



Home Ownership Savings Plan, “HOSP”, Schemes in Kenya, & Cytonn Weekly #37/2019

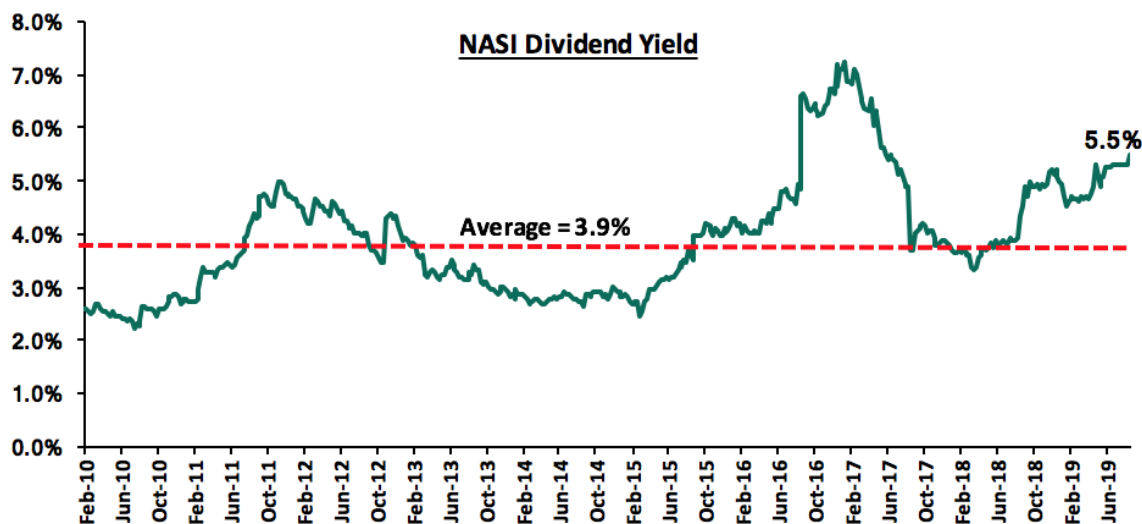
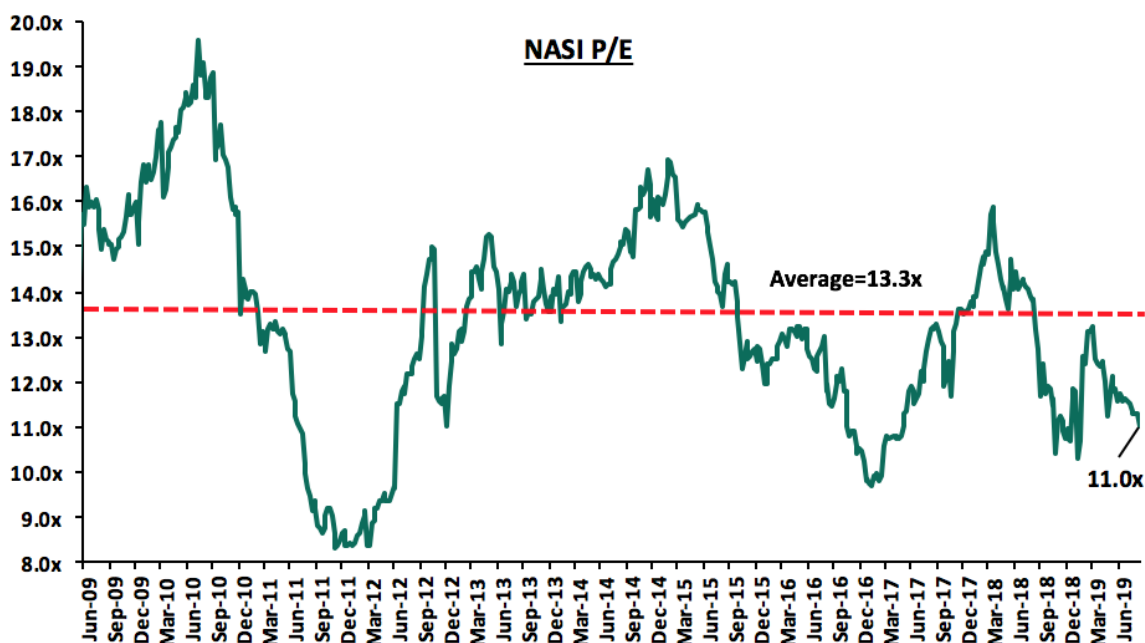
Equities

Market Performance:

During the week, the equities market recorded a mixed performance with NASI and NSE 25 gaining by 0.9% and 1.0%, respectively while NSE 20 declined by 3.6%, taking their YTD performance to gains/ (declines) of 2.4%, (17.7%) and (3.0%), for NASI, NSE 20 and NSE 25, respectively. The performance in NASI was driven by gains in Co-operative Bank, Equity Group and EABL, which rose by 5.8%, 2.3% and 2.1%, respectively. The gains were weighed down by declines recorded in Bamburi, Diamond Trust Bank Kenya (DTBK) and Barclays Bank Kenya (BBK) of 5.5%, 2.6% and 1.8%, respectively.

Equities turnover declined by 42.6% during the week to USD 17.2 mn, from USD 30.1 mn the previous week, taking the YTD turnover to USD 1.0 bn. Foreign investors remained net sellers for the week, with the net selling position increasing by 198.8%, to USD 1.3 mn, from a net selling position of USD 0.4 mn the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 11.0x, 17.3% below the historical average of 13.3x, and a dividend yield of 5.5%, above the historical average of 3.9%. With the market trading at valuations below the historical average, we believe there is value in the market. The current P/E valuation of 11.0x is 13.4% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 32.5% 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, the Insurance Regulatory Authority (IRA) released the Q2'2019 Insurance Industry Report, highlighting the improvement in the sector's profit after tax, which rose by 138.8% to Kshs 5.7 bn, from Kshs 2.4 bn in Q2'2018. Key highlights of the performance during the period include:

- The performance was largely supported by the 4.4% rise in gross premium income to Kshs 117.3 bn, from Kshs 112.4 bn in Q2'2018, which outpaced the marginal 1.6% rise in claims expense to Kshs 54.7 bn, from Kshs 53.8 bn in Q2'2018,
- Commission expense declined by 2.3% to Kshs 5.4 bn, from Kshs 5.5 bn in Q2'2018,
- The industry's combined ratio was 102.8%, with a loss ratio at 64.2% and an expense ratio at 38.6%, indicating the underwriting business still remains unprofitable. This is comparable to a combined ratio of 106.0% in Q2'2018, where the industry had a loss ratio of 65.3% and an expense ratio of 40.7%,
- The industry recorded an expansion of the balance sheet, as shown by 7.6% rise in total assets to Kshs 672.1 bn, from Kshs 624.6 bn in Q2'2018, largely supported by the 9.1% increase in investment securities to Kshs 556.3 bn, from Kshs 509.7 bn in Q2'2018, with 60.0% of the investment portfolio held in government securities, 15.0% in investment property and 9.3% in bank deposits, and 7.0% in quoted ordinary shares, and the remaining 8.7% in loan and mortgages, unquoted ordinary shares and investments in subsidiaries,
- Total liabilities rose by 8.8% to Kshs 514.3 bn, from Kshs 474 bn in Q2'2018, largely driven by the

- 13.6% rise in insurance contract liabilities to Kshs 348.7 bn, from Kshs 307.1 bn in Q2'2018, and, Shareholders equity rose by 4.0% to Kshs 157.8 bn, from Kshs 151.8 bn, driven by the 12.0% rise in retained earnings to Kshs 62.0 bn, from Kshs 55.4 bn, in Q2'2018, with the increase weighed down by the 29.8% decline in the revaluation reserve to Kshs 4.0 bn, from Kshs 5.8 bn in Q2'2018.

We note that the sector's performance was largely supported by investment income, as has been the case with the sector, as the investment yield rose to 5.1%, from Kshs 4.4% in Q2'2018. The sector's underwriting losses of Kshs 1.3 bn in Q2'2019, albeit a 52.8% decline, from the Kshs 2.7 bn loss recorded in Q2'2018, highlight the profitability challenges that still remain in underwriting, with the industry largely weighed down by price undercutting from intense rivalry amongst firms.

During the week, Equity Group Holdings entered into a binding Term Sheet with shareholders of Banque Commerciale du Congo (BCDC), for the purchase of a controlling stake in the Congo-based lender. The proposed transaction is pending the completion of the various due diligence, agreements between the two parties, and granting of necessary approvals by the Capital Markets Authority (CMA), Central Bank of Kenya (CBK), Central Bank of Congo and the Competition Authority of Congo. Equity Group Holdings has continued its regional diversification drive by venturing and focusing in Congo, where the bank acquired Pro Credit Bank in September 2015, a Small Medium Enterprise (SME)-focused bank for Kshs 4.5 bn, for a 79.0% stake, effectively valuing the bank at Kshs 5.7 bn, compared to the equity position of Kshs 2.9 bn, implying a P/B multiple of 2.0x. With the pending transaction of BCDC, which had assets of USD 706.0 mn, deposits of USD 485 mn, and shareholders' equity of USD 73 mn, Equity Group would be acquiring the second-largest bank by assets in Congo, with a branch network of 29 branches. The bank recorded a Return on Equity (ROE) of 11.0%, Return on Assets (ROA) of 1.2%, and a Cost to Income Ratio (CIR) of 70.0% as at FY'2017. Comparing with Equity Group Congo, which recorded an ROE of 17.9%, ROA of 1.9% and CIR of 70.9%, we view that the subsidiary would still require improvements in operational efficiency to improve on its bottom line. Equity Group holdings recorded an ROE of 22.1%, ROA of 3.5% and CIR of 54.8% as at H1'2018, with the relatively high ROE compared to the banking sector average of 19.5%, attributable to Equity Group's utilization of its assets, as well as relatively high operational efficiency better than the average banking sector CIR, of 55.1%. Assuming the transaction were to be conducted at a 2.0x P/B, similar to the initial acquisition of Pro Credit Bank, it would mean that Equity Group would pay USD 146.0 mn, based on FY'2017 equity position of USD 73 mn. We are of the view that the bank would essentially increase its foothold in the Congo market if the transaction is successful. The bank would likely be looking to employ the same strategy as the Kenyan market, by pushing its retail banking unit through the digital and alternative transaction channels. We view that this presents Equity Group with headroom for growth, with Congo having an adult population of 40.0 mn, with only 14.8 mn (37.0%) having access to any form of financial service thus availing a significant unaddressed segment of the market.

Co-operative Bank of Kenya indicated its plan to open 5 new additional branches during the week, which will bring the total branch network to 160. Co-operative bank will buck the trend of branch closures seen in the listed banking sector space. With a deposit per branch ratio of Kshs 2.1 bn as at H1'2019, lower than the listed bank average of Kshs 3.3 bn. The bank's strategy of increasing its branch network is largely to support the bank's advisory and support network for SMEs and Saccos, with 88.0% of the transactions done outside the branches, with branches reduced to handling high-value transactions. With a cost to income ratio of 54.8%, the bank remains one of the most efficient banks, below the industry average of 55.1%. The bank is likely looking to increase its penetration in areas it does not have a presence, such as Kapenguria, Maralal and Chogoria, as it continues to lag behind its major competitors Equity Group and KCB Group who have 283 branches and 257 branches, respectively, and possibly aid the bank in deposit mobilization.

Universe of Coverage

Banks	Price as at 6/09/2019	Price as at 13/09/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
KCB Group***	38.2	38.5	0.8%	2.8%	56.3	9.1%	56.3%	1.0x	Buy
Diamond Trust Bank	113.5	110.5	(2.6%)	(29.4%)	180.8	2.4%	55.9%	0.6x	Buy
Sanlam	18.0	19.0	5.3%	(13.9%)	29.0	0.0%	53.0%	0.7x	Buy
Kenya Reinsurance	2.9	2.8	(2.4%)	(18.6%)	3.8	5.3%	37.3%	0.3x	Buy
Equity Group***	37.1	37.9	2.3%	8.8%	49.2	5.3%	31.7%	1.6x	Buy
Britam	7.1	7.0	(1.4%)	(31.2%)	8.8	5.0%	31.1%	0.8x	Buy
CIC Group	3.2	3.1	(2.8%)	(20.2%)	3.8	4.2%	27.6%	1.2x	Buy
Co-operative Bank***	11.3	12.0	5.8%	(16.4%)	14.1	8.4%	25.6%	1.0x	Buy
Barclays Bank***	11.0	10.8	(1.8%)	(1.8%)	12.0	10.2%	25.3%	1.3x	Buy
I&M Holdings	46.5	45.7	(1.8%)	7.4%	63.5	7.7%	23.1%	0.8x	Buy
NIC Group	28.1	28.1	0.0%	0.9%	36.3	3.6%	22.3%	0.6x	Buy
Liberty Holdings	9.7	10.0	3.1%	(22.6%)	11.3	5.0%	18.2%	0.8x	Accumulate
Jubilee Holdings	370.0	370.0	0.0%	(8.6%)	418.5	2.4%	15.5%	1.1x	Accumulate
Stanbic Holdings	96.0	96.0	0.0%	5.8%	94.9	6.1%	1.9%	1.1x	Lighten
Standard Chartered	195.5	196.0	0.3%	0.8%	183.5	6.4%	0.7%	1.4x	Lighten
National Bank	4.1	4.1	0.0%	(22.6%)	3.5	0.0%	(15.4%)	0.2x	Sell
HF Group	4.4	5.5	25.0%	(0.7%)	2.9	0.0%	(47.3%)	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 are invested in

We are "Positive" on equities for investors as the sustained 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.

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