Cytonn SSA Financial Services Research: Weekly Note #07/2019

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Executive Summary

During the week, the equities markets had mixed performances with the NGSEASI and GGSECI gaining 3.8% and 0.4%, respectively, and NASI declining by 2.0%. In Kenya, The International Finance Corporation (IFC) entered into a technical advisory agreement with Equity Bank to offer technical advisory services with the aim of helping the lender to better its customer base of small and meduim-sized (SME) customers. In Nigeria, according to the Central Bank of Nigeria's (CBN) Economic Report for the Fourth Quarter 2018, the total assets and liabilities of commercial banks in Nigeria stood at NGN 37.1 tn as at the end of November 2018, a 0.4% decline from NGN 37.2 tn as at the end of September 2018. In Ghana, a report by KPMG, the Receiver Manager of defunct bank, uniBank, which was placed under receivership in March 2018, revealed that there was no way the bank was going to recover from the challenges it was facing.

Section I: Market Performance:

During the week, the equities markets recorded mixed performances with the NGSEASI and GGSECI gaining 3.8% and 0.4%, respectively, and NASI declining by 2.0%. This takes the YTD performance of Kenya, Nigeria and Ghana to 11.9%, 4.1%, and (2.0%), 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	10.4%	HF Group	Kenya	(6.3%)
FBN Holdings	Nigeria	5.6%	National Bank	Kenya	(5.0%)
Ecobank Transnational	Nigeria	5.1%	Barclays Bank	Kenya	(3.7%)
UBA Bank	Nigeria	4.6%	Co-operative Bank	Kenya	(2.8%)
Stanbic Holdings	Kenya	3.9%	Guaranty Trust Bank	Nigeria	(1.8%)
NIC Group	Kenya	3.3%	Standard Chartered Bank Kenya	Kenya	(1.1%)

Kenya

During the week, the equities market was on a downward trend with NASI declining 2.0%, taking the YTD performance to 11.9%. The decline in NASI was mainly driven by declines in large cap banking stocks such as Barclays Bank, Cooperative Bank, and Standard Chartered Bank, which declined by 3.7%, 2.8%, and 1.1%, respectively.

Nigeria

The Nigerian All Share Index (NGSEASI) gained by 3.8% during the week, largely driven by gains in the oil and gas sector, consumer goods and industrial goods sector, with weighted gains of 5.9%, 5.4%, and 1.6%, respectively. In our universe of coverage, Union Bank Plc, FBN Holdings, Ecobank Transnational Incorporated (ETI) were the largest gainers gaining by 10.4%, 5.6% and 5.1%, respectively.

Ghana

The GSE Composite Index gained by 0.4% during the week, driven by gains in the financial services sector with the Financial Stocks Index gaining 0.2% during the week. In our universe of coverage, CAL Bank was the only mover, gaining 2.2%, while GCB Bank, Ecobank Ghana and Standard Chartered remained flat during the week.

Section II: Earnings Releases:

Kenya Banks' Performance:

There were no earnings releases during the month.

Nigeria Banks' Performance:

There were no earnings releases during the month.

Ghana Banks' Performance:

There were no earnings releases during the month.

Section III: Weekly Highlights:

Kenya

The International Finance Corporation (IFC) has entered into a technical advisory agreement with Equity Bank to offer technical advisory services with the aim of helping the lender to better its customer base of small and meduim-sized (SME) customers. The project will see the development of new products and services tailored mainly for the SMEs. It will assist the Equity Group design and deliver an efficient SME business model, improve SME credit related processes, and train staff to effectively serve the targeted SME segments. Equity Bank is already the country's leading SME bank with the segment comprising close to 60% of the bank's loan portfolio with the lender having 10.0 mn customers in Kenya. The bank is well placed to deliver additional products and services to its SME customers given its country-wide coverage through a network of 177 branches and over 32,000 agents, and its innovative digital channels. Equity bank becomes the latest local bank to benefit from IFC's technical advisory services, after Co-op Bank which is also getting IFC's input in a Kshs 243.6 mn deal to help the lender expand its digital banking services. We note that various lenders in the local banking space such as KCB, Co-operative bank and I&M bank have been increasing focus on the SME banking segment, which was adversely affected by the implementation of the Banking (Amendment) Act 2015, as access to credit became difficult, with banks citing inability to price them within the margins set under the law. Banks have been obtaining finance from international institutions mainly for onward lending to the private sector mainly comprise of SMEs, so as to plug a funding deficit occassioned by a mismatch in their assets and liabilities by tenor, as deposits tend to be relatively short term while loans are relatively long term. The funds issues so far have been summarised in the table below:

Loans to Banks by International Organizations					
	Issuer	Bank	Issue Period	Amount of Loan(Kshs bn)	Term of Credit
1	IFC	Cooperative Bank	Feb-18	15.2	7-years
2	Africa Development Bank	Kenya Commercial Bank	Oct-17	10.4	Not specified
3	14 financial Institutions (syndicated)	Stanbic Bank	May-18	10.0	2,3 years

4	Africa Development Bank	Diamond Trust bank	Mar-18	7.5	7-years
5	FMO	I&M Holdings	Oct-18	4.0	Not specified
6	IFC	I&M Holdings	Jan-18	1.0	Not specified
7	SwedFund	Victoria Commercial Bank	Apr-18	0.5	Not specified
8	East African Development Bank	Sidian Bank	Nov-18	0.2	8-years
	Total			**48.9**	

With SMEs forming 80.0% of the private sector, reduced credit extension saw the private sector credit growth remain below 5.0%, averaging 3.3% in 2018, below the 5-year average of 11.8%. With increased focus in the segment by larger banks such as Equity Group, Co-operative Bank and KCB, this would likely increase credit extension to the private sector, in addition to increasing the respective banks' interest and fee income.

Nigeria

According to the Central Bank of Nigeria's (CBN) Economic Report for the Fourth Quarter 2018, the total assets and liabilities of commercial banks in Nigeria stood at NGN 37.1 tn as at the end of November 2018, a 0.4% decline from NGN 37.2 tn as at the end of September 2018. The liability funds were sourced, largely, from foreign liabilities, draw down on reserves and acquisition of credit from the CBN. The funds were used, mainly, for payment of matured demand deposits, and settlement of claims on CBN and The Federal Government. Credit extended to the domestic economy stood at NGN 19.6 tn, a 2.0% increase from NGN 19.2 tn issued as at the end of September 2018. This was attributed to a 9.0% rise in Treasury bonds and bills and a 32.8% rise in bonds and bills issued by the local governments during the month. This was offset by declines in issuance to the private sector during the month under review. Total specified liquid assets of Nigerian banks were NGN 12.2 tn at end November 2018, representing 56.8% of the total current liabilities, this implies a liquidity ratio of 66.4%, 3% points below 63.4% recorded in September 2018, and 33.4% above the stipulated minimum ratio of 30.0%. The loan-to-deposit ratio as at end of November 2018 stood at 65.0%, 0.1% points higher than 64.9% recorded in September. The loan-to-deposit ratio was 15.0% points lower than the prescribed maximum of 80.0%. We however note that financial intermediation in the Nigerian economy has remained low, given the lower loan to deposit ratio, implying continuing overreliance on government papers at the cost of extending credit into the economy. This may in part be attributed to banks adopting tighter credit standards in a bid to curb the rising Non-Performing Loans (NPLS). With improving oil prices and economic conditions, coupled with the Nigerian National Government pledging to cut down on domestic lending, Nigerian banks would be better off redeploying a portion of the investments in government paper, to loans, which would result in an improvement the interest income, given the higher yields on loans, and consequently an improvement in the bottom line.

Ghana

A report by KPMG, the Receiver Manager of defunct bank, uniBank, which was placed under receivership in March 2018, has revealed that there was no way the bank was going to recover from the challenges it was facing. According to the report, the bank had a negative equity position from March 20, 2018. Its total assets after adjustment as at March 20, 2018 was GHC 2.5 bn compared with net liabilities of GHC 9.1 bn in March 20, 2018. This implies a negative equity position of GHC 6.5 bn. Before the liquidation of the bank by Bank of Ghana (BoG), uniBank's unadjusted total assets was GHC 8.8 bn at the end of March 20, 2018 against total liabilities of GHC 8.9 bn. The assets included cash and cash equivalent and government securities whilst the liabilities included customer deposits and borrowings. In August 1, 2018, the negative equity position had risen to negative GHC 7.2 bn after liabilities to other banks and financial institutions increased to GHC 4.9 bn from

GHC 3.8 bn. This resulted in the negative equity position increasing to GHC 7.2 bn as at August 1, 2018 from GHC 6.5 bn in March 20, 2018. Key findings from the balance sheet revealed exclusion of customer deposits of GHC 2.3 bn from December 2017 prudential returns to Bank of Ghana, and an overstatement of loans and advances to customers by GHC 1.3 bn in December 2017 prudential returns. The GHC 2.3 bn representing 53.4% of total deposits of GHC 4.3 bn were not disclosed in prudential returns to BoG. There were also significantly impaired loans and advances booked and inadequate cash flows to meet short to medium term maturing obligations, and as a result the bank was in an insolvent position. Related party loans and advances included GHC 243.0 mn to uniSecurities, GHC 176.0 mn to uniPrecision and GHC 174.0 mn to LHS Ghana. We note that fraud, poor operating procedures and loose corporate governance contributed to the poor performance of the bank leading it to go into insolvency. We are of the view that the stricter regulations by BoG, including the raising of minimum capital requirements, leading to consolidations, that will weed out the weaker players and reducing the number of banks, enabling more oversight by BoG, and enforcement of regulation, will eventually lead to a more stable Banking Sector in Ghana.

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 08/02/2019**	**Price as at 15/02/2019**	**w/w change**	**YTD Change**	**Target Price***	**Dividend Yield**	**Upside/Downside****	**P/TBv Multiple**
GCB Bank***	4.2	4.2	0.0%	(9.1%)	7.7	9.3%	94.0%	**1.0x**
Diamond Trust Bank	151.0	150.0	(0.7%)	(4.2%)	283.7	1.8%	90.9%	**0.8x**
CRDB	135.0	135.0	0.0%	(10.0%)	207.7	0.0%	53.9%	**0.5x**
CAL Bank	0.9	0.9	2.2%	(7.1%)	1.4	0.0%	53.8%	**0.8x**
Access Bank	6.7	6.6	(0.8%)	(2.9%)	9.5	6.7%	50.6%	**0.4x**
I&M Holdings	95.0	95.5	0.5%	12.4%	138.6	3.7%	48.8%	**1.0x**
KCB Group***	43.6	43.5	(0.3%)	16.0%	61.3	7.3%	48.4%	**1.3x**
Zenith Bank***	24.4	24.8	1.4%	7.4%	33.3	11.8%	46.4%	**1.0x**
UBA Bank	7.7	8.0	4.6%	3.9%	10.7	11.9%	45.6%	**0.5x**
Ecobank	7.5	7.5	0.0%	(0.1%)	10.7	0.0%	43.3%	**1.6x**
Equity Group	42.3	42.5	0.5%	22.0%	56.2	4.9%	37.1%	**2.0x**
Co-operative Bank	16.0	15.6	(2.8%)	8.7%	19.9	5.1%	33.1%	**1.4x**
Stanbic Bank Uganda	29.0	29.0	(0.1%)	(6.5%)	36.3	3.9%	29.1%	**2.1x**
NIC Group	38.3	39.5	3.3%	42.1%	48.8	2.9%	26.4%	**0.9x**
Union Bank Plc	6.3	6.9	10.4%	23.2%	8.2	0.0%	18.1%	**0.7x**
Barclays Bank	12.3	11.8	(3.7%)	7.8%	12.5	8.7%	14.7%	**1.6x**
SBM Holdings	5.9	6.0	1.0%	0.7%	6.6	5.0%	14.3%	**0.9x**
Bank of Kigali	278.0	276.0	(0.7%)	(8.0%)	299.9	5.0%	13.7%	**1.5x**
HF Group	7.0	6.5	(6.3%)	17.7%	6.6	5.3%	6.5%	**0.3x**
Guaranty Trust Bank	38.7	38.0	(1.8%)	10.2%	37.1	7.1%	4.9%	**2.1x**
Standard Chartered	206.5	204.3	(1.1%)	5.0%	196.3	6.4%	2.5%	**1.6x**
Stanbic Holdings	90.8	94.3	3.9%	3.9%	92.6	2.5%	0.7%	**0.9x**
Bank of Baroda	134.2	134.0	(0.1%)	(4.3%)	130.6	1.9%	(0.7%)	**1.2x**
Standard Chartered	21.0	21.0	0.0%	0.0%	19.5	0.0%	(7.3%)	**2.6x**
National Bank	6.0	5.7	(5.0%)	6.8%	4.9	0.0%	(13.7%)	**0.4x**
FBN Holdings	8.0	8.5	5.6%	6.3%	6.6	3.4%	(18.1%)	**0.4x**
Stanbic IBTC Holdings	47.0	48.5	3.2%	1.1%	37.0	1.3%	(22.4%)	**2.3x**
Ecobank Transnational	13.7	14.4	5.1%	(15.3%)	9.3	0.0%	(35.6%)	**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.