Cytonn SSA Financial Services Research Weekly Note – 22nd October 2018

Executive Summary

In this week's research note, we highlight the performance of the listed banks in the Sub-Saharan Africa Financial Services Sector, looking at their market performance, earning results, the latest developments in the Sub Saharan Africa Banking Sector during the week, and our equities universe of coverage. Over the week, the markets covered were on an upward trend with NASI, NGSEASI and GGSECI gaining by 1.4%, 0.9% and 0.9%, respectively.

Section I: Market Performance:

During the week, the equities market was on an upward trend with NASI, NGSEASI and GGSECI gaining by 1.4% 0.9% and 0.9% respectively. This takes their YTD performance to (12.7%), (15.1%) and 4.2% for the NASI NGSEASI and GGSECI, respectively.

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

Summary of Top Gainers and Losers in Universe of Coverage for Week Ending 19th October 2018					
Top Gainers			Top Losers		
Company	Country	Change	Company	Country	Change
KCB Group	Kenya	4.1%	CRDB	Tanzania	(6.3%)
Access Bank	Nigeria	3.8%	CAL Bank	Ghana	(5.2%)
Zenith Bank	Nigeria	3.2%	Co-operative Bank	Kenya	(4.9%)
NIC Bank	Kenya	1.0%	HF Group	Kenya	(4.1%)
Union Bank Plc	Nigeria	1.0%	National Bank	Kenya	(3.8%)

Kenya

NASI gained by 1.4% last week. The performance was driven by gains in large cap counters such as KCB Group, Safaricom, NIC, and Barclays Bank of Kenya, which gained by 4.1%, 3.3%, 1.0% and 1.0% respectively. In our financial services universe of coverage, KCB Group, NIC Bank and Barclays Kenya gained by 4.1%, 1.0% and 1.0% respectively, while Co-operative Bank, HF Group, and National Bank declined by 4.9%, 4.1%, and 3.8% respectively. Equities turnover increased by 133.9% to USD 26.5 mn from USD 11.3 mn the previous week, bringing the YTD turnover to USD 1.5 bn. During the week, foreign investors remained net sellers, with net weekly outflows increasing by 83.9% to USD 12.9 mn from USD 7.0 mn, the previous week.

Nigeria

The Nigerian All Share index gained 0.9% during the week, largely driven by gains in the Insurance and the banking sector that gained by 2.0% and 1.0% respectively. For our financial services universe of coverage, Access Bank, Zenith Bank and Union Bank Plc gained by 3.8%, 3.2% and 1.0% respectively, while Ecobank Transnational and Stanbic IBTC Holdings declined by 2.9% and 0.2%, respectively. Total turnover for the week decreased by 0.4% to USD 27.0 mn from USD 27.1 mn the previous week.

Ghana

The GSE Composite Index gained by 0.9% during the week, driven by gains in the Ghana Oil Company, which gained by 8.5% w/w, while the majority of other counters remaining flat with little trading activity taking place.

In our universe of coverage for Ghana, CAL Bank, Standard Chartered and Ecobank declined by 5.2%, 0.4% and 0.6%, respectively. There were no gainers. Total turnover for the week decreased by 14.3% to USD 0.6 mn from USD 0.7 mn the previous week.

Section II: Earnings Releases:

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

Kenya

Following the enactment of the Finance Bill 2018 in September 2018, banks are no longer mandated to pay a minimum 70% of Central Bank Rate (CBR) on interest-earning deposits as was previously required, since the enactment of Banking (Amendment) Act 2015. As a result, banks have initiated the process of revising their deposit rates downwards as they aim to reduce their cost of funding. Kenya Commercial Bank (KCB) issued a notice that it had slashed interest rates on its Goal Savings Account from 8.5 % to 7.0 %. The bank also announced that customers would be paid less than 6.3% interest on all the other savings accounts. The classifications are summarized below;

KCB Revision of Interest Rates		
	Before	Revised interest rate (p.a)
KCB Cub Account	6.3%	5.0%
KCB Simba Account	6.3%	5.0%
KCB Goal Savings Account	8.5%	7.0%
Fixed Deposits Accounts	>6.3%	6.0%

The notice will be effective 16th November, 2018. As a result, we expect the interest expense to reduce on the back of a downward revision of interest rate payable on deposits, and consequently improve the Net Interest Margin. Historically, the bank's performance has been as highlighted below;

KCB Historical Cost of funding and Net Interest Margin							
	2012	2013	2014	2015	2016	2017	H1'2018
Net Interest Margin	10.5%	10.3%	9.6%	8.6%	9.2%	8.7%	8.6%
Cost of Funding	4.2%	2.8%	3.2%	3.9%	3.3%	3.0%	3.0%

Standard Chartered Bank also revised downwards its deposit rate for savings accounts where only deposits of above Kshs 50.0 mn will get an annual return of 6.0%. The tiers are classified as highlighted below;

Standard Chartered Bank Revision of Interest Rates	
Savings (Kshs mn)	Revised interest rate (p.a)
0 - 1.9	1.0%
2 - 4.9	2.0%
5 - 9.9	2.5%
10 - 14.9	3.0%
15 - 19.9	3.5%
20 - 24.9	4.0%
25 - 29.9	4.5%
30 - 49.9	5.0%
Above 50	6.0%

National Bank of Kenya (NBK) also announced lower, albeit relatively competitive deposit rates. In a new deposit mobilization plan, the bank introduces a tiered interest rate structure that will see customers earn between 1.0% and 7.0% depending on the amount of deposits. The tiers are classified as highlighted below;

National Bank Revised deposit Rates	
Savings (Kshs)	**Revised interest rate (p.a)**
5,001 - 50,000	1.0%
50,000 - 2.0 mn	5.0%
Above 2.0 mn	7.0%

This is an effort by the lender to increase deposits, which dropped after peaking in 2015, as indicated below;

NBK Historical Cost of funding and Net Interest Margin							
	2012	**2013**	**2014**	**2015**	**2016**	**2017**	**H1'2018**
Deposits	55.1	78.0	104.7	110.6	93.9	94.3	96.0
Cost of Funding	6.5%	3.8%	4.1%	5.3%	4.1%	3.3%	3.0%

According to data from the Central Bank of Kenya (CBK), the average cost of deposits in the banking sector has been on a decline since 2015. This was largely due to reclassification of bank accounts to non-interest earning accounts, effectively reducing the associated interest expense. As at December 2017, the average cost of deposits stood at 4.3%, translating to a total interest expense of Kshs 124.4 bn as indicated below;

Banking Sector Interest Expenses						
	2012	**2013**	**2014**	**2015**	**2016**	**2017**
Average Cost of Deposits	5.9%	3.8%	4.9%	5.5%	5.0%	4.3%
Total Interest Expense	110.9	83.8	103.6	133.1	130.8	124.4

We expect other banks to follow suit and lower their deposit rates and as a result, the average cost of deposit is set to continue declining, which is likely to improve the sector's overall Net Interest Margin (NIM).

Nigeria

Nigerian telecom operators' sets up a Financial Inclusion Committee to drive up financial inclusion in the country: Nigerian telecom operators have set up a committee to drive up financial inclusion in the country. The Association of Telecommunication Operators of Nigeria (ALTON) set up the Financial Inclusion Committee comprising of representatives from Globacom, 9Mobile, Airtel, MTN Nigeria and Ntel, all telecoms in Nigeria. The aim of the committee is to boost financial literacy in the country as well as provide financial services to up to 35.0 mn Nigerians within the next 12 months. 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. The committee will also work with other stakeholders and engage the local government to help achieve the Central Bank of Nigeria's 80.0% financial inclusion target by 2020. Currently, only 58.0 mn of Nigerians have access to financial services, with a population of over 200.0mn, translating to only 29.0% of the population. 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.

Lending by Nigerian Banks Expected to Decline Ahead of Elections: The Nigerian banks are expected to decrease their lending ahead of the 2019 election to reduce the political risk due to the uncertainty in the environment, which will have potential impact on the businesses and the investor confidence. According to trading economics global, the lending rate in Nigeria will decline to 14.8% in 2020 from 17.8% in 2017. The 2018 lending rate is already at 16.6% as of Q3'2018 a 6.5% decline from the previous year. The decline in lending will slow down the country's economic growth. The country's economic growth has not recovered post-recession, as the population growth has been higher than the economic growth amid concerns that the majority of the population are growing poor amid growing income inequality. The decreased lending will further slowdown the economic growth in the country and structural reforms such as assets sale to lessen the strain in the budget as well as reduced over-reliance in oil are in order and necessary to turn this country's fortunes around.

<u>**Ghana**</u>

Bank of Ghana to put in place Regulatory Measures for Microfinance Institutions: The World Bank has asked the Bank of Ghana to put in place effective regulatory systems for the Microfinance Institutions (MFIs) and the rural banks. The World Bank indicated that there is a regulatory gap from the MFIs as the Bank of Ghana lacks the capacity to offer supervisory role to the financial institutions in the rural areas of the country, and this will diversely distract the economy due to direct impact these institutions have on the local economy. The World Bank has offered to work with the Bank of Ghana to come up with measures that can be used extend regulation to these institutions. This comes after the reforms in the banking sector by Bank of Ghana led to the withdrawal of banking licenses from five banks, Unibank, Sovereign Bank, Construction Bank, Beige Bank and Royal Bank, and transferring all their assets and liabilities to a newly formed Consolidated Bank of Ghana. The withdrawal of these licenses was due to the banks inability meet the 2017 minimum capital requirements of GHS 120 mn as dictated by the Bank of Ghana. The minimum capital requirement has been further, revised upwards to GHS 400 mn in 2018. In our view, the reforms in the financial sector will 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.

Ghana's Financial Sectors Growth on a Declining Trend: Over the last 2 years, Ghana's financial sector growth has been on a declining trend having decline by 11.2%, 8.6%, 25.5% and 25.0% in Q1, Q2, Q3, and Q4'2017. In 2018, this sector declined further by 11.6% in Q1'2018 and 13.4% in Q2'2018. The negative growth in the financial sector can be attributed to inadequate credit to the private sector, which has declined from 32.0% in 2012 to 16.4% in Q2'2018, as a percentage of GDP, the delays in the government in repaying its debt owed to banks and the high non-performing loans. The low credit in the private sector has led to weak economic growth. The recent banking reforms are however expected to turn around as the new minimum capital requirement will increase credit flow by encouraging small local banks to consolidate, resulting in bigger banks with the capital and capacity needed to clean up loan books and steer more credit to the private sector.

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:

Banks	Price as at 12/10/2018	Price as at 19/10/2018	w/w change	YTD Change	LTM Change	Target Price*	Dividend Yield	Upside/Downside*	P/TBv Multiple
NIC Bank***	24.5	24.8	**1.0%**	(26.7%)	(26.4%)	48.8	4.0%	101.2%	**0.6x**
KCB Group	36.8	38.3	**4.1%**	(10.5%)	4.8%	61.3	7.8%	68.1%	**1.2x**
Diamond Trust Bank	165.0	164.0	**(0.6%)**	(14.6%)	(8.4%)	283.7	1.6%	74.6%	**0.9x**

Union Bank Plc	5.0	5.0	**1.0%**	(35.9%)	(18.2%)	8.2	0.0%	63.0%	**0.5x**
Zenith Bank***	22.2	22.9	**3.2%**	(10.7%)	(12.8%)	33.3	11.8%	57.3%	**1.0x**
Equity Group	38.0	38.3	**0.7%**	(3.8%)	5.5%	56.2	5.2%	52.2%	**1.8x**
Ghana Commercial Bank***	5.4	5.4	**0.0%**	5.9%	33.8%	7.7	7.1%	51.4%	**1.3x**
I&M Holdings***	95.0	95.0	**0.0%**	(25.2%)	(23.4%)	138.6	3.7%	49.6%	**1.0x**
UBA Bank	8.1	8.2	**0.6%**	(20.9%)	(7.9%)	10.7	10.4%	41.7%	**0.5x**
Co-operative Bank	15.4	14.6	**(4.9%)**	(8.8%)	(9.3%)	19.9	5.5%	41.8%	**1.4x**
Ecobank	8.0	8.0	**(0.6%)**	4.6%	16.8%	10.7	0.0%	35.0%	**1.8x**
Barclays	10.4	10.5	**1.0%**	8.9%	16.1%	12.5	9.6%	29.2%	**1.4x**
CRDB	160.0	150.0	**(6.3%)**	(6.3%)	(11.8%)	207.7	0.0%	38.5%	**0.5x**
Access Bank	8.0	8.3	**3.8%**	(20.6%)	(12.6%)	9.5	4.8%	19.3%	**0.5x**
CAL Bank	1.2	1.1	**(5.2%)**	1.9%	19.7%	1.4	0.0%	27.3%	**1.0x**
Stanbic Bank Uganda	33.0	32.5	**(1.5%)**	19.3%	19.3%	36.3	3.6%	15.2%	**2.3x**
HF Group***	6.2	5.9	**(4.1%)**	(43.3%)	(38.5%)	6.6	5.9%	17.8%	**0.2x**
Standard Chartered	186.0	187.0	**0.5%**	(10.1%)	(13.4%)	196.3	6.7%	11.7%	**1.5x**
SBM Holdings	6.3	6.3	**(0.3%)**	(16.5%)	(19.3%)	6.6	4.8%	9.6%	**0.9x**
Bank of Kigali	289.0	289.0	**0.0%**	(3.7%)	1.4%	299.9	4.8%	8.6%	**1.6x**
Guaranty Trust Bank	36.5	36.8	**0.8%**	(9.7%)	(11.8%)	37.1	6.5%	7.3%	**2.3x**
Bank of Baroda	126.0	126.0	**0.0%**	11.5%	14.5%	130.6	2.0%	5.6%	**1.1x**
Stanbic Holdings	91.0	90.0	**(1.1%)**	11.1%	13.9%	92.6	2.5%	5.4%	**0.9x**
National Bank	5.2	5.0	**(3.8%)**	(46.5%)	(48.5%)	4.9	0.0%	(2.0%)	**0.4x**
Stanbic IBTC Holdings	45.1	45.0	**(0.2%)**	8.4%	1.6%	37.0	1.3%	(16.5%)	**2.3x**
FBN Holdings	9.1	9.1	**0.0%**	3.4%	51.4%	6.6	2.7%	(24.4%)	**0.5x**
Standard Chartered	26.1	26.0	**(0.4%)**	3.0%	55.7%	19.5	0.0%	(25.2%)	**3.3x**
Ecobank Transnational	17.5	17.0	**(2.9%)**	0.0%	(2.9%)	9.3	0.0%	(45.4%)	**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. For full disclosure, Cytonn and/or its affiliates holds a significant stake in NIC Bank, ranking as the 5th largest shareholder**
****** Stock prices are in respective country currency**

We are "NEUTRAL" on equities since the markets are currently trading below historical P/E averages. 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.