Cytonn SSA Financial Services Research Weekly Note - 12th November 2018

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Executive Summary: During the week, the equities market recorded mixed performances with NGSEASI gaining by 0.2%, while NASI and GGSECI declined by 0.6% and 1.1%, respectively. This takes their YTD performance to (2.2%), (13.3%), and (16.5%) for the GGSECI, NASI, and NGSEASI, respectively.

Section I: Market Performance:

During the week, the equities market recorded mixed performances with NGSEASI gaining by 0.2%, while NASI and GGSECI declined by 0.6% and 1.1%, respectively. This takes their YTD performance to (2.2%), (13.3%), and (16.5%) for the GGSECI, NASI, and NGSEASI, respectively.

Below is a summary of top gainers and losers in our universe of coverage for last week:

Summary of Top Gainers and Losers for Week Ending 9th November 2018					
Top Gainers			Top Losers		
Company	**Country**	**Change**	**Company**	**Country**	**Change**
National Bank	Kenya	**22.3%**	Bank of Baroda	Uganda	**(10.7%)**
Ecobank	Ghana	**4.6%**	Access Bank	Nigeria	**(7.8%)**
Zenith Bank	Nigeria	**3.6%**	Union Bank Plc	Nigeria	**(4.0%)**
Diamond Trust Bank	Kenya	**3.2%**	CRDB	Tanzania	**(3.3%)**
Barclays Kenya	Kenya	**2.3%**	Ecobank Transnational	Nigeria	**(2.8%)**

Kenya

NASI declined by 0.6% last week, driven by declines in large cap stocks such as Equity Group Holdings, Co-operative Bank, Safaricom and East Africa Breweries Limited (EABL), which declined by 1.3%, 1.1%, 1.0% and 0.6%, respectively. In our financial services universe of coverage, the best stocks w/w were National Bank, Diamond Trust Bank and Barclays Kenya, which gained 22.3%, 3.2% and 2.3%. Equities turnover declined by 71.7% during the week to USD 10.7 mn from USD 37.8 mn the previous week, taking the YTD turnover to USD 1.6 bn. Foreign investors remained net sellers for the week, with a net selling position of USD 0.3 mn, a 95.4% decline from last week's net selling position of USD 7.1 mn. We expect the market to remain subdued in the near-term as international investors exit the broader emerging markets due to the expectation of rising US interest rates coupled with the strengthening of the US Dollar.

Nigeria

The Nigerian All Share index gained 0.2% during the week, largely driven by gains in the consumer staples, energy and industrials segments, which gained 2.0%, 2.3% and 1.6%, respectively. For our financial services universe of coverage, Zenith Bank gained 3.6%, while Access Bank, Union Bank and Ecobank Transnational declined by 7.8%, 4.0% and 2.8%, respectively. Total turnover for the week decreased by 10.6% to USD 50.0 mn from USD 55.9 mn the previous week.

Ghana

The GSE Composite Index declined by 1.1% during the week. In our universe of coverage for Ghana, Ecobank gained by 4.6%, while CAL Bank and Ghana Commercial Bank declined by 1.9% and 1.2%. Total turnover for the week was USD 0.06 mn (GHS 0.3 mn).

Section II: Earnings Releases:

Equity Group Holdings released Q3'2018 results during the week;

Equity Group Holdings released their Q3'2018 results, registering core earnings per share growth of 8.1% to Kshs 4.2 from Kshs 3.9 in Q3'2017, below our expectation of a 23.2% increase to Kshs 4.8. The performance was driven by a 1.1% increase in total operating income, coupled with a 4.0% decline in the total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 6.7% decline in Non-Funded Income (NFI) to Kshs 19.8 bn from Kshs 21.3 bn. We had expected a 4.8% increase in NFI to Kshs 22.3 bn from Kshs 21.3 bn in Q3'2017. Highlights of the performance from Q3'2017 to Q3'2018 include:

- Total operating income increased by 1.1% to Kshs 49.3 bn from Kshs 48.8 bn over the same period to Q3'2017. This was due to a 7.2% increase in Net Interest Income (NII) to Kshs 29.5 bn from Kshs 27.5 bn in Q3'2017, which outweighed the 6.7% decline in Non-Funded Income (NFI) to Kshs 19.8 bn, from Kshs 21.3 bn in Q3'2017,

- Interest income increased by 8.6% to Kshs 38.5 bn, from Kshs 35.4bn in Q3'2017. This was driven by a 24.1% growth in interest income from government securities to Kshs 12.1 bn from Kshs 9.8 bn in Q3'2017, and a 2.9% increase in interest income on loans and advances to Kshs 25.8 bn, from Kshs 25.0 bn in Q3'2017. Interest income on deposits and placements with banking institutions rose by 15.2% to Kshs 0.5 bn from Kshs 0.4 bn in Q3'2017. However, the yield on interest earning assets declined to 11.1% in Q3'2018 from 12.1% in Q3'2017, due to a faster increase at 24.1% in government securities that have relatively lower yields than loans,

- Interest expense increased by 13.5% to Kshs 9.0 bn from Kshs 7.9 bn in Q3'2017, following an 8.8% increase in the interest expense on customer deposits to Kshs 7.0 bn, from Kshs 6.5 bn in Q3'2017. Interest expense on deposits and placements from banking institutions increased by 108.7% to Kshs 0.4 bn from Kshs 0.2 bn in Q3'2017. Other interest expenses increased by 23.7% to Kshs 1.6 bn, from Kshs 1.3 bn in Q3'2017. The cost of funds thus increased to 2.7%, from 2.6% in Q3'2017. As a consequence, the Net Interest Margin (NIM) declined to 8.5%, from 9.4% in Q3'2017,

- Non-Funded Income (NFI) declined by 6.7% to Kshs 19.8 bn, from Kshs 21.3 bn in Q3'2017. The decline in NFI was realized across all NFI segments. Fees and commissions on loans declined by 1.7% to Kshs 4.28 bn from Kshs 4.35 bn in Q3'2017. Other fees and commission income declined by 2.7% to Kshs 9.4 bn, from Kshs 9.6 bn in Q3'2017. Forex trading income declined by 7.4% to Kshs 2.4 bn, from Kshs 2.6 bn in Q3'2017. Other income declined by 19.1% to Kshs 3.8 bn, from Kshs 4.7 bn in Q3'2017. As a result, the current revenue mix shifted to 60:40 funded to non-funded income as compared to 56:44 in Q3'2017. The proportion of NFI to total revenue decreased owing to the decline in NFI coupled with the increase in NII,

- Total operating expenses declined by 4.0% to Kshs 26.9 bn, from Kshs 28.0 bn, largely driven by a 54.0% decrease in Loan Loss Provisions (LLP) to Kshs 1.3 bn in Q3'2018, from Kshs 2.9 bn in Q3'2017, coupled with a marginal decrease in other operating expenses to Kshs 17.31 bn in Q3'2018, from Kshs 17.34 bn in Q3'2017. Staff costs however rose by 6.0% to Kshs 8.3 bn from Kshs 7.8 bn in Q3'2017, attributed to heavy recruitment by the bank for several managerial positions, and the data analytics departments across its group and subsidiary offices,

- The Cost to Income Ratio (CIR) improved to 55.0%, from 57.5% in Q3'2017. Without LLP, the cost to income ratio deteriorated albeit marginally to 51.9%, from 51.6% in Q3'2017,
- Profit before tax increased by 8.1% to Kshs 22.4 bn, up from Kshs 20.7 bn in Q3'2017. Profit after tax also increased by 8.1% to Kshs 15.8 bn in Q3'2018, from Kshs 14.6 bn in Q3'2017,
- The balance sheet recorded an expansion as total assets increased by 8.1% to Kshs 560.4 bn from Kshs 518.2 bn in Q3'2017. This growth was largely driven by a 24.1% increase in government securities to Kshs 158.6 bn, from Kshs 127.7 bn in Q3'2017, coupled with an 8.6% increase in their loan book to Kshs 288.4 bn from Kshs 265.5 bn in Q3'2017,
- Total liabilities rose by 9.7% to Kshs 469.7 bn from Kshs 428.1 bn in Q3'2017, driven by a 9.1% increase in total deposits to Kshs 402.3 bn from Kshs 368.8 bn in Q3'2017. Deposits per branch also increased by 9.1% to Kshs 1.4 bn from Kshs 1.3 bn in Q3'2017, with no new branches opened or closed. Placement liabilities increased by 304.3% to Kshs 9.9 bn from Kshs 2.5 bn in Q3'2017. Borrowings increased by 1.4% to Kshs 46.3 bn from Kshs 45.7 bn in Q3'2017,
- The faster growth in deposits as compared to loans led to a slight decline in the loan to deposit ratio to 71.7% from 72.0% in Q3'2017,
- Gross Non-Performing Loans (NPLs) increased by 28.1% to Kshs 26.5 bn in Q3'2018 from Kshs 20.7 bn in Q3'2017. Consequently, the NPL ratio deteriorated to 8.9% in Q3'2018 from 7.5% in Q3'2017. General Loan Loss Provisions (LLPs) increased by 3.8% to Kshs 7.6 bn from Kshs 7.3 bn in Q3'2017. With the growth in NPLs not matched with a similar increase in provisioning, the NPL coverage decreased to 38.9% in Q3'2018 from 48.2% in Q3'2017. The increase in the non-performing loans was attributed major corporate clients. Large enterprises contributed the largest proportion of NPLs at 14.7%, with Small and Medium Enterprises (SMEs) contributing 9.4% and agriculture 5.4%. In terms of regional contribution, South Sudan contributed 40.9% of total NPLs, with Tanzania and Kenya contributing 12.9% and 9.1%, respectively,
- Shareholders' funds increased marginally by 0.6% to Kshs 90.7 bn in Q3'2018 from Kshs 90.1 bn in Q3'2017, as retained earnings grew by 6.9% y/y to Kshs 80.3 bn from Kshs 75.1 bn. The growth was however weighed down by revaluation losses, which rose 41.0% to Kshs 8.4 bn from Kshs 6.0 bn in Q3'2017,
- Equity Group Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 18.0%, 7.5% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 18.0%, exceeding the statutory requirement by 3.5%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 21.9%, while total capital to risk weighted assets came in at 18.8%, indicating that the bank's total capital relative to its risk-weighted assets declined by 0.8% due to implementation of IFRS 9,
- The bank currently has a Return on Average Assets (ROaA) of 3.9% and a Return On Average Equity (ROaE) of 22.2%.

We expect the bank's growth to be further propelled by:

Channelled diversification, which is likely to further improve 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. With management indicating their strategy of capturing market share and monetize later, this will likely propel the bank's prospects of achieving sustainable growth in the segment, as it deploys its successful business model across its various regional subsidiaries, such as DRC Congo, which has 85.0% of the population that is unbanked, thereby presenting significant headroom for growth.

For more information, [see our Equity Group Holdings Q3'2018 Earnings Note]

Section III: Latest Developments in the Sub Saharan Africa Banking Sector during the week:

Kenya

Morocco based bank Attijariwafa Bank highlighted its plans for several acquisitions in Africa in the coming year, with the key focus countries being Rwanda, Kenya and Ethiopia. Attijariwafa, Morocco's biggest bank with an asset base of USD 51.0 bn, has subsidiaries in Cameroon, Congo Republic, Egypt, Gabon, Ivory Coast, Mali, Mauritania, Senegal, Tunisia and Togo. The bank highlighted its strategy to acquire the top five banks in terms of asset base, in their respective operating markets. In August 2017, the bank acquired the Egyptian unit of Barclays, with the transaction details yet to be disclosed. However, the Bank's CEO indicated the acquisition happened at almost 2 times the bank's equity, which translates to USD 0.5 bn, with the bank's equity at the time being USD 0.3 bn. The 5 largest banks in Kenya by asset base include KCB Group, Equity Group Holdings, Cooperative Bank, Standard Chartered Bank Kenya and Diamond Trust Bank Kenya, and there is no indication that any of them could be up for sale hence in Kenya, Attijariwafa would have to look into second and third tier banks. The Kenyan banking sector has had several acquisitions in the last 5-years, with the acquisition of Chase Bank by SBM Bank Kenya being the most recent. The acquisition of Imperial Bank Limited under Receivership by KCB is still ongoing, with the Kenya Deposit Insurance Corporation (KDIC) acknowledging the receipt of the revised proposal from KCB in July 2018. We maintain our expectations of continued acquisitions in the Kenyan banking sector, as the smaller banks that do not serve any niche, and are constrained in capital, become acquired by the larger and more stable banks. This would improve the industry's overall stability by having fewer but stronger players.

Nigeria

Access Bank Plc has collaborated with Transfast, a cross-border payments and remittance firm, to facilitate inflow of remittance to bank accounts and delivery in the form of cash pay-outs from any of Access Bank's outlets in Nigeria. The two entities signed a global agreement to offer remittance services to expatriates sending money across select markets in Africa. The new partnership further expands Transfast's presence in Nigeria, allowing its customers in over 125 countries to send money to millions of Access Bank accounts as well as non-account holders. Access Bank is one a leading commercial banks in Nigeria, with an extensive network of 15 million customer accounts and over 318 branches in Nigeria, Democratic Republic of the Congo, Ghana, Rwanda, The Gambia, Sierra Leone and Zambia. With approximately 15 million Nigerians living in the diaspora, remittances play a significant role in Nigeria's economy. According to World Bank estimations, Nigeria received USD 22 bn (NGN 8.0 tn) in diaspora remittances in 2017, making it the largest recipient in Africa. In our view, the new partnership would increase convenience and ease of banking for Access Bank's customers in Nigeria as well as support the country's efforts to achieve financial inclusion.

Ghana

Societe Generale Ghana Limited (SOGEGH) announced the results of the rights issue that run between 4th to 24th, 2018. The exercise managed to raise GHS 165.4 mn from issuance of 204.2 mn shares, representing a success rate of 97.9%. The bank had planned to raise GHS 168.9 mn by issuing 208.6 mn shares at a price of GHS 0.81 per share, which translated to a 19.0% discount from the GHS 1.0 market price as at book closure, for a ratio of 1 for every 2.4 shares held. SG Financial Services Holding, who had committed to ensure full subscription, subscribed to the remaining GHS 3.5 mn by covering 4.3 mn shares. This brings the total number of outstanding shares to 709.1 mn, from an initial 500.6 mn shares before the issue, translating to a total valuation of GHS 574.4 mn. The newly offered shares will be listed on the Ghana Stock Exchange on Tuesday November 13, 2018. The bank is now adequately capitalized, with the capital raised increasing its stated capital to GHS 400.7 mn from GHS 235.3 mn.

Section IV: Equities Universe of Coverage:

The week-on-week performance, valuation and expected return of the companies in our SSA universe of coverage is highlighted in the table below:

Equities Universe of Coverage									
Banks	Price as at 2/11/2018	Price as at 9/11/2018	w/w change	YTD Change	LTM Change	Target Price	Dividend Yield	Upside/Downside	P/TBv Multiple
NIC Bank***	23.0	23.0	0.0%	(31.9%)	(33.4%)	48.8	4.3%	116.5%	**0.6x**
Diamond Trust Bank	155.0	160.0	3.2%	(16.7%)	(14.9%)	283.7	1.6%	78.9%	**0.9x**
KCB Group***	38.0	38.0	0.0%	(11.1%)	(7.3%)	61.3	7.9%	69.2%	**1.2x**
Union Bank Plc	5.1	4.9	(4.0%)	(37.8%)	(20.8%)	8.2	0.0%	68.0%	**0.5x**
Ghana Commercial Bank***	5.2	5.1	(1.2%)	0.8%	20.3%	7.7	7.5%	59.1%	**1.2x**
I&M Holdings***	90.0	90.0	0.0%	(29.1%)	(25.0%)	138.6	3.9%	57.9%	**0.9x**
Ecobank	6.7	7.0	4.6%	(7.9%)	2.1%	10.7	0.0%	53.3%	**1.5x**
Equity Group	39.5	39.0	(1.3%)	(1.9%)	(2.5%)	56.2	5.1%	49.2%	**1.9x**
Zenith Bank***	23.6	24.4	3.6%	(4.8%)	(2.8%)	33.3	11.1%	47.6%	**1.1x**
Co-operative Bank	14.4	14.2	(1.0%)	(11.3%)	(13.1%)	19.9	5.6%	45.8%	**1.2x**
UBA Bank	7.9	8.0	0.6%	(22.8%)	(18.0%)	10.7	10.7%	45.3%	**0.5x**
CRDB	150.0	145.0	(3.3%)	(9.4%)	(9.4%)	207.7	0.0%	43.2%	**0.5x**
CAL Bank	1.0	1.0	(1.9%)	(5.6%)	11.0%	1.4	0.0%	37.3%	**0.9x**
HF Group	5.3	5.4	0.9%	(48.6%)	(51.1%)	6.6	6.5%	29.9%	**0.2x**
Access Bank	8.4	7.7	(7.8%)	(26.3%)	(23.2%)	9.5	5.2%	28.6%	**0.5x**
Barclays	11.0	11.2	2.3%	16.7%	12.0%	12.5	8.9%	20.5%	**1.5x**
Stanbic Bank Uganda	33.0	33.0	0.0%	21.1%	21.1%	36.3	3.5%	13.5%	**2.3x**
SBM Holdings	6.2	6.1	(0.3%)	(18.1%)	(17.9%)	6.6	4.9%	11.7%	**0.9x**
Standard Chartered	188.0	192.0	2.1%	(7.7%)	(15.4%)	196.3	6.5%	8.8%	**1.5x**
Bank of Kigali	289.0	289.0	0.0%	(3.7%)	1.4%	299.9	4.8%	8.6%	**1.6x**
Bank of Baroda	140.0	125.0	(10.7%)	10.6%	13.6%	130.6	2.0%	6.5%	**1.1x**
Guaranty Trust Bank	37.5	37.2	(0.9%)	(8.8%)	(12.6%)	37.1	6.5%	6.3%	**2.3x**
Stanbic Holdings	91.5	91.5	0.0%	13.0%	14.4%	92.6	2.5%	3.7%	**0.9x**
FBN Holdings	7.7	7.5	(2.6%)	(15.3%)	2.9%	6.6	3.4%	(7.7%)	**0.4x**
Standard Chartered	21.8	21.8	0.0%	(13.7%)	27.2%	19.5	0.0%	(10.7%)	**2.7x**
National Bank	4.7	5.8	22.3%	(38.5%)	(45.0%)	4.9	0.0%	(14.8%)	**0.4x**
Stanbic IBTC Holdings	47.0	47.1	0.2%	13.5%	10.8%	37.0	1.3%	(20.2%)	**2.4x**
Ecobank Transnational	16.0	15.6	(2.8%)	(8.5%)	(8.5%)	9.3	0.0%	(40.3%)	**0.6x**

****Target Price as per Cytonn Analyst estimates***
*****Upside / (Downside) is adjusted for Dividend Yield***
******Banks in which Cytonn and/or its affiliates holds a stake.***
******* Stock prices are in respective country currency***

We are "NEUTRAL" on equities since the markets are currently trading below historical P/E averages. However, pockets of value continue to exist, with a number of undervalued sectors like Financial Services, which provide an attractive entry point for medium and long-term investors, and with expectations of higher corporate earnings this year, we are "POSITIVE" for investors with a long-term investment horizon.