	21.4%	5.6	8.2	0.0%	19.9%	0.7x	Accumulate
Bank of Kigali	265.0	265.0	0.0%	(11.7%)	300.0	299.9	5.2%	18.4%	1.5x	Accumulate
Barclays Bank	12.1	12.0	(0.8%)	9.1%	11.0	13.1	8.4%	18.0%	1.6x	Accumulate
SBM Holdings	5.9	5.8	(1.4%)	(2.3%)	6.0	6.6	5.2%	17.9%	0.8x	Accumulate
Guaranty Trust Bank	35.1	34.8	(0.7%)	1.0%	34.5	37.1	6.9%	13.5%	2.2x	Accumulate
National Bank	4.7	4.7	(0.2%)	(11.5%)	5.3	5.2	0.0%	10.4%	0.3x	Accumulate
Standard Chartered(K)	207.0	206.0	(0.5%)	5.9%	194.5	203.8	6.1%	5.0%	1.7x	Hold
Standard Chartered(G)	19.5	19.0	(2.6%)	(9.5%)	21.0	19.5	0.0%	2.4%	2.4x	Lighten
Bank of Baroda	129.2	130.0	0.6%	(7.1%)	140.0	130.6	1.9%	2.4%	1.1x	Lighten
FBN Holdings	7.5	7.7	2.0%	(3.8%)	8.0	6.6	3.3%	(10.1%)	0.4x	Sell
Ecobank Transnational	10.7	10.8	0.5%	(36.8%)	17.0	9.3	0.0%	(13.7%)	0.4x	Sell

Banks	Price as at 12/04/2019	Price as at 18/04/2019	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
Stanbic IBTC Holdings	46.0	46.2	0.4%	(3.6%)	48.0	37.0	1.3%	(18.6%)	2.4x	Sell
HF Group	4.6	4.4	(6.0%)	(21.5%)	5.5	2.9	8.0%	(25.3%)	0.2x	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*

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.

Liason House, StateHouse Avenue

The Chancery, Valley Road

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