

Cytonn H1'2019 Markets Review

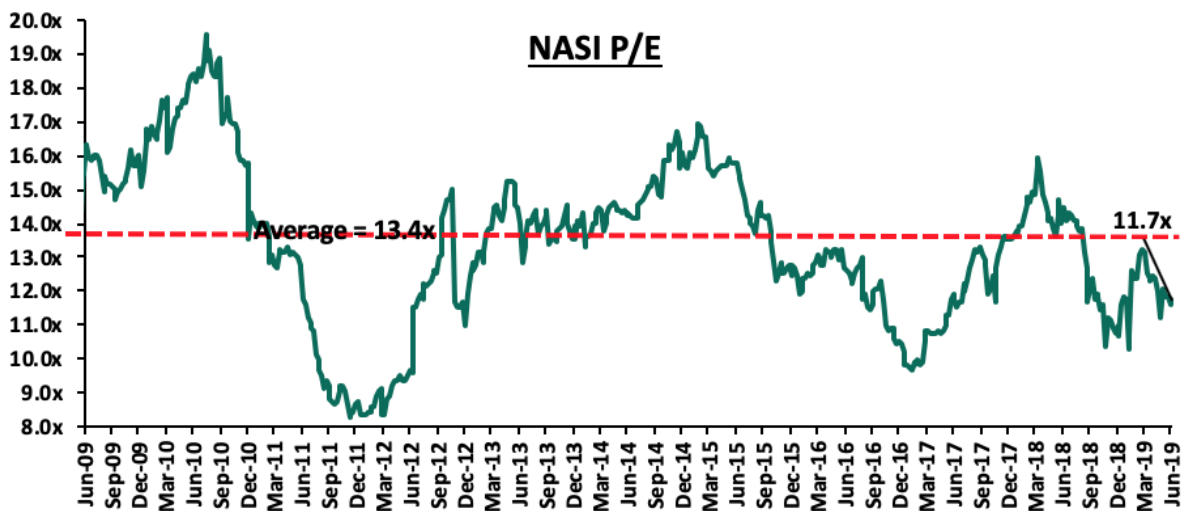
Equities

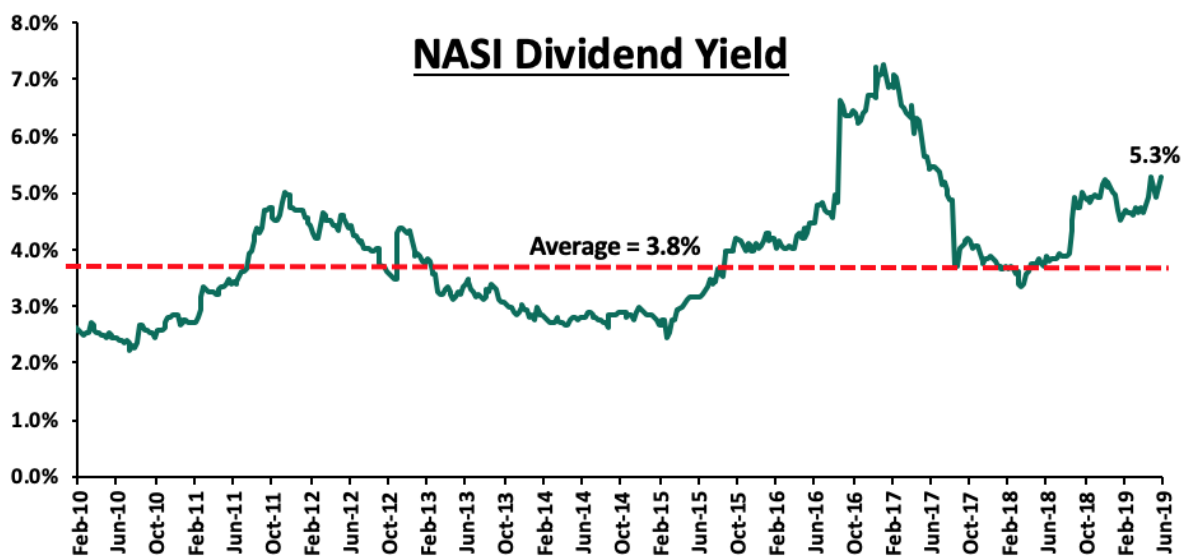
Market Performance:

The Kenyan equities market had an upward trend in the first quarter of 2019 gaining by 12.2% and declined in the second quarter of 2019 by 5.9%, bringing the half year gains for NASI and NSE 25 to 5.6% and 0.6%, respectively, and a decline for NSE 20 by 6.5%. The decline in market performance during the second quarter was as a result of declines in large cap stocks such as Co-operative Bank, NIC Group, KCB and Bamburi which gained by 19.7%, 13.6%, 13.2% and 12.9%, respectively.

During the week, the equities market was on an upward trend with NASI, NSE 25 and NSE 20 gaining by 0.7%, 0.4% and 0.1%, respectively, due to gains in large cap stocks such as NIC, Safaricom and EABL, which gained by 3.0%, 2.8% and 2.1%, respectively. For the last twelve months (LTM), NASI, NSE 25 and NSE 20 have declined by 14.9%, 19.8% and 19.3%, respectively.

Equity turnover declined by 29.7% to Kshs 773.7 mn in H1'2019, from USD 1.1 bn in H1'2018. The market is currently trading at a price to earnings ratio (P/E) of 11.7x, 12.7% below the historical average of 13.4x. The market has a dividend yield of 5.3%, above the historical average of 3.8%.





During the first half of 2019, banks released their FY'2018 and Q1'2019 results, recording earnings growth of 13.8% and 12.2% in their core EPS in FY'2018 and Q1'2019, respectively. The growth in core EPS in FY'2018 is attributable to a 2.6% growth in Net Interest Income (NII), coupled with 3.8% growth in NFI. Non-Funded income total income proportion decline to 33.2% from 33.6% in FY'2018.

Listed Banks Q1'2019 results:

Kenyan listed banks released their Q1'2019 results, recording a 12.2% growth in core EPS compared to a growth of 14.4% in Q1'2018. The performance for Kenyan listed banks in Q1'2019 is summarized below:

| Bank | Core EPS growth | Interest Income Growth | Interest Expense Growth | Cost of funds | Net interest income growth | Net Interest Margin | Non-Funded Income Growth | NFI to Total Operating Income | Growth in Total Fees & Commissions | Deposit Growth | Loan Growth | Growth in Govt Securities |
|--|-----------------|------------------------|-------------------------|---------------|----------------------------|---------------------|--------------------------|-------------------------------|------------------------------------|----------------|-------------|---------------------------|
| SCBK | 31.2% | (6.4%) | (28.8%) | 3.4% | 2.8% | 7.8% | 5.6% | 32.4% | (10.0%) | 0.3% | 3.3% | 13.9% |
| I&M | 30.5% | 8.9% | 18.2% | 5.0% | 2.1% | 6.1% | 9.7% | 38.2% | 4.0% | 28.8% | 10.6% | 8.2% |
| Barclays | 13.8% | 7.1% | 38.8% | 3.6% | (1.3%) | 8.7% | 14.0% | 32.2% | 11.6% | 15.9% | 9.0% | 24.0% |
| KCB Group | 11.4% | 7.1% | (4.1%) | 3.1% | 11.2% | 8.5% | 9.2% | 32.3% | 11.6% | 11.2% | 10.9% | 18.9% |
| DTBK | 9.3% | (5.1%) | (3.0%) | 5.0% | (6.6%) | 6.2% | 15.3% | 25.3% | (7.4%) | 1.3% | (2.9%) | 5.3% |
| Equity | 4.9% | 6.5% | 7.4% | 2.6% | 6.3% | 8.6% | 6.9% | 40.8% | 3.2% | 12.1% | 12.7% | 13.0% |
| Co-op | 4.4% | (2.9%) | 6.2% | 3.7% | (6.5%) | 8.7% | 19.1% | 37.7% | 33.6% | 7.4% | (0.5%) | 33.1% |
| NIC | (4.3%) | 1.3% | (7.9%) | 5.1% | 9.4% | 5.9% | 7.2% | 29.1% | 6.2% | 5.0% | 2.1% | 10.3% |
| NBK | N/A | 18.7% | (17.8%) | 3.3% | 41.7% | 8.2% | (9.2%) | 22.5% | (10.8%) | 2.6% | (10.2%) | 15.1% |
| Stanbic Bank | N/A | 12.9% | 2.2% | 3.2% | 19.3% | 4.9% | 17.7% | 49.0% | 61.5% | 29.0% | 12.6% | (8.8%) |
| HF | N/A | (16.2%) | (8.3%) | 7.4% | (26.7%) | 4.1% | (8.8%) | 33.6% | 79.7% | (5.3%) | (13.9%) | 45.1% |
| Q1' 2019 Weighted Average | 12.2% | 3.6% | 2.5% | 3.4% | 4.5% | 8.0% | 10.7% | 36.0% | 11.2% | 11.0% | 7.7% | 16.1% |
| Q1' 2018 Mkt Cap Weighted Average | 14.4% | 9.3% | 11.4% | 3.6% | 8.1% | 8.1% | 9.5% | 37.1% | 12.2% | 9.4% | 6.1% | 25.0% |

Key takeaways from the table above include:

- The Listed Banks recorded a 12.2% average increase in core Earnings Per Share (EPS), compared to a growth of 14.4% in Q1'2018, with the relatively lower performance attributed to the base

effect, as the sector was coming from a relatively poor performance in Q1'2017;

- Deposit growth came in at 11.0%, faster than the 9.4% growth recorded in Q1'2018. Despite the relatively fast deposit growth, interest expenses rose by 2.5% compared to 11.4% in Q1'2018 indicating that banks have been mobilizing relatively cheaper deposits;
- Average loan growth came in at 7.7%, which was faster than the 6.1% recorded in Q1'2018, indicating that there was improvement in credit extension, with banks targeting select segments such as corporate entities, and small and medium enterprises (SMEs). Government securities on the other hand recorded a growth of 16.1% y/y, which outpaced loan growth, albeit slower than the 25.0% recorded in Q1'2018. This highlights banks' continued preference towards investing in government securities, which offer better risk-adjusted returns. Interest income increased by 3.6%, compared to a growth of 9.3% recorded in Q1'2018. The slower growth in interest income despite the increased allocations to both loans and government securities may be attributable to the decline in yields on loans owing to the 100-bps decline in the CBR, and the decline in yields on government securities, and consequently, the Net Interest Margin (NIM) declined to 8.0% from 8.1% in Q1'2018; and,
- Non-Funded Income grew by 10.7% y/y, faster than the 9.5% recorded in Q1'2018. The growth in NFI was supported by the 11.2% average increase in total fee and commission income, albeit slower than the 12.2% growth recorded in Q1'2018. The fee and commission income growth continues to be subdued by the implementation of the Effective Interest Rate (EIR) model under IFRS 9 in 2018, which requires banks to amortize the fees and commissions on loans, over the tenor of the loan. The relatively slower loan growth, a majority of which is to corporates, also inhibited the growth in fee and commission income loans, as corporates tend to be charged relatively lower commission rates.

Half-Year Highlights:

During the first half of 2019:

- Consolidation in the Banking sector has continued in the first half of 2019, with the following table summarizing the deals that have either happened or have been announced and expected to be concluded:

| Acquirer | Bank Acquirer | Book value at Acquisition (Kshs bns) | Transaction Stake | Transaction Value (Kshs bns) | P/Bv Multiple | Date |
|-------------------|----------------------------|--------------------------------------|-------------------|------------------------------|---------------|---------|
| KCB Group | National Bank of Kenya | 7 | 100.00% | 6.6 | 0.9x | 19-Apr* |
| CBA Group | Jamii Bora Bank | 3.4 | 100.00% | 1.4 | 0.4x | 19-Jan* |
| AfricInvest Azure | Prime Bank | 21.2 | 24.20% | 5.1 | 1.0x | 19-Jan |
| NIC Group | CBA Group | 30.5** | 47:53*** | 18 | 0.6x | 19-Jan* |
| KCB Group | Imperial Bank | Unknown | Undisclosed | Undisclosed | N/A | 18-Dec |
| SBM Bank Kenya | Chase Bank Ltd | Unknown | 75.00% | Undisclosed | N/A | 18-Aug |
| DTBK | Habib Bank Kenya | 2.4 | 100.00% | 1.8 | 0.8x | 17-Mar |
| SBM Holdings | Fidelity Commercial Bank | 1.8 | 100.00% | 2.8 | 1.6x | 16-Nov |
| M Bank | Oriental Commercial Bank | 1.8 | 51.00% | 1.3 | 1.4x | 16-Jun |
| I&M Holdings | Giro Commercial Bank | 3 | 100.00% | 5 | 1.7x | 16-Jun |
| Mwalimu SACCO | Equatorial Commercial Bank | 1.2 | 75.00% | 2.6 | 2.3x | 15-Mar |
| Centum | K-Rep Bank | 2.1 | 66.00% | 2.5 | 1.8x | 14-Jul |

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|----------------|-----------------|--------------------------------------|-------------------|------------------------------|---------------|--------|
| GT Bank | Fina Bank Group | 3.9 | 70.00% | 8.6 | 3.2x | 13-Nov |
| Average | | | 78.30% | | 1.4x | |

* **Announcement date**

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

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

**** **KCB acquired certain assets and liabilities of Imperial Bank, hence Imperial Bank remains in existence**

We expect more consolidation in the banking sector, as the relatively weaker banks that probably do not serve a niche become acquired by larger counterparts. For more information, see our Consolidation in Kenya's Banking Sector Note.

- ii. Equity Group opened a commercial representative office in Addis Ababa, Ethiopia, which is expected to commence operations in July. This is line with the bank's strategy to expand into 10 African countries within the year, with Ethiopian market being the first phase of regional expansion drive to attain Pan African status. The venture will affirm the bank's position as the biggest bank in Kenya by customers. Kenyan banks have been expanding their operations in neighbouring countries in search for growth, to diversify their earnings as completion intensifies in the local market, as margins remains compressed under the current interest cap regime. For more information, see our *Cytonn Weekly#24/2019*.
- iii. The Central Bank of Kenya (CBK), in conjunction with five commercial banks (NIC Group, KCB Group, Diamond Trust Bank Kenya (DTBK), Co-operative Bank Kenya and Commercial Bank of Africa (CBA)), have come up with a mobile loan facility dubbed "Stawi". The facility targeting Micro Small and Medium Enterprises (MSMEs) who don't have access to formal credit because of their informal nature of businesses and lack of collateral. For more information, see our *Cytonn Weekly #21/2019*.
- iv. The Capital Markets Authority (CMA) released The Report on the State of Corporate Governance of Issuers of Securities to the Public in Kenya. The finding suggest a "Fair" status of 55.0% weighted overall score in the application of corporate governance practices by Kenyan issuers of securities to the public. The report analysed 62 listed companies and 5 issuers of corporate bonds. For more information, see our *Cytonn Weekly #12/2019*.

Equities Universe of Coverage:

Below is a summary of our SSA universe of coverage:

| Banks | Price as at 21/06/2019 | Price as at 28/06/2019 | w/w change | YTD Change | Target Price | Dividend Yield | Upside/Downside | P/TBv Multiple | Recommendation |
|--------------------|------------------------|------------------------|------------|------------|--------------|----------------|-----------------|----------------|----------------|
| Diamond Trust Bank | 116.0 | 117.8 | 1.5% | (24.8%) | 228.4 | 2.2% | 99.1% | 0.6x | Buy |
| Zenith Bank | 20.0 | 19.8 | (1.0%) | (14.1%) | 33.3 | 13.6% | 80.2% | 0.9x | Buy |
| UBA Bank | 6.4 | 6.2 | (3.6%) | (19.5%) | 10.7 | 13.7% | 80.1% | 0.4x | Buy |
| CRDB | 120.0 | 110.0 | (8.3%) | (26.7%) | 207.7 | 0.0% | 73.1% | 0.4x | Buy |
| KCB Group | 39.0 | 38.3 | (1.9%) | 2.1% | 60.4 | 9.2% | 64.1% | 1.0x | Buy |
| GCB Bank | 5.0 | 4.9 | (1.4%) | 7.2% | 7.7 | 7.7% | 62.1% | 1.2x | Buy |
| I&M Holdings | 54.3 | 55.0 | 1.4% | 29.4% | 81.5 | 6.4% | 56.6% | 1.0x | Buy |
| CAL Bank | 0.9 | 1.0 | 7.5% | 2.0% | 1.4 | 0.0% | 50.5% | 0.8x | Buy |
| Co-operative Bank | 12.1 | 12.0 | (0.8%) | (16.1%) | 17.1 | 8.3% | 49.3% | 1.0x | Buy |
| Access Bank | 6.9 | 6.5 | (5.4%) | (4.4%) | 9.5 | 6.2% | 44.4% | 0.4x | Buy |
| NIC Group | 30.5 | 30.6 | 0.3% | 10.1% | 42.5 | 3.3% | 42.6% | 0.6x | Buy |
| Equity Group | 39.3 | 39.0 | (0.8%) | 11.8% | 53.7 | 5.1% | 41.8% | 1.7x | Buy |
| Ecobank | 7.8 | 9.0 | 15.1% | 20.0% | 10.7 | 0.0% | 37.2% | 2.0x | Buy |
| Barclays Bank | 10.4 | 10.5 | 0.5% | (4.6%) | 12.8 | 10.5% | 33.5% | 1.3x | Buy |

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|-----------------------|------------------------|------------------------|------------|------------|--------------|----------------|-----------------|----------------|----------------|
| Guaranty Trust Bank | 31.2 | 32.9 | 5.3% | (4.5%) | 37.1 | 7.3% | 26.1% | 2.1x | Buy |
| Stanbic Bank Uganda | 30.0 | 29.0 | (3.3%) | (6.5%) | 36.3 | 4.0% | 24.9% | 2.1x | Buy |
| SBM Holdings | 5.7 | 5.6 | (2.1%) | (6.4%) | 6.6 | 5.4% | 20.5% | 0.8x | Buy |
| Stanbic Holdings | 100.0 | 99.0 | (1.0%) | 9.1% | 113.6 | 5.9% | 19.5% | 1.1x | Accumulate |
| Union Bank Plc | 7.0 | 7.0 | 0.7% | 25.0% | 8.2 | 0.0% | 17.3% | 0.7x | Accumulate |
| Bank of Kigali | 275.0 | 290.0 | 5.5% | (3.3%) | 299.9 | 4.8% | 13.8% | 1.6x | Accumulate |
| Standard Chartered | 192.0 | 194.5 | 1.3% | 0.0% | 200.6 | 6.4% | 10.9% | 1.4x | Accumulate |
| Bank of Baroda | 129.0 | 128.7 | (0.2%) | (8.1%) | 130.6 | 1.9% | 3.2% | 1.1x | Lighten |
| FBN Holdings | 7.0 | 6.6 | (5.9%) | (17.6%) | 6.6 | 3.8% | (0.9%) | 0.4x | Sell |
| National Bank | 4.0 | 4.1 | 3.5% | (22.2%) | 3.9 | 0.0% | (1.4%) | 0.2x | Sell |
| Standard Chartered | 20.5 | 19.0 | (7.2%) | (9.4%) | 19.5 | 0.0% | (5.1%) | 2.4x | Sell |
| Stanbic IBTC Holdings | 39.9 | 40.3 | 0.9% | (16.1%) | 37.0 | 1.5% | (5.8%) | 2.1x | Sell |
| Ecobank Transnational | 11.4 | 11.0 | (3.1%) | (35.3%) | 9.3 | 0.0% | (18.2%) | 0.4x | Sell |
| HF Group | 4.3 | 4.0 | (5.6%) | (27.6%) | 2.9 | 0.0% | (31.8%) | 0.2x | Sell |

**Target price is adjusted for Dividend Yield*

***Upside/(Downside) is adjusted for Dividend yield*

****Banks in which Cytonn and/or its affiliates are invested in*

*****Share prices in respective country local currency*

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 possible increased inflows from foreign investors, as they take advantage of the attractive valuations to support the positive performance.

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