Cytonn SSA Financial Services Research Weekly Note - 15th October 2018

Executive Summary: In this weekly research note, we highlight the performance of the listed banks in the Sub-Saharan Africa Financial Services Sector, looking at their market performance, earning results, the latest developments in the Sub Saharan Africa Banking Sector during the week, and our equities universe of coverage.

Section I: Market Performance:

During the week, the equities market recorded mixed performances with NGSEASI gaining by 0.2%, while NASI and GGSECI declined by 4.4% and 0.9%, respectively. This takes their YTD performance to 3.2%, (13.8%), and (15.8%) for the GGSECI, NASI, and NGSEASI, respectively.

Below is a summary of top gainers and losers in our universe of coverage for last week:

Summary of Top Gainers and Losers for Week Ending 12th October 2018					
Top Gainers			Top Losers		
Company	Country	Change	Company	Country	Change
Stanbic IBTC Holdings	Nigeria	6.1%	Bank of Baroda	Uganda	(10.0%)
I&M Holdings	Kenya	4.4%	Access Bank	Ghana	(7.9%)
HF Group	Kenya	4.2%	Equity Group	Kenya	(6.2%)
Zenith Bank	Nigeria	3.0%	Ecobank	Ghana	(5.3%)
FBN Holdings	Nigeria	2.2%	KCB Group	Kenya	(5.2%)

Kenya

NASI declined by 4.4% last week, driven by declines in large cap stocks such as, Safaricom, Equity Group, KCB Group, Barclays Bank of Kenya and Standard Chartered Bank, which declined by 7.1%, 6.2%, 5.2%, 2.8% and 2.1%, respectively. In our financial services universe of coverage, I&M Holdings, HF Group and Stanbic Holdings gained by 4.4%, 4.2% and 1.1% respectively, while Equity Group, KCB Group, Barclays Bank and Standard Chartered Bank declined by 6.2%, 5.2%, 2.8%, and 2.1% respectively. Equities turnover decreased by 66.7% to USD 11.3 mn from USD 34.0 mn the previous week, bringing the YTD turnover to USD 1.5 bn. During the week, foreign investors remained net sellers, with net weekly outflows decreasing by 12.5% to USD 7.0 mn, from USD 8.0 mn the previous week.

Nigeria

The Nigerian All Share index gained 0.2% during the week, largely driven by gains in the financial services sector, which gained by 1.4%, with an average weighting of 33.7%. For our financial services universe of coverage, Stanbic IBTC Holdings, Zenith Bank, FBN Holdings and Guaranty Trust Bank gained by 6.1%, 3.0%, 2.2% and 0.4% respectively, while UBA Bank, Union Bank and Access Bank declined by 1.2%, 1.0% and 0.6% respectively. Total turnover for the week increased by 23.2% to USD 27.1 mn from USD 22.0 mn the previous week.

Ghana

The GSE Composite Index declined by 0.9% during the week, driven by declines mainly in the financial services and processing sectors where Trust Bank, Benso Oil Palm Plantation, Access Bank, Ecobank and Societe Generale Ghana Ltd declined by 16.7%, 14.4%, 7.9%, 5.3% and 3.9% respectively. Ghana Oil Company gained by 4.6% while other stocks remained relatively unchanged. In our universe of coverage for Ghana, Ghana Commercial Bank gained by 0.2%, while CAL Bank declined by 0.9%, in addition to the earlier mentioned. Total turnover for the week decreased by 58.2% to USD 0.7 mn from USD 1.7 mn the previous week.

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 Central Bank of Kenya (CBK) released the Kenya Financial Sector Stability Report 2017, highlighting the stability of the banking sector over the period between January to December 2017. Key highlights for the banking sector in the period covered in the report include:

- The banking industry comprised 42 commercial banks, 1 mortgage finance company, 13 microfinance banks, 8 representative offices of foreign banks, 73 foreign exchange bureaus, 19 money remittance providers, 8 non-operating bank holding companies and 3 credit reference bureaus in 2017. DIB (Dubai Islamic Bank) Bank Kenya Limited and Mayfair Bank Limited were licensed to operate banking businesses in Kenya, while Société Générale of France opened a Representative Office in Kenya, while Central Bank of India (CBI) closed down its Representative Office;
- Three acquisitions were completed in the period; Fidelity Commercial Bank Ltd was acquired by SBM Holdings Ltd, Giro Commercial Bank Ltd was also acquired by I&M Holdings Ltd, while Habib Bank (K) Ltd was acquired by Diamond Trust Bank Kenya Ltd. Below is a summary of the completed deals in the last 5 years;

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date*
SBM bank Kenya	Chase Bank ltd	Unknown	75.0%	Undisclosed	**N/A**	Aug-18
Diamond Trust Bank Kenya	Habib Bank Limited Kenya	2.38	100.0%	1.82	**0.8x**	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.75	100.0%	2.75	**1.6x**	Nov-16
M Bank	Oriental Commercial Bank	1.80	51.0%	1.30	**1.4x**	Jun-16
I&M Holdings	Giro Commercial Bank	2.95	100.0%	5.00	**1.7x**	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.15	75.0%	2.60	**2.3x**	Mar-15
Centum	K-Rep Bank	2.08	66.0%	2.50	**1.8x**	Jul-14
GT Bank	Fina Bank Group	3.86	70.0%	8.60	**3.2x**	Nov-13
Average			**80.3%**		**1.8x**	
***Announcement date**						

- Banks were generally well capitalized during the period, with capital adequacy ratios remaining above minimum regulatory requirements. Total Capital to Total Risk Weighted Assets ratio increased to 18.8% as at December 2017, from 16.6% as at March 2017, which was higher than the minimum requirement of 14.5%;
- The aggregate banks' balance sheet expanded in 2017, with total net assets growing by 8.1% to Kshs 4.0 tn in December 2017 from Kshs 3.2 tn in December 2016. Growth in assets was attributed to increased investment in government securities, which grew by 15.3% to Kshs 998.4 bn in 2017, from Kshs 865.9 bn in 2016. There was slower private-sector credit growth of 2.5% in the period compared to 9.4% in 2016. This was attributed to increased uncertainties during the election period, which limited banks' ability to price risk appropriately in an interest rate-cap environment. Majority of loans were allocated to Manufacturing, Real Estate, Energy and Water, and Personal/Household sectors;
- Aggressive mobilization of deposits by banks saw a 10.8% growth in deposits to Kshs 2.9 tn in December 2017 from Kshs 2.6 bn in 2016. However, most deposits were local currency deposits from

transactional accounts, hence limiting banks' capacity to finance long-term assets. The faster growth in deposits compared to loans led to a decrease in the loan to deposit ratio (LDR) to 83.1% in December 2017 from 87.4% in December 2016;

- The asset quality, as measured by the non-performing loans ratio, deteriorated to 11.0% in December 2017 from 9.3% in December 2016, signifying increased credit risks in 2017. Gross non-performing loans (NPLs) grew by 23.4% to Kshs 264.6 bn in December 2017 from Kshs 214.4 bn in December 2016. Trade, personal/household, real estate and manufacturing sectors accounted for the largest share of NPLs, at 73.1% of gross NPLs. The decline in asset quality was attributed to sluggish economic growth, occasioned by a prolonged election period, coupled with the effects of drought in 2017. The NPL coverage ratio decreased to 34.5% in December 2017 from 37.6% in December 2016, implying more exposure to credit risks;
- The banking sector's pre-tax profits decreased by 9.6% to Kshs 133.2 bn in December 2017 from Kshs 147.3 bn in December 2016. Total operating income decreased by 3.1% in 2017 to Kshs 486.3 bn, while total expenses fell by 0.5% to Kshs 353.1 bn in December 2017. The decrease in profitability resulted from reduced lending to the private sector, high cost of deposits and slow economic growth in 2017 compared to 2016. We are of the view that banks' earnings will increase going forward as banks adjust their business models by lowering the deposit rates to increase their net interest spreads to reflect the scrapping of the floor on deposits, which had been pegged at 70% of the prevailing CBR rate;
- Return on Equity (ROE) and Return on Assets (ROA) of the banking sector have declined since 2016, with ROA declining to 2.6% from 3.2% in December 2016 while ROE declined to 20.6% from 24.4% in December 2016. This indicates a decrease in profitability of the banking sector over the period, with earnings being affected by the interest rates capping legislation that came into law in September 2016;
- Banks' overall liquidity rose to 43.7% in December 2017 from 41.4% in December 2016, against a minimum ratio of 20.0%. The increase in liquidity is attributed to 16.3% growth in total liquid assets, which were mainly government securities.

The data shows that commercial banks adjusted their business models in favor of lending to large corporate borrowers and purchase of government debt. This in turn reduced lending to small borrowers who were perceived as risky by the lenders. Overall, the banking sector remained resilient despite interest rates caps. As at December 2017, banks were well-capitalized with core and total capital to risk weighted assets averaging 16.5% and 18.8% above the regulatory requirements of 10.5% and 14.5%, respectively.

From our Kenya Listed Banks H1'2018 report, we saw that the banking sector has had an improvement in performance in H1'2018, largely aided by the improving economic conditions and a more conducive operating environment compared to a similar period last year. However, the banking sector continues to be fraught by two main challenges: (i) the deteriorating asset quality brought about by spilled over effects of the challenging operating environment experienced in 2017, and (ii) the capping of interest rates, which has led to subdued growth in the credit extended to the private sector. We believe the key factors banks need to consider going forward are asset quality management, continued revenue diversification, efficiency, and downside regulatory compliance risks amid tighter regulatory requirements. We believe the banking sector is well poised to grow in future and continue to outperform other sectors.

Nigeria

The Central Bank of Nigeria (CBN) revoked the license of Garu Microfinance Bank, a microfinance Institution in Bauchi State, for its inability to meet liquidity requirements and other financial obligations guiding operations of micro finance banks. The closure, which comes after the CBN issued a license revocation notice to 154 Micro-Finance Banks (MFBs), 6 Primary Mortgage Banks (PMBs) and 22 Finance Companies (FCs) in September this year, indicates the tough stance taken by CBN in mitigating money laundering risks in the financial services industry. While giving out the notice, the CBN noted that there was generally a low level of rendition of Anti-Money Laundering/ Combating the Financing of Terrorism (AML/CFT) returns by Other Financial Institutions (OFIs), contrary to regulatory requirement. These returns include: Currency Transaction Reports, CTR; Suspicious Transactions Report, STRs; Foreign currency transactions reports, FIRS; Risk Assessment Report, Politically Exposed Persons (PEPs); Annual Employee Education and Training programme, Compliance with Employee Training Program, Monitoring of Employee conduct, three Tiered KYC and Testing for the Adequacy of AML/CFT Compliance. The bank, which has so far been taken over by the Nigeria Deposit Insurance Corporation (NDIC), has been operating for over 20 years. The NDIC and the Bank's management are currently collecting forms from depositors to process their payment with designated banks across Bauchi State, to enable them receive their money. Nigeria has been adversely affected by terrorism activities over the years and implementation of CBN AML/CFT regulations will reduce the risks associated with money laundering and protect customer deposits.

Ghana

Over GHS 400 million has been realized from the sale and recovery of Unique Trust (UT) and Capital banks' assets with the greatest value of the banks' assets being the loan stock that amounted to GHC 2.7 bn, making up approximately 70.0% of the total assets of GHC 3.9 bn, as at the receivership date. The receivers of both banks have been engaged in the process of winding down the activities of UT Bank Ltd and Capital Bank Ltd after the banks went into receivership in August 2017, due of severe impairment of their capital. GCB Bank Ghana Limited, through a Purchase and Assumption Agreement, has since purchased some assets and assumed certain liabilities of the two banks. A key component of the Receiverships is to secure all assets including the recovery of outstanding loans and advances not assumed by GCB for the benefit of creditors, with the total amount realized to date being GHC 400 mn through sale and other recovery efforts. The creditor base of the two banks includes the Bank of Ghana, depositors, Development Finance Institutions, employees and trade suppliers of the two banks. Following the Receivers' request for creditors to submit their claims and proof of debt for validation, claims worth approximately GHC 3.7 bn have been validated and agreed out, representing a success rate of 84.1% out of a combined creditor claim amounting to approximately GHC 4.4 bn, lodged with the Joint receivers so far. The underlying reason leading to the banks' significant capital deficiencies and consequent closure was poor corporate governance practices within these institutions. The tough actions taken by GCB on the two banks will most likely prompt other banks in the industry to strengthen their corporate governance structures such as risk management systems, financial reporting processes, audit processes and oversight responsibilities of board of directors, thereby improving 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:

Equities Universe of Coverage									
Banks	**Price as at 5/10/2018**	**Price as at 12/10/2018**	**w/w change**	**YTD Change**	**LTM Change**	**Target Price***	**Dividend Yield**	**Upside/Downside****	**P/TBv Multiple**
NIC Bank***	24.5	24.5	0.0%	(27.4%)	(25.1%)	48.8	4.1%	103.3%	**0.6x**
KCB Group	38.8	36.8	(5.2%)	(14.0%)	(1.7%)	61.3	8.2%	75.0%	**1.2x**
Diamond Trust Bank***	165.0	165.0	0.0%	(14.1%)	(9.3%)	283.7	1.6%	73.5%	**0.9x**
Union Bank Plc	5.0	5.0	(1.0%)	(36.5%)	(13.9%)	8.2	0.0%	64.6%	**0.5x**
Zenith Bank***	21.6	22.2	3.0%	(13.4%)	(12.1%)	33.3	12.2%	62.3%	**1.0x**
Equity Group	40.5	38.0	(6.2%)	(4.4%)	7.0%	56.2	5.3%	53.2%	**1.9x**
Ghana Commercial Bank***	5.3	5.4	0.2%	5.9%	33.8%	7.7	7.1%	51.4%	**1.3x**
I&M Holdings***	91.0	95.0	4.4%	(25.2%)	(21.5%)	138.6	3.7%	49.6%	**0.9x**

UBA Bank	8.2	8.1	(1.2%)	(21.4%)	(12.0%)	10.7	10.5%	42.6%	**0.5x**
Co-operative Bank	15.4	15.4	0.0%	(4.1%)	(7.0%)	19.9	5.2%	34.9%	**1.4x**
Ecobank	8.5	8.0	(5.3%)	5.3%	22.4%	10.7	0.0%	34.1%	**1.9x**
Barclays	10.7	10.4	(2.8%)	7.8%	6.7%	12.5	9.7%	30.4%	**1.5x**
CRDB	160.0	160.0	0.0%	0.0%	(8.6%)	207.7	0.0%	29.8%	**0.5x**
Access Bank	8.1	8.0	(0.6%)	(23.4%)	(17.9%)	9.5	5.0%	23.8%	**0.5x**
CAL Bank	1.2	1.2	(0.9%)	7.4%	32.6%	1.4	0.0%	20.7%	**1.0x**
Stanbic Bank Uganda	33.0	33.0	0.0%	21.1%	21.1%	36.3	3.5%	13.5%	**2.3x**
HF Group***	5.9	6.2	4.2%	(40.9%)	(37.9%)	6.6	5.7%	13.0%	**0.2x**
Standard Chartered	190.0	186.0	(2.1%)	(10.6%)	(17.3%)	196.3	6.7%	12.3%	**1.5x**
SBM Holdings	6.3	6.3	(0.6%)	(16.3%)	(19.1%)	6.6	4.8%	9.2%	**0.9x**
Bank of Kigali	289.0	289.0	0.0%	(3.7%)	1.4%	299.9	4.8%	8.6%	**1.6x**
Guaranty Trust Bank	36.4	36.5	0.4%	(10.4%)	(12.5%)	37.1	6.6%	8.2%	**2.3x**
Bank of Baroda	140.0	126.0	(10.0%)	11.5%	14.5%	130.6	2.0%	5.6%	**1.2x**
Stanbic Holdings	90.0	91.0	1.1%	12.3%	14.5%	92.6	2.5%	4.2%	**0.9x**
National Bank	5.2	5.2	0.0%	(44.4%)	(47.2%)	4.9	0.0%	(5.8%)	**0.4x**
Stanbic IBTC Holdings	42.5	45.1	6.1%	8.7%	9.5%	37.0	1.3%	(16.6%)	**2.2x**
FBN Holdings	8.9	9.1	2.2%	3.4%	48.9%	6.6	2.7%	(24.4%)	**0.5x**
Standard Chartered	26.1	26.1	0.0%	3.4%	54.8%	19.5	0.0%	(25.4%)	**3.3x**
Ecobank Transnational	17.5	17.5	0.0%	2.9%	4.5%	9.3	0.0%	(47.0%)	**0.6x**

****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. For full disclosure, Cytonn and/or its affiliates holds a significant stake in NIC Bank, ranking as the 5th largest shareholder***
******* Stock prices are in respective country currency***

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.