Cytonn SSA Financial Services Research: CAFF Weekly Note #8/2019

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Executive Summary

During the week, the Central Bank of Kenya (CBK) published draft regulations for mortgage refinance companies (MRCs), setting the stage for creation of a State-backed firm that will advance cash to banks for onward lending to home buyers. In Nigeria, data from the Nigeria Bureau of Statistics showed an improvement in the Banking Sector's asset quality, with the industry's gross NPL ratio declining to 11.7% in Q4'2018, from 14.8% in Q4'2017. In Ghana, the President Nana Akufo Addo in a state of the Nation address, highlighted that the 'clean up' of the banking sector cost The National Treasury GHC 12.7 bn (USD 2.5 bn).

Section I: Market Performance:

During the week, the equities markets had mixed performances with the NASI and NGSEASI declining by 1.9% and 0.6%, respectively, while GGSECI remained flat. This takes the YTD performance of Kenya, Nigeria and Ghana to 9.8%, 0.9%, and (3.2%), 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
National Bank of Kenya	Kenya	6.7%	Co-operative Bank	Kenya	(6.1%)
Zenith Bank	Nigeria	2.2%	HF Group	Kenya	(3.7%)
Union Bank Nigeria	Nigeria	1.4%	KCB Group	Kenya	(3.3%)
NIC Group	Kenya	1.0%	Access Bank	Nigeria	(3.0%)
Diamond Trust Bank	Kenya	0.7%	Stanbic Holdings	Kenya	(2.7%)
			Equity Group Holdings	Kenya	(2.7%)

Kenya

During the week, the equities market was on a declining trend with NASI, NSE 20 and NSE 25 declining by 1.9%, 2.2% and 2.8%, respectively, taking their year-to-date (YTD) gains to 9.8%, 5.1% and 9.6%, respectively. The decline in NASI was driven by declines in large cap stocks such as East Africa Breweries Limited (EABL), Cooperative Bank, British American Tobacco (BAT) and Equity Group, which declined by 9.8%, 6.1%, 4.7% and 2.7%, respectively.

Nigeria

The Nigerian All Share Index (NGSEASI) declined marginally by 0.6% during the week, as the marginal 0.7% and 0.1% gains in the banking and Oil & gas sectors were eroded by the 1.5% decline in the consumer goods sector. For our universe of coverage, Zenith Bank and Union Bank were the largest gainers, gaining by 2.2% and 1.4%, respectively with Access Bank, FBN Holdings and Ecobank Transnational Incorporated (ETI) being the largest decliners, declining by 3.0%, 1.8% and 1.7%, respectively.

Ghana

The GSE Composite Index remained flat during the week. In our universe of coverage, Ghana Commercial Bank (GCB) and Ecobank Ghana, declined by 1.9% and 0.3%, respectively, with a majority of other counters remaining flat during the week on minimal trading activity.

Section II: Earnings Releases:

Kenya Banks' Performance:

There were no earnings releases during the week.

Nigeria Banks' Performance:

Zenith Bank released their FY'2018 results with core earnings per share increasing by 8.7% to NGN 6.2 from NGN 5.7 in FY'2017. Performance was driven by a 25.0% decrease in the total operating expenses to NGN 243.9 bn from NGN 325.1 bn in FY'2017, which outpaced a 10.0% decrease in total operating income to NGN 475.6 bn from NGN 528.6 bn in FY'2017.Highlights of the performance from FY'2017 to FY'2018 include:

- Total operating income decreased by 10.0% to NGN 475.6 bn from NGN 528.6 bn in FY'2017. This was due to a 33.5% decrease in Non-Funded Income (NFI) to NGN 180.0 bn from NGN 270.6 bn in FY'2017, despite a 14.6% increase in Net Interest Income (NII) to NGN 295.6 bn from NGN 258.0 bn in FY'2017,
- Interest income decreased by 7.3% to NGN 440.1 bn from NGN 474.6 bn in FY'2017. Consequently, the yield on interest earning assets decreased to 10.9% in FY'2018 from 12.6% in FY'2017,
- Interest expense decreased by 33.3% to NGN 144.5 bn from NGN 216.6 bn in FY'2017. The cost of funds decreased to 3.3% from 5.7% in FY'2017, while the Net Interest Margin increased to 7.3% from 6.9% in FY'2017,
- Non-Funded Income decreased by 33.5% to NGN 180.0 bn from NGN 270.6 bn in FY'2017. The decline in NFI was driven by a 49.2% decrease in trading income to NGN 80.2 bn from NGN 158.0 bn in FY'2017, and a 20.0% decrease in other income to NGN 17.9 bn from NGN 22.4 bn in FY'2017. Fees and commission income also decreased by 9.2% to NGN 81.8 bn from NGN 90.1 bn in FY'2017. The revenue mix shifted to 62:38 funded to non-funded income from 49:51 in FY'2017, with the proportion of NFI to total income declining owing to the faster decline in NFI as compared to the increase in NII,
- Total operating expenses decreased by 25.0% to NGN 243.9 bn from NGN 325.1 bn in FY'2017, largely driven by an 81.3% decrease in impairment loss on financial assets (loan loss provisions) to NGN 18.4 bn in FY'2018 from NGN 98.2 bn in FY'2017. Other operating expenses decreased by 3.4% to NGN 156.9 bn from NGN 162.4 bn in FY'2017. Personnel expenses increased by 6.4% to NGN 68.6 bn in FY'2018 from NGN 64.5 bn in FY'2017,
- The cost to income ratio improved to 51.3%in FY'2018 from 61.5% in FY'2017. Without Loan Loss Provision (LLP), the cost to income ratio improved to 55.1% in FY'2018 from 80.1% in FY'2017,

- Profit before tax increased by 13.9% to NGN 231.7 bn from NGN 203.5 bn in FY'2017. Profit after tax increased by 8.7% to NGN 193.4 bn in FY'2018 from NGN 177.9 bn in FY'2017,
- Zenith Bank has declared a final dividend of NGN 2.5 per share, translating to a total payout of NGN 78.5 bn, subject to shareholders' approval. This brings the total annual dividend payout to NGN 87.9 bn translating to NGN 2.8 per share,
- The balance sheet recorded an expansion with total assets increasing by 6.4% to NGN 6.0 tn from NGN 5.6 tn in FY'2017. This growth was largely driven by a 68.5% increase in investment securities to NGN 0.7 tn from NGN 0.4 tn in FY'2017, coupled with a 6.8% increase in treasury bills to NGN 1.0 tn in FY'2018 from NGN 0.9 tn in FY'2017,
- The loan book contracted by 13.2% to NGN 1.8 tn from NGN 2.1 tn in FY'2017. Placements with other banks increased by 36.0% to NGN 0.7 tn from NGN 0.5 tn in FY'2017,
- Total liabilities rose by 7.7% to NGN 5.1 tn from NGN 4.8 tn in FY'2017, driven by a 7.3% increase in deposits to NGN 3.7 tn from NGN 3.4 tn in FY'2017, and a 15.8% increase in borrowed funds to NGN 0.8 tn from NGN 0.7 tn in FY'2017,
- The faster growth in deposits as compared to the decline in loans led to a decrease in the loan to deposit ratio (LDR) to 49.4% from 61.1% in FY'2017,
- Shareholders' funds decreased, albeit marginally, to NGN 814.2 bn in FY'2018 from NGN 820.3 bn in FY'2017,
- Zenith Bank Plc is currently sufficiently capitalized with a capital adequacy ratio of 25.0%, which is well above the statutory requirement of 16.0%, and,
- Zenith Bank currently has a return on average assets of 3.3% and a return on average equity of 23.7%.

Key Take-Outs:

1. Zenith Bank recorded a 10.0% decline in operating income over the period, largely due to declining interest income and trading income, occasioned by a challenging operating environment, with the 13.2% contraction of the loan book leading to compressed yields on interest earning assets. However, the Group was able to absorb these shocks by enhancing cost efficiency through optimization of cost of funds as well as their cost of risk and cost to income ratio (CIR), which led to a 25.0% reduction in total operating expenses. The Group hence managed to maintain its profitability position as the cost efficiency strategies begin to bear fruit.

For a comprehensive analysis, please see our Zenith Bank FY'2018 Earnings Note

Ghana Banks' Performance:

There were no earnings releases during the week.

Section III: Weekly Highlights:

Kenya

The Central Bank of Kenya (CBK) has published draft regulations for mortgage refinance companies (MRCs), setting the stage for creation of a State-backed firm that will advance cash to banks for onward lending to home buyers. Through CBK (Mortgage Refinance Companies) Regulations 2019, the regulator provides for establishment of non-deposit taking firms under the Companies Act, licensed by the CBK to conduct mortgage refinance business. The MRCs will be used to advance loans to primary mortgage lenders such as commercial banks, microfinance banks and Savings and Cooperative Societies (Sacco's) using funds from the capital markets so as to provide affordable mortgages to eligible individuals. Refinance firms are being fashioned as implementation vehicles for meeting Kenya's affordable housing plan that targets 500,000 decent, affordable housing units by the year 2022. According to the CBK, the regulations are intended to provide a clear framework for licensing, capital adequacy, liquidity management, corporate governance, risk management as well as reporting requirements of MRCs. The draft regulations for MRCs are almost similar to those of commercial banks. According to the draft, which will be subjected to public comments up to the end of the month, the details for the set-up of MRCs include:

(i) Minimum core capital of MRCs will be at least Kshs 1.0 bn, which is the same level as that of commercial banks,
(ii) The MRCs will be required to have a master servicing and refinancing agreement governing the lending operations between the mortgage refinance company and the participating primary mortgage lenders, and,
(iii) CBK proposes that no MRC shall grant direct finance to any primary mortgage lender of amounts exceeding 25.0% of core capital.

The draft regulations come at a time the Housing Fund Regulations (2018) are also still in draft form and deductions are yet to be made from formal employees towards funding the housing projects. According to Housing PS Charles Hinga, the flagship low-cost housing plan has received Kshs 2.6 tn in investment pledges. In our view, the introduction of the MRCs should boost credit extension to the private sector, which would be instrumental in developing at least 500,000 affordable housing units by 2022, in line with the President's Big 4 Agenda.

Nigeria

According to data from the Nigeria Bureau of Statistics, total Non-Performing Loans (NPLs) in the banking sector have declined by 24.2% y/y to NGN 1.8 tn from NGN 2.4 tn, as at Q4'2017. Gross loans in the banking sector stood at NGN 15.4 tn, a 3.8% decline from the NGN 16.0 tn recorded in Q4'2017. This implies that the industry's gross NPL ratio declined to 11.7% in Q4'2018, from 14.8% in Q4'2017. This consequently implies an improvement in the industry's overall asset quality, with the tight lending guidelines adopted by banks bearing fruit, as demonstrated by the decline in the gross loans. The oil and gas sector still accounted for the largest proportion of credit extended to the private sector, recording 23.5% of total credit, with manufacturing, recording the second highest with 14.7% of total credit. The banking sector increased the number of its staff headcount by 1.8% q/q to 104,669 from 102,821 in Q3'2018. The increase in the staff count was mainly to reflect the higher staff demands, as major banks such as Guaranty Trust, FBN Holdings, Access and UBA implement their retail banking strategies by increasing their physical presence in previously unbanked areas. Furthermore, several recruitments done were to complement the increased usage of the online channels, with hiring done mainly on data analytics and security. We note that the Nigerian economy has been improving recording a 1.9% improvement in GDP y/y as at Q3'2018. Thus with the economy recovering from the recession, and the improvement in global crude prices, remediation of bad loans largely in the oil & gas, and telecommunication sectors, has enabled the improvement in asset quality. However, the decline in gross loans implied reduced credit extension to the private sector, an indicator of banks retaining the tighter credit standards they had adopted to curb the rising NPLs, preferring instead to lend to the Government, as shown by the listed banking sector's Loan to Deposit Ratio (LDR), which stood at 58.7% in Q3'2018. With the Nigerian government pledging to reduce the overall domestic debt, we are of the view that banks may need to redeploy funds invested in government securities, towards credit extension, so as to protect, and possibly improve their Net Interest Margins (NIMs).

Access Bank Nigeria is set to issue the country's first ever green bond of NGN 15.0 bn, with a tenor of 5 years, and a variable coupon rate, between 14.9% and 15.1%. The bond with a settlement date of 1st March 2019, is to be used to fund 'green' projects, such as renewable energy generation projects, that meet the Climate Bonds Initiative Standards (CBI). The bond has been rated 'B2' investment grade by credit rating agency Moody's; was verified by PwC (UK), and has met the Climate Bond Standards. We note that with an active bond market, the issuance which has pioneered green bond issuances in the Nigerian market, will open more activity in the local fixed income market, and will likely attract both local and foreign capital in the Nigerian economy, to drive expenditure in green initiatives, and in the process aiding impact and 'green' investors in achieving their respective investment objectives. Furthermore, this would likely boost the bank's own portfolio, given that most of the initiatives would be largely asset-backed securities generating returns in hard currency such as the US dollar.

Ghana

Ghana's President Nana Akufo Addo in a state of the Nation address, highlighted that the 'clean up' of the banking sector cost The National Treasury GHC 12.7 bn (USD 2.5 bn). The funds have been successfully deployed to remediate the banking sector, which was marred by multiple cases of corruption and fraudulent activities. With various banks operating under financial distress, the general public confidence in the banking sector had deteriorated, prompting a cleanup of the sector. This even saw the formation of The Presidential Financial Stability Advisory Council, an inter-institutional consultative body formed by individuals from all the regulatory bodies of the financial services sector, which has been charged with the mandate to investigate and resolve any malpractices observed in the financial services sector. We note that the Ghanaian banking sector has been at the fore front in enforcing strict regulation, with the Bank of Ghana (BoG) raising the minimal capital requirements to GHC 400.0 mn from GHC 150.0 mn, all in an attempt at weeding out undercapitalized and distressed companies, and even revoking of licenses of banks found in contravention of the set rules and regulations thereby making the enforcement of regulation even easier. These are all attempts at tightening the regulatory standards in the banking sector, and with the apex bank adopting a tough stance on regulatory matters, we are of the view that this should spur improved compliance and possibly reduce cases of fraud and malpractices, with banks more concerned with the downside regulatory and compliance risks. In the long term, this should improve the public's confidence in the sector, and consequently improve the sector's stability.

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 15/02/2019	Price as at 22/02/2019	w/w change	YTD Change	LTM Change	Target Price	Dividend Yield	Upside/Downside	P/TBv Multiple
GCB Bank***	4.2	4.1	(1.9%)	(10.9%)	(40.5%)	7.7	9.3%	97.6%	**1.0x**
Diamond Trust Bank	150.0	151.0	0.7%	(3.5%)	(28.1%)	283.7	1.8%	89.6%	**0.9x**
Access Bank	6.6	6.4	(3.0%)	(5.9%)	(50.4%)	9.5	6.7%	55.1%	**0.4x**
CRDB	135.0	135.0	0.0%	(10.0%)	(32.5%)	207.7	0.0%	53.9%	**0.5x**
CAL Bank	0.9	0.9	0.0%	(7.1%)	(18.1%)	1.4	0.0%	53.8%	**0.8x**
KCB Group***	43.5	42.0	(3.3%)	12.1%	(7.2%)	61.3	7.3%	53.3%	**1.3x**
I&M Holdings	95.5	93.8	(1.8%)	10.3%	(21.9%)	138.6	3.7%	51.5%	**0.9x**
UBA Bank	8.0	8.0	0.0%	3.9%	(38.5%)	10.7	11.9%	45.6%	**0.5x**
Ecobank	7.5	7.5	(0.3%)	(0.4%)	(29.8%)	10.7	0.0%	43.6%	**1.6x**
Zenith Bank***	24.8	25.3	2.2%	9.8%	(20.3%)	33.3	11.8%	43.5%	**1.1x**

Co-operative Bank	15.6	14.6	(6.1%)	2.1%	(14.6%)	19.9	5.1%	41.4%	**1.3x**
Equity Group	42.5	41.4	(2.7%)	18.7%	(3.3%)	56.2	4.9%	40.8%	**2.0x**
Stanbic Bank Uganda	29.0	28.8	(0.8%)	(7.3%)	(0.9%)	36.3	3.9%	30.1%	**2.0x**
NIC Group	39.5	39.9	1.0%	43.5%	25.4%	48.8	2.9%	25.2%	**1.1x**
Barclays Bank	11.8	11.5	(2.5%)	5.0%	6.0%	12.5	8.7%	17.4%	**1.6x**
Union Bank Plc	6.9	7.0	1.4%	25.0%	2.2%	8.2	0.0%	16.4%	**0.7x**
SBM Holdings	6.0	6.0	0.0%	0.7%	(22.3%)	6.6	5.0%	14.3%	**0.9x**
Bank of Kigali	276.0	276.0	0.0%	(8.0%)	(6.4%)	299.9	5.0%	13.7%	**1.5x**
HF Group	6.5	6.3	(3.7%)	13.4%	(32.6%)	6.6	5.3%	10.4%	**0.2x**
Guaranty Trust Bank	38.0	38.0	0.1%	10.3%	(20.8%)	37.1	7.1%	4.8%	**2.4x**
Standard Chartered	204.3	200.0	(2.1%)	2.8%	(3.8%)	196.3	6.4%	4.6%	**1.6x**
Stanbic Holdings	94.3	91.8	(2.7%)	1.1%	11.9%	92.6	2.5%	3.4%	**0.9x**
Bank of Baroda	134.0	134.0	0.0%	(4.3%)	17.5%	130.6	1.9%	(0.7%)	**1.2x**
Standard Chartered	21.0	21.0	0.0%	0.0%	(28.6%)	19.5	0.0%	(7.3%)	**2.6x**
FBN Holdings	8.5	8.3	(1.8%)	4.4%	(31.1%)	6.6	3.4%	(16.7%)	**0.5x**
National Bank	5.7	6.1	6.7%	13.9%	(26.5%)	4.9	0.0%	(19.1%)	**0.4x**
Stanbic IBTC Holdings	48.5	48.5	0.0%	1.1%	5.4%	37.0	1.3%	(22.4%)	**2.5x**
Ecobank Transnational	14.4	14.2	(1.7%)	(16.8%)	(28.2%)	9.3	0.0%	(34.4%)	**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 "NEUTRAL" on equities since the markets are currently trading below historical P/E averages. However, 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.