Kenyan Banking Sector, & Cytonn Weekly Report #14

Cytonn Weekly

Executive Summary

- **Fixed Income:** Yields on government securities declined for the eighth consecutive week. The Kenyan Government began an international bond roadshow with prospects of issuing another Eurobond;
- **Equities:** The market performance was mixed during the week, with NASI and NSE 25 declining 0.4% and 0.3%, respectively, while NSE 20 gained 0.1%. During the week, the Communications Authority of Kenya released their report for the quarter ended December 2015, while KCB and Longhorn plan for rights issues to shore up capital and expand regionally, respectively;
- **Private Equity:** Geothermal investment attracting additional capital, with prospecting in Olkaria, Naivasha, to establish the first private sector greenfield geothermal development in Sub Saharan Africa;
- **Real Estate:** Developers continue venturing into the low to middle income areas such as Ruiru in a bid to bridge the large housing deficit, while the industrial real estate sector picks up boosted by government support and decentralization;
- **Focus of the Week:** With the release of FY?2015 results by banks, and following the closure of Chase bank, we examine the state of the banking sector in Kenya and the measures taken by the CBK thus far.

Company Updates

- This week we signed a contract to partner with China National Aero Technology International Engineering Corporation (CATIC). The Kshs 3 billion project is a comprehensive lifestyle development, The Alma, where we shall be breaking ground this coming Monday, 11th April, Alma Ground Breaking.
- We released our FY?15 Banking Report, analysing the 11 listed banks from both a franchise value and Intrinsic value perspective. Download the full report at: Banking Report.
- Our Head of Private Equity Real Estate, Shiv Arora discussed Kenya?s banking sector and the roles of the CBK on Citizen TV. Shiv Arora on Citizen TV.
- Our Senior Investment Analyst, Duncan Lumwamu, discussed the increase in Kenyan banks? loan loss provisions on CNBC Africa. Duncan Lumwamu on CNBC.
- Our Investment Manager, Maurice Oduor discussed Kenya?s volatile banking industry on KTN news. Maurice Oduor on KTN.
- We continue to beef up the team with other ongoing hires: Careers at Cytonn.

Fixed Income

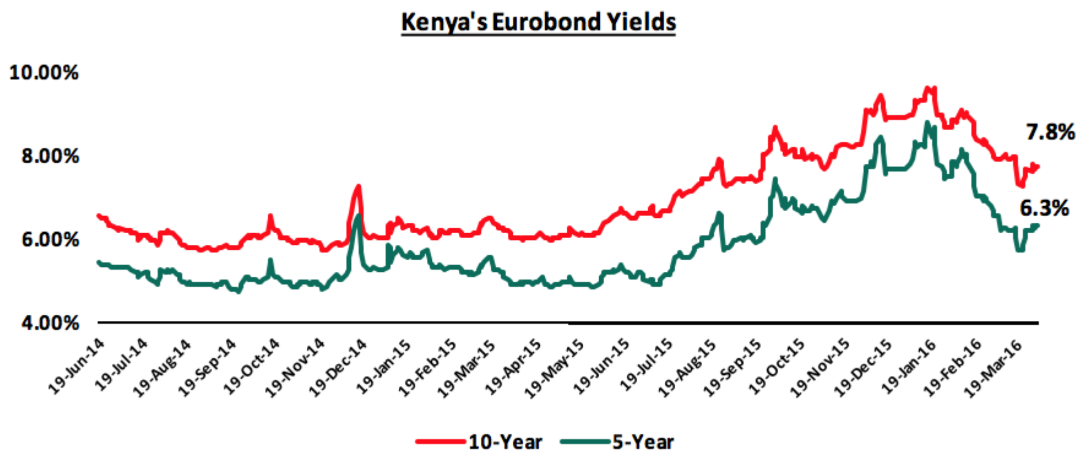
Treasury bills auctions saw an oversubscription this week, with the subscription rate coming in at 178.5%, compared to 50.5% the previous week, on the back of a liquid money market. Subscription rates for the 91, 182 and 364-day T-bills rose to 139.5%, 205.4% and 117.6%, respectively, from 29.0%, 42.5% and 72.8%, respectively, the previous week. Liquidity in the market was as a result of (i) T-bill maturities of Kshs 10.7 bn, (ii) reverse repo maturities of Kshs 4.9 bn, and (iii) Kshs 31.3 bn of government payments.

Despite the increased liquidity, yields remained relatively flat, with the 91, 182 and 364-day papers coming in at 9.0%, 10.8%, and 11.9%, from 9.0%, 10.7%, and 11.9%, respectively, the previous week. In our view:

- The stability in yields is an indication that the domestic borrowing target is achievable without putting significant upward pressure on rates, and,
- Yields on the treasuries have bottomed out and we could see them oscillate around the current levels in the short-term.

The shilling remained stable against the dollar during the week closing at Kshs 101.3, from Kshs 101.4 the previous week, as a result of (i) subdued activity, with low dollar demand from corporates, (ii) thin trading volumes, and (iii) the market shrugging off jitters from the placing under receivership of Chase Bank. The shilling has appreciated by 1.0% on a YTD basis, and we expect the shilling to hold stable against the dollar on the back of (i) improved forex reserves currently at USD 7.4 bn, equivalent to 4.7 months of import cover, (ii) approval of a precautionary facility by IMF amounting to USD 1.5 bn, and (iii) improved diaspora remittances. However, in the short-term, as we enter into the dividend-paying season, which may result into an increase in dollar demand by foreign investors seeking to expatriate their dividends, we expect mild downward pressure on the Kenya Shilling, which may lead to slight depreciation.

Kenya began an international bond roadshow this week to gauge investor?s prospects of issuing another Eurobond. Kenya first issued Eurobonds in June 2014 currently trading at yields of 7.8% and 6.3% for the 10-year and 5-year bonds, respectively, as can be seen below:



In addition to the Eurobond, which in our view cannot be completed during this fiscal year given the approximately 4-months lead-time for the last Eurobond, Kenya is in the process of:

- Securing a USD 600.0 mn (Kshs 60.1 bn) loan from China aimed at closing the budget deficit gap for 2015/2016 fiscal year, and,
- A bilateral loan between Kenya and France to receive Euros 250.0 mn (Kshs 28.9 bn) for infrastructure projects in energy, roads, security as well as financial inclusion.

In as much as the increased foreign borrowing will (i) reduce pressure on domestic borrowing, and (ii) assist in financing development projects, there are inherent risks to the increased borrowing:

- Currently the Kenya Eurobond is trading at a higher yield of 6.3% and 7.8% for the 5 and 10-year bonds, respectively, higher than the issued rates coupon of 5.8% and 6.8% for the 5 and 10-year, respectively. Additional foreign borrowing is bound to attract a premium over these rates, as

investors will require a higher yield to compensate for the increase in Kenya?s country risk, evidenced by the recent uptick in yields of 66 bps and 37 bps for the 5-year and 10-year bonds, respectively, following news of the plan to issue a new Eurobond. Any new foreign financing will be at these expensive rates,
- Borrowing will increase Kenyan foreign currency risk exposure making the country more vulnerable to external market conditions and shocks, given the huge level of foreign denominated debt at 29.2% of GDP, and,
- Increased debt to GDP levels, which currently at 57.5% is already much above the 50.0% levels generally prescribed for emerging markets by the IMF.

The government is ahead of schedule with its borrowing programme, having borrowed Kshs. 215.1 billion for the current fiscal year compared to a target of Kshs.173.3 billion (assuming a pro-rated borrowing throughout the financial year of Kshs. 219 billion budgeted for the full financial year). This shows that the government is about to hit their domestic borrowing target, and will therefore shift their attention to achieve their foreign borrowing target. However, failure to borrow in the foreign markets may lead to upward pressure on domestic rates as domestic borrowing is increased. Interest rates have been dropping since the beginning of February due to (i) reduced pressure on government borrowing, and (ii) high liquidity in the market. The government will continue borrowing locally to bridge the external financing deficits to date and the expected shortfall in collection by KRA. With interest rates coming down, we advise investors to lock in their funds in short to medium-term papers of tenors between six months and one-year, as the rates are attractive on a risk-adjusted basis.

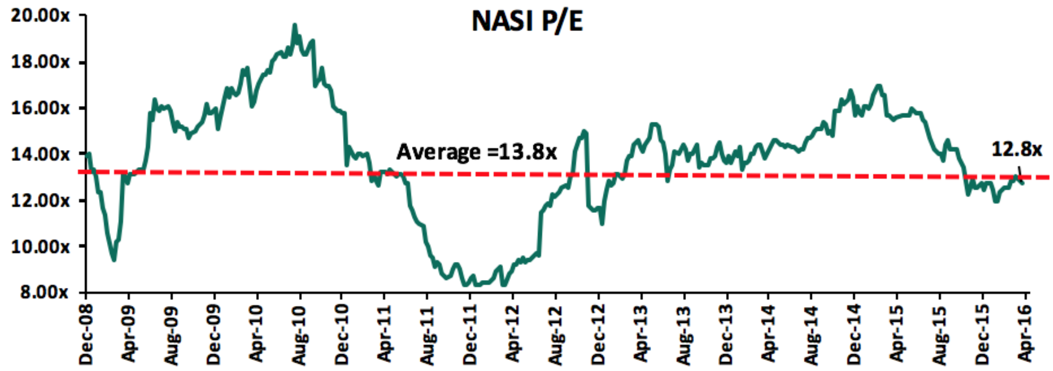
Equities

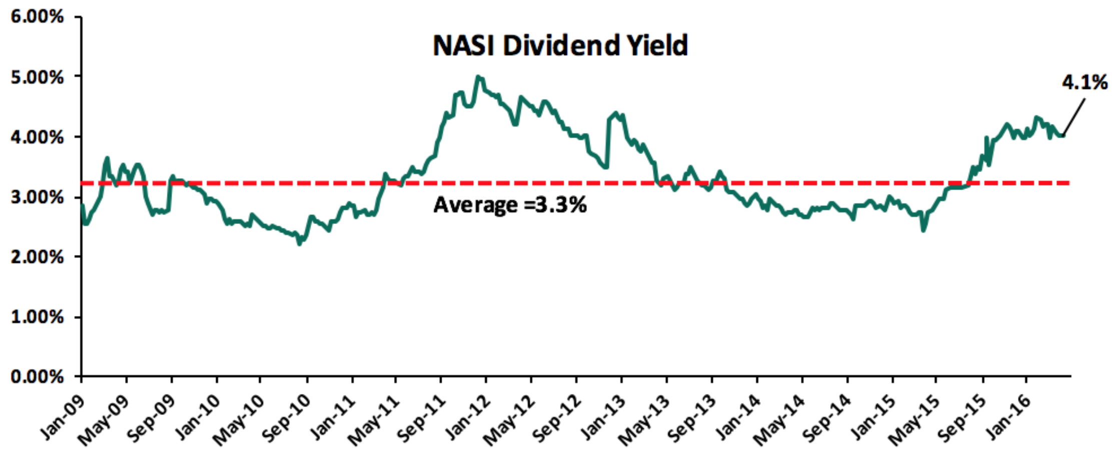
During the week, market performance was on a mixed trend with NASI and NSE 25 declining 0.4% and 0.3%, respectively, while NSE 20 gained 0.1%, taking their YTD performance to 0.5%, (1.0%) and 0.6%, respectively. Large cap stocks such as BAT, EABL and Safaricom declined 5.8%, 1.1% and 0.6%, respectively, during the week. Safaricom and Equity Group were the leading movers for the week jointly accounting for 43.7% of market activity, with Equity Group recording the highest net foreign inflows of USD 1.8 mn. Since the peak in February 2015, NASI and NSE 20 are down 17.5% and 27.3%, respectively.

Equity turnover rose during the week by 34.6% to USD 24.5 mn, from USD 18.2 mn last week. Foreign investors were net sellers with net outflows of Kshs 68 mn as compared to net inflows of Kshs 505 mn last week, with foreign participation rising to 72.3%, from 59.5 % the previous week.

The market is currently trading at a price to earnings ratio of 12.4x versus a historical average of 13.8x, with a dividend yield of 4.1% versus a historical average of 3.3%.

The charts below indicate the historical PE and dividend yields of the market.





The Communications Authority of Kenya (CAK) released industry data for the quarter ended December 2015, which indicated that Safaricom had a 2.7% q/q decline in subscriber numbers to 24.4 mn, resulting in a market share decline to 64.7%, down from 66.3% in the previous quarter due to increasing competition. Key from the report was:

- Mobile subscription in the country increased by 5.1% to 87.7%, from 82.6% in December 2014
- Safaricomrecorded its biggest ever drop in voice market share by 11.9%, to 72.1% in the year ended December 2015, while Airtel increased their market share to 16.8% from 9.8% previously,
- Safaricom?s minutes of use per subscriber per month declined from 109.6 in the previous quarter to 101, vs. the industry at 90.7,
- Mobile data market share remained unchanged with Safaricom at 63.0%, and Airtel, Orange andEquity?s Finserve with 18.0%, 14.0% and 5.0%, respectively, and,
- Value of M-Pesa transactions stood at Kshs 267.1 bn, equivalent to 92% of total amount transacted via mobile money.

As indicated in our Cytonn FY?15 Banking Report, where we indicated one of the challenges of KCB Group was that they seemed stretched in Total Capital Ratio adequacy, KCB Group announced two measures to shore up their capital, subject to ratification at their Annual General Meeting (AGM). These include:

- Increasing the authorised share capital by Kshs 1.0 bn to Kshs 4.5 bn, from Kshs 3.5 bn currently. This will be through the creation of 1 bn new and ordinary shares, which will have no dilutive effect to current shareholders as the increase is on authorised and not issued shares, and,
- Raise Kshs 10 bn through a rights issue by way of ordinary shares. Once ratified at the AGM, further details will be released, following which we will issue a recommendation on the rights issue to investors.

In our view, this is a positive step by KCB to shore up capital in a volatile banking sector. KCB Group?s Total Capital Ratio currently stands at 15.4%, which is a marginal 0.9% above the statutory requirement of 14.5%. This ratio is used to protect depositors and promote the stability and efficiency of the financial services company. As KCB continues to expand both regionally and in Kenya, they will need a sufficient capital buffer to safely carry out their expansion agenda as well as further buffer KCB Group from any shocks in the economy. Of key to note is that National Bank are currently below the statutory requirements for Total Capital Ratio, at 14.0% versus the requirement of 14.5%, with their rights issues having not been approved by CMA.

Longhorn Publishers received the green light from the Capital Markets Authority (CMA) to undertake a rights issue intended to raise Kshs 530 mn. The company plans to use the to fund its regional expansion plans into Ethiopia, Zimbabwe and DRC and diversify its digital products. The company has obtained exclusive rights to distribute Cambridge Dictionary, Biblica?s NIV Bible and has signed distributorship agreement with Bible Society and Scripture Union, making it the sole distributor of school reference material. The cash call will involve issuing 126 mn new shares at a ratio of 0.9 for every shares held, bringing the number of shares to 272.5 mn, resulting in a 53.7% dilution in share ownership for those who do not participate in the issue. The new shares will be issued at a discount of 20.8% at Kshs 4.2 factoring the current MPS of Kshs 5.3.

Despite a robust expansion plan, we expect an undersubscription of the rights issue on the basis of:

- Stiff competition in developing digital content by local companies as Longhorn has no exclusive orders for digital content, with the company?s recent deals being more analogue in nature while the education sector and publishing market is fast moving to digital, and,
- Decline in Government orders as they pursue a digitization programme.

Below is our equities recommendations table: The key changes for the week include:

- Britam has moved to a **?Lighten?** from a **?Buy?** following this week?s rise of 20.7% driven by local investor demand. The insurer is the only listed insurer yet to release its FY?2015 results, and had issued a profit warning for 2015

all prices in Kshs unless stated								
EQUITY RECOMMENDATIONS - for the week ending 08/04/2016								
No.	**Company**	**Price as at 01/04/16**	**Price as at 08/04/16**	**w/w Change**	**Target Price***	**Dividend Yield**	**Upside/ (Downside)****	**Recommendation**
1.	KCB Group	41.8	42.0	0.6%	53.7	5.2%	33.1%	Buy
2.	Centum	45.3	45.3	0.0%	57.2	0.0%	26.4%	Buy
3.	Kenya Re	20.0	20.0	(0.3%)	23.5	3.3%	21.1%	Buy
4.	Pan Africa	40.0	37.3	(6.9%)	44.0	0.0%	18.1%	Accumulate
5.	NIC	40.3	39.5	(1.9%)	42.9	2.5%	11.1%	Accumulate
6.	I&M Holdings	103.0	105.0	1.9%	112.0	3.4%	10.1%	Accumulate
7.	Equity Group	40.0	40.3	0.6%	41.9	5.1%	9.2%	Hold
8.	Safaricom	16.9	16.8	(0.6%)	16.6	5.1%	4.3%	Lighten
9.	HF Group	20.0	20.3	1.3%	19.6	6.9%	3.7%	Lighten
10.	Britam	10.9	13.1	20.7%	13.4	1.3%	3.6%	Lighten
11.	Barclays	11.0	10.8	(1.8%)	10.3	7.7%	3.5%	Lighten
12.	DTBK	214.0	210.0	(1.9%)	214.0	1.4%	3.3%	Lighten
13.	Liberty	16.1	16.2	0.6%	16.7	0.0%	3.3%	Lighten
14.	CIC Insurance	6.0	5.8	(3.4%)	5.8	1.8%	2.5%	Lighten
15.	Jubilee	471.0	463.0	(1.7%)	440.7	1.5%	(3.3%)	Sell
16.	Co-op bank	20.5	20.5	0.0%	18.0	3.9%	(8.1%)	Sell
17.	CfC Stanbic	94.0	93.5	(0.5%)	85.4	0.0%	(8.7%)	Sell
18.	Stanchart	247.0	248.0	0.4%	207.2	5.4%	(11.1%)	Sell

19.	National Bank	11.8	10.0	(14.9%)	8.5	0.0%	(15.0%)	Sell
***Target Price as per Cytonn Analyst estimates**								
****Upside / (Downside) is adjusted for Dividend Yield**								
Accumulate ? Buying should be restrained and timed to happen when there are momentary dips in stock prices.								
Lighten ? Investor to consider selling, timed to happen when there are price rallies								

We remain neutral on equities given the low earnings growth prospects for this year. The market is now purely a stock picker?s market, with few pockets of value.

Private Equity

Centum Investment?s subsidiary, Akiira Geothermal Ltd, will commence exploration drilling of Olkaria One at the Olkaria Valley in Naivasha, Kenya, in June 2016. When completed, it will be the first private sector greenfield geothermal development in Sub Saharan Africa. The project will be developing 140 MW in two phases of 70 MW each at a cost of Kshs 1.4 bn in 2 years. Centum has a 37.5% equity stake in the Kshs 30 bn project that will be funded through a mix of 30% equity and 70% debt, implying that Centum will invest about Kshs 3.4 bn equity in the project. Akira Ltd has signed a 25-year Purchasing Power Agreement (PPA) with Kenya Power whereby Kenya Power will buy electricity at Kshs 9.3 per kWh for onward feeding in to the national grid. The firm is exploring two wells and will explore two more in June this year.

For investors looking to invest in energy, geothermal is an attractive investment area. Kenya?s geothermal potential is in excess of 7,000 MW and thus has vast investment opportunities ranging from (i) exploration for steam, (ii) supply of equipment, and (iii) construction of power plants.

Private equity investment in Kenya continues on the upward surge, as evidenced by the increased deals in the country and the continent at large. Financial services, energy, healthcare, education, and IT continue to be the main sectors attracting private equity activity with infrastructure, real estate, and natural resources gaining ground. We remain bullish on PE as an asset class in Sub Saharan Africa given (i) the rapidly increasing demand driven by the rising middle income class in Africa, (ii) attractive valuations in the private sector, and (iii) better rates of return to investors with higher economic growth projections compared to global markets.

Real Estate

Kenya Projects, a real estate development firm, has announced the breaking ground on a Kshs 100 mn housing project in Ruiru to develop 50 two-bedroom semi-detached maisonettes, each of which will sell for Kshs 2.5 mn. This development comes at a time when the real estate scene has witnessed new entrants with a key focus towards the fast-growing and attractive Nairobi Metropolitan area. Developments including Tilisi in Kiambu, The Alma in Ruaka and Mega Real Estate in Limuru are looking to cater for the large housing deficit among for the expanding middle class population seeking residential lifestyle developments.

Ruiru area is a prime location for residential market due to the following factors:

1. The market contributes 18% of the land supply in satellite markets, as per the 2015 Hass Consult report,
2. As indicated in the Cytonn Qualitative Survey on Settlement Characteristics in Satellite Towns, Ruiru attracts middle income earners seeking residential areas for families, away from the busy Nairobi area, with purchases done through their personal savings, and,
3. The relatively lower land prices in Ruiru provide an opportunity for large-scale housing development catering to the growing middle class.

However, in order to tap into this market, developers need to address infrastructure challenges faced by a majority of the residents in the area such as poor drainage, sewerage and impassable feeder roads. In our view, the pricing point for the Kenya Projects development is affordable and attractive to potential home-owners. Kenya Projects are employing cheaper methods of finishes including use of red oxide floors instead of tiles, shared walls, and kitchens without fittings to make the houses affordable. In the past, majority of residents in Ruiru acquired plots and constructed their own houses, with a gradual shift now occurring in the market towards the purchase of developed homes.

As per the Industrial Market Report 2016 released by Mentor Management Limited (MML), the industrial sector is the new frontier for growth in the real estate sector, having witnessed exponential growth over the last six years supported by:

- **Planning Approvals**: Nairobi County Government has approved approximately 280,000m² of warehouse space in 2015, with majority expected to be delivered in two years,
- **Investment:** Investments in the industrial market in Nairobi, which stands at Kshs 3 billion per year exclusive of land costs, compared to Kshs 20 billion in commercial offices,
- **Decentralization:** The industrial sector has begun shifting from Nairobi Industrial Area to counties, especially Kiambu and Mavoko sub-County, and,
- **Increased Demand:** Demand for light industrial serviced plots, driven by manufacturing companies acting upon their expansion strategies in areas that are not as congested as the Nairobi Industrial Area, yet are close to key nodes such as airports and major highways.

One of the main factors driving this growth is improved infrastructure developments, especially the road network, which has seen several industrial parks come along the SGR and Bypasses such as the Vkken 30 park along the Eastern Bypass.

In our view, as stated in the Cytonn Real Estate?s Industrial Note, the sector remains attractive with average rental yields of 6.0%, and annual capital appreciation in excess of 5.0%, with the key determinants of returns in the sector being location and proximity to infrastructural nodes. Scarcity of development land has however hindered further developments in the Nairobi Industrial Area, prompting developers to shift focus to zones such as Athi River, where Government has established Export Processing Zones (EPZ?s). In our view, we expect the momentum of growth in the industrial sector to be sustained in the nearby future, driven by increased demand, boosted by the establishment of large industries such as Wrigley?s setting up regional factories in Kenya, and searching for specialised industrial areas to cater for their production techniques. Increased government support, especially through establishment of Special Economic Zones (SEZ?s), will support growth.

Kenyan Banking Sector

Following the release of the FY?2015 results by banks, we carried out an analysis on Kenya?s banking sector to decipher any material changes from our Q3?2015 banking report. In our analysis of the banking sector, we recommend to our investors which banks are the most attractive and stable for investment from a franchise value and from a future growth opportunity perspective. See report at: Cytonn Downloads.

The report was themed ?*A Sector in Volatile Transition*? to sustainable and stable growth, and two days after the report, Chase Bank, a mid-tier bank, was placed under receivership. This was the third bank in Kenya to fail over the last one year.

Consequently, this week we give a quick status overview of the Kenya banking sector 2015 financial performance, explain what is going on in the sector, and potential ways to avoid aggravating the current panic in the sector.

On the back of a growing and stable economic environment in Kenya, the country?s banking sector has also experienced robust growth over the years, with the financial services sector in Kenya currently contributing 10.1% to Kenya?s GDP growth, from a 3.5% contribution 10-years ago. This is as a result of the sector?s ability to develop products that respond to the needs of Kenyans, such as (i) convenience and efficiency through alternative banking channels such as mobile and agency banking, (ii) increased financial inclusion and banking the informal market, and (iii) a demographic boost in Kenya, such as a growing middle class, which has led to increased demand for intermediary services such as banking. Despite the tough operating environment that was witnessed last year, the banking sector still recorded core EPS growth of 2.8%, even though this was lower than 9.3% the previous year.

Key Metrics of Listed banks in Kenya								
Bank	**Core EPS Growth**	**Deposit Growth**	**Loan Growth**	**Interest Margin**	**NPL/Total Loans**	**Cost to Income****	**ROaE**	**ROaA**
I&M Bank	26.2%	16.4%	13.6%	7.2%	4.4%	35.0%	24.5%	3.7%
Co-op Bank	25.4%	21.9%	16.2%	8.8%	3.8%	53.2%	25.1%	3.7%
KCB Group	12.1%	12.5%	21.9%	7.9%	6.8%	50.1%	25.0%	3.7%
DTB	11.5%	20.6%	29.0%	6.5%	2.8%	41.0%	18.7%	2.9%
Equity Group	1.0%	23.1%	26.0%	6.5%	3.4%	52.9%	25.5%	4.8%
Barclays	(0.2%)	0.2%	15.9%	10.2%	3.7%	53.0%	21.6%	3.7%
NIC	(2.6%)	11.9%	13.7%	6.1%	12.4%	41.6%	18.0%	3.1%
CFC	(13.7%)	18.7%	26.6%	6.4%	4.8%	50.6%	17.1%	2.6%
HF	(18.5%)	15.4%	17.2%	6.3%	7.7%	47.4%	16.9%	2.2%
Standard Chartered	(28.7%)	11.7%	6.2%	9.4%	12.8%	44.6%	15.5%	2.9%
NBK	(232.5%)	5.6%	3.3%	6.4%	17.3%	78.2%	(19.3%)	(1.0%)
Weighted Average*	**2.8%**	**14.3%**	**14.5%**	**7.4%**	**7.3%**	**49.8%**	**17.1%**	**2.9%**

***Averages are market cap weighted**
****Without loan loss provisions charge**

There are three take-aways from the table above:

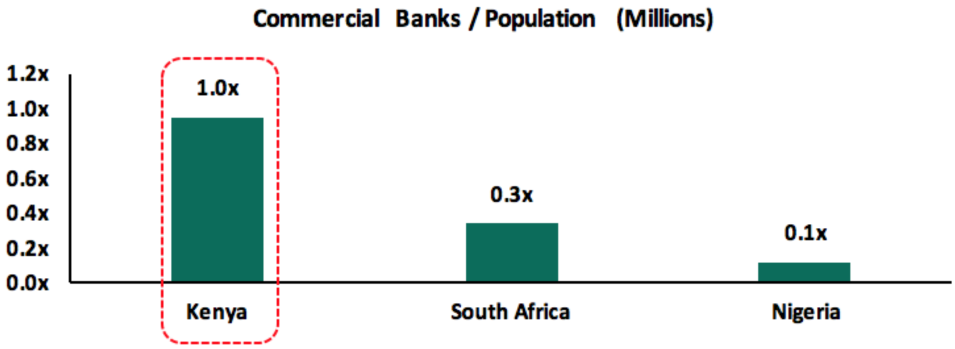
- While core EPS growth was anaemic at 2.8%, Co-op, I&M, KCB Group and DTB still managed to report respectable double digit EPS growth. Equity Group, Barclays and NIC were relatively flat and the rest (CFC, HF, Stanchart and NBK) reported significant EPS declines.
- Only 4 banks, Co-op, I&M, Stanchart and NBK reported deposit growth faster than loan growth, even though in the case of NBK, it appears that weak deposit growth was greater than loan growth only because loan growth was extremely weak.
- NBK was the only bank to report negative return on equity.

Following the strong growth achieved by the banking sector over the last 10 years, there is need for the sector to transition into a more stable and sustainable sector. The Central Bank of Kenya (CBK) is at the forefront of this initiative, pushing for the observance of prudential guidelines, including using a risk-based approach to bank capitalisation, better corporate governance of financial institutions and increased transparency in reporting of results. As indicated in our FY?15 Banking Report, the core areas of transition include the following key 4 areas:

- **Clarity around strategy & niche markets:** As Warren Buffet says, ?you only get to know who is swimming naked when the tide goes out.? In good times, all banks were reporting profits, but then in 2015 given the difficult operating environment, it seems that only banks with a clear strategic advantage and / or niche market reported positive profitability.
  1. Strong deposit gatherers with a strong branch network and alternative distribution channels such as agency and mobile banking did well. This category includes KCB, Co-op and Equity, who seemed to have fared well in 2015 compared with those with limited branch coverage
  2. Banking the informal sector, which is also closely intertwined with strong branch coverage, hence favouring those with strong networks and alternative distribution channels, seemed to have helped performance. On the other hand, inability to adapt to local dynamics seemed to

have weighed down the big foreign banks like Stanchart and Barclays, whose parent is contemplating abandoning the African market
3. Niche market players such as DTB and I&M, which are viewed to offer good service to mid-level corporates, and have reasonable flexibility, also did well
4. Disciplined growth was helpful as evidenced by the top two profitable banks (Co-op and I&M) who had deposit growth faster than loan growth, and revenue growth outpacing expense growth, while a historical strong growth bank like Equity is beginning to get distracted by regional expansion such as expansion into Congo, which has been dilutive to EPS, as well as forays into telecommunications

- **Scale will become increasingly important:** Kenya is overbanked with 1 bank for every one million people, compared with South Africa and Nigeria, which have 0.3 and 0.1 banks for every one million people. It is going to be increasingly difficult for the small banks to survive unless they have a clearly defined competitive advantage or are serving a specific market niche. Otherwise, the faster they merge, sell out or bring strategic investors (as can be seen in the table highlighting Kenyan Banks by Size), the better for them, as evidenced by ECB?s sale to Mwalimu Sacco, Fina?s sale to GT Bank, Fidelity?s sale of stake to Duet of London, and Giro Bank?s sale to I&M.



Kenyan Banks by Size

Tier	Local Banks	Banks with significant foreign ownership	Banks with Gov. Participation
Tier I >5% Market share [(a)]	· Commercial Bank of Africa · Equity Group Holdings · Co-operative Bank	· Barclays Bank · Standard Chartered	· KCB Group
Tier II >1%&<5% Market share [(a)]	· Diamond Trust Bank · Chase Bank* · Family Bank · Imperial Bank* · I&M Holdings · NIC · Prime Bank	· Bank of Africa · Bank of Baroda · Bank of India · CfC Stanbic · Citibank N.A · Ecobank · Guaranty Trust	· HF Group · National Bank
Tier III <1% Market share [(a)]**	· ABC Bank · Credit Bank · Equatorial Bank · Fidelity Bank · Giro Bank · Guardian bank · Jamii Bora Bank · Middle East Bank · Oriental Commercial · Paramount · Trans-National · Victoria · Sidian	· First Community · Habib A.G. Zurich · Habib Bank · Gulf African · United Bank for Africa	· Consolidated Bank · Development Bank

** - Under receivership*

*** -Given that Kenya is overbanked, and the sector is in transition, these are the banks ripe for consolidation or being bought out by larger banks* *(a) ? Market share by net assets, total deposits, total equity, deposit accounts and local accounts*

- **Better Corporate Governance:** The market, CBK and CMA are all going to be demanding better corporate governance going forward. It is clear from the market?s swift and decisive negative reaction to Chase Bank?s qualified financial accounts, which revealed previously not fully disclosed loans to directors of over Kshs 10 billion, that corporate governance and professional ethics are key for investors and depositors. One key commonality between the two recent bank failures at Imperial and Chase Bank is a colossal failure of corporate governance and existence of bad ethical practices.
- **Increased Regulation & Emphasis on Compliance:** With the new CBK governor, there is going to be increased regulation, emphasis on compliance and market discipline. CBK has made it clear that it is increasing its surveillance and supervision capacity.

While there is broad public perception of a sector in crisis, we view the incidences at Imperial and Chase Bank as isolated cases of ethical malpractices in a sector that otherwise remains fully functioning, safe and sound. Key metrics such as interbank rates, exchange rates and money market yields do not point to a systemic issue in the banking sector and the money markets remain well functioning.

While the Governor appears to be enjoying broad public support for his intolerance to indiscipline in the banking sector, and is doing all the right things to restore discipline, we think that there could be a better resolution of cases such as Imperial or Chase Bank. In the interest of stability of both the economy and financial markets, closing a bank should be the option of the very last resort. While the Kenyan situation is nowhere near the banking crisis faced by the US banks during the global financial crisis of 2009, there are techniques and tactics that we think the Governor and the Government should consider borrowing from the approach deployed by the US Government and Fed in resolving potential bank failures. When it was clear that a bank was losing market confidence, banks were coerced by heavy-handed regulators to sell to stronger banks, which immediately restores market confidence.

From October 2015 when questions began to surface around Chase Bank to the bank?s eventual failure six months later in April 2016, there has to be a range of strategic alternatives that either bigger banks or private investors could have brought to shore up confidence in Chase Bank. There still exists market concerns around a few banks, the regulator should be very heavy-handed in terms of asking the respective boards to take decisive actions to restore market confidence and failure upon which CBK should orchestrate take overs of weak banks by stronger banks. Well-functioning financial markets are critical to funding economic growth. Consequently, it is in our national interest to speedily and aggressively resolve any issues that threaten continued economic growth and financial markets stability, such as weak or unethical market participants.