Kenya Listed Banks H1'2019 Report, & Cytonn Weekly #39/2019

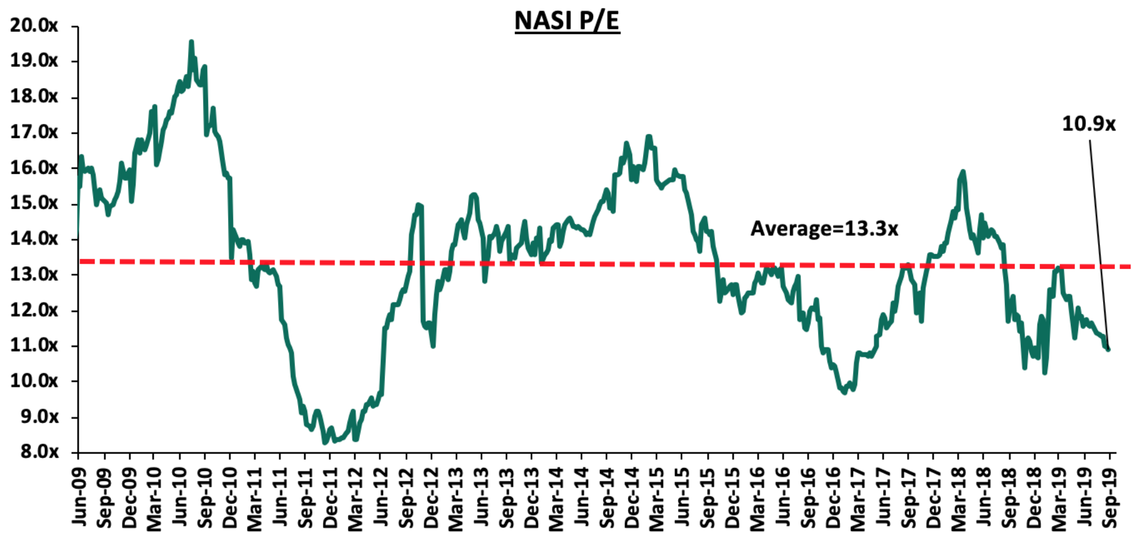
Equities

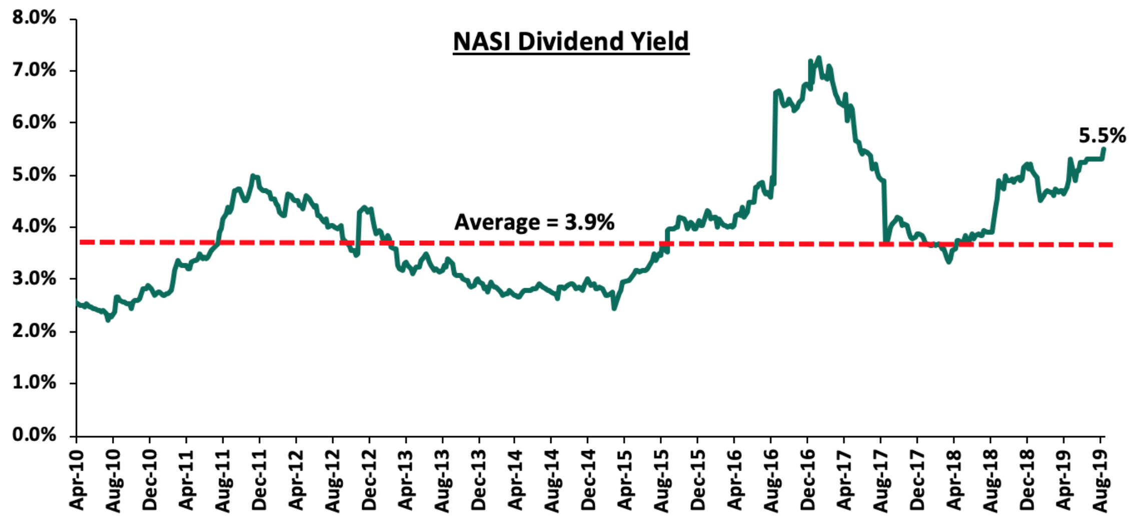
Market Performance:

During the week, the equities market was on a downward trend with NASI, NSE 25 and NSE 20 declining by 0.3%, 0.3% and 0.5%, respectively, taking their YTD performance to gains/(declines) of 2.9%, (14.0%) and (2.7%), for NASI, NSE 20 and NSE 25, respectively. The performance in NASI was driven by declines in Bamburi, NIC Group, Co-operative Bank of Kenya, EABL and Safaricom, which declined by 7.3%, 3.2%, 2.5%, 1.5% and 1.5%, respectively.

Equities turnover declined by 7.5% during the week to USD 25.2 mn, from USD 27.3 mn the previous week, taking the YTD turnover to USD 1.1 bn. Foreign investors remained net buyers for the week, with a net buying position of USD 2.6 mn, a 53.7% decline from a net buying position of USD 5.5 mn the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 10.9x, 17.9% 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 10.9x is 12.6% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 31.6% 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, the Central Bank of Kenya (CBK) announced the issuance of the final regulatory approval for the merger between Commercial Bank of Africa (CBA) and NIC Group. The final approval of the transaction comes after the approval by The Cabinet Secretary of the National Treasury on 20th September 2019, under Section 9 of the Banking Act, which guides on amalgamations and transfer of assets and liabilities for banking institutions. Key things to note is that:

i. The combined entity is supposed to commence operations on 1st October 2019, with both NIC Group and CBA Group set to operate under a non-operating holding company NCBA Group Plc,
ii. The banking businesses in Kenya of both banks will operate under the Kenyan banking subsidiary NCBA Bank Kenya PLC, and,
iii. The management details of the combined entity have already been fleshed out, with Mr. John Gachora, the current Managing Director (MD) of NIC Group set to be the Group Chief Executive Officer (CEO) of the combined entity (NCBA Group Plc). Mr. Isaac Awuondo, the current Group MD of CBA Group will become the Chairman of NCBA Bank Kenya Plc, and maintain oversight on the digital banking subsidiary.

In terms of operations, we expect a relatively smooth transition, with the integration of the two bank's core banking systems already done, as well as staff alignment of the two banks. There however may be minimal internal operation disruptions as staff are physically relocated. Furthermore, with the bank having set up a merger integration and operations center in June 2019, we expect the banks to have finalized their own internal integration operations, which should see a smooth transition to a combined entity. We expect NCBA Group Plc to focus on branding and increased consumer awareness campaigns in the near term, as they endeavor to minimize service disruptions to clientele as well as highlight the synergies and benefits expected to be reaped from the merger. We maintain our view as highlighted in our merger note, that the deal will be accretive to shareholders in the long term, as the scale achieved at the group level will lead to an enhanced balance sheet, which should see a shift towards improved deposit mix and alignment towards cost effective deposit mobilization, coupled with improved capital markets access, which will position the combined entity for growth and expansion into other regional markets. The new-found scale as shown in the table below, should also see the bank increase its branch network, as the bank increases is customer service points, adopting a relatively similar strategy to its new peer group of KCB Group, Equity Group and Co-operative Bank of Kenya, in addition to establishing presence in areas it doesn't have. However, there may be branch closures in areas where there are overlapping branches. As shown in the table below, NCBA Group PLC will become the third largest bank in Kenya, by both deposits and asset base.

Bank	KCB Group	Equity Group	NCBA Group	Co-operative Bank
Customer Deposits	654.6	458.6	358.0	323.6
Total Assets	861.1	638.7	476.1	429.6

Values in Kshs bn

CIC Group announced the redemption of its 5-year corporate bond issued in October 2014 of Kshs 5.0 bn, with a coupon rate of 13.0%, which will be redeemed in October 2019. The bond that was issued to fund CIC's regional expansion into Uganda and Malawi, as well as bolstering the capital requirements of the insurer's subsidiaries, and supporting investments in their medical and real estate projects, will be redeemed at par, which should see CIC Group save Kshs 650.0 mn per annum in interest expense, which the firm has been paying in coupon payments to bondholders since the issuance of the bond. CIC Group recorded a 96.1% decline in profit after tax in H1'2019 to Kshs 20.9 mn, from Kshs 0.5 bn in H1'2018. The performance was largely due to the flat growth in the total income, which grew by 0.1% to Kshs 8.74 bn, from Kshs 8.72 bn in H1'2018, which was weighed down by the 6.3% rise in operating expenses, to Kshs 8.6 bn, from Kshs 8.1 bn in H1'2018. With the cost base rising faster compared to the flat revenue, the company saw its combined ratio rise to 120.8% in H1'2019, from 114.1% in H1'2018, highlighting that the core insurance business remains unprofitable. We are thus of the view that the repayment will free CIC Group's bottom line owing to the Kshs 650.0 mn headroom created after the repayment. The repayment is likely being funded by the sale of non-core assets such as the 712 acres of land in Kajiado and Kiambu counties.

Sanlam Plc announced the launch of a voluntary early retirement program, aimed at reducing the operating expenses by approximately Kshs 200.0 mn. The program is targeted at individuals aged 50-years and above in its insurance subsidiary. Participants who take up the retirement option will be given a sendoff package equivalent to a month's salary for every three years of service, write off of a third of outstanding in-house loans, and will be retained on medical cover for the remainder of the year. They will also be paid for accrued leave days and pension dues in line with prevailing regulations and laws. Sanlam Plc recorded an improved performance in H1'2019, as the profits rose to Kshs 0.6 bn, from a loss of Kshs 1.5 bn in H1'2018, aided by an 84.6% rise in total revenue to Kshs 4.7 bn, from Kshs 2.5 bn in H1'2018, and a 5.7% reduction in total operating expenses. As a consequence, the combined ratio improved to 135.8%, from 172.6% in H1'2018. This however indicates that the core insurance business remains unprofitable, and largely relied on investment income. If completed, we are of the view that the program should see the insurance company reduce its cost base, and aid the insurer in improving its expense ratio even further, which improved to 63.5% in H1'2019, from 74.5% in H1'2018, and likely enable the firm improve on its underwriting business performance.

Universe of Coverage

KCBGBuyp***

SaBnulyam

I&M Holdings	[illegible]
Diamond Trust Bank	[illegible]

Equity Group***

Kenya Reinsurance

Buy

Co-operative Bank***

Barclays Bank***

[illegible]

NIC Group

Jubilee Buildings

CIC Group

Holdings

Standard

Accumulated

Stanbic Holdings

HF Group

*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 has 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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