NIC Group and Commercial Bank of Africa (CBA) Merger Note 31st January 2019

The directors of NIC Group and Commercial Bank of Africa (CBA) announced their agreement to a proposed merger between the two banks that was first announced on 6th December 2018. The merger will be completed upon fulfilment of a certain set of conditions, and is expected to be completed by the onset of Q3'2019. The proposed transaction will be executed through a share swap in the ratio of 53:47 between CBA and NIC, meaning that shareholders of CBA Group will be entitled to own 53.0% of the merged entity's issued shares while shareholders of NIC Group will be allotted 47.0% of the combined entity. Given that NIC Group has 703.9 mn issued shares, it will have to issue 793.8 mn new shares to CBA shareholders, in order to adhere to the 53:47 share swap ratio. The merged company, NIC Group, is set to remain listed on the Nairobi Securities Exchange (NSE). The merger timelines have been provided as follows:

1. Obtaining of shareholder approval – Q1'2019
2. Obtaining regulatory approval – Q2'2019
3. Commencement of operations as merged entity - Q3'2019

The potential merger aims at achieving the following synergies;

i. **Revenue growth and commercial organization** – This will be achieved through cross-selling of enhanced product offerings, increased yields on interest-earning assets and reduced cost of funds as a result of potential economies of scale as well as better risk management to reduce loan impairments.
ii. **Operational optimization** – This will be done at branch and headquarter level, across business systems and support functions, in addition to consolidation of procurement and facility management.
iii. **Scale for growth** - An enhanced balance sheet, a shift towards improved deposit mix and alignment towards cost effective deposit raising, coupled with improved capital markets access, will position the combined entity for growth and expansion into other markets.

The combined franchise will boast of 26 million customers in Kenya and 41 million regional customers at group level (combining CBA'S 41.0 mn and NIC's 0.1 mn regional customers), making it the largest bank in the region by customer base.

Below is a table showing the combined proforma financials for the banks;

Combined Proforma Financials – Kenya Bank			
Balance Sheet	**CBA (Kshs bn)**	**NIC Group (Kshs bn)**	**Combined Entity (Kshs bn)**
Net Loans and Advances	103.5	107.8	211.3
Total Assets	**227.4**	**188.0**	**415.3**
Customer Deposits	179.0	136.3	315.3
Gross Earnings	20.3	16.3	36.6
Net Income	**13.5**	**9.8**	**23.4**
No. of Customers (mn)	**26.0**	**0.14**	**26.1**
No. of Staff	**1,031**	**841**	**1,872**
No. of Branches	**41**	**44**	**85**
No. of ATMs	**31**	**43**	**74**

Key take-outs from the above table include:

- The franchise will hold a 9.6% market share of total banking sector assets (Kshs 415.3 bn) from 5.2% (Kshs 227.4 bn) for CBA and 4.3% (Kshs 188.0 bn) for NIC. It will cumulatively hold the third-largest market share based on assets, after KCB Bank's 13.7% and Equity Bank's 9.8%,
- It will also hold 9.6% market share of total deposits (Kshs 315.0 bn), from 5.5% (Kshs 179.0 bn) and 4.2% (Kshs 136.3 bn) for CBA Bank and NIC Bank, respectively. On this metric, it will be second behind KCB Bank's 14.4% market share of customer deposits (Kshs 472.0),
- The combined entity will also hold a 9.0% market share of banking sector loans, amounting to Kshs 211.3 mn. It will be the fourth-largest bank after KCB Bank (17.8%), Co-operative Bank (11.3%) and Equity Bank (9.6%),
- The weightings imply that the bank will effectively become a top tier bank, with a weighted market share above the 5.0% threshold for Tier I banks,
- The combined entity will expand its reach in Kenya through a network of 85 branches and 74 ATM machines,
- No lay-offs are expected during the merger process, and the staff count of the combined entity is expected to come in at 1,872.

CBA Group announces the merger after recently acquiring Jamii Bora Bank for Kshs 1.4 bn, representing a Price to Book (P/B) ratio of 0.4x, which came in way cheaper than the average 1.6x P/B of previous acquisitions. The buyout was a sound opportunity on CBA's part as the bank's financial performance had been deteriorating since the interest capping legislation was passed in 2016, partly attributable to the shrinking of interest income following the reduction of interest rates chargeable on loans. At the time of the buyout, Jamii Bora had a book value of Kshs 3.4 bn, a deposit base of Kshs 5.0 bn and a Kshs 7.9 bn loan book. We maintain our expectation that CBA's Mshwari lending platform might be spun off to Jamii Bora, possibly with the intention of sharping management's focus on the corporate and Small and Medium Enterprise (SME) banking in the merged entity after the NIC-CBA merger. The table below highlights the various transactions that have happened in the banking sector over the last 5-years.

Acquirer	**Bank Acquired**	**Book Value at Acquisition (Kshs bns)**	**Transaction Stake**	**Transaction Value (Kshs bns)**	**P/Bv Multiple**	**Date**
CBA Group	Jamii Bora Bank	3.4	100.0%	1.4	**0.4x**	19-Jan*
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	**1.0x**	19-Jan
CBA Group	NIC Group	33.5**	53:47***	Undisclosed	**N/A**	19-Jan*
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	**N/A**	18-Dec
SBM Bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	**N/A**	18-Aug
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	**0.8x**	17-Mar
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	**1.6x**	16-Nov
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	**1.4x**	16-Jun
I&M Holdings	Giro Commercial Bank	3	100.0%	5	**1.7x**	16-Jun
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	**2.3x**	15-Mar
Centum	K-Rep Bank	2.1	66.0%	2.5	**1.8x**	14-Jul
GT Bank	Fina Bank Group	3.9	70.0%	8.6	**3.2x**	13-Nov
Average			**76.10%**		**1.6x**	

** Announcement date*

*** Book Value as of the announcement date*

**** Shareholder swap ratio between CBA and NIC, respectively*

In conclusion, we expect that the merger will enhance the franchise value of the separate firms by complimenting NIC Group's asset finance mainstay with CBA Group's leadership position in digital banking. In addition, both banks engage in corporate banking, therefore the merger holds the potential of becoming a market leader in the corporate segment as well. The process will also create a top-tier bank by regulatory standards, augmented by a robust capital position that will enable it take advantage of big-ticket projects, chief among them being the President's Big 4 Agenda.

We note that the pace of consolidation in the banking sector has picked up, and is likely to continue as banks merge to form strategic partnerships, and struggling banks especially those that do not serve a niche, are acquired.