Kenya Listed Insurance H1’2019 Report, & Cytonn Weekly #46/2019

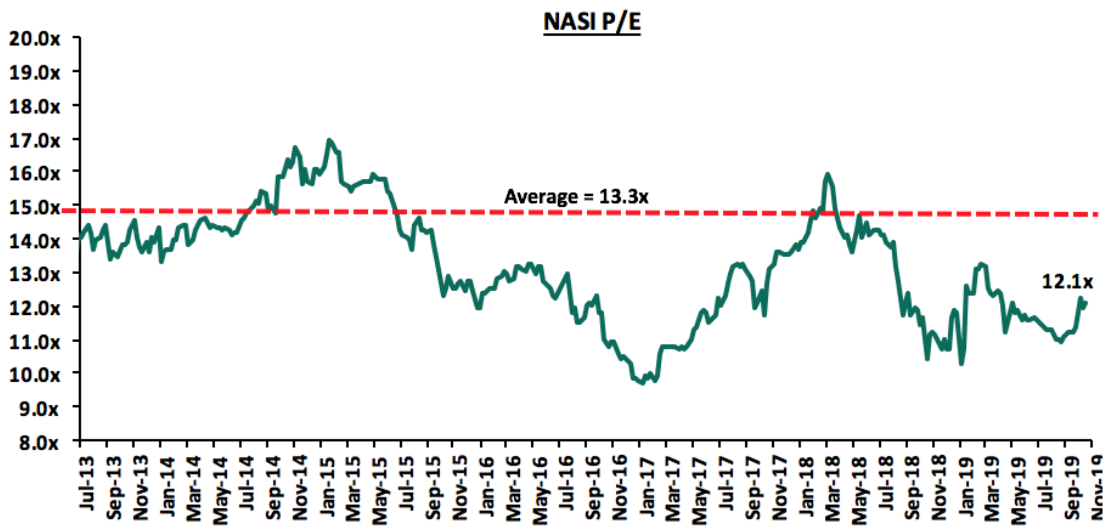
Equities

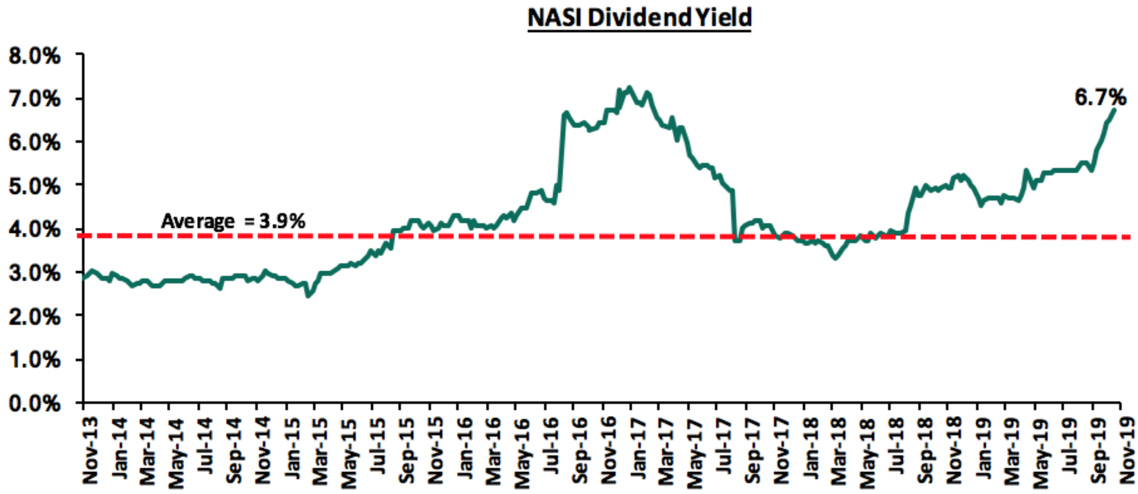
Market Performance

During the week, the equities market was on a downward trend with NASI, NSE 20 and NSE 25 declining by 2.4%, 3.1% and 2.7%, respectively, taking their YTD performance to gains/(losses) of (6.4%), 11.1% and 8.5%, respectively. The performance in NASI was driven by losses recorded by large-cap stocks, with BAT, Barclays Bank of Kenya, Co-operative Bank and Safaricom recording losses during the week of 8.3%, 6.7%, 4.5%, and 4.2%, respectively.

Equities turnover decreased by 54.6% during the week to USD 26.4 mn, from USD 58.3 mn the previous week, taking the YTD turnover to USD 1,326.8 mn. Foreign investors remained net buyers for the week, with a net buying position of USD 2.3 mn, a 134.1% increase from a net selling position of USD 6.6 mn recorded the previous week.

The market is currently trading at a price to earnings ratio (P/E) of 12.1x, 9.0% below the historical average of 13.3x, and a dividend yield of 6.7%, 2.8% points 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 12.1x is 24.7% above the most recent trough valuation of 9.7x experienced in the first week of February 2017, and 45.8% 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

Equity Group Holdings Plc released Q3'2019 results:

Equity Group Holdings Plc released their Q3'2019 results, recording a 10.4% increase in core earnings per share to Kshs 4.6, from Kshs 4.2 in Q3'2018, attributed to an 11.2% increase in total operating income to Kshs 54.8 bn from Kshs 49.3 bn in Q3'2018. Key highlights of the performance from Q3'2018 to Q3'2019 include:

- Core earnings per share increased by 10.4% to Kshs 4.6, from Kshs 4.2 in Q3'2018, slower than our projections of a 13.3% increase to Kshs 4.8. The performance was driven by an 11.2% increase in total operating income. The variance in core earnings per share growth against our expectations was largely due to a slower growth in total operating income by 11.2% to Kshs 54.8 bn, from Kshs 49.3 bn in Q3'2018, which was not in line with our expectation of a 12.3% increase to Kshs 55.4 bn,

- Total operating income recorded an 11.2% growth to Kshs 54.8 bn, from Kshs 49.3 bn in Q3'2018. This was driven by a 13.7% growth in Non-Funded Income (NFI) to Kshs 22.6 bn, from Kshs 19.8 bn in Q3'2018, coupled with a 9.5% growth in Net Interest Income to Kshs 32.3 bn, from Kshs 29.5 bn in Q3'2018,
- Interest income increased by 11.2% to Kshs 42.8 bn, from 38.5 bn in Q3'2018. This was driven by a 12.5% increase in interest income on loans and advances to Kshs 29.0 bn, from Kshs 25.8 bn in Q3'2018. Interest income on government securities, on the other hand, increased by 4.1% to Kshs 12.6 bn, from Kshs 12.1 bn in Q3'2018. The slightly stronger growth in interest income on loans as compared to interest from government securities is indicative of the benefits accruing to Equity Group Holding's strategy to increase lending to the private sector, focusing on Small and Medium Enterprises. The yield on interest earning assets, however, declined by 0.2% points to 10.9%, from 11.1% in Q3'2018,

- Interest expense rose by 16.8% to Kshs 10.5 bn, from Kshs 9.0 bn in Q3'2018, following the 15.4% increase in the interest expense on customer deposits to Kshs 8.1 bn, from Kshs 7.0 bn in Q3'2018, coupled with an 42.2% increase in interest expense on placements to Kshs 0.5 bn from Kshs 0.4 bn in Q3'2018, and a 17.5% increase in other interest expenses to Kshs 1.9 bn, from Kshs 1.6 bn in Q3'2018. The cost of funds, however, declined to 2.6%, from 2.7% in Q3'2018, owing to a faster increase in interest bearing liabilities that rose by 18.7% to Kshs 544.4 bn, from Kshs 458.5 bn in Q3'2018. Consequently, the Net Interest Margin (NIM) declined to 8.4%, from 8.5% in Q3'2018,

- Non-Funded Income (NFI) recorded a 13.7% growth to Kshs 22.6 bn, from Kshs 19.8 bn in

Q3'2018. The growth was mainly driven by the 21.7% increase in other fees to Kshs 11.4 bn, from Kshs 9.4 bn in Q3'2018. The growth was also supported by the 19.9% growth in forex trading income to Kshs 2.8 bn, from Kshs 2.4 bn in Q3'2018, and a 5.3% growth in other income to Kshs 4.0 bn, from Kshs 3.8 bn in Q3'2018, with management noting that the forex income segment benefitted from increased flows from the diaspora. Fees and commissions on loans, on the other hand, increased marginally by 0.4% points to Kshs 4.29 bn, from Kshs 4.28 bn in Q3'2018,

- The revenue mix shifted to 59:41 from 60:40 funded to non-funded income, owing to the faster growth in NFI as compared to growth in NII,

- Total operating expenses rose by 11.7% to Kshs 30.0 bn, from Kshs 26.9 bn in Q3'2018, largely driven by a 41.8% increase in Loan Loss Provisions (LLP) to Kshs 1.9 bn, from Kshs 1.3 bn in Q3'2018, coupled with a 12.8% rise in staff costs to Kshs 9.3 bn, from Kshs 8.3 bn in Q3'2018, and a 8.9% growth in other operating expenses to Kshs 18.9 bn, from Kshs 17.3 bn in Q3'2018
- As a result, the Cost to Income Ratio (CIR) deteriorated to 54.8%, from 54.6% in Q3'2018 However, without LLP, the cost to income ratio improved to 51.4%, from 51.9% in Q3'2018,
- Profit before tax increased by 10.6% to Kshs 24.8 bn, up from Kshs 22.4 bn in Q3'2018. Profit after tax recorded a 10.4% growth to Kshs 17.5 bn, from Kshs 15.8 bn, with the difference in growth attributable to the marginal increase in the effective tax rate to 29.5% from 29.4% in Q3'2018,
- The balance sheet recorded an expansion as total assets grew by 20.8% to Kshs 677.1 bn, from Kshs 560.4 bn in Q3'2018. The growth was supported by a 21.0% growth in loans and advances to Kshs 348.9 bn, from Kshs 288.4 bn in Q3'2018, coupled with a 7.7% growth in government securities to Kshs 135.1 bn, from Kshs 125.3 bn in Q3'2018. The growth was also driven by merger and acquisition activity with the bank announcing entering into a non-binding agreement with shareholders of Democratic Republic Bank of Congo to acquire a majority stake, a move which will see it increase its market share in Congo, having expanded into the region through its subsidiary, Equity Bank Congo. The bank has also entered into a binding term sheet agreement with Atlas Mara Ltd to acquire certain banking assets in Rwanda, Zambia, Tanzania and Mozambique,
- Total liabilities recorded a 21.0% growth to Kshs 568.4 bn, from Kshs 469.7 bn in Q3'2018, supported by a 18.9% growth in customer deposits, which rose to Kshs 478.1 bn, from Kshs 402.2 bn in Q3'2018, coupled with the 114.0% growth in other liabilities to Kshs 24.0 bn, from Kshs 11.2 bn in Q3'2018,
- The growth in both loans and deposits led to a marginal increase in the loan to deposit ratio to 73.0%, from 71.7% in Q3'2018, attributable to the faster growth in loans compared to deposits,
- Gross Non-Performing Loans (NPLs) increased by 15.4% to Kshs 30.5 bn in Q3'2019, from Kshs 26.5 bn in Q3'2018. The NPL ratio, however, improved to 8.4% in Q3'2019 from 8.9% in Q3'2018, attributable to a 21.5% growth in gross loans which outpaced the 15.4% growth in NPLs. The slight improvement in asset quality was largely attributed to a drop in the Large Enterprise sector's contribution to total NPL, from 14.7% to 9.2% in Q3'2019. The group's Tanzania subsidiary contributed 27.5% of the NPLs, with South Sudan and Kenya contributing 23.5% and 8.0%, respectively. General Loan Loss Provisions increased by 31.9% to Kshs 10.0 bn, from Kshs 7.6 bn in Q3'2018, thus, the NPL coverage improved to 45.8% in Q3'2019, from 38.9% in Q3'2018,
- Shareholder's funds recorded a 19.9% growth to Kshs 107.7 bn, from Kshs 89.8 bn in Q3'2018, supported by an 18.1% increase in retained earnings to Kshs 94.8 bn, from Kshs 80.3 bn in Q3'2018,
- Equity Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.7%, 6.2% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 20.5%, exceeding the statutory requirement of 14.5% by 6.0% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 17.5%, while total capital to risk-weighted assets came in at 21.2%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.9%, and a Return on Average

Equity (ROaE) of 21.3%.

Key Take-Outs:

1. The bank’s geographical diversification strategy has continued to emerge as a net positive, with the bank’s various subsidiaries in Uganda, DRC, Rwanda, Tanzania and South Sudan cumulatively contributing 18.0% of the bank’s total profitability and 27.0% of the group’s total asset base. Equity Group Holdings opened a commercial representative office in Addis Ababa, Ethiopia, and expected to commence operations in July. This is line with the bank’s strategy to expand into 9 African countries within the year, with the Ethiopian market being the first phase of regional expansion drive to attain Pan African status,
2. Increased innovation and digitization have seen 97.0% of all transactions of the bank being done on alternative channels, with mobile transactions taking up 77.0% of all transactions, and agency banking contributing 12.0% of all transactions. However, in terms of value of transactions, branches contributed 50.0% of the value of all transactions, with agency banking and mobile contributing 16.0% and 16.0%, respectively,
3. The bank’s asset quality improved, with the NPL ratio improving to 8.4% in Q3’2019, from 8.9% in Q3’2018. The main sectors that contributed to the NPLs are large enterprises and SMEs. In terms of the regional distribution of NPLs, the regions with the highest NPLs were Tanzania at 27.5% of their loan book, followed by South Sudan at 23.5% of their loan book. With the repeal of interest rate cap in Kenya, due to the Group’s focus on lending to the Small and Medium Enterprises (SMEs), we expect a slight deterioration of the loan book quality as the Group is set to lend more towards trade and real estate sectors.

Going forward, we expect the bank’s growth to be further propelled by;

?. **Channelled diversification:** This is likely to further improve on efficiency, with emphasis on alternative channels of transactions, as the bank rides on the digital revolution wave, thereby further improving the cost to income ratio by cost rationalization and revenue expansion. This will likely propel the bank’s prospects of achieving sustainable growth, as it replicates its successful business model across its various regional subsidiaries, and,

i. **The bank’s operating model of enhancing balance sheet agility:** This is likely to place the bank in a prime position to take advantage of any opportunities that may arise, such as attractive inorganic growth via acquisitions or fast lending in the event of a repeal of the interest rate cap. The bank’s balance sheet agility is seen given the bank’s high liquidity ratio of 54.2%.

For more information, see our Equity Group Holdings Q3'2019 Earnings Note

KCB Group released Q3’2019 results:

KCB Group released their Q3’2019 results, recording a 6.2% increase in core earnings per share to Kshs 6.3, from Kshs 5.9 in Q3’2018, attributed to a 10.0% increase in total operating income to Kshs 59.7 bn, from Kshs 54.2 bn in Q3’2018. Key highlights of the performance from Q3’2018 to Q3’2019 include:

- Core earnings per share increased by 6.2% to Kshs 6.3, from Kshs 5.9 in Q3’2018, driven by a 10.0% growth in total operating income to Kshs 59.7 bn from Kshs 54.2 bn in Q3’2018. The growth in core earnings per share was not in line with our expectations of an 8.6% growth, with the variance being attributable to the 13.4% increase in total expenses to Kshs 32.5 bn from Kshs 28.6 bn in Q3’2018, which exceeded our expectations of a 6.2% increase,
- Total operating income increased by 10.0% to Kshs 59.7 bn, from Kshs 54.2 bn in Q3’2018. This was due to a 16.9% increase in Non-Funded Income (NFI) to Kshs 21.0 bn, from Kshs 17.9 bn in Q3’2018, coupled with a 6.5% increase in Net Interest Income (NII) to Kshs 38.7 bn from Kshs 36.3 bn in Q3’2018,
- Interest income increased by 4.6% to Kshs 51.4 bn, from Kshs 49.2 bn in Q3’2018. This was driven

by a 4.7% increase in interest income from government securities to Kshs 10.2 bn, from Kshs 9.7 bn in Q3'2018, coupled with a 3.7% increase in interest income on loans and advances to Kshs 40.5 bn, from Kshs 39.0 bn in Q3'2018. The yield on interest-earning assets however declined to 11.0% from 11.4% in Q3'2018 attributed to a decline in yields on government securities as well as a decline in lending rates, which saw interest income growing by only 4.6% despite interest earning assets growing by 7.9%,

- Interest expenses declined by 0.8% to Kshs 12.8 bn, from Kshs 12.9 bn in Q3'2018, following an 8.1% decline in interest expense on deposits and placements from banking institutions to Kshs 1.5 bn, from Kshs 1.6 bn in Q3'2018. However, there was a 0.3% rise in interest expense on customer deposits to Kshs 11.31 bn from Kshs 11.28 bn in Q3'2018. The cost of funds thus declined to 2.9% from 3.2% in Q3'2018. The Net Interest Margin (NIM) declined to 8.2%, from 8.5% in Q3'2018, due to the faster growth of interest earning assets that outpaced the growth in Net Interest Income (NII),
- Non-Funded Income (NFI) increased by 16.9% to Kshs 21.0 bn, from Kshs 17.9 bn in Q3'2018. The increase was mainly driven by a 78.9% rise in fees and commissions on loans to Kshs 7.9 bn, from Kshs 4.4 bn in Q3'2018. The growth was however weighed down by the 5.5% and 5.8% declines in other fees and forex trading income to Kshs 6.2 bn and Kshs 3.5 bn from Kshs 6.6 bn and Kshs 3.7 bn, respectively. As a result, the revenue mix shifted to 65:35 from 67:33 funded to non-funded income, due to the faster growth in NFI compared to NII,
- Total operating expenses increased by 13.4% to Kshs 32.5 bn, from Kshs 28.6 bn, largely driven by a 224.2% rise in Loan Loss Provisions (LLP) to Kshs 5.8 bn in Q3'2019, from Kshs 1.8 bn in Q3'2018, coupled with a 6.2% rise in staff costs to Kshs 13.6 bn in Q3'2019, from Kshs 12.8 bn in Q3'2018,
- Due to the faster growth of total operating expenses that outpaced the growth in operating income, Cost to Income Ratio (CIR) deteriorated to 54.4%, from 52.8% in Q3'2018. Without LLP however, the cost to income ratio improved, to 44.7%, from 49.5% in Q3'2018,
- Profit before tax increased by 6.1% to Kshs 19.2 bn, up from Kshs 18.0 bn in Q3'2018. Profit after tax grew by 6.2% to Kshs 19.2 bn in Q3'2019, from Kshs 18.0 bn in Q3'2018 with the effective tax rate remaining unchanged at 29.5%,
- The balance sheet recorded an expansion as total assets increased by 11.7% to Kshs 764.3 bn, from Kshs 684.2 bn in Q3'2018. This growth was largely driven by an 11.7% increase in the loan book to Kshs 486.4 bn from Kshs 435.3 bn in Q3'2018. Investment in government and other securities also recorded a 7.5% growth to Kshs 128.5 bn, from Kshs 119.6 bn in Q3'2018,
- Total liabilities rose by 11.1% to Kshs 643.1 bn, from Kshs 578.7 bn in Q3'2018, driven by an 11.4% increase in deposits to Kshs 586.7 bn, from Kshs 526.8 bn in Q3'2018. Deposits per branch increased by 10.9% to Kshs 2.3 bn from Kshs 2.0 bn in Q3'2018, with the number of branches having increased to 258 from 257 in Q3'2018,
- The faster growth in loans as compared to deposits led to a rise in the loan to deposit ratio to 82.9% from 82.6% in Q3'2018,
- Gross Non-Performing Loans (NPLs) rose by 22.4% to Kshs 42.6 bn in Q3'2019 from Kshs 34.8 bn in Q3'2019. The NPL ratio thus deteriorated to 8.3% from 7.6% in Q3'2018 due to the faster growth in Gross Non-Performing Loans (NPLs) which outpaced the growth in loans. General Loan Loss Provisions increased by 15.0% to Kshs 19.2 bn, from Kshs 16.7 bn in Q3'2018. The NPL coverage however declined to 56.5% from 60.4% in Q3'2018 due to the faster growth in Gross Non-Performing Loans (NPLs) which outpaced the growth in General Loan Loss Provisions,
- Shareholders' funds increased by 15.0% to Kshs 121.2 bn in Q3'2019, from Kshs 105.5 bn in Q3'2018, as retained earnings grew by 27.8% y/y to Kshs 101.1 bn, from Kshs 79.1 bn in Q3'2018,
- KCB Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.1%, 7.6% above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio was 19.5%, exceeding the statutory requirement of 14.5% by 5.0%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 18.7%, while total capital to risk-weighted assets came in at 20.1%, and,

- The bank currently has a Return on Average Assets (ROaA) of 3.6%, and a Return on Average Equity (ROaE) of 22.2%.

Key Take-Outs:

1. The bank's asset quality deteriorated, with the NPL ratio increasing to 8.3%, from 7.6% in Q3'2018, due to the faster growth in Gross Non-Performing Loans (NPLs), which outpaced the growth in loans. The deterioration of the NPL ratio was mainly attributed to a deterioration in the corporate loan book's NPL ratio to 10.4% in Q3'2019 from in 9.6% in Q3'2018, the mortgage loan book to 9.4% from 7.5% in Q3'2018 as well as the SME and Micro loan book, which deteriorated to 14.7% in Q3'2019, from 14.3% in Q3'2018, respectively, and,
2. There was an improvement in operational efficiency as evidenced by the decline in the Cost to Income Ratio (CIR) without LLP to 44.7% in Q3'2019, from 49.5% in Q3'2018. This has mainly been driven by increased innovation and digitization which is evidenced by 95.0% of total transactions been performed outside the branch. This is comprising of 75.0% on mobile, 15.0% on agency, internet and POS and 5.0% on the ATM, while only 5.0% was performed by branch tellers. This has facilitated the faster growth of transactional income while maintaining a slower pace in the growth of operating expenses. This has also seen a 141.0% growth in non-branch revenue to over Kshs 8.6 bn.

Going forward, we expect the bank's growth to be driven by:

?. **Increased channelled diversification**: This is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt, as the bank aligned its staff head count to its operational needs. Continued emphasis on these alternative channels of transactions, as the bank rides on the digital revolution wave, will likely lead to further cost to income ratio improvements by cost rationalization and NFI expansion.

For more information, see our KCB Group Q3'2019 Earnings Note

Co-operative Bank released Q3'2019 results:

Co-operative Bank released their Q3'2019 results, recording a 5.5% increase in core earnings per share to Kshs 1.6, from Kshs 1.5 in Q3'2018, attributed to a 10.0% increase in total operating income to Kshs 35.2 bn, from Kshs 32.3 bn in Q3'2018. Key highlights of the performance from Q3'2018 to Q3'2019 include:

- Core earnings per share increased by 5.5% to Kshs 1.6 in Q3'2019, from Kshs 1.5 in Q3'2018, which was not in line with our projections of a 7.3% increase. The performance was driven by a 9.1% increase in total operating income to Kshs 35.2 bn in Q3'2019, from Kshs 32.3 in Q3'2018 and an 11.3% increase in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 11.3% rise in total operating expenses to Kshs 19.8 bn in Q3'2019, from Kshs 17.8 bn in Q3'2018, which was not in line with our expectation of an 8.0% increase to Kshs 19.2 bn,
- Total operating income increased by 9.1% to Kshs 35.2 bn in Q3'2019 from Kshs 32.3 bn in Q3'2018. This was due to a 33.3% increase in Non-Funded Income (NFI) to Kshs 14.1 bn from Kshs 10.6 bn in Q3'2018. The growth was however mitigated by the 2.7% decline in Net Interest Income (NII) to Kshs 21.2 bn from Kshs 21.7 bn in Q3'2018,
- Interest income declined by 1.6% to Kshs 30.4 bn in Q3'2019, from Kshs 30.9 bn in Q3'2018. This was caused by a 33.7% decline in interest income from loans and advances to Kshs 21.8 bn, from Kshs 32.9 bn in Q3'2018, as well as the 16.2% decrease in interest income from government securities to Kshs 8.2bn from Kshs 9.8 bn in Q3'2018. The yield on interest-earning assets thus declined to 11.5%, from 11.9% in Q3'2018,
- Interest expense rose marginally by 0.9% to Kshs 9.2 bn in Q3'2019, from Kshs 9.1 bn in Q3'2018, largely due to a 34.2% rise in other interest expenses to Kshs 1.2 bn from Kshs 0.9 bn in Q3'2018.

Interest expense on customer deposits, however, decreased by 2.5% to Kshs 8.0 bn, from Kshs 8.2 bn in Q3 2018. Whereas, interest expense on bank placements recorded a decline of 25.6% to 35.5 mn, from 47.7 mn in Q3’2018. The cost of funds declined to 3.6%, from 3.8% in Q3’2018, owing to a 9.2% increase in interest-bearing liabilities to Kshs 353.5 bn, from Kshs 323.6 bn in Q3’2018 despite the 0.9% decline in interest expense,

- Non-interest Income rose by 33.3 % to Kshs 14.1 bn in Q3’2019, from Kshs 10.6 bn in Q3’2018. The increase was mainly driven by the 37.8% increase in fees and commissions on loans to Kshs 1.8 bn, from Kshs 1.3 bn in Q3’2018, as well as, a 48.3% increase in other fees to 9.8 bn from 6.6 bn in Q3’2018. The improvement in NFI was however weighed down by the 7.7% decline in forex trading income to Kshs 1.6 bn, from Kshs 1.8 bn in Q3’2018. As a consequence, the revenue mix shifted to 60:40, from 67:33 funded to non-funded income in Q3’2018 owing to the fast growth in NFI compared to NII,
- Total operating expenses increased by 11.3% to Kshs 19.8 bn in Q3’2019, from Kshs 17.8 bn in Q3’2018, largely driven by the 66.8% rise in Loan Loss Provisions (LLP) to Kshs 2.1 bn from Kshs 1.3 bn in Q3’2018, coupled with the staff costs increase of 12.1% to Kshs 9.1 bn in Q3’2019 from Kshs 8.1 bn in Q3’2018,
- The Cost to Income Ratio (CIR) deteriorated to 56.2%, from 55.1% in Q3’2018, following the faster rise in total operating expenses that outpaced total operating income. Without LLP, the cost to income ratio improved to 50.2%, from 51.2% in Q3’2018,
- The bank registered a growth of 5.5% in profit after tax to Kshs 10.9 bn in Q3’2019, from Kshs 10.3 bn in Q3’2018 and a 5.5% growth in profit before tax to Kshs 15.5 bn, from Kshs 14.6 bn in Q3’2018 with the similarity in growth attributable to the unchanged effective tax rate of 29.6% in both Q3’2019 and Q3’2018,
- The balance sheet recorded an expansion as total assets grew by 9.1% to Kshs 440.8 bn in Q3’2019 from Kshs 404.2 bn in Q3’2018 owing to the increases in government securities by 13.6% to Kshs 94.6 bn in Q3’2019, from Kshs 83.3 bn, coupled with increase in placements by 47.5% to Kshs 24.3 from Kshs 16.5 bn, and, an increase in net loans and advances by 5.8% to Kshs 268.9 bn in Q3’2019, from Kshs 254.2 bn in Q3’2018,
- Total liabilities grew by 9.9% to Kshs 365.4 bn in Q3’2019 from Kshs 332.5 bn in Q3’2018 which was largely attributable to the 8.9% rise in customer deposits to Kshs 322.5 bn in Q3’2019, from Kshs 296.1 bn in Q3’2018,
- Borrowings rose by 14.4% to Kshs 29.7 bn, from Kshs 26.0 bn in Q3’2018,
- The faster 8.9% growth in deposits which outpaced the 5.8% growth in net loans and advances, led to a decline in the loan to deposit ratio to 83.4%, from 85.9% in Q3’2018,
- Gross Non-Performing Loans (NPLs) increased by 1.3% to Kshs 30.1 bn in Q3’2019, from Kshs 29.7 bn in Q3’2018. The NPL ratio however improved to 10.5% in Q3’2019, from 11.2% in Q3’2018 owing to a faster growth in gross loans by 7.7% outpacing the 1.3% growth in gross non-performing loans
- General Loan Loss Provisions increased by 15.2% to Kshs 11.4 bn, from Kshs 9.9 bn in Q3’2018. The NPL coverage ratio thus improved to 55.5% in Q3’2019 from 36.8% in Q3’2018, due to the faster growth in General Loan Loss Provisions which outpaced the growth in Gross Non-Performing Loans (NPLs)
- Shareholders’ funds increased by 4.3% to Kshs 73.9 bn in Q3’2019 from Kshs 70.9 bn in Q3’2018, mainly driven by a 3.1% increase in the retained earnings to Kshs 64.4 bn, from Kshs 62.5 bn in Q3’2018,
- Co-operative Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.4%, 4.9% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 15.7%, exceeding the statutory requirement of 14.5% by 1.2% points.
- The bank currently has a Return on Average Assets (ROaA) of 3.2%, and a Return on Average Equity (ROaE) of 18.4%.

Key Take-Outs:

1. Non-Funded Income (NFI) rose by 33.3 % to Kshs 14.1 bn in Q3’2019, from Kshs 10.6 bn in Q3’2018 exceeding the industry average growth of 21.3%. The increase was mainly driven by the 37.8% increase in fees and commissions on loans to Kshs 1.8 bn, from Kshs 1.3 bn in Q3’2018, as well as, a 48.3% increase in other fees to Kshs 9.8 bn from Kshs 6.6 bn. The improvement in NFI was however weighed down by the 7.7% decline in forex trading income to Kshs 1.6 bn, from Kshs 1.8 bn in Q3’2018. As a consequence, the revenue mix shifted to 60:40, from 67:33 funded to non-funded income in Q3’2018 owing to the fast growth in NFI which was attributable to increased activity in Bancassurance and advisory and training services, compared to NII, and,
2. The bank’s asset quality improved, with the NPL ratio decreasing to 10.5% in Q3’2019, from 11.2% in Q3’2018 owing to a faster growth in gross loans by 7.7% outpacing the 1.3% growth in gross non-performing loans which is attributable to the implementation of credit management strategies implemented since the beginning of the year such as adherence to credit risk appetite and limits, credit risk early warning indicators, proper credit appraisal and approval mechanisms.

Going forward, we expect the bank’s growth to be driven by:

?. **Refocus on the core operations**: Prior to Q3’2019 the bank preferred to diversify to increase NFI due to the declining interest income however, now that there is potential for increasing interest income, the bank should refocus on lending to private sector which will not only increase interest income but also, it will increase fees and commissions on loans,

i. **Maximization of the interest rate cap repeal:** With the repeal of the interest rate cap the bank does not have to focus on cherry-picking loans to ensure proper credit management, instead, they can price loans according to the level of risk which will increase their loans to deposits ratio and interest income,

ii. **Improved cost efficiency through technology:** If the focus is placed more on online platforms and e-platforms the bank could be able to reduce costs especially staff costs which increased by 12.1%.

For more information, see our Co-operative Bank Q3'2019 Earnings Note

The table below summarizes the performance of listed banks that have released their Q3’2019 results:

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
Equity Group	10.4%	11.2%	16.8%	9.5%	8.4%	13.7%	41.1%	15.0%	18.9%	7.8%	73.0%	21.0%	22.8%
KCB Group	6.2%	4.6%	(0.8%)	6.5%	8.2%	16.9%	35.2%	28.5%	11.4%	7.5%	82.9%	11.7%	22.2%
Co-operative Bank	5.5%	(1.6%)	0.9%	(2.7%)	8.3%	33.3%	40.0%	46.6%	8.9%	13.6%	83.4%	5.8%	18.4%
NBK	(4.7%)	4.7%	(8.2%)	11.6%	7.2%	(4.6%)	23.8%	4.5%	(11.1%)	(17.1%)	58.0%	(0.3%)	5.5%
Q3'2019 Mkt Weighted Average*	**7.8%**	**6.1%**	**6.9%**	**5.9%**	**8.3%**	**18.9%**	**38.6%**	**26.5%**	**13.9%**	**8.8%**	**78.8%**	**14.3%**	**21.6%**
Q3'2018 Mkt Weighted Average**	**16.2%**	**6.1%**	**12.5%**	**3.8%**	**8.0%**	**5.9%**	**34.5%**	**0.6%**	**7.4%**	**17.8%**	**75.3%**	**4.2%**	**18.8%**

***Market cap weighted as at 15/11/2019**

****Market cap weighted as at 30/11/2018**

Key takeaways from the table above include:

?. The four listed Kenyan banks that have released their results recorded an 7.8% average increase in core Earnings Per Share (EPS), compared to an increase of 16.2% in Q3’2018 for all listed banks. Consequently, the Return on Average Equity (ROaE) increased to 21.6%, from 18.8% in Q3’2018,

i. The banks recorded stronger deposit growth, which came in at 13.9%, faster than the 7.4%

growth recorded in the sector in Q3'2018. Interest expenses increased at a slower pace of 6.9%, compared to 12.5% in Q3'2018, indicating the banks have been able to mobilize relatively cheaper deposits,

ii. Average loan growth came in at 14.3%, which was faster than the 4.2% recorded in the sector in Q3'2018, indicating that there was an improvement in credit extension by the banks. Government securities recorded a growth of 8.8% y/y, which was slower compared to the loans, and a decline from the 17.8% recorded in the sector in Q3'2018. This highlights that banks are beginning to adjust their business models back to private sector lending as opposed to investing in government securities, as the yields on government securities declined during the year. Interest income increased by 6.1%, similar to the growth receorded in the sector in Q3'2018. Consequently, the Net Interest Income (NII) grew by 5.9% compared to a growth of 3.8% in the sector in Q3'2018,

iii. The banks recorded a Net Interest Margin of 8.3%, 30 bps higher than 8.0% the sector recorded in Q3'2018, this can be attributed to the faster growth in loans compared to lower yielding governement securities, and,

iv. Non Funded Income grew by 18.9% y/y, faster than the 5.9% recorded in the sector in Q3'2018. The growth in NFI was boosted by the total fee and commission income which improved by 26.5%, compared to the 0.6% growth recorded in the sector Q3'2018, owing to the faster loan growth.

Universe of Coverage

Below is a summary of our universe of coverage:

Banks	Price at 8/11/2019	Price at 15/11/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Sanlam	17.0	17.0	0.0%	(14.8%)	29.0	0.0%	70.6%	**0.7x**	**Buy**
I&M Holdings* **	50.0	49.1	(1.9%)	5.9%	79.8	8.0%	70.6%	**0.8x**	**Buy**
Diamond Trust Bank	120.0	115.3	(4.0%)	(27.2%)	175.6	2.3%	54.6%	**0.6x**	**Buy**
Kenya Reinsurance	3.1	3.1	(0.6%)	(17.2%)	3.8	14.4%	34.6%	**0.3x**	**Buy**
KCB Group* **	49.9	50.3	0.7%	12.1%	61.4	7.0%	29.1%	**1.3x**	**Buy**
CIC Group	3.2	3.2	(2.2%)	(20.5%)	3.8	4.1%	24.4%	**1.1x**	**Buy**
Jubilee holdings	350.3	350.0	(0.1%)	(13.5%)	418.5	2.6%	22.1%	**0.9x**	**Buy**
Britam	7.4	7.5	1.1%	(30.2%)	8.8	0.0%	17.3%	**0.7x**	**Accumulate**
NCBA	34.9	34.0	(2.6%)	7.7%	37.9	4.4%	16.0%	**0.7x**	**Accumulate**
Equity Group* **	48.9	47.5	(2.9%)	7.5%	53.0	4.2%	15.9%	**1.9x**	**Accumulate**
Barclays Bank* **	12.7	11.9	(6.7%)	0.0%	12.6	9.3%	15.4%	**1.5x**	**Accumulate**
Standard Chartered	202.3	200.0	(1.1%)	2.7%	208.0	9.5%	13.5%	**1.5x**	**Accumulate**
Liberty Holdings	10.3	10.5	1.9%	(24.7%)	11.3	4.8%	12.4%	**0.7x**	**Accumulate**
Co-op Bank* **	15.7	15.0	(4.5%)	(16.8%)	15.0	6.7%	6.6%	**1.3x**	**Hold**
Stanbic Holdings	110.0	109.5	(0.5%)	5.8%	100.5	4.4%	(3.8%)	**1.2x**	**Sell**
HF Group	7.2	6.7	(7.8%)	27.1%	2.8	0.0%	(58.5%)	**0.3x**	**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.