Cytonn SSA Financial Services Research: CAFF Weekly Note #15/2019

Executive Summary

During the week, Standard Chartered Bank Kenya launched an innovation hub lab in Nairobi dubbed eXellerator, in a bid to boost its revenue streams and diversify by riding on financial technology. In Nigeria, Ecobank Transnational Incorporated (ETI) highlighted its plan to raise a USD 500 mn, 5-year Eurobond, which is expected to fund its corporate obligations, as well as refinance outstanding debt obligations.

Section I: Market Performance:

During the week, the equities markets were on a downward trend with NASI, NGSEASI and GGSECI declining by 1.0%, 0.2% and 1.6%, respectively. This takes the YTD performance of NASI, NGSEASI and GGSECI to 12.4%, (5.9%), and (3.7%), respectively.

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

Weekly Top Gainers and Losers					
Top Gainers			Top Losers		
Company	Country	Change	Company	Country	Change
UBA PLC	Nigeria	4.8%	Ecobank Transnational Inc	Nigeria	(7.8%)
Access Bank	Nigeria	4.4%	Union Bank	Nigeria	(7.1%)
FBN holdings	Nigeria	2.0%	HF Group	Kenya	(6.3%)
Ghana Commercial Bank	Ghana	0.8%	Stanbic Holdings	Kenya	(5.3%)
Zenith Bank	Nigeria	0.5%	National Bank of Kenya	Kenya	(5.2%)

Kenya

During the week, the equities market had a mixed performance, with NSE 20 gaining by 2.4%, while NASI and NSE 25 declined by 1.0% and 0.6%, respectively, taking their YTD performance to gains of 2.9%, 12.4% and 11.6%, for NSE 20, NASI and NSE 25, respectively. The performance in NASI was driven by gains in large cap stocks such as EABL, Barclays Bank of Kenya and NIC Group, which gained by 0.8%, 0.8% and 0.6%, respectively. Which were outweighed by declines in Standard Chartered Bank Kenya, Equity Group Holdings and Safaricom, which recorded declines of 2.4%, 1.8% and 1.8%, respectively. Equities turnover declined by 15.7% during the week to USD 23.2 mn, from USD 27.5 mn the previous week, taking the YTD turnover to USD 497.0 mn. Foreign investors were net sellers for the week, with the net selling position coming in at USD 2.5 mn, from last week's net buying position of USD 0.5 mn.

Nigeria

The Nigerian All Share Index (NGSEASI) declined albeit marginally by 0.2%. The performance was as a result of the 2.6%, 2.2% and 2.0% gains in Utilities, financials and communications, respectively being wiped out by the 3.6%, 1.8% and 1.4% declines in Real Estate, consumer discretionary and stocks segments. This takes the YTD performance of the NGSEASI to a decline of 5.9%. For our universe of coverage, the largest decliners were

Ecobank Transnational Incorporated (ETI) and Union Bank Nigeria which recorded declines of 7.8% and 7.1%, respectively.

<u>Ghana</u>

The GSE Composite Index declined by 1.6% during the week, driving YTD gains to (3.7%). In our universe of coverage, Ghana Commercial Bank was the only gainer, gaining by 0.8%, with Standard Chartered Ghana and CAL bank declining by 2.5% and 1.8%, respectively.

Section II: Earnings releases

There were no earnings released during the week.

Section III: Weekly Highlights:

<u>Kenya</u>

During the week, Standard Chartered (StanChart) Kenya launched an innovation hub lab in Nairobi dubbed eXellerator. This in a bid to boost its revenue streams and diversify by riding on financial technology. StanChart plans to allocate Kshs 10.0 bn into supporting Financial Technology (FinTech) startups to scale up and generate innovative solutions to problems in the banking sector. StanChart views FinTech firms as partners amid their growing disruption of the local financial sector. The Nairobi hub will be run by the lender’s business unit, SC Ventures Kenya, and will engage tech innovators with an eye on investing in viable FinTechs for product activation within home markets and cross the world. In our view FinTech companies are an attractive investment due to;

- High Returns - According to data collected by Crunchbase, since 2007, Fintech start-ups have raised an average of Kshs 4.1 bn (USD 41.0 mn) in Venture Capital and exited for an average value of Kshs 24.5 bn (USD 242.9 mn). This gives investors a better opportunity to invest in a sector that attracts a growing pool of new investors and in the end exit at a high price,
- Attractive Realization Periods - Many Fintech companies start showing profits by year three hence giving a chance for investors to realize their gains early, and,
- Cheaper Running Costs - They are cheaper to run since a FinTech company is not weighed down by the same burden of costly regulation that governs traditional businesses

Employees of Commercial Bank of Africa Group (CBA) are set to emerge with a 1.3% stake worth Kshs 870.0 mn in the merger between CBA Group and NIC Group. NIC, which currently has no Employee Share Ownership Plan (ESOP), will create one to accommodate workers of CBA, which has an ESOP for the benefit of its employees that holds 2.5% of the shares of CBA. Besides CBA staff who are already entitled to shares under their current employer, the scheme is expected to admit more members including current NIC employees following completion of the merger. NIC Group, which will remain listed on the Nairobi Securities Exchange (NSE), will be the vehicle to house the ownership of the merged entity in which CBA shareholders will take a 53% stake. For existing employees of the privately-held CBA Group, the new scheme will give them an easier means of selling their shares on the stock market. Some of the benefits of ESOPs include:

i. It increases a company's competitiveness and attractiveness to employees, thus enabling them to attract and retain top talent. Especially for professional services firms, talent is the defining factor in competitiveness, hence employers must consider innovative and long-term ways of incentivizing their employees,

ii. ESOPs are also favored by small and medium size enterprises when developing an incentive, and, compensation structure, as they do not involve a direct cash outflow, like a bonus payment would, and,

iii. Employees are able to sell their shares on the market, usually at a gain, enabling them to benefit from capital appreciation when the company shares perform well.

Equity Bank Group's share of Diaspora cash grew by 197.2% to Kshs 107.0 bn in 2018 from Kshs 36.0 bn in 2017. Diaspora banking earned the bank Kshs 751.0 mn in commissions charged for facilitating the cash transfers from abroad, in 2018, a 169.2% increase from Kshs 279.0 mn in 2017. The commission rate however declined by 0.1% points to 0.7% in 2018, from 0.8% in 2017. Diaspora remittances grew by 38.6% in 2018 to Kshs 272.0 bn from Kshs 196.3 bn in 2017, consolidating the position of Kenyans abroad as the country's top foreign exchange earners ahead of tourism which earned, Kshs 157.4 bn in 2018, horticultural exports which earned Kshs 153.7 bn in 2018, and tea which earned Kshs 140.9 bn in 2018, according to the data from Central Bank of Kenya. The diaspora remittances data implies that Equity Bank handled 39.3% of the Diaspora remittances to Kenya. Despite this, Equity Banks Non-Interest Income declined by 6.3% to Kshs 25.9 bn in 2018 from Kshs 27.6 bn in 2017 mainly attributed to a 16.6% decline in fees and commissions on loans to Kshs 4.9 bn in 2018 from Kshs 5.9 bn in 2017, and a 19.5% decline in FX trading income to Kshs 3.3 bn in 2018 from Kshs 4.1 bn in 2017. See the Equity Group FY'2018 Earnings Note.

Nigeria

The Nigeria Deposit Insurance Agency (NDIC) has set aside NGN 258.8 bn for the 2019 fiscal year, to be utilized for reimbursement of depositors in the event of a closure of any licensed bank. From the amounts set aside, NGN 109.7 mn will be provided to depositors in Deposit Money Banks, while NGN 149.1 bn would be provided to depositors in Primary Mortgage Banks (PMBs) and Micro Finance Banks (MFBs). The funds utilized are critical for ensuring that depositors are protected in the event of a failure in a bank, as was the case for Skye bank's depositors. Skye bank run into turbulence that was attributed to weak corporate governance and financial malpractices, and as a result, the bank became unable to meet the Central Bank of Nigeria (CBN) prudential and adequacy ratios, leading to persistent illiquidity, and consequently making it difficult for depositors to access their funds. Thus consequently, the bank became completely dependent on the CBN lending window to remain in operations. With a depleted capital position, the bank needed urgent recapitalization, which the bank's shareholders were unable to partake in. Thus the CBN revoked the bank's license, and in conjunction with NDIC, formed a bridge bank named Polaris to takeover Skye, which received a NGN 786.0 bn capital injection. Polaris' main task was to ensure depositors' funds are protected and available, while ensuring that existing employees retain their jobs. The takeover aided in ensuring the bank's continuity, and in the process gave depositors access to their deposits. We note that the remediation accorded to Skye helped avert a possible systemic distress in the financial system, given the bank's systemic importance. The actions helped in instilling confidence in the financial services sector, and consequently foster stability. However, we are also of the view that there should be no recourse for fraud and malpractices, and as such there should be increased focus on oversight and the enforcement of regulation.

Ecobank Transnational Incorporated (ETI) has highlighted its plan to raise a USD 500 mn 5-year Eurobond. The debt is expected to priced at comparatively high yields, estimated at "around 9.0%". The bank is expected to utilize the debt to fund its corporate obligations, as well as help to refinance the bank's debt obligations. ETI has obligations of USD 200.0 mn, expected to mature in November 2019. We note that some of the large Nigerian banks have been raising capital from the Eurobond market, which are expected to be utilized in shoring up capital reserves, with the expectation of higher provisioning impairments, which will be brought about by the "contra cyclical" framework proposed by the CBN. The framework requires increased capital provisions in periods of economic downturns. Banks are also seeking capital in a bid to expand product offerings and geographical presence, with several banks such as UBA and Access seeking to drive their retail banking strategies. We note that more banks are tapping into the international markets, as concerns of the dollar shortages that hindered several banks in 2018, dissipate. We view the time of floating this bond as being strategic, given the current compression of yields in international Eurobond markets, and the stabilization of the Nigerian Naira, supported by increased forex reserves of USD 37.6 bn, which may mitigate the bank's exposure to foreign currency risk.

Ghana

There were no highlights in Ghana

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. Kenyan banks have been excluded, as they are under review following the release of the FY'2018 results.

Banks	Price as at 5/04/2019	Price as at 12/04/2019	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
GCB Bank	3.9	4.0	0.8%	(13.7%)	4.6	7.7	9.6%	104.0%	**0.9x**	**Buy**
UBA Bank	6.2	6.5	4.8%	(15.6%)	7.7	10.7	13.1%	77.7%	**0.4x**	**Buy**
Zenith Bank	20.4	20.5	0.5%	(11.3%)	23.1	33.3	13.2%	76.1%	**0.9x**	**Buy**
Access Bank	5.7	6.0	4.4%	(12.5%)	6.8	9.5	6.7%	66.4%	**0.4x**	**Buy**
CRDB	125.0	125.0	0.0%	(16.7%)	150.0	207.7	0.0%	66.2%	**0.4x**	**Buy**
CAL Bank	1.1	1.0	(1.9%)	5.1%	1.0	1.4	0.0%	35.9%	**0.9x**	**Buy**
Ecobank	8.0	8.0	0.0%	7.1%	7.5	10.7	0.0%	33.6%	**1.8x**	**Buy**
Union Bank Plc	7.0	6.5	(7.1%)	16.1%	5.6	8.2	0.0%	25.4%	**0.7x**	**Buy**
SBM Holdings	6.0	5.9	(1.0%)	(1.0%)	6.0	6.6	5.1%	16.3%	**0.9x**	**Accumulate**
Bank of Kigali	275.0	275.0	0.0%	(8.3%)	300.0	299.9	5.0%	14.1%	**1.5x**	**Accumulate**
Guaranty Trust Bank	35.0	35.1	0.1%	1.7%	34.5	37.1	6.8%	12.7%	**2.2x**	**Accumulate**
Bank of Baroda	130.0	129.2	(0.6%)	(7.7%)	140.0	130.6	1.9%	3.0%	**1.1x**	**Lighten**
Stanbic Holdings	100.0	97.5	(2.5%)	7.4%	90.8	92.6	6.0%	1.0%	**1.0x**	**Lighten**
Standard Chartered	215.3	207.0	(3.8%)	6.4%	194.5	196.3	6.0%	0.9%	**1.7x**	**Lighten**
Standard Chartered	20.0	19.5	(2.5%)	(7.1%)	21.0	19.5	0.0%	(0.2%)	**2.5x**	**Sell**
FBN Holdings	7.4	7.5	2.0%	(5.7%)	8.0	6.6	3.3%	(8.3%)	**0.4x**	**Sell**
Ecobank Transnational	11.6	10.7	(7.8%)	(37.1%)	17.0	9.3	0.0%	(13.3%)	**0.4x**	**Sell**
Stanbic IBTC Holdings	46.3	46.0	(0.5%)	(4.1%)	48.0	37.0	1.3%	(18.3%)	**2.4x**	**Sell**

**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 indicated in respective country currencies*

We are "Positive" on equities for investors as the sustained price declines have 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.