Cytonn SSA Financial Services Research: CAFF Weekly Note #23/2019

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Executive Summary

During the week, the National Bank of Kenya (NBK) shareholders approved the buyout offer by KCB group which will be beneficial to both the shareholders and the bank's clients. In Nigeria, Ecobank Transnational Incorporated (ETI) successfully listed a USD 50.0mn Eurobond on the London Stock Exchange. In Ghana, the Bank of Ghana is reassessing rural and microfinance institutions as part of the financial sector cleanup.

Section I: Market Performance:

During the week, the equities markets recorded a mixed performance with NASI and GGSECI gaining by 0.2%, 0.1%, respectively, while the NGSEASI declined by 1.9%. This takes the YTD performance of NASI, NGSEASI and GGSECI to 7.9%, (2.1%), and (10.0%), 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
Union Bank Plc	Nigeria	12.0%	Ecobank Transnational	Nigeria	(10.3%)
National Bank	Kenya	8.3%	Guaranty Trust Bank	Nigeria	(3.8%)
Access Bank	Nigeria	3.3%	Stanbic Bank Uganda	Uganda	(3.0%)
Equity Group	Kenya	3.0%	FBN Holdings	Nigeria	(1.4%)
Barclays Bank	Kenya	2.5%	CAL Bank	Ghana	(1.2%)

Kenya

During the week, the equities market recorded a positive performance with NASI, NSE 20 and NSE 25 having gained by 0.4%, 0.9%, and 0.9% respectively; taking their YTD performance to gains (losses) of 7.1%, (4.7%), and 2.7%for NSE 20, NASI and NSE 25, respectively. The performance of NASI was driven by gains in large-cap stocks such as Bamburi, EABL, Equity Group and Barclays Bank, which gained by 9.4%, 3.0%, 3.0% and 2.5% respectively. Equities turnover declined by 65.8% during the week to USD 12.9 mn, from USD 37.6 mn the previous week, due to reduced market activity and a shortened trading week; taking the YTD turnover to USD 680.0 mn. Foreign investors were net buyers for the week, with the net buying position coming in at USD 0.3 mn, a 97.5% decline from last week's net selling position of USD 11.2 mn.

Nigeria

The Nigerian All Share Index (NGSEASI) declined by 1.9 %. The decline is attributable to declines in the Oil and gas, Insurance and the Industrial goods sectors with (5.2%), (4.0%) and (2.9%) respectively. This takes the YTD performance of the NGSEASI to a decline of 2.1%. For our universe of coverage, the largest gainers were Union Bank and Access Bank which recorded gains of 12.0% and 3.3%, respectively while the largest decliners were

Ecobank Transnational, Guaranty Trust Bank and FBN Holdings, which recorded declines of 10.3%, 3.8% and 1.4%, respectively.

Ghana

The GSE Composite Index rose by 0.1% during the week, driving YTD gains to (10.0%). In our universe of coverage, Ghana Commercial Bank was the only gainer, gaining by 0.2%, with Ecobank Ghana remaining flat, and CAL and Standard Chartered Ghana bank declining by 1.2% and 0.2% respectively.

Section II: Earnings releases

There were no earnings released during the week.

Section III: Weekly Highlights:

Kenya

National Bank of Kenya (NBK) shareholders approved the buyout offer by KCB Group, in agreement with the company's Board of Directors who also unanimously agreed on the buyout offer by KCB Group. NBK's two main principal shareholders: the National Treasury and the National Social Security Fund who will own a combined 93.2% after the conversion of the preference shares into ordinary shares, voted in favor of the transaction, as both the major shareholders and the board of directors expect the acquisition to be beneficial to both shareholders and the bank's clients. If successful, the transaction will see KCB Group significantly increase its balance sheet, , with management highlighting in a circular sent to shareholders, that they expected to reach the Kshs 1.0 tn mark by the end of 2022, consequently cementing KCB Group's position as the largest bank by assets. In a bid to streamline the operations of the group, management also highlighted that there may be job cuts, as the bank removes overlapping roles, reduce the associated expenses, and consequently improve the overall efficiency. We expect completion of the transaction to negatively affect KCB Group's asset quality in the short term, largely due to NBK's relatively larger Non-Performing Loans Ratio of 47.6% as at FY'2018. With adequate capital buffers, we do not expect a significant impact on KCB Group's capital base, which would necessitate a capital raise by the bank. The merger should aid KCB in getting a majority of the government business handled by NBK, and presumably aid in keeping the cost of funds relatively low, as NBK's cost of funds of 3.3%, as at Q1'2019, and KCB's cost of funds of 3.1%, should see the combined entity maintain the cost of funds below the market average of 3.4%, as at Q1'2019. We maintain our view that Kenya remains overbanked, and there is the need to remove the struggling banks that are undercapitalized, do not serve any niche, and do not have any systemic importance, so as to improve the sector's overall stability.

Co-operative Bank of Kenya highlighted its plan of growing the business of its leasing-focused subsidiary Co-op Bank Fleet. Co-op Bank Fleet intends to leverage on the synergies created by Co-operative Bank's client base to grow its business, with the main business case of the subsidiary being the easing of the cash flow constraints of acquisitions of fleets, repair and maintenance, thus allowing businesses to focus on their core business. Thus, with lower costs, firms would be able to acquire more fixed assets, which would aid in boosting their productivity. With a leasing deal of Kshs 890.0 mn already sealed with the government, the subsidiary focusses not only on government entities but also on non-government entities. As the business gains traction, we are of the view that this would continue to aid Co-operative Bank in growing its Non-Funded Income (NFI) as the bank continues to focus on this segment of income. We note that continued focus on this segment has seen its contribution to total operating income rise to 37.7% in Q1'2019, from 32.2% in Q1'2018. This should continue to buffer the bank's bottom line from significant declines, as interest revenue remains depressed in the current interest-capped regime.

Nigeria

Ecobank Transnational Incorporated (ETI) listed a USD 50.0 mn Eurobond on the London Stock Exchange in addition to the USD 450.0 mn Eurobond issued in April, bringing the total value of Eurobonds issued to USD 500.0 mn. The US Dollar-denominated Eurobond, was issued at a yield of 9.5%, and was oversubscribed by 4.6x. The bank expects to utilize the proceeds of the bond to expand its presence in Nigeria, increase investments on the digital distribution channels, and refinance maturing debt facilities. We note that the issue was at a yield of 9.5% which compares to 7.4% issued by Zenith bank recently. The issue is strategic by the bank, as it come at a time there are yield compressions, with increased inflows in the fixed income asset class, amid expectations of a slowdown in global economic growth, and consequently increased capital outflows from equities. With improved liquidity, ETI's improved performance will improve the performance of the overall sector. We note that the successful issuance of the Eurobond signals investors' appetite for the African financial services sector, influenced by the expectations of continued growth. We also note that various players in the banking sector have been seeking additional capital to venture into new business segments, increase their presence in their markets and refinance maturing debt facilities. We expect ETI to utilize the facility to close the gap on its competitors that have increased their presence, leveraging mainly on the digital and internet banking channels. This should aid the bank in expanding the bank's Non-Funded Income segment, and consequently the bottom line.

Ghana

The Bank of Ghana (BOG) highlighted that it is assessing the status of rural banks across the country as part of the financial sector cleanup which follows the decision to increase the minimum capital for commercial banks to GHS 400.0 mn, from GHS 120.0 mn initially. The apex bank has noted that some of the rural banks are facing liquidity challenges, and is advising the financial institutions to seek strategic partners before further action is taken. Given the different business models incorporated by rural banks, the BOG is assessing ways on how to manage rural banks. In its clean-up exercise, the BOG has revoked 386 microfinance and microcredit companies for being insolvent. We expect there to be mergers and acquisitions in the market as the players comply with the new regulations. Furthermore, we expected for there to be restructuring in business models of the rural and microfinance institutions from the current publicly limited liability where the community owns the bank to appointment of organization and individuals who will oversee the management of the financial institutions.

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 31/05/2019	Price as at 7/06/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple	Recommendation
Diamond Trust Bank	120.0	120.0	0.0%	(23.3%)	241.5	2.2%	103.4%	**0.6x**	**Buy**
UBA Bank	6.3	6.3	0.0%	(18.8%)	10.7	13.6%	84.8%	**0.4x**	**Buy**
Zenith Bank	20.1	20.4	1.2%	(11.7%)	33.3	13.3%	77.0%	**0.9x**	**Buy**
CRDB	120.0	120.0	0.0%	(20.0%)	207.7	0.0%	73.1%	**0.4x**	**Buy**
CAL Bank	0.8	0.8	(1.2%)	(17.3%)	1.4	0.0%	72.8%	**0.7x**	**Buy**
NIC Group	30.5	30.6	0.2%	9.9%	48.8	3.3%	63.0%	**0.8x**	**Buy**
KCB Group***	39.5	39.5	0.0%	5.5%	60.0	8.9%	60.8%	**1.0x**	**Buy**

GCB Bank	5.0	5.1	0.2%	9.8%	7.7	7.5%	60.4%	**1.2x**	**Buy**
Access Bank	6.1	6.3	3.3%	(7.4%)	9.5	6.3%	57.1%	**0.4x**	**Buy**
Co-operative Bank	12.5	12.5	0.0%	(12.9%)	18.5	8.0%	56.6%	**1.1x**	**Buy**
I&M Holdings	57.0	58.0	1.8%	36.5%	83.9	6.0%	50.6%	**1.2x**	**Buy**
Equity Group	38.9	40.0	3.0%	14.8%	58.1	5.0%	50.3%	**1.7x**	**Buy**
Barclays Bank	10.2	10.5	2.5%	(4.6%)	13.1	10.5%	35.9%	**1.4x**	**Buy**
Ecobank	8.0	8.0	0.0%	6.7%	10.7	0.0%	34.1%	**1.8x**	**Buy**
Guaranty Trust Bank	31.6	30.4	(3.8%)	(11.8%)	37.1	7.9%	29.9%	**1.9x**	**Buy**
Stanbic Bank Uganda	30.0	29.1	(3.0%)	(6.2%)	36.3	4.0%	28.7%	**2.1x**	**Buy**
Stanbic Holdings	98.0	98.3	0.3%	8.3%	115.6	6.0%	23.6%	**0.9x**	**Buy**
Bank of Kigali	265.0	265.0	0.0%	(11.7%)	299.9	5.2%	18.4%	**1.5x**	**Accumulate**
National Bank	4.1	4.4	8.3%	(16.5%)	5.2	0.0%	17.1%	**0.3x**	**Accumulate**
SBM Holdings	5.9	5.9	0.0%	(1.7%)	6.6	5.1%	17.1%	**0.8x**	**Accumulate**
Union Bank Plc	6.3	7.0	12.0%	25.0%	8.2	0.0%	16.4%	**0.7x**	**Accumulate**
Standard Chartered	186.5	190.0	1.9%	(2.3%)	203.8	6.6%	13.8%	**1.4x**	**Accumulate**
Bank of Baroda	129.0	128.2	(0.6%)	(8.4%)	130.6	1.9%	3.8%	**1.1x**	**Lighten**
FBN Holdings	7.1	7.0	(1.4%)	(12.6%)	6.6	3.6%	(1.0%)	**0.4x**	**Sell**
Ecobank Transnational	11.2	10.0	(10.3%)	(41.2%)	9.3	0.0%	(7.2%)	**0.4x**	**Sell**
Standard Chartered GH	21.7	21.7	(0.2%)	3.1%	19.5	0.0%	(10.1%)	**2.7x**	**Sell**
Stanbic IBTC Holdings	42.0	42.5	1.2%	(11.4%)	37.0	1.4%	(11.5%)	**2.2x**	**Sell**
HF Group	4.4	4.4	0.0%	(20.6%)	2.9	8.0%	(26.1%)	**0.2x**	**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.