Personal Financial Planning, & Cytonn Weekly #32/2019

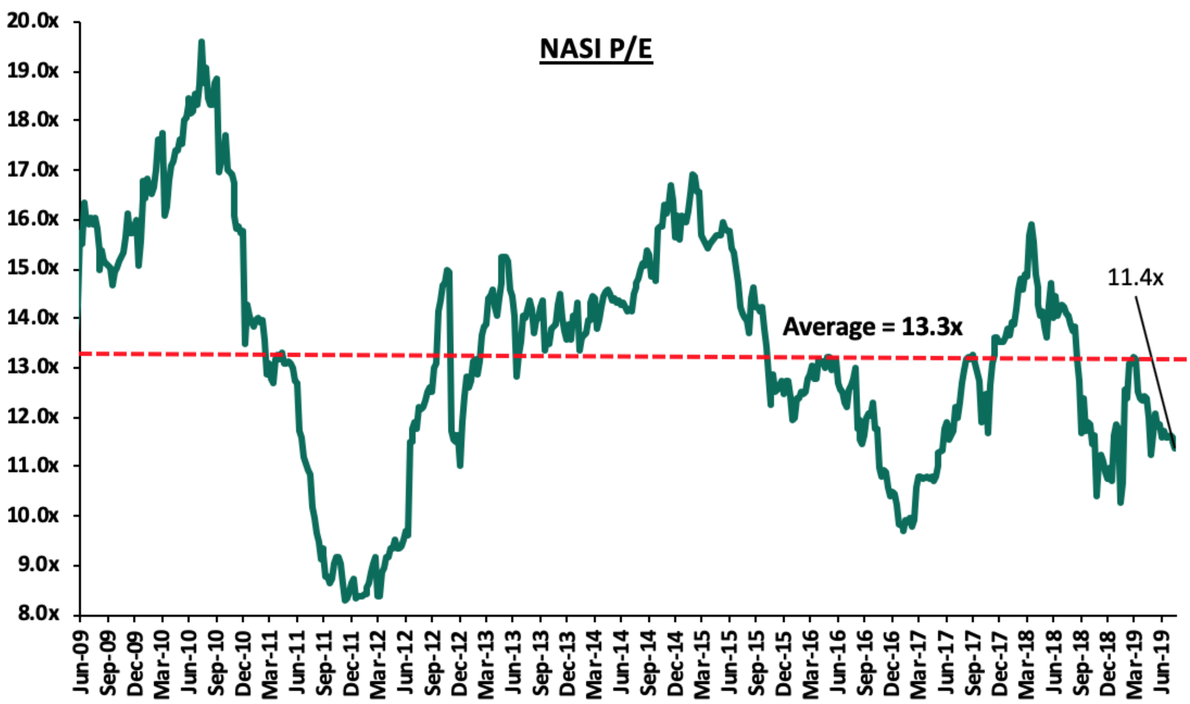
Equities

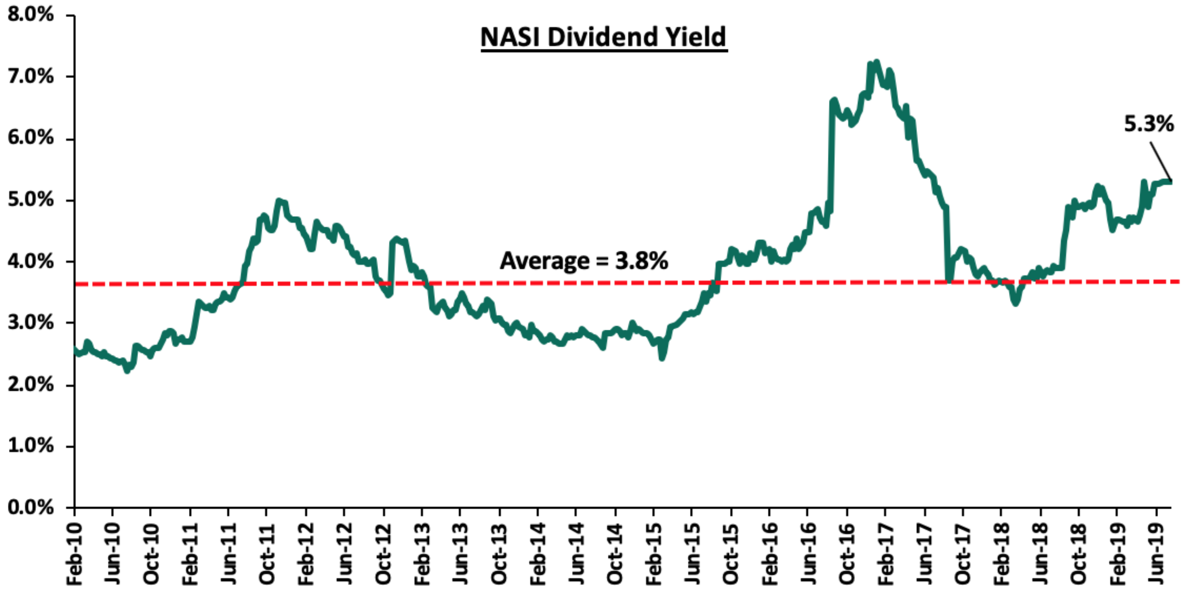
Market Performance

During the week, the equities market was on an downward trend with NASI, NSE 20 and NSE 25 falling by 0.8%, 1.2% and 0.6%, respectively, taking their YTD performance to gains/losses of 4.7%, (9.8%) and 0.3%, for NASI, NSE 20 and NSE 25, respectively. The performance in NASI was driven by declines in Diamond Trust Bank, NIC Group, KCB Group, and Standard Chartered, which declined by 1.8%, 1.0%, 0.7%, and 0.4%, respectively.

Equities turnover decreased by 74.7% during the week to USD 5.4 mn, from USD 21.3 mn the previous week, taking the YTD turnover to USD 888.2 mn. Foreign investors remained net sellers for the week, with a net selling position of USD 1.8 mn, from a net buying position of USD 2.1 mn the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 11.4x, 14.7% below the historical average of 13.3x, and a dividend yield of 5.3%, 1.5% points 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 11.4x is 17.5% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 37.3% 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.





Earnings Releases

Stanbic Bank released their H1'2019 financial results, recording a 14.4% increase in core earnings per share to Kshs 10.3, from Kshs 9.0 in H1'2018, driven by a 14.8% increase in total operating income, despite the 21.6% increase in total operating expenses. Highlights of the performance from H1'2018 to H1'2019 include:

- Total operating income increased by 14.8% to Kshs 12.8 bn in H1'2019, from Kshs 11.2 bn in H1'2018. This was driven by a 19.5% increase in Net Interest Income (NII) to Kshs 6.7 bn, from Kshs 5.6 bn in H1'2018, coupled with a 10.1% increase in Non-Funded Income (NFI) to Kshs 6.1 bn, from Kshs 5.6 bn in H1'2018,
- Interest income increased by 10.5% to 10.1 bn, from 9.1 bn recorded in H1'2018, driven by the 12.9% increase in interest income from loans and advances to Kshs 7.6 bn, from Kshs 6.7 bn in H1'2018, coupled with the 64.5% increase in interest income from deposit placements to Kshs 147.2 mn, from Kshs 89.5 mn in H1'2018, and the 1.4% increase in interest income from government securities to Kshs 2.32 bn, from Kshs 2.28 bn in H1'2018. The yield on interest earning assets however declined to 7.9%, from 8.4% in H1'2018, owing to the decline in yield on loans as a result of the 50 bps decline of the Central Bank Rate (CBR) from 9.5% to 9.0% in Q2'2018 as well as the decline in yields on government securities,
- Interest expense increased by 5.2% to 3.7 bn, from 3.5 bn in H1'2018, caused by the 11.6% increase in interest expense from customer deposits to Kshs 2.5 bn, from Kshs 2.2 bn in H1'2018, coupled with the 31.6% increase in other interest expenses to Kshs 0.4 bn, from Kshs 0.3 bn in H1'2018, and offset slightly by the 17.8% decline in interest expenses on placement liabilities to Kshs 0.8 bn, from Kshs 1.0 bn. Cost of funds declined marginally to 3.0%, from 3.1% in H1'2018, as a result of a decline in deposits costs after the removal of the 70.0% of the CBR minimum interest payable on deposits in the Finance Act 2018, as interest bearing liabilities increased faster by 12.3% to Kshs 254.7 bn, from Kshs 226.8 bn in H1'2018.The Net Interest Margin (NIM) rose marginally to 5.1%, from 4.9% in H1'2018,
- Non-Funded Income (NFI) increased by 10.1% to Kshs 6.1 bn, from Kshs 5.6 bn in H1'2018, mainly driven by a 53.2% increase in fees and commissions on loans to Kshs 0.2 bn, from Kshs 0.1 bn in H1'2018, coupled with a 37.5% increase in other fees and commissions to Kshs 2.5 bn, from Kshs 1.8 bn in H1'2018, and a 59.4% increase in Forex trading gains to Kshs 2.7 bn, from Kshs 1.7 bn in H1'2018. The increase in NFI was however weighed down by the 76.7% decline in other income to Kshs 0.4 bn, from Kshs 1.6 bn in H1'2018,
- Total operating expenses increased by 21.6% to Kshs 7.3 bn, from Kshs 6.0 bn, largely driven by a 387.6% increase in Loan Loss Provisions (LLP) to Kshs 1.2 bn in H1'2019, from Kshs 0.3 bn in

H1’2018, and a 3.2% increase in staff costs to Kshs 2.9 bn, from Kshs 2.8 bn, in H1’2018,
- The cost to income ratio thus deteriorated to 56.7%, from 53.5% in H1’2018 as a result of the faster growth in operating expenses Without LLP, the Cost to income ratio improved to 47.1% from 51.3% in H1’2018, highlighting the increase in cost of risk to 9.6%, from 2.3% in H1’2018,
- Profit before tax increased by 7.1% to Kshs 5.6 bn, up from Kshs 5.2 bn in H1’2018. Profit after tax increased 14.4% to Kshs 4.1 bn in H1’2019, from Kshs 3.6 bn in H1’2018, highlighting the decline in the effective tax rate to 26.9%, from 31.6% in H1’2018, and,
- The bank declared an interim dividend of Kshs 1.25, a 45.7% decline from the Kshs 2.3 interim dividend declared in H1’2018. Assuming a similar final dividend payout of Kshs 3.6, it translates to a dividend yield of 4.8%.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 12.4% to Kshs 313.3 bn, from Kshs 278.8 bn in H1’2018. This growth was largely driven by a 15.0% increase in net loans and advances to Kshs 177.1 bn, from Kshs 154.0 bn in H1’2018, coupled with an 8.1% increase in investment securities to Kshs 94.1 bn, from Kshs 87.0 bn in H1’2018,
- Total liabilities rose by 12.6% to Kshs 266.5 bn, from Kshs 236.6 bn in H1’2018, driven by a 10.3% increase in total deposits to Kshs 238.0 bn, from Kshs 215.8 bn in H1’2018, coupled with the 30.6% increase in borrowings to Kshs 9.2 bn, from Kshs 7.0 bn in H1’2018,
- Deposits per branch increased by 10.3% to Kshs 9.2 bn, from Kshs 8.3 bn in H1’2018, as the number of branches remained unchanged at 26,
- The faster growth in loans as compared to deposits led to an increase in the loan to deposit ratio to 74.4%, from 71.4% in H1’2018,
- Gross Non Performing Loans (NPLs) increased by 69.7% to Kshs 17.9 bn from Kshs 10.6 bn recorded in H1’2018, and consequently the Gross NPL ratio rose to 9.6%, from 6.6% in H1’2018. General provisions rose by 100.7% to Kshs 6.5 bn, from Kshs 3.3 bn in H1’2018. As a result, the NPL Coverage increased by 11.5% points to 57.5%, from 51.5% in H1’2018,
- Shareholders’ funds increased by 10.9% to Kshs 46.8 bn in H1’2019, from Kshs 42.2 bn in H1’2018, driven by the 19.8% increase in revenue and other reserves to Kshs 28.0 bn, from Kshs 23.3 bn in H1’2018,
- Stanbic Bank remains sufficiently capitalized with a core capital to risk weighted assets ratio of 14.2%, 3.7% points above the statutory requirement of 10.5%. In addition, the total capital to risk weighted assets ratio stood at 17.5%, exceeding the statutory requirement by 3.0% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 15.3%, while total capital to risk weighted assets came in at 18.6%, and,
- Stanbic Holdings currently has a return on average assets of 2.3% and a return on average equity of 15.3%.

Key Take-Outs:

- The bank recorded a relatively strong performance in both funded and NFI segments. The bank’s aggressive lending has led to increased interest income, as well as the associated fees and commissions. The increased lending has however, come at a cost as asset quality deteriorated, as shown by the rise in the NPL ratio to 9.6%, from 6.6% in H1’2018. Consequently, impairment costs rose by 387.6%, which saw the cost of risk rise to 9.6% from 2.3% in H1’2018.

For more information, please see our Stanbic Holdings Earnings Note.

Weekly Highlights

During the week, the Finance and National Planning Committee voted to halt the planned acquisition of National Bank of Kenya (NBK) by KCB Group, on grounds that the offer undervalues the lender. The report of the committee, which was tabled in the National Assembly will, however, require the approval of the National Assembly. As an alternative, the committee has recommended that NBK's principal shareholders - the National Social Security Fund (NSSF) and the National Treasury, who hold 48.1% and 22.5% of the ordinary shares of NBK, respectively, reject KCB's offer to acquire 100.0% shareholding. The committee wants the Treasury to seek alternative means to fund the lender in order to ensure that the bank is compliant with capital adequacy requirements as stipulated in the Banking Act. However, the Treasury continues to back the proposed buyout by KCB Group, and warned that should the proposed takeover by KCB fail, NBK is likely to collapse and this may lead to a systemic shock in the banking sector. This is because the principal shareholders have previously failed to honour their obligations following their failure to follow through plans of raising cash through a rights issue in 2013, and thus the acquisition presents the most likely certain option of recapitalization. Further, the committee is of the opinion that of the two lenders, NBK is the stronger bank with 70 branches across the country compared to KCB Group with 257 branches, which is inaccurate as fewer branches does not imply a bank is stronger. KCB Group is also sufficiently capitalized with a total capital to risk weighted assets ratio of 20.0%, which is 5.5% points above the regulatory requirement of 14.5%, compared to NBK, which has a total capital to risk-weighted assets ratio of 3.8%, which is 10.7% points below the minimum requirement of 14.5%.

We are of the view that the acquisition would present NBK with the opportunity to recapitalize and grow, as under the current undercapitalized conditions, the bank is constrained from deposit mobilization and lending. This is in line with our expectation of additional consolidation in the banking sector, as highlighted in our topical Consolidation in Kenya's Banking Sector to Continue .

Universe of Coverage

Below is a summary of our SSA universe of coverage:

Banks	Price as at 02/08/2019	Price as at 09/08/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/ Downside	P/TBv Multiple	Recommendation
Diamond Trust Bank	114	112	(1.8%)	(28.4%)	228.4	2.3%	96.3%	0.6x	Buy
CRDB	100.0	100.0	0.0%	(33.3%)	207.7	0.0%	88.8%	0.3x	Buy
UBA Bank	5.9	5.7	(4.2%)	(26.6%)	10.7	15.0%	87.6%	0.4x	Buy
Zenith Bank	18.4	16.8	(8.4%)	(27.1%)	33.3	16.1%	84.4%	0.7x	Buy
KCB Group***	40.0	39.7	(0.7%)	6.0%	60.4	8.8%	66.8%	1.1x	Buy
GCB Bank	5.0	5.0	0.6%	9.3%	7.7	7.6%	64.1%	1.2x	Buy
I&M Holdings	52.0	53.0	1.9%	24.7%	81.5	6.6%	54.8%	1.0x	Buy
Access Bank	6.2	6.2	0.0%	(8.8%)	9.5	6.5%	52.6%	0.4x	Buy
Co-operative Bank	12.0	12.1	0.8%	(15.7%)	17.1	8.3%	50.4%	1.0x	Buy
Equity Group	40.3	40.5	0.6%	16.2%	53.7	4.9%	42.7%	1.7x	Buy
NIC Group	29.3	29.0	(0.9%)	4.3%	42.5	3.4%	42.3%	0.6x	Buy
CAL Bank	1.0	1.0	0.0%	1.0%	1.4	0.0%	40.0%	0.8x	Buy
Barclays Bank***	10.7	10.8	0.5%	(1.8%)	12.8	10.2%	32.7%	1.3x	Buy
Stanbic Bank Uganda	29.0	29.0	0.0%	(6.5%)	36.3	4.0%	29.1%	2.1x	Buy
SBM Holdings	5.5	5.5	(0.4%)	(8.1%)	6.6	5.5%	23.0%	0.8x	Buy
Guaranty Trust Bank	27.9	26.8	(3.9%)	(22.2%)	37.1	9.0%	21.7%	1.7x	Buy
Stanbic Holdings	98.5	100.0	1.5%	10.2%	113.6	5.9%	20.6%	1.1x	Buy
Ecobank	8.5	8.5	0.0%	13.3%	10.7	0.0%	19.2%	1.9x	Accumulate
Union Bank Plc	7.0	6.8	(2.9%)	21.4%	8.2	0.0%	16.4%	0.7x	Accumulate