Cytonn SSA Financial Services Research Weekly Note #04/2019

Executive Summary: During the week, the equities market recorded mixed performances, with NGSEASI and NASI gaining by 1.6% and 1.8%, respectively, while the GGSECI declined by 4.8% taking their YTD performance to 0.4%, 5.5% and (5.4%) for NGSEASI, NASI and GGSECI, respectively. During the week, the Capital Markets Authority (CMA) and the Nairobi Securities Exchange (NSE) suspended a law that allowed listed companies to buy back their own shares from the capital markets with the regulators noting that the law would erode market liquidity, provide a window for companies to manipulate share prices and generally stiffle activity at the bourse;

Section I: Market Performance:

During the week, the equities market recorded mixed performances, with NGSEASI and NASI gaining by 1.6% and 1.8%, respectively, while the GGSECI declined by 4.8% taking their YTD performance to 0.4%, 5.5% and (5.4%) 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
Co-operative Bank	Kenya	8.6%	CAL Bank	Ghana	(12.1%)
Guaranty Trust Bank	Nigeria	8.0%	Union Bank Plc	Nigeria	(8.9%)
Ecobank Transnational	Nigeria	7.1%	CRDB	Tanzania	(3.6%)
UBA Bank	Nigeria	5.5%	Ecobank Ghana	Ghana	(3.6%)
HF Group	Kenya	5.5%	Stanbic Holdings	Kenya	(3.2%)

Kenya

During the week, NASI gained by 1.8% driven by gains in banking stocks such as Co-operative Bank, KCB Group and Equity Group, which gained by 8.6%, 2.8%, and 1.7%, respectively. Equities turnover declined by 5.4% during the week to USD 32.9 mn from USD 34.7 mn the previous week, taking the YTD turnover to USD 96.8 mn. Foreign investors remained net sellers for the week, with a net selling position of USD 0.3 mn, which is an 85.3% decrease from last week's net selling position of USD 2.2 mn. For our financial services universe of coverage, HF Group gained by 5.5%, while Stanbic Holdings declined by 3.2%.

Nigeria

The Nigerian All Share index gained by 1.6% during the week, driven by gains in banking stocks such as Guaranty Trust Bank, Ecobank Transnational, UBA Bank, and FBN Holdings, which gained by 8.0%, 7.1%, 5.5% and 4.8%, respectively. For our financial services universe of coverage, Union Bank declined by 8.9%, while Access Bank, Stanbic IBTC and Zenith Bank remained flat.

Ghana

The GSE Composite Index declined by 4.8% during the week, driven mainly by declines in the financial, energy and consumable sector stocks. Our universe of coverage delivered mixed results, with Standard Chartered Ghana gaining by 1.9% while CAL Bank and Ecobank Ghana declining by 12.1% and 3.6%, 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

The Capital Markets Authority (CMA) and the Nairobi Securities Exchange (NSE) have moved to fully suspend a law that allowed listed companies to buy back their own shares from the capital markets. The regulators noted that the law would erode market liquidity, provide a window for companies to manipulate share prices and generally stiffle activity at the bourse. Share buy-backs, a trading strategy that is common in Europe and the United States, are suitable for listed companies trading below book values and wish to enhance the share price and earnings per share while maintaninig policy on issuing of dividends and retained earnings. In the US, Apple Inc. spent USD 20.8 bn in share buy-back programs in Q3'2018, highighting a surge in stock buy-back in S&P 500 companies, with the total buyback authorization reaching USD 754.0 bn by the close of Q3'2018. The share buy-back law in Kenya, enacted in September 2015 as part of the New Companies Act, was suspended in November the same year after regulators noted that there was need for further work relating to mitigating against challenges expected to be brought about by the new law especially with regards to stiffling liquidity in the market. In our view, the new move is likely to lock out well-capitalized firms such as Safaricom Plc and East African Breweries Ltd, who in the past expressed a desire to repurchase shares in the market, from reducing the number of minority-held shares in the market and require them to find other avenues of improving their net asset value.

Co-op Bank, through its joint leasing partner Super Group, a South African logistics firm, announced that it concluded a deal with the Government to provide 125 vehicles, worth over Kshs. 890.0 mn, which is part of an agreement to provide 412 vehicles to the state. Through the joint venture, Co-op Bank aims to leverage on Super Goup's capabilities in product structuring, technology and customer risk management while at the same time, Super Group will tap into the bank's large customer base of over 8 million clients. The partnership will target collaboration of the two entities in undertaking infrastructure projects, exploration and mining activites, government leasing, and ICT. Through the joint venture, Co-op Bank is likely to stamp its presence in the leasing market, a move that will enhance the bank's diversification strategy on growing its non-funded income that stood at Kshs. 10.6 bn in Q3'2018, a growth of 4.3% from Kshs 10.1 bn in Q3'2017. Co-op Bank reported a funded to non-funded income ratio of 67:33 in Q3'2018 compared to an industry average of 66:34. The broad move by the government to lease state vehicles with the aim of enhancing the cost-efectiveness of acquiring government assets, is likely to expand the leasing market paving way to new entrants including banks seeking to tap into the opportunites at hand. Banks have been making forays in various segments to grow their fee income, to try and mitigate the impact of compressed Net Interest Margins (NIMs) which declined from 9.6% in 2016 to 8.3% in 2017, in the wake of the interest rate capping regime. Despite the recent push by various stakeholders to amend the Banking (Amendment) Act 2015 that is likely to improve credit growth and consequently improve interest income for banks, we expect that banks will continue diversifying their income sources by focusing on the Non-Funded Income (NFI) which include; venturing in bancassurance and transactional income from alternative channels, as the cap on interest rates remains in place.

Nigeria

The Central Bank of Nigeria (CBN) will introduce new capital requirements for banks in Q2'2019, a move that threatens to heap pressure on lenders already weighed down by bad loans. The capital requirements will be stricter in terms of what funding qualifies as capital and will also require lenders to create "capital conservation" which is a new prudential instrument serving to preserve a bank's capital and it is equivalent to 2.5% of the total risk exposure amount and "counter-cyclical" buffers which intend to protect the banking sector against losses that could be caused by cyclical systemic risks. Countercyclical capital buffer requirement requires banks to add capital at times when credit is growing rapidly so that the buffer can be reduced when the financial cycle turns. This will help banks to cover losses that may arise during periods of stress and to continue supplying credit to the real economy. The rule seeks to protect banks from shocks emanating locally and from abroad by increasing the level of regulatory capital and the quality of assets. With the introduction of the new rule, the regulator is aligning itself with Basel III, three years after a contraction in Nigeria's economy spurred delay of implementation of tougher capital rules. It also comes after policy makers in 2013 rejected some requirements drawn up by the Basel Committee on Banking Supervision. Last year, banks were compelled to migrate to a new accounting standard known as IFRS 9 to improve disclosure by forcing lenders to provide for existing losses as well as those that might occur in the future. Currently, Nigerian banks are struggling to contend with non-performing loans and this has led to many small to medium sized banks struggle to raise capital. In our view, the struggle of small to medium size banks in raising the capital requirements will lead to mergers and acquisitions by bigger and already established banks, which will improve the asset quality as well as stability of Nigeria's banking sector.

Ghana

A report prepared by KPMG on the inventory of assets and property of the five consolidated banks has revealed that Construction Bank's entire loan portfolio of GHS 0.6 mn consisted of term loans given to nine of the company's employees. The report, which covers five banks: Beige, Union bank, Construction, Sovereign and Royal banks, gives the value of assets including cash, loans, securities, property, intangible assets and other assets. KPMG acts as the receiver of the five banks and in accordance with section 130 (4) of the Banks and Specialized Deposit-Taking Institution Act 2016, which requires the receiver to prepare and submit a report, within one month of taking over the bank, on the inventory, assets and property of these banks to the Bank of Ghana. The report highlighted the five Banks as follows;

I. Union Bank

It had assets of GHS 2.2 bn. Loans and other securities constituted GHS 1.8 bn which is 82.0% of the total assets of the Bank. Most of the bank's debtors were in the construction sector owing GHS 934.3 mn, followed by the financial sector with GHS 558.0 mn, manufacturing sector with GHS 283.0 mn, and services sector with GHS 283.0 mn. Union Bank's net liability of GHS 7.2 bn was accumulated losses from operations, a deterioration in the Bank's asset quality and money given to related and connected parties.

II. Sovereign Bank

The Company had a total asset base of GHS 191.0 mn. Loans and other securities stood at GHS 9.8 mn. The receiver attributed the bank's high non-performing loans to inconsistencies in recovery efforts.

III. Beige Bank

Total assets stood at GHS 494.0 mn. Loans and other securities stood at GHS 282.0 mn constituting 57.0% of the total assets while GHS 274.0 mn was given to related parties.

IV. Construction Bank

Total assets stood at GHS 24.7 mn. 3.0% of total assets was made of loans given to 9 of the bank's employees which totaled GHS 620,000.

V. Royal Bank

It had an asset base of GHS 376.0 mn. Loans and securities constituted 56.0% of the bank's total assets. The receiver attributed the high percentage of loans to the bank's non-adherence to credit administration policies and inadequacies in recovery efforts.

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 18/1/2019	Price as at 25/1/2019	w/w change	YTD Change	Target Price*	Dividend Yield	Upside/Downside**	P/TBv Multiple
Diamond Trust Bank	150.0	150.0	0.0%	(4.2%)	283.7	1.7%	90.9%	**0.9x**
Ghana Commercial Bank***	4.5	4.5	0.0%	(2.2%)	7.7	8.4%	80.0%	**1.1x**
Access Bank	5.6	5.6	0.0%	(17.6%)	9.5	7.1%	76.8%	**0.4x**
NIC Group	29.7	29.7	0.0%	6.7%	48.8	3.4%	68.0%	**0.8x**
Zenith Bank***	21.5	21.5	0.0%	(6.7%)	33.3	12.6%	67.5%	**1.0x**
KCB Group	38.8	38.8	0.0%	3.6%	61.3	7.7%	65.7%	**1.2x**
UBA Bank	7.3	7.7	5.5%	0.0%	10.7	11.0%	50.0%	**0.5x**
I&M Holdings	94.3	95.0	0.8%	11.8%	138.6	3.7%	49.6%	**1.0x**
Co-operative Bank	14.0	15.2	8.6%	5.9%	19.9	5.3%	36.6%	**1.3x**
CRDB	140.0	135.0	(3.6%)	(10.0%)	207.7	0.0%	53.9%	**0.5x**
Equity Group	39.3	40.0	1.7%	14.6%	56.2	5.0%	45.7%	**1.9x**
Ecobank	7.5	7.2	(3.6%)	(4.0%)	10.7	0.0%	49.0%	**1.6x**
CAL Bank	1.0	0.9	(12.1%)	(11.2%)	1.4	0.0%	60.9%	**0.7x**
Stanbic Bank Uganda	30.0	30.0	0.0%	(3.2%)	36.3	3.9%	24.8%	**2.1x**
Guaranty Trust Bank	32.0	34.5	8.0%	0.1%	37.1	7.0%	14.5%	**2.2x**
Union Bank Plc	6.8	6.2	(8.9%)	9.8%	8.2	0.0%	32.5%	**0.6x**
HF Group	5.8	6.1	5.5%	10.5%	6.6	5.7%	13.6%	**0.2x**
Barclays	11.7	11.4	(2.6%)	3.7%	12.5	8.8%	18.9%	**1.5x**
SBM Holdings	6.1	6.1	0.0%	2.3%	6.6	4.9%	12.5%	**0.9x**
Bank of Kigali	278.0	278.0	0.0%	(7.3%)	299.9	5.0%	12.9%	**1.5x**
Standard Chartered	195.8	194.3	(0.8%)	(0.1%)	196.3	6.4%	7.5%	**1.6x**
Stanbic Holdings	95.0	92.0	(3.2%)	1.4%	92.6	2.4%	3.1%	**0.9x**
Bank of Baroda	135.0	135.0	0.0%	(3.6%)	130.6	1.9%	(1.4%)	**1.2x**
FBN Holdings	7.3	7.7	4.8%	(3.8%)	6.6	3.3%	(10.1%)	**0.4x**
Standard Chartered	21.1	21.4	1.5%	1.9%	19.5	0.0%	(9.1%)	**2.7x**
National Bank	5.2	5.3	2.3%	(0.8%)	4.9	0.0%	(7.2%)	**0.4x**
Stanbic IBTC Holdings	47.0	47.0	0.0%	(2.0%)	37.0	1.3%	(20.0%)	**2.4x**
Ecobank Transnational	14.0	15.0	7.1%	(11.8%)	9.3	0.0%	(38.1%)	**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 for investors as the sustained price declines has 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.