



Cytonn Q3'2019 Markets Review

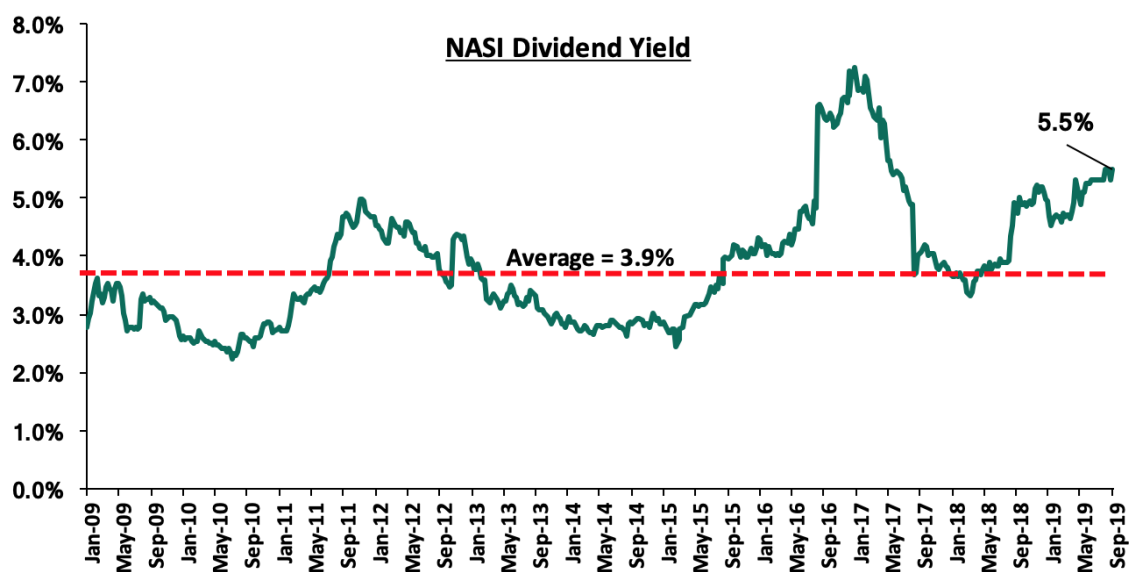
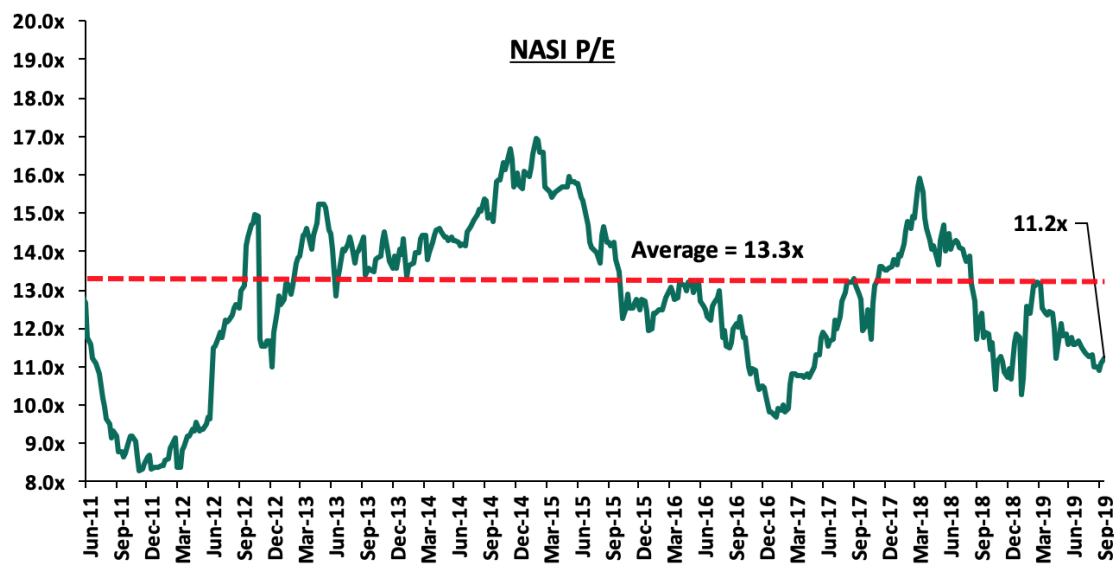
Equities

Market Performance

During Q3'2019, the equities market was on a downward trend, with NASI, NSE 20 and NSE 25 declining by 3.0%, 8.3%, and 4.3%, respectively, taking their YTD performance as at the end of September to gains and losses of 3.6%, (14.2%) and (2.9%) for NASI, NSE 20 and NSE 25, respectively. The equities market performance during the quarter was shaped by declines in large caps such as Bamburi, Equity Group, and Safaricom, which declined by 17.9%, 3.9%, and 2.1%, respectively. During the week, the equities market was on an upward trend, with NASI, NSE 20 and NSE 25 gaining by 1.8%, 1.6%, and 1.5%, respectively, taking their YTD performance to gains and losses of 4.8%, (13.9%) and (1.3%), respectively. The performance in NASI during the week was driven by gains in Safaricom, BAT, Co-operative Bank of Kenya, and Standard Chartered Bank, which gained by 3.5%, 2.9%, 2.1% and 1.9%, respectively.

Equities turnover declined by 7.5% during the quarter to USD 289.6 mn, from USD 313.1 mn recorded in Q2'2019, taking the YTD turnover to USD 1.1 bn. During the week, equities turnover increased by 1.5% to USD 25.6 mn, from USD 25.2 mn the previous week. In the quarter under review, foreign investors were net buyers, with a net buying position of USD 0.8 mn, a 9.4% decline from the net buying position of USD 14.9 mn recorded in Q2'2019. During the week, foreign investors remained net buyers for the week, with a net buying position of USD 2.2 mn, a 13.6% decline from a net buying position of USD 2.6 mn the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 11.2x, 15.5% 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 11.2x is 15.9% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 35.4% 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.



Listed Banks H1'2019 Results:

The table below highlights the performance of the banking sector, showing the performance using several metrics, and the key take-outs of the performance. For more details, see our H1'2019 Banking Report [here](#).

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-Funded Income Growth	NFI to Total Operating Income	Growth in Total Fees & Commissions	Deposit Growth	Growth in Government Securities	Loan to Deposit Ratio	Loan Growth	Return on Average Equity
Barclays Bank Kenya	18.0%	7.4%	30.8%	0.6%	8.4%	12.6%	32.4%	11.1%	5.9%	15.4%	81.3%	6.0%	18.1%
I&M Bank	17.0%	8.8%	18.3%	2.2%	6.0%	21.9%	39.3%	6.0%	12.5%	28.5%	72.6%	5.7%	17.7%
Stanbic Holdings	14.4%	10.5%	5.2%	19.5%	5.1%	10.1%	47.8%	53.2%	10.3%	8.1%	74.4%	15.0%	15.3%
Diamond Trust Bank	11.0%	(6.6%)	(5.5%)	(7.5%)	6.0%	8.5%	24.5%	(15.6%)	0.5%	14.4%	67.4%	(3.8%)	13.9%
Equity Group	9.1%	9.2%	14.3%	7.6%	8.5%	25.6%	44.0%	16.1%	16.5%	13.0%	70.0%	16.7%	22.1%
NIC Group	8.6%	0.9%	(7.0%)	7.7%	6.0%	23.9%	32.5%	29.3%	3.5%	8.1%	77.8%	3.1%	12.0%
SCBK	5.4%	(7.3%)	(26.0%)	0.0%	7.6%	(2.2%)	32.4%	(12.8%)	(1.0%)	(15.2%)	52.5%	7.4%	18.2%
KCB Group	5.0%	4.3%	1.6%	5.2%	8.2%	14.7%	34.1%	3.5%	7.3%	20.3%	85.0%	13.6%	22.7%
Co-operative Bank	4.6%	(1.7%)	3.5%	(3.8%)	8.4%	25.1%	38.0%	38.1%	9.0%	14.2%	79.6%	2.6%	18.8%
National Bank of Kenya	(40.1%)	7.3%	(14.4%)	20.0%	8.2%	(28.7%)	19.4%	(4.6%)	(4.9%)	(17.5%)	51.8%	(1.0%)	6.7%

- i. Kenya Listed Banks recorded a 9.0% average increase in core Earnings per Share (EPS), compared to a growth of 19.0% in H1'2018. As a result, the Return on Average Equity decreased marginally to 19.3% compared to 19.5% recorded a similar period in 2018,
- ii. Deposit growth came in at 8.6%, slower than the 10.0% growth recorded in H1'2018. On the other hand, interest expense increased at a slower pace of 5.3%, compared to 12.0% in H1'2018, indicating that banks have been able to mobilize relatively cheaper deposits. In addition, the removal of the 70.0% minimum deposit payable on deposits in the Finance Act 2018 reduced the cost of deposit funding,
- iii. Average loan growth came in at 9.8%, which was faster than the 3.8% recorded in H1'2018, indicating that there was an improvement in credit extension to the economy. Government Securities on the other hand recorded growth of 12.1%, which was a slower growth rate compared to the 14.9% in H1'2018. This shows that banks have begun to adjust their business models, focusing more on private sector lending as opposed to investing in government securities, whose yields declined during the year. Interest income increased by 3.7%, slower than the 7.9% recorded in H1'2018. Consequently, the Net Interest Income grew by 3.8%, slower than the 6.4% recorded in H1'2018,
- iv. The average Net Interest Margin in the sector came in at 7.7%, lower than the 8.1% in H1'2018. The decline was mainly due to a decline in yields recorded in government securities, coupled with the decline in yields on loans due to the 100-bps decline in the Central Bank Rate, and,
- v. Non-Funded Income grew by 16.5% y/y, faster than the 6.9% recorded in H1'2018. The growth in NFI was boosted by the total fee and commission income which improved by 12.7%, compared to the 4.6% growth recorded in H1'2018, owing to the faster loan growth.

Quarterly Highlights

During the quarter;

1. 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, as highlighted in our **Cytonn Weekly #39/2019**,
2. KCB Group revised its final offer to take over 7.5% of the deposits and loans held by Imperial Bank Limited Under Receivership (IBLR) as at the end of July 2019, after the bank conducted extensive due diligence on IBLR. With approximately Kshs 53.0 bn outstanding deposits, this translates to a final payout of approximately Kshs 3.975 bn, bringing the final recovery rate to approximately 38.0%. The transaction has seen 92.0% depositors who held deposits in IBLR gain access to their deposits. We thus continue to maintain our view that a resolution of the matter would mark the second instance a bank is successfully brought out of receivership, thereby providing more confidence in the Kenyan financial services space regulation, which provides an avenue for remediation of collapsed entities as well as providing protection for depositors' funds. For more information, see [here](#),
3. The Banking Amendment Bill was tabled in the National Assembly. The Bill seeks to seal the loopholes in the wordings of the Banking (Amendment) Act 2015. In March 2019, the High Court suspended the Banking (Amendment) Act 2015 in a ruling that declared Section 33B (1) and (2) of the Banking Act unconstitutional, and gave the National Assembly one year to amend the anomalies, failure to which will mean a reversion to a free-floating interest rates regime. For more details, please see our **Cytonn Weekly #30/2019**,
4. 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 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. For more details, please see our *Cytonn Weekly #39/2019*, and,

- Barclays Bank of Kenya announced that three of its branches namely, Bamburi, Maragua and Supplies, were up for sale, valued at Kshs 65.0 mn. This is in line with the lender's strategy of deepening digital channels to accommodate the changing pattern of customer preferences towards alternate channels. Previously, in FY'2017, the lender closed 13 branches as part of its consolidation strategy and drive to achieve operational efficiencies. For a more detailed analysis, please see our *Cytonn Weekly #27/2019*.

Universe of Coverage

Banks	Price at 4/10/2019	w/w change	q/q change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
I&M Holdings	45.1	7.4%	(18.2%)	5.9%	79.8	7.8%	84.7%	0.8x	Buy
Sanlam	17.4	(7.2%)	(8.5%)	(14.8%)	29.0	0.0%	66.7%	0.8x	Buy
KCB Group***	41.9	(7.0%)	9.8%	12.1%	61.4	8.3%	54.9%	1.1x	Buy
Diamond Trust Bank	115	1.3%	(3.2%)	(27.2%)	175.6	2.3%	55.0%	0.6x	Buy
Equity Group***	37.9	1.2%	(3.9%)	7.5%	53.0	5.3%	45.2%	1.6x	Buy
Co-operative Bank***	12.1	2.1%	(0.8%)	(16.8%)	15.0	8.4%	32.8%	1.0x	Buy
NIC Group	29.5	3.3%	(2.1%)	7.7%	37.9	3.3%	32.0%	0.6x	Buy
Kenya Reinsurance	3.0	2.7%	(23.1%)	(17.2%)	3.8	5.2%	30.6%	0.1x	Buy
Britam	7.0	(0.3%)	(13.7%)	(30.2%)	8.8	4.9%	30.3%	0.7x	Buy
Barclays Bank***	11.2	1.8%	4.8%	0.0%	12.6	10.0%	22.3%	1.4x	Buy
CIC Group	3.1	(0.7%)	(13.5%)	(20.5%)	3.8	4.2%	28.8%	1.2x	Buy
Liberty Holdings	9.7	0.2%	(7.0%)	(24.7%)	11.3	5.1%	21.2%	0.7x	Buy
Jubilee holdings	346.0	(1.1%)	(12.4%)	(13.5%)	418.5	2.6%	23.5%	1.0x	Accumulate
Standard Chartered	198.0	1.9%	2.7%	2.7%	208.0	6.3%	11.3%	1.5x	Accumulate
Stanbic Holdings	96.3	0.3%	0.0%	5.8%	100.5	6.1%	10.5%	1.1x	Accumulate
HF Group	6.9	(4.7%)	75.6%	27.1%	2.8	0.0%	(60.2%)	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 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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