Cytonn SSA Financial Services Research Weekly Note #02/2019

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Executive Summary: During the week, the equities market recorded mixed performances with NASI having gained by 4.4%, while GGSECI and NGSEASI declined by 1.3% and 2.8%, respectively, taking their YTD performance to 1.7%, (1.9%) and (5.3%) for NASI, GGSECI and NGSEASI, respectively. Commercial Bank of Africa (CBA) issued a cash buy-out offer of Kshs 1.4 bn to Jamii Bora bank. If accepted, would mark the second consolidation deal in 2019.

Section I: Market Performance:

During the week, the equities market recorded mixed performances with NASI gaining by 4.4% while GGSECI and NGSEASI declined by 1.3% and 2.8%, respectively, taking their YTD performance to 1.7%, (1.9%) and (5.3%) for NASI, GGSECI and NGSEASI, respectively. Below is a summary of top gainers and losers in our universe of coverage for last week:

Weekly Top Gainers and Losers					
Top Gainers			Top Losers		
Company	Country	Change	Company	Country	Change
Equity Group	Kenya	9.5%	UBA Bank	Nigeria	(7.0%)
National Bank	Kenya	5.4%	CRDB	Tanzania	(6.7%)
Standard Chartered	Kenya	2.2%	HF Group	Kenya	(3.9%)
Barclays	Kenya	1.8%	Ecobank Transnational	Nigeria	(3.6%)
SBM Holdings	Mauritius	1.7%	Stanbic Bank Uganda	Uganda	(3.0%)

Kenya

During the week, NASI gained by 4.4% driven by gains in large cap stocks such as Safaricom, Equity Group, National Bank, Standard Chartered and Barclays, which gained by 9.9%, 9.5%, 5.4, 2.2% and 1.8%%, respectively. In our universe of coverage Diamond Trust Bank, and KCB Group declined by 2.6% and 1.2% respectively, while NIC Bank gained by 0.5%. Equities turnover rose by 103.7% during the week to USD 21.9 mn from USD 10.7 mn the previous week, owing to a shortened trading week due to the New Year holiday, taking the YTD turnover to USD 29.2 mn. Foreign investors remained net sellers for the week, with a net selling position of USD 1.9 mn, a 30.6% decrease from last week's net selling position of USD 2.8 mn.

Nigeria

The Nigerian All Share index declined by 2.8% during the week, owing to drops Insurance, Oil & Gas and Consumer goods sectors which recorded declines of 7.0%, 6.3% and 3.6%, respectively. For our financial services universe of coverage, UBA Bank and Ecobank Transnational declined by 7.0% and 3.6 %, respectively while Guaranty Trust Bank and Zenith Bank gained by 1.8% and 0.7%, respectively

Ghana

The GSE Composite Index declined by 1.3% during the week, driven mainly by declines in large cap stocks. Our universe of coverage delivered mixed results, with CAL Bank gaining by 1.0%, while Ghana Commercial Bank declined by 0.2%.

Section II: Earnings Releases

There were no earnings released during the week

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

Kenya

During the week, the amendment to the Income Tax Act, included in the Finance Act 2018, was made public. The amendment makes it a requirement for Kenyan firms to pay a 30.0% tax on dividends received from their subsidiaries, and are redistributed to shareholders. Under the previous legislation, a holding company would receive dividends from its subsidiary, without paying the withholding tax, if its ownership in the subsidiary exceeded 12.5%. The tax is payable on dividends distributed out of net income that have not been previously taxed. The introduced amendments scrapped the requirement by companies to maintain a dividend tax account, effectively abolishing and replacing the compensating tax, which would be chargeable on distribution of untaxed gains or profits. The distribution of qualifying dividends attracts withholding tax at the rate of 5.0% for residents, and 10.0% for non-resident shareholders. However, distribution of dividends to a company controlling more than 12.5% of the distributing company is exempt from withholding tax. Thus, with the new regulation being enforced, it seems that companies distributing the tax-exempt dividends from subsidiaries to their holding companies, would not be exempted from the withholding tax even if the holding company owns more than 12.5% of the subsidiary, and effectively, in our view, creating a higher tax expense, which is a contradiction to the prevailing provision. Secondly this would also mean that there would be double taxation, given that dividends are obtained from after-tax income, and redistribution of the same, does not change the fact the income had undergone taxation. When enforced, it may also lead to a downgrade of the country's investment attractiveness, given the relatively stricter tax profile that would effectively reduce the absolute dividend income received by investors.

Commercial Bank of Africa (CBA) has issued a cash buy-out offer of Kshs 1.4 bn to Jamii Bora bank. The Kshs 1.4 bn buyout represents a steep discount from the Kshs 3.4 bn book value as at Q1'2018. This essentially implies the transaction, if the offer is accepted and no further injections made, would happen at a Price to Book ratio (P/Bv) of 0.4x, significantly lower than the average P/B ratio of 1.6x of recent transactions in the banking sector. Jamii Bora had a deposit base of Kshs 5.0 bn, and a net loan book of Kshs 7.9 bn. The bank had a relatively solid capital base, with a total capital to risk-weighted assets ratio of 19.3%, exceeding the 14.5% statutory requirement by 4.8% points. The bank's financial performance has been deteriorating since Q1'2017, possibly caused by the implementation of the Banking (Amendment) Act 2015, which capped interest chargeable on loans at 4.0% above the Central Bank Rate (CBR), with the bank's loan book declining to Kshs 8.3 bn as at FY'2017, from Kshs 10.5 bn in FY'2016, in the first full year of the interest rate cap implementation. The declining loan book consequently saw the interest income decline by 36.2% to Kshs 1.4 bn in FY 2017, from Kshs 2.2 bn as at FY'2016. Consequently, operating income declined 57.8% to Kshs 0.5 bn from Kshs 1.3 bn in FY'2016. With the decline in operating income faster than the decline in total operating expenses of 28.0% to Kshs 1.3 bn from Kshs 1.8 bn, the bank consequently recorded losses, and the loss-making trend continued to Q1'2018. We are of the view that the bank's acquisition presents the best-case scenario, to navigate the relatively tougher and competitive operating environment, amid expectation that Mshwari under CBA may be spun off and operate under Jamii Bora, with possibly the intention of sharping management's focus on the corporate and Small and Medium Enterprise (SME) banking in the merged entity after the NIC-CBA merger. We are of the view that the huge discount to the equity value in the offer, may be due to (i) the possibility of an additional capital injection by CBA, with Jamii Bora operating at a negative liquidity position, and (ii) the high Non Performing Loans ratio (NPL) of 22.4% as at Q1'2018, with gross NPLs of Kshs 2.2 bn. In conclusion, we note that the pace of consolidation activity especially in the banking sector has picked up, and we expect this to continue, as banks merge to form strategic partnerships, or are acquired, especially those that do not serve a niche, and are struggling to operate in the current environment. We also expect acquisition transactions to take place at significantly cheaper multiples, going forward. The table below highlights the various transactions that have happened in the banking sector over the last 5-years.

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date
CBA Group	Jamii Bora Bank	3.4	100.0%	1.4	0.4x	19-Jan*
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	1.0x	19-Jan
NIC Group	CBA Group	30.6**	Undisclosed	Undisclosed	N/A	Dec-18*
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	N/A	18-Dec
SBM Bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	N/A	18-Aug
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	0.8x	17-Mar
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	1.6x	16-Nov
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	1.4x	16-Jun
I&M Holdings	Giro Commercial Bank	3	100.0%	5	1.7x	16-Jun
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	2.3x	15-Mar
Centum	K-Rep Bank	2.1	66.0%	2.5	1.8x	14-Jul
GT Bank	Fina Bank Group	3.9	70.0%	8.6	3.2x	13-Nov
Average			**76.1%**		**1.6x**	

Nigeria

The Nigeria Inter-Bank Settlement System (NIBSS) released data showing that the number of Customer Bank Accounts in the industry grew by 15.0% to 115.2 mn accounts as of November 2018 from 100.2 mn accounts in December 2017. The 15 mn accounts opened in 2018 include 12.4 mn savings accounts, a 16.6% growth in savings accounts to 87.0 mn in November 2018 from 74.6 in December 2017, and 2.6 mn current accounts, a 11.5% growth in current accounts to 25.2 mn from 22.6 mn in December 2017. The number of active bank accounts rose by 17.6% to 74.7 mn in November 2018 from 63.5 mn in December 2017. The improvement in financial inclusion in Nigeria was attributed to (i) the nation's gradual recovery from economic recession, and the emergence of new businesses, and (ii) efforts by the Central Bank of Nigeria (CBN), and other organizations to boost financial inclusion as seen in 2018, where the Nigerian telecom operators set up a committee, The Association of Telecommunication Operators of Nigeria (ALTON), with the aim of boosting financial literacy in the country as well as provide financial services to up to 35.0 mn Nigerians by the end of 2019. By the year 2020, the committee aims to have provided financial services to 90.0 mn Nigerians, through conversion of over

1.0 mn airtime agents to mobile money agents. In our view, the increased financial inclusion will contribute to the stability of the banking sector due to increased cheaper retail deposits, which therefore lead to decreased overreliance by the banks on the volatile and costly money market funding. In addition, this will likely increase the number of transactions, thereby possibly higher transactional income for players in the segment.

Ghana

Bank of Ghana (BoG) has confirmed that 23 banks are now operational having met the GHC 400 mn paid up capital requirement set by BoG. Prior to this capital requirement, 36 banks were operational. In a bid to reform the Banking Sector, BoG has been revising the minimum capital requirement for Universal Banks in the past few years, raising it to GHC 120 mn in 2017 and to GHC 400 mn in 2018. Banks in Ghana were given up to 31st December 2018 to comply with the requirement. Most banks met this capital requirement through capitalization of income surplus, fresh capital injections and well as mergers that saw the following banks merge; First Atlantic Merchant Bank and Energy Commercial Bank, Omni Bank and Bank Sahel Sahara, First National Bank and GHL Bank. In our view, the reforms in the financial sector will continue to encourage smaller banks to consolidate which will increase credit flow resulting to bigger and resilient banks that are sufficiently capitalized thereby building investor and depositor confidence.

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 4/1/2019	Price as at 11/1/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
Diamond Trust Bank	156.0	152.0	(2.6%)	(2.9%)	283.7	1.7%	88.4%	**0.9x**
NIC Bank	27.4	27.6	0.5%	(0.9%)	48.8	3.6%	80.8%	**0.7x**
Ghana Commercial Bank***	4.6	4.6	(0.2%)	(0.2%)	7.7	8.3%	76.5%	**1.1x**
Access Bank	5.8	5.7	(2.6%)	(16.9%)	9.5	7.1%	75.2%	**0.4x**
KCB Group	37.4	36.9	(1.2%)	(1.5%)	61.3	8.1%	74.3%	**1.2x**
Zenith Bank***	21.7	21.9	0.7%	(5.2%)	33.3	12.4%	64.9%	**1.0x**
Equity Group	33.8	37.0	9.5%	6.0%	56.2	5.4%	57.5%	**1.8x**
UBA Bank	7.9	7.4	(7.0%)	(4.5%)	10.7	11.6%	57.1%	**0.5x**
I&M Holdings	90.5	91.0	0.6%	7.1%	138.6	3.8%	56.2%	**0.9x**
Co-operative Bank	13.9	13.9	(0.4%)	(3.1%)	19.9	5.8%	49.5%	**1.2x**
CRDB	150.0	140.0	(6.7%)	(6.7%)	207.7	0.0%	48.4%	**0.5x**
Ecobank Ghana	7.5	7.5	0.0%	0.0%	10.7	0.0%	43.1%	**1.6x**
CAL Bank	1.0	1.0	1.0%	2.0%	1.4	0.0%	40.0%	**0.8x**
Union Bank Plc	6.0	6.0	0.0%	7.1%	8.2	0.0%	35.8%	**0.6x**
HF Group	5.6	5.4	(3.9%)	(2.5%)	6.6	6.5%	28.7%	**0.2x**
Stanbic Bank Uganda	30.9	30.0	(3.0%)	(3.2%)	36.3	3.9%	24.8%	**2.1x**
Barclays	10.9	11.1	1.8%	1.4%	12.5	9.0%	21.6%	**1.5x**
Guaranty Trust Bank	33.5	33.5	0.0%	(2.8%)	37.1	7.2%	17.9%	**2.1x**
SBM Holdings	5.9	6.0	1.7%	1.0%	6.6	5.0%	14.0%	**0.9x**
Bank of Kigali	290.0	290.0	0.0%	(3.3%)	299.9	4.8%	8.2%	**1.6x**
Standard Chartered	190.3	194.5	2.2%	0.0%	196.3	6.4%	7.4%	**1.6x**

Equities Universe of Coverage								
Banks	Price as at 4/1/2019	Price as at 11/1/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
Stanbic Holdings	90.0	90.0	0.0%	(0.8%)	92.6	2.5%	5.4%	**0.9x**
Bank of Baroda	138.0	135.0	(2.2%)	(3.6%)	130.6	1.9%	(1.4%)	**1.2x**
FBN Holdings	7.5	7.4	(0.7%)	(6.9%)	6.6	3.4%	(7.0%)	**0.4x**
Standard Chartered Ghana	21.1	21.1	0.0%	0.4%	19.5	0.0%	(7.7%)	**2.6x**
National Bank	5.2	5.5	5.4%	2.6%	4.9	0.0%	(10.3%)	**0.4x**
Stanbic IBTC Holdings	47.0	46.2	(1.8%)	(3.8%)	37.0	1.3%	(18.5%)	**2.4x**
Ecobank Transnational	14.0	13.5	(3.6%)	(20.6%)	9.3	0.0%	(31.3%)	**0.5x**

****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****

****Stock prices indicated in respective country currencies***

We are "POSITIVE" on equities for investors as the sustained price declines has seen the market P/E decline to below its historical average. With a number of counters in sectors such as Financial Services, trading at attractive prices relative to historical level, we expect increased market activity, and possibly increased inflows from foreign investors, as they take advantage of the attractive valuations, and repatriate funds from developed economies, which are expected to record economic slowdowns in 2019, thereby resulting in positive performance, relative to 2018.