Cytonn SSA Financial Services Research Weekly Note #03/2019

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Executive Summary: During the week, the equities market was on an upward trend, with NGSEASI, NASI and GGSECI gaining by 4.4%, 1.9% and 1.3%, respectively, taking their YTD performance to (1.1%), 3.6% and (0.6%) for NGSEASI, NASI and GGSECI, respectively. An amendment to the Banking Act (2015) to allow credit consumers negotiate for interest rates on loans, depending on their risk profile, with an upper limit of up to 6.0% above the existing interest rate cap levels, currently at 13.0%.

Section I: Market Performance:

During the week, the equities market was on an upward trend, with NGSEASI, NASI and GGSECI gaining by 4.4%, 1.9% and 1.3%, respectively, taking their YTD performance to (1.1%), 3.6% and (0.6%) for NGSEASI, NASI and GGSECI, 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
Union Bank Plc	Nigeria	12.5%	Guaranty Trust	Nigeria	(4.6%)
NIC Group	Kenya	7.6%	Ecobank Transnational	Nigeria	(3.6%)
HF Group	Kenya	7.4%	Ghana Commercial	Ghana	(2.0%)
Equity Group	Kenya	6.4%	Stanbic IBTC	Nigeria	(1.8%)
National Bank	Kenya	5.8%	Standard Chartered	Ghana	(1.7%)

Kenya

During the week, NASI gained by 1.9% driven by gains in banking stocks such as NIC Group, Equity Group Holdings, KCB Group and Barclays Bank of Kenya, which gained by 7.6%, 6.4%, 5.1% and 5.0%, respectively. In our universe of coverage, HF Group and National Bank also gained by 7.4% and 5.8%, respectively. The gain in banking sector stocks was due to a proposed policy to widen the interest rate band that banks can charge borrowers above the Central Bank Rate, which would allow banks to charge a higher rate for perceived riskier borrowers. Equities turnover gained by 58.7% during the week to USD 34.7 mn, from USD 21.9 mn the previous week, taking the YTD turnover to USD 63.9 mn. Foreign investors remained net sellers for the week, with a net selling position of USD 2.2 mn, which is a 12.1% increase from last week's net selling position of USD 1.9 mn.

Nigeria

The Nigerian All Share index gained by 4.4% during the week, owing to gains in NEM Insurance, Sovereign Trust, Royal Exchange Plc and Cement Company of North Nigeria, which advanced by 43.4%, 30.0%, 28.6% and 25.5%, respectively. For our financial services universe of coverage, Union Bank gained by 12.5%, while Guaranty Trust, Ecobank Transnational and Stanbic IBTC declined by 4.6%, 3.6 % and 1.8%, respectively.

Ghana

The GSE Composite Index advanced by 1.9% 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 and Standard Chartered declined by 2.0% and 1.7%, respectively.

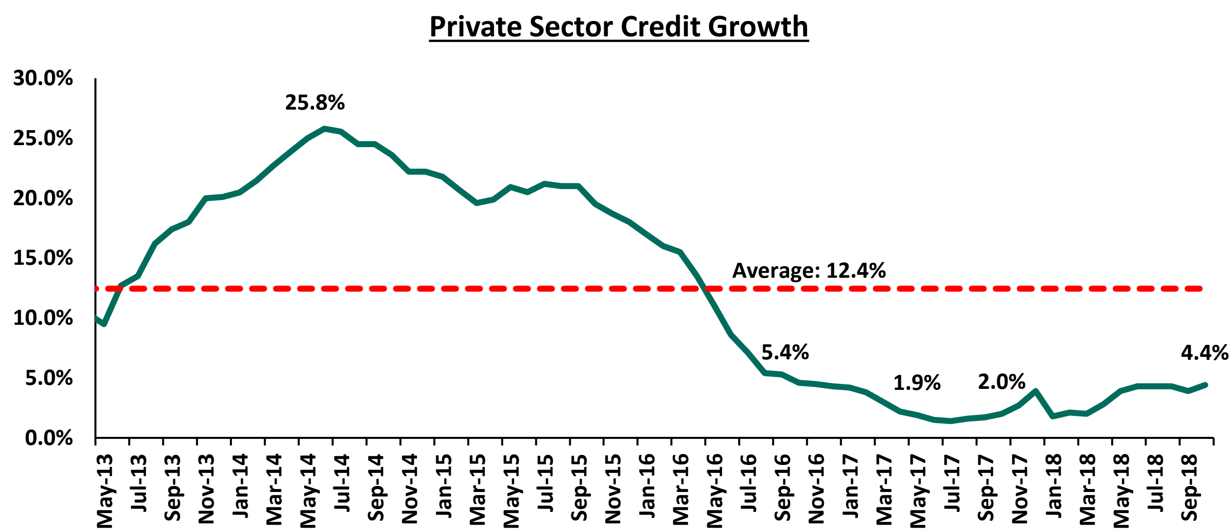
Section II: Earnings Releases

There were no earnings released during the week

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

Kenya

A proposal has been made by Mr. Moses Kuria, who is the Member of Parliament for Gatundu South, to amend the Banking (Amendment) Act 2015, to allow credit consumers negotiate for interest rates on loans, depending on their risk profile, with an upper limit of up to 6.0% above the existing interest rate cap levels, currently at 13.0%. This proposal, if passed, will see borrowers be able to access credit at rates of a maximum of 19.0% per annum. The move comes in a bid to try and improve credit extension to the private sector, comprised largely of the Micro, Small and Medium Enterprises (MSMEs). Credit extension to the private sector has remained below 5.0%, and below the 5-year average of 12.4%, as can be seen in the graph below:



The proposal aims to provide the room for banks to price risk within the new margins, with banks citing the inability to price risk within the 4.0% margin above the Central Bank Rate (CBR), as a key impediment to lending, owing to the lower risk adjusted returns when compared to investments in government securities. As such banks had continually increased allocations to government securities, shunning lending to MSMEs in the process. With the rate cap having failed to achieve its intended objective of improving credit access, we are of the view that the amendment presents an opportunity for risk-based lending to kick off, as the cost of credit becomes pegged to the associated risks. If successfully tabled and passed in Parliament, it would go a long way towards significantly improving credit access, as banks begin to lossen the tighter credit standards adopted after the enactment of the Banking (Amendment) Act 2015, as they will likely have enough headroom to price risk.

Barclays Bank of Kenya's (BBK) mobile app dubbed "Timiza" has seen its loan applications rise to 10,000 applications per day, from 5,000 per day, which the bank was processing before the launch of Timiza in March 2018. The mobile application with 3.0 mn subscribers has seen the bank venture into a target market that doesn't have the requisite documentation and is in need of faster processing of loans. Commercial banks have increasingly been focusing on the adoption and promotion of mobile applications in a bid to leverage on the alternative channel, to boost lending activities with the high number of low-value loans, and consequently increase transactional income. Examples of applications by banks include Commercial Bank of Africa's Mshwari and Loop, Equity Group's Equity EazzyApp, Equity EazzyBiz and Equitel, KCB's KCB Mpesa, Co-operative Bank's MCo-op cash, and HF Group's HF Whizz. We maintain our view that continued focus and increased adoption of these alternative channels will continue to see banks increase their Non-Funded Income (NFI), which contributed 34.5% of total operating income as at Q3'2018, an increase from the 33.3% in Q3'2017 for listed banks, while at the same time aiding banks in improving their operational efficiency, with the Cost to Income Ratio (CIR) of listed banks declining to 56.3% as at Q3'2018 from 59.4% in Q3'2017, owing to the relatively lower cost demands of these channels compared to the brick and mortar model of operation. Revenue expansion and cost containment will aid banks in achieving sustainable growth going forward.

Nigeria

Access Bank Plc plans to sell green bonds totalling USD 410.0 mn (NGN 150 bn) by the year 2021, stating that it looks to raise USD 41.0 mn (NGN 15.0 bn) in Q1'2019. The bond, which is the country's first corporate green bond, will be raised to fund environmental projects. The Federal Government of Nigeria sold the country's first green bond worth NGN 10.7 bn in 2017, with plans to raise as much as NGN 150 bn by 2021, according to the Central Bank of Nigeria's Debt Management Office. A green bond is a bond specifically raised to fund environmental and climate-related projects. Nigeria, Africa's biggest oil producer, issues green bonds as part of the plans to cut carbon emissions and meet its obligations to the Paris Agreement on the environment. The Securities Exchange Commission and the FMDQ OTC Securities Exchange launched the Nigerian Green Bond Market Development Programme last year to encourage private companies to sell climate-related debts.

The Nigerian Stock Exchange (NSE) has revealed plans to reduce the compliance burden on listed firms. Speaking at the 2018 Market Recap and 2019 Outlook, Mr. Oscar Onyema, the CEO of the Nigerian Securities Exchange, observed that listing activity remained low in 2018, while equity turnover remained relatively stable, marginally declining by 5.5% to NGN 1.2 tn from NGN 1.3 tn in 2017. The year saw only one listing on the NSE, and 4 de-listings from the bourse as firms struggled to comply with capital markets requirements. The NSE equity market started the year on a positive note, with the All-Share Index reaching 10-year peak of 45,092.83 points in January, largely driven by the positive performance of the ASI in 2017, which emerged the best in Africa. However, political risks, oil price volatility and rising global yields in Q2'2018 resulted in bearish sentiments that saw the ASI and equity market capitalisation fall by 17.8% and 13.9%, to close at 31,430.50 points and NGN 11.73 tn, respectively. Turnover velocity inched up 0.9 percentage points to 10.3%, with traded volumes in the period increased by 1.0% to 101.4 bn. The Financial Services sector being responsible for the highest traded volume and value. According to the CEO, the NSE has strengthened its government engagement efforts on privatisation and listing of state-owned enterprises. In our view, the approval and implementation of the 2019 budget will have a positive impact on companies' earnings as well as consumer spending. Therefore, we expect an uptick in market activity during the second half of 2019.

Ghana

Ratings Agency, Moody's says Ghana's banking sector consolidation trend is credit positive. According to the rating agency, the sector's consolidation is credit positive because it supports financial stability by removing weaker banks and gives remaining banks pricing power, enhancing their efficiency and profitability. The Bank of Ghana (BoG) undertook the consolidation exercise to clean up the sector as it emerged that there existed inherent weaknesses including poor asset quality, insolvency and poor corporate governance practices, which threatened the stability of the banking industry and the economy by extension. As a result, the number of banks declined to 23 at year-end 2018 from 34 in 2017, after Ghanaian banks were required to increase the minimum nominal capitalization threshold to GHS 400.0 mn by December 2018. Of the 34 banks at the beginning of 2018, five were consolidated into a single bank, six banks merged to create three larger banks, and four banks had their licences revoked, converted into a savings and loans license or exited Ghana altogether. The consolidation has removed weaker, undercapitalized banks that posed a risk to financial stability, leading to higher capital for the sector, hence improving banks' capacity to absorb loan losses. The remaining 23 banks have recapitalized their operations either organically or through capital injections and mergers, increasing the industry's capital adequacy ratio (CAR) to 20.0% in October 2018 from 17.0% in October 2016. We expect the average CAR to increase as banks complete recapitalization efforts and further liquidations in line with the BoG's new minimum CAR threshold. Better capitalization will imply that lending institutions are adequately positioned to resolve their high non-performing loans (NPLs). Consolidation will also improve banks' ability to underwrite larger corporate loans as they will be able to increase their single-name borrower limits. Consequently, banks' franchises will improve, benefiting their business opportunities and profitability. Fewer banks will likely enhance regulators' capacity to rigorously monitor and improve the sector's overall supervisory framework. The BOG has already started to tighten the regulatory framework by issuing a corporate governance directive that will enhance banks' corporate governance practices. The completion of the recapitalization exercise within the planned timeframe also shows the BOG's willingness to strictly enforce prudential regulations. Improved supervision quality and corporate governance will gradually boost confidence in the banking system. For more updates on the consolidation efforts, see the BoG's banking sector reforms here.

Former workers of Capital and UT banks are likely to receive their severance packages later this week if the Joint Receivers, PricewaterhouseCoopers (PwC), complete the processes on the payment modalities. This move is expected to ease the apprehension among the workers, who have been complaining of their discomfort following the revocation of the two banks' operating licenses in August 2017. According to the joint receivers, the payment follows the Bank of Ghana's decision to cede its share of money recovered from the assets and liabilities of the defunct banks. So far, PwC has recovered GHS 400.0 mn, which is to be used to pay the ex-workers arrears based on humanitarian grounds. In effecting the agreement, each former worker will be expected to sign a deed of subrogation with the Joint Receiver before payment will be effected. Amongst others, a worker's loan liability with his or her bank will be tallied against the entitlement and the difference paid. In all, about 1,200 workers are expected to be paid severance packages.

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:

Universe of Coverage								
Banks	**Price as at 11/1/2019**	**Price as at 18/1/2019**	**w/w change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/Downside****	**P/TBv Multiple**
Diamond Trust Bank	152.0	150.0	(1.3%)	(4.2%)	283.7	1.7%	90.9%	**0.9x**
Ghana Commercial Bank***	4.6	4.5	(2.0%)	(2.2%)	7.7	8.4%	80.0%	**1.1x**
Access Bank	5.7	5.6	(0.9%)	(17.6%)	9.5	7.1%	76.8%	**0.4x**
NIC Bank	27.6	29.7	7.6%	6.7%	48.8	3.4%	68.0%	**0.8x**
Zenith Bank***	21.9	21.5	(1.6%)	(6.7%)	33.3	12.6%	67.5%	**1.0x**
KCB Group	36.9	38.8	5.1%	3.6%	61.3	7.7%	65.7%	**1.2x**
UBA Bank	7.4	7.3	(0.7%)	(5.2%)	10.7	11.6%	58.2%	**0.5x**

I&M Holdings	91.0	94.3	3.6%	10.9%	138.6	3.7%	50.8%	**1.0x**
Co-operative Bank	13.9	14.0	0.7%	(2.4%)	19.9	5.7%	48.4%	**1.2x**
CRDB	140.0	140.0	0.0%	(6.7%)	207.7	0.0%	48.4%	**0.5x**
Equity Group	37.0	39.3	6.4%	12.8%	56.2	5.1%	48.1%	**1.9x**
Ecobank	7.5	7.5	(0.4%)	(0.4%)	10.7	0.0%	43.6%	**1.6x**
CAL Bank	1.0	1.0	(1.0%)	1.0%	1.4	0.0%	41.4%	**0.8x**
Stanbic Bank Uganda	30.0	30.0	0.0%	(3.2%)	36.3	3.9%	24.8%	**2.1x**
Guaranty Trust Bank	33.5	32.0	(4.6%)	(7.3%)	37.1	7.5%	23.6%	**2.0x**
Union Bank Plc	6.0	6.8	12.5%	20.5%	8.2	0.0%	20.7%	**0.7x**
HF Group	5.4	5.8	7.4%	4.7%	6.6	6.0%	19.8%	**0.2x**
Barclays	11.1	11.7	5.0%	6.4%	12.5	8.6%	15.9%	**1.6x**
SBM Holdings	6.0	6.1	1.3%	2.3%	6.6	4.9%	12.5%	**0.9x**
Bank of Kigali	290.0	290.0	0.0%	(3.3%)	299.9	4.8%	8.2%	**1.6x**
Standard Chartered	194.5	195.8	0.6%	0.6%	196.3	6.4%	6.7%	**1.6x**
Stanbic Holdings	90.0	95.0	5.6%	4.7%	92.6	2.4%	(0.2%)	**0.9x**
Bank of Baroda	135.0	135.0	0.0%	(3.6%)	130.6	1.9%	(1.4%)	**1.2x**
FBN Holdings	7.4	7.3	(1.4%)	(8.2%)	6.6	3.4%	(5.8%)	**0.4x**
Standard Chartered	21.4	21.1	(1.7%)	0.4%	19.5	0.0%	(7.7%)	**2.6x**
National Bank	5.2	5.5	5.8%	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 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.