Kenya Listed Banks Q3'2020 Report, & Cytonn Weekly #50/2020

Fixed Income: During the week, T-bills remained undersubscribed, with the overall subscription rate coming in at 41.1%, down from 45.5% recorded the previous week. This can be mainly attributed to the tight liquidity position in the market as well as the concurrent bonds issued during the week. In the primary bond, the government reopened two bonds namely, FXD1/2012/15 and FXD2/2019/15, which recorded an overall subscription rate of 60.9% down from 140.0% recorded in the month of November. Due to the tightening liquidity in the market, the average interbank rate increased by 0.4% points to 4.3% from 3.9%, recorded last week. In the T-bill market, interest shifted to the 364-day paper whose overall subscription increased marginally to 52.8%, from 52.6% recorded the previous week. The yields on the 91-day, 182-day and 364-day increased by 4.0 bps, 3.0 bps and 4.2 bps to 6.9%, 7.4% and 8.2%, respectively;

Equities: During the week, the equities market recorded mixed performance, with NSE 20 gaining by 0.4%, while NASI and NSE 25 declined by 0.7% and 0.5% respectively, taking their YTD performance to losses of 11.6%, 32.4%, and 19.6%, for NASI, NSE 20 and NSE 25, respectively. The equities market performance was mainly driven by losses recorded by large-cap stocks such as BAT, ABSA Bank and Safaricom of 2.5%, 2.0% and 1.6% respectively. The losses were however mitigated by gains recorded by Bamburi, Diamond Trust Bank and NCBA Group, which gained by 29.9%, 9.1% and 1.7% respectively. During the week, I&M Holdings plc received approval from its shareholders to pay Kshs 3.6 bn to acquire a 90.0% stake in Uganda's Orient Bank Limited (OBL). The Central Bank of Kenya, (CBK), recently released the Financial Stability Report, October 2020, highlighting that the banking sector was resilient in 2019 despite the interest rate controls and the subdued economic environment seen during the period;

Real Estate: During the week, the government of Kenya raised approximately Kshs 536.5 mn in deposits from the sale of its 1,370 low-cost houses within the Park Road housing project in Nairobi. Under listed real estate, the Capital Markets Authority (CMA) approved the issuance of the Development Real Estate Investment Trust (D-REIT) and Investment Real Estate Investment Trust (I-REIT) by real estate developer Acorn Holdings;

Focus of the Week: Following the release of Q3'2020 results by Kenyan listed banks, this week we analyse the performance of the 10 listed local banks (previously 11, before the acquisition of National Bank by KCB Group Plc), identify the key factors that influenced their performance, and give our outlook for the banking sector;

Company Updates

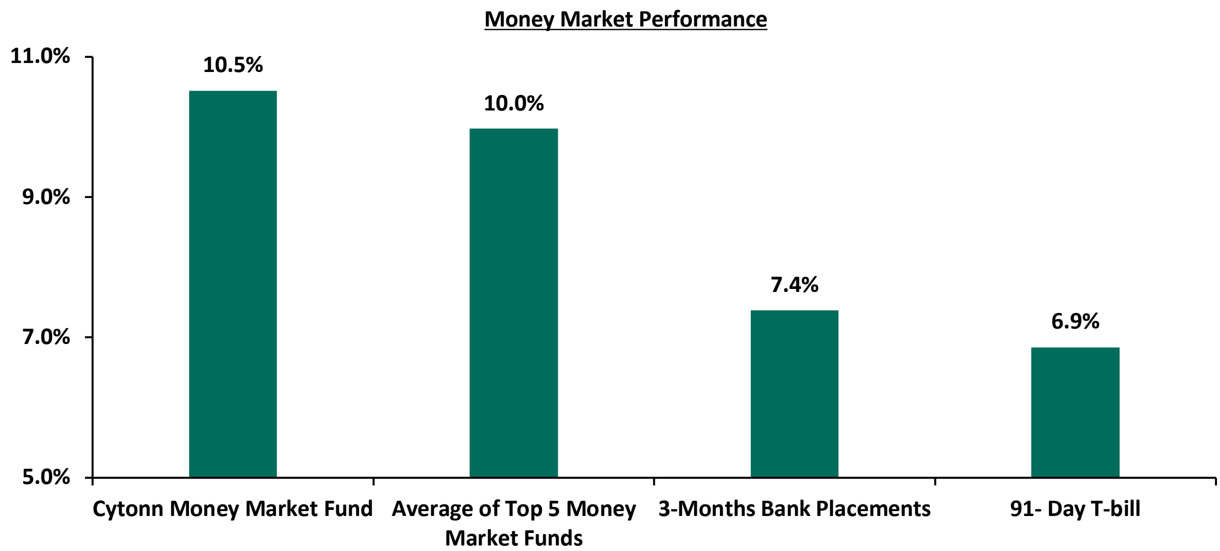
- Weekly Rates:
  - Cytonn Money Market Fund closed the week at a yield of 10.50%. To invest, just dial *809#;
  - Cytonn High Yield Fund closed the week at a yield of 13.42% p.a. To invest, email us at sales@cytonn.com and to withdraw the interest you just dial *809#;
- For an exclusive tour of Cytonn's real estate developments, visit: Sharp Investor's Tour and for more information, email us at sales@cytonn.com;
- We continue to offer Wealth Management Training daily, from 9:00 am to 11:00 am, through our Cytonn Foundation. The training aims to grow financial literacy among the general public. To register for any of our Wealth Management Training, click here;
- For Pension Scheme Trustees and members, we shall be having different industry player's talk about matters affecting Pension Schemes and the pensions industry at large. Join us every Wednesday from 9:00 am to 11:00 am for in-depth discussions on matters pension;
- If interested in our Private Wealth Management Training for your employees or investment group, please get in touch with us through wmt@cytonn.com;
- We have 10 investment-ready projects, offering attractive development and buyer targeted returns. See further details here: Summary of Investment-ready Projects;
- For recent news about the company, see our news section here.

Fixed Income

Money Markets, T-Bills & T-Bonds Primary Auction:

During the week, T-bills remained undersubscribed, with the overall subscription rate coming in at 41.1%, down from 45.5% the previous week. This can be mainly be attributed to the concurrent primary bond issue where the government reopened two bonds namely, FXD1/2012/15 and FXD2/2019/15, which recorded an overall subscription rate of 60.9% down from 140.0% recorded in the month of November. Due to the tightening liquidity in the market, the average interbank rate increased by 0.4% points to 4.3% from 3.9%, recorded last week. The highest subscription on treasury bills was in the 364-day paper, which increased marginally to 52.8% from 52.6% recorded the previous week. The subscription for the 182-day paper increased to 30.2% from 26.9%, while that of the 91-day paper, declined to 38.8% from 74.3% recorded the previous week. The yields on the 91-day, 182-day and 364-day increased by 4.0 bps, 3.0 bps and 4.2 bps to 6.9%, 7.4% and 8.2%, respectively. The government continued to reject expensive bids but the acceptance rate increased to 98.7%, from 90.6% recorded the previous week, with bids worth Kshs 9.7 bn accepted out of the Kshs 9.9 bn worth of bids received.

During the month of December, the Central Bank of Kenya re-opened 2 bonds; FXD1/2012/15 and FXD2/2019/15 with coupons of 11.0% and 12.7%, respectively, and effective tenors of 6.5 years and 13.8 years, respectively. There was low demand for the bond issue, with the overall subscription rate for the two bonds coming in at 60.9%, partly due to the relatively tightening liquidity in the market. The government offered to collect Kshs 40.0 bn but received bids worth Kshs 24.3 and accepted only Kshs 18.3 bn. Investors preferred the longer-term paper i.e. FXD2/2019/15, which received bids worth Kshs 15.1 bn, representing 62.0% of the total bids received. The weighted average rate of accepted bids for FXD1/2012/15 and FXD2/2019/15 came in at 11.5% and 12.8%, compared to 11.6% and 12.7% when they were last issued in the primary market, and 11.5% and 12.2% in the secondary market, respectively.



In the money markets, 3-month bank placements ended the week at 7.4% (based on what we have been offered by various banks), while the yield on the 91-day T-bill increased by 4.0 bps to 6.9%. The average yield of Top 5 Money Market Funds remained unchanged at 10.0%, similar to what was recorded the previous week. The yield on the Cytonn Money Market remained unchanged at 10.5%, similar to what was recorded the previous week.

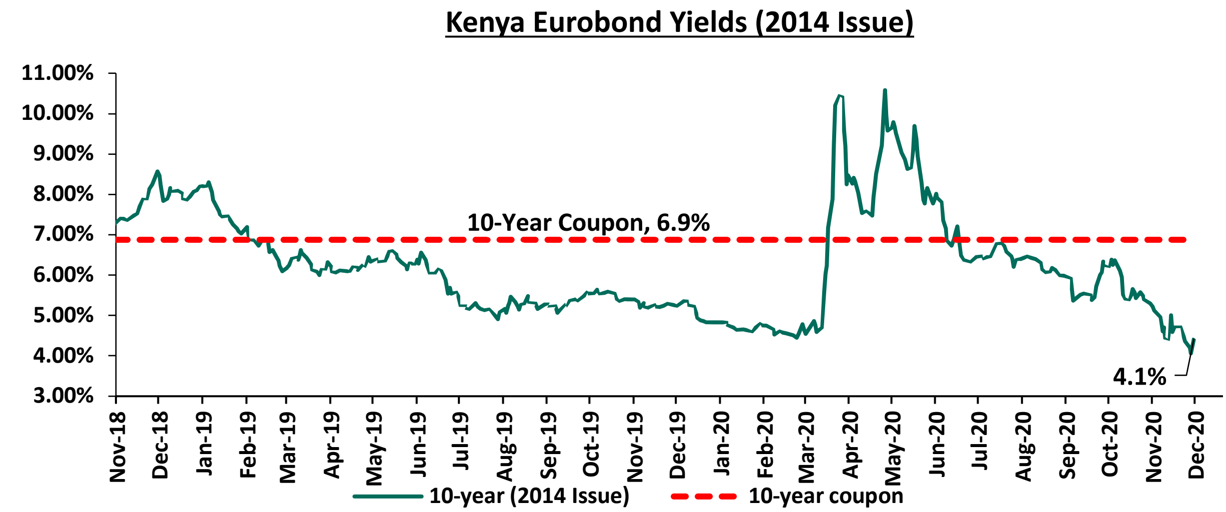
Liquidity:

During the week, liquidity in the market continued to tighten with the average interbank rate increasing by 0.4% points, to 4.3% from 3.9% recorded the previous week. The average interbank volumes increased by 76.1% to Kshs 10.6 bn, from Kshs 6.0 bn recorded the previous week. According to the Central Bank of

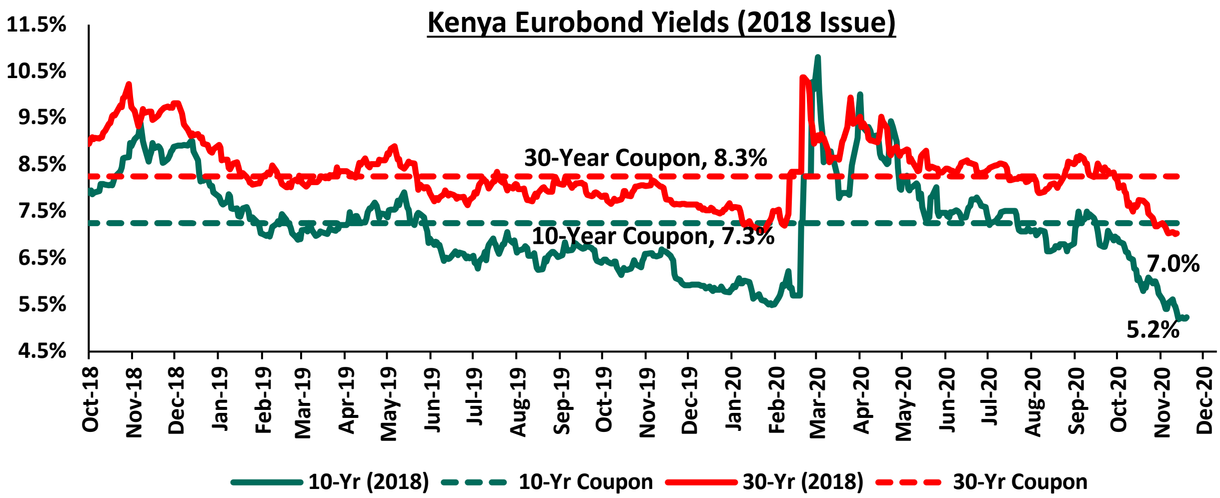
Kenya's weekly bulletin, released on 11th December 2020, commercial banks' excess reserves came in at Kshs 24.6 bn in relation to the 4.25% Cash Reserve Ratio.

Kenya Eurobonds:

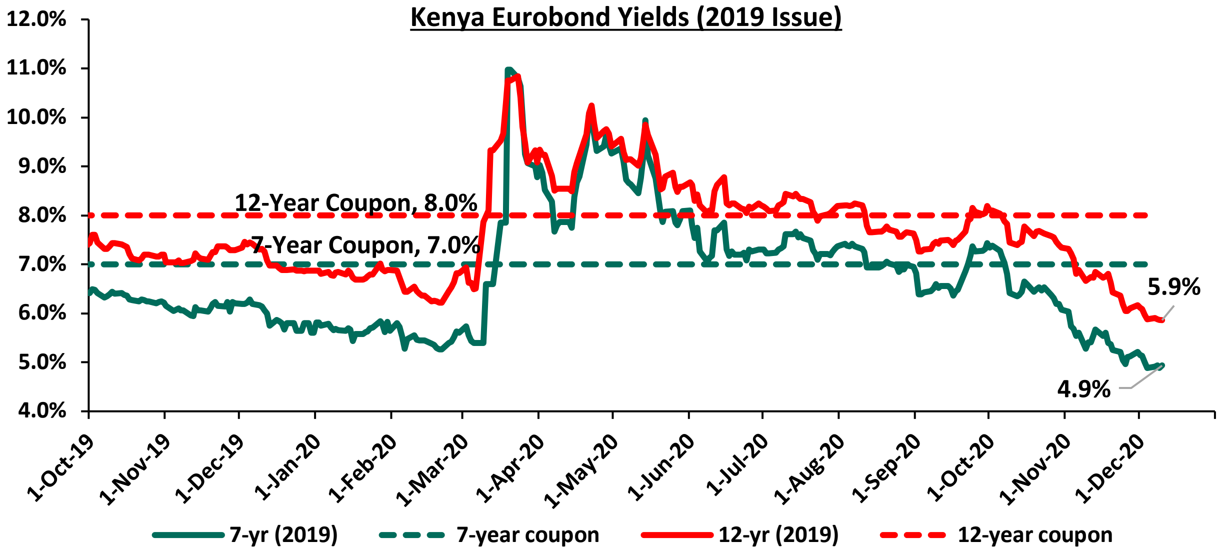
During the week, the yields on all Eurobonds recorded declines. According to Reuters, the yield on the 10-year Eurobond issued in June 2014 declined marginally by 0.1% points to 4.1%, from 4.2% recorded the previous week.



During the week, the yields on the 10-year and 30-year Eurobonds issued in 2018 declined, with the 10-year issue declining by 0.2% points to 5.2%, from 5.4% recorded last week. The 30-year issue declined marginally by 0.1% points to 7.0%, from 7.1% recorded last week.



During the week, the yields on the 2019 dual-tranche Eurobonds declined, with both the 7-year Eurobond and 12-year Eurobond declining marginally by 0.1% points. The 7-year Eurobond declined to 4.9%, from 5.0% recorded last week, while the 12-year Eurobond declined to 5.9%, from the 6.0% recorded last week.



Kenya Shilling:

During the week, the Kenyan shilling depreciated against the US dollar by 0.4% to an all-time low of Kshs 111.5 from Kshs 110.7. This is partly attributable to insufficient dollar inflows from subdued sectors such as tourism and horticulture, which failed to match the dollar demand from businesses as they rush to meet their end year obligations. On an YTD basis, the shilling has depreciated by 10.0% against the dollar, in comparison to the 0.5% appreciation in 2019. We expect continued pressure on the Kenyan shilling due to:

i. Demand from merchandise traders as they beef up their hard currency positions ahead of the festive season, amid a slowdown in foreign dollar currency inflows, and,
ii. Continued uncertainty globally making people prefer holding dollars and other hard currencies.

However, in the short term, the shilling is expected to be supported by:

i. The Forex reserves which are currently at USD 7.8 bn (equivalent to 4.8-months of import cover), which is above the statutory requirement of maintaining at least 4.0-months of import cover, and the EAC region's convergence criteria of 4.5-months of import cover,
ii. The improving current account position which narrowed to 4.9% of GDP in the 12 months to October 2020 compared to 5.3% of GDP during a similar period in 2019, and,
iii. Improving diaspora remittances evidenced by a 17.3% y/y increase to USD 263.1 mn in October 2020, from USD 224.3 mn recorded over the same period in 2019, has cushioned the shilling against further depreciation,

Rates in the fixed income market have remained relatively stable due to the high liquidity in the money markets, coupled with the discipline by the Central Bank as they reject expensive bids. The government is 29.7% ahead of its prorated borrowing target of Kshs 215.1 bn having borrowed Kshs 278.8 bn. In our view, due to the current subdued economic performance brought about by the effects of the COVID-19 pandemic, the government will record a shortfall in revenue collection with the target having been set at Kshs 1.9 tn for FY'2020/2021 thus leading to a larger budget deficit than the projected 7.5% of GDP, ultimately creating uncertainty in the interest rate environment as additional borrowing from the domestic market may be required to plug the deficit. Owing to this uncertain environment, our view is that investors should be biased towards short-term to medium-term fixed income securities to reduce duration risk.

Equities

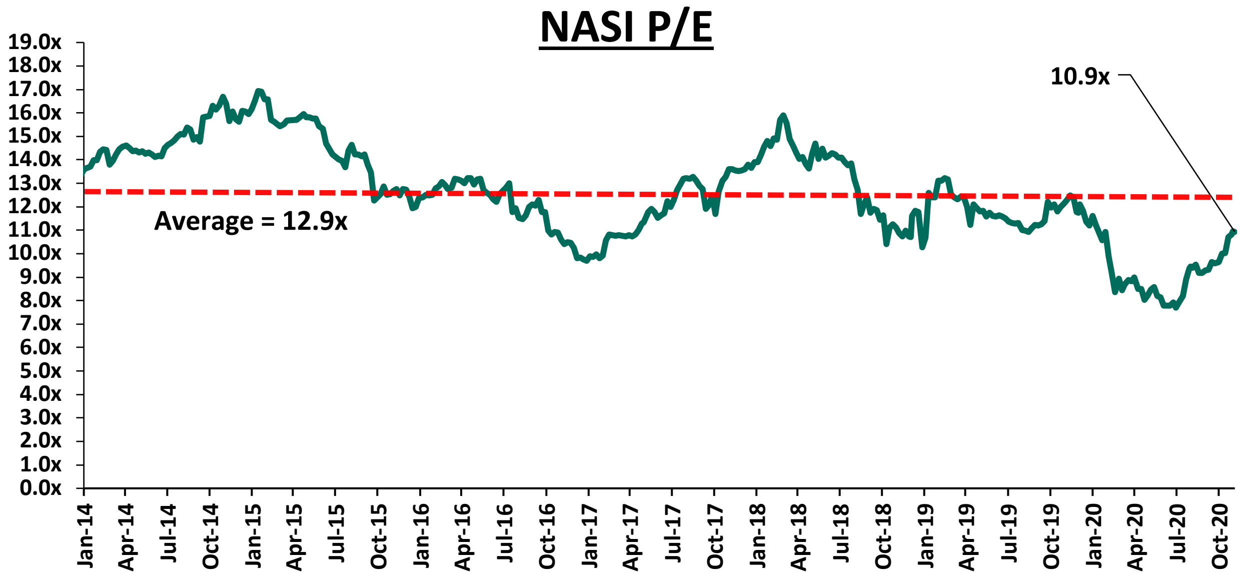
Markets Performance

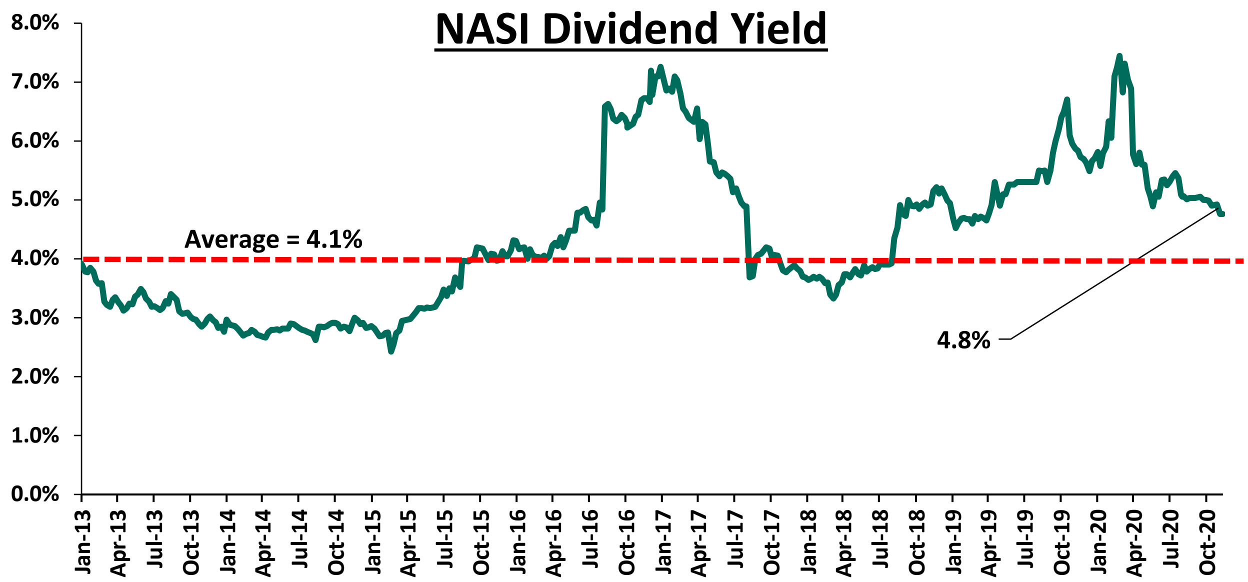
During the week, the equities market recorded a mixed performance, with NSE 20 gaining by 0.4%, while NASI and NSE 25 declined by 0.7% and 0.5% respectively, taking their YTD performance to losses of 11.6%, 32.4%, and 19.6%, for NASI, NSE 20 and NSE 25, respectively. The equities market performance was mainly driven by losses recorded by large-cap stocks such as BAT, ABSA Bank and Safaricom of 2.5%, 2.0% and 1.6% respectively. The losses were however mitigated by gains recorded by Bamburi, Diamond Trust Bank and NCBA Group, which gained by 29.9%, 9.1% and 1.7% respectively. Key to note, Bamburi's current price of Kshs 38.9 is the highest recorded since June 2020.

Equities turnover declined by 50.1% during the week to USD 24.1 mn, from USD 48.2 mn recorded the previous week, taking the YTD turnover to USD 1.4 bn. Foreign investors turned net sellers during the week, with a net selling position of USD 1.6 mn, from a net buying position of USD 5.0 mn recorded the previous week, taking the YTD net selling position to USD 277.5 mn.

The market is currently trading at a price to earnings ratio (P/E) of 10.9x, 15.9% below the 11-year historical average of 12.9x. The average dividend yield is currently at 4.8%, unchanged from the previous week, and 0.7% points above the historical average of 4.1%.

With the market trading at valuations below the historical average, we believe there are pockets of value in the market for investors with higher risk tolerance and are willing to wait out the pandemic. The current P/E valuation of 10.9x is 41.4% above the most recent valuation trough of 7.7x experienced in the first week of August 2020. The charts below indicate the historical P/E and dividend yields of the market.





Weekly Highlight

During the week, I&M Holdings plc received approval from its shareholders to pay Kshs 3.6 bn to acquire a 90.0% stake in Uganda's Orient Bank Limited (OBL). Key to note, the amount will be subject to adjustments on account of several factors including exchange rate fluctuations and amounts raised from the sale of the Ugandan bank's property in Kampala (Orient Plaza). The announcement comes 4 months after the two banks started negotiations, from 17th July 2020, which was covered in our Cytonn Weekly #30/2020. As highlighted in the report, the transaction was subject to approval from the Central Bank of Kenya, Central Bank of Uganda, the Capital Markets Authority as well as the company shareholders. For the 90.0% Orient Bank acquisition, I&M will pay a cash consideration based on the net asset value of Orient Bank at completion of the transaction using an estimated price to book multiple of 1.1x. Key to note, according to the FY'2019 Orient Bank financials, the bank had a book value of Ushs 114.0 bn (Kshs 3.5 bn). Following this acquisition, I&M will be the fourth Kenyan bank to venture into the Ugandan market, joining KCB Group, Equity Group and DTB Group. The acquisition is in line with I&M's expansion strategy and will thus help reduce the bank's reliance on the Kenyan Market. The acquisition multiple of 1.1x P/Bv is 0.1x lower than the 5 year average which is at 1.2x P/Bv, but higher than the last one year average, which is at 0.7x P/Bv. Below is a summary of the deals in the last 5-years that have either happened, been announced, or expected to be concluded;

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs. Bns)	Transaction Stake	Transaction Value	P/Bv Multiple	Date
KCB Group	Banque Populaire du Rwanda	5.2	62.1%	5.7	1.1x	Nov-20*
KCB Group	ABC Tanzania	Unknown	100.0%	Undisclosed	0.4x	Nov-20*
Co-operative Bank	Jamii Bora Bank	3.4	90.0%	1	0.3x	Aug-20
I&M Holdings	Orient Bank Ltd	3.5	90.0%	3.6	1.1x	Jul-20*
Commercial International Bank	Mayfair Bank Limited	1	51.0%	Undisclosed	N/D	May-20*
Access Bank PLC (Nigeria)	Transnational Bank PLC.	1.9	100.0%	1.4	0.7x	Feb-20*
Equity Group **	Banque Commerciale Du Congo	8.9	66.5%	10.3	1.2x	Nov-19*
KCB Group	National Bank of Kenya	7	100.0%	6.6	0.9x	Sep-19
CBA Group	NIC Group	33.5	53%:47%	23	0.7x	Sep-19
Oiko Credit	Credit Bank	3	22.8%	1	1.5x	Aug-19
CBA Group**	Jamii Bora Bank	3.4	100.0%	1.4	0.4x	Jan-19
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	1.0x	Jan-18

KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	N/A	Dec-18
SBM Bank Kenya	Chase Bank Ltd	Unknown	75.0%	Undisclosed	N/A	Aug-18
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	0.8x	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	1.6x	Nov-16
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	1.4x	Jun-16
I&M Holdings	Giro Commercial Bank	3	100.0%	5	1.7x	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	2.3x	Mar-15
Centum	K-Rep Bank	2.1	66.0%	2.5	1.8x	Jul-14
GT Bank	Fina Bank Group	3.9	70.0%	8.6	3.2x	Nov-13
Average			**74.7%**		**1.2x**	

*** Announcement Date**
**** Deals that were dropped**

The Central Bank of Kenya, (CBK), recently released the [Financial Stability Report, October 2020](), highlighting that the banking sector was resilient in 2019 despite the interest rate controls and the subdued economic environment seen during the period. Key to note, in 2019, the country recorded a slower GDP growth of 5.4%, compared to the 6.3% growth recorded the previous year. For the first half of 2010, the banking sector registered a 7.8% growth in net assets to Kshs 5.2 tn in June 2020, from Kshs 4.8 tn in December 2019 and 9.8% growth in deposits to Kshs 3.9 tn in June 2020, from Kshs 3.6 tn recorded in December 2019. The increase in deposits is attributed to the increased usage of digital channels such as the mobile money and agency banking. Other key take-outs from the report include:

i. Gross loans grew by 4.8% to Kshs 2.9 tn in June 2020, from Kshs 2.8 tn in December 2019, attributed to efforts by the Central Bank to inject liquidity through lowering the Central Bank Rate (CBR) to 7.00% from 7.25% as at March 2020. Key to note, the CBR stood at 8.50% in November 2019. The Central Bank also lowered the Cash Reserve Ratio to 4.25% from 5.25%, which released Kshs 35.2 bn into the economy through the banking system, of which Kshs 32.6 bn (92.7%) was used to support lending,
ii. The tourism sector had the highest restructured loans at 71.3% of total loans to the sector as at June 2020, amounting to Kshs 67.5 mn, mainly attributable to local and international travel restrictions that reduced the inflows to the sector, following the lockdown measures put in place by the government to curb the spread of the virus. On the other hand, job layoffs and reduced disposable income led to personal/household loans accounting for the highest amount of restructured loans by the sector at Kshs 240.1 mn, which was 30.1% of total outstanding loans,
iii. Investment in government securities grew by 12.0% compared to a 7.0% growth in net loans and advances in June 2020, an indication of the banking sector's preference to loan to the government as they drifted away from lending to the private sector due to the elevated credit risk, and,
iv. The COVID-19 pandemic eroded the banks' assets quality with the Gross NPL ratio rising to 13.1% in June 2020, from 12.0% in FY'2019, reflecting the subdued business environment caused by restricted movements, lockdowns, disruptions in supply chains and closure of businesses. Gross Non-Performing Loans in the sector grew by 14.6% in H1'2020 to Kshs 382.0 bn, from Kshs 333.4 bn in FY'2019.

The banking sector posted reduced earnings in Q3'2020, with core EPS growth declining by 32.4% compared to a growth of 8.7% in Q3'2019, attributed to increased provisioning, high NPLs and waiving of fees from mobile money transactions, which led to a slower growth of Non-funded income by 2.1% compared to a growth of 15.8% recorded in Q3'2019. Asset quality also deteriorated in the period, with the NPL ratio rising by 2.6% points to a market cap weighted average of 12.4% in Q3'2020 from 9.8% in Q3'2019. Despite the deteriorating asset quality, we believe that the banking sector remains resilient due to the proactive monitoring of the loan books coupled with the measures taken by the Central Bank to support the sector.

Universe of Coverage:

Company	Price at 4/12/2020	Price at 11/12/2020	w/w change	YTD Change	Year Open	Target Price*	Dividend Yield	Upside/ Downside**	P/TBv Multiple	Recommendation
Kenya Reinsurance	2.2	2.1	(2.3%)	(30.4%)	3.0	4.0	5.2%	94.8%	**0.2x**	Buy
Diamond Trust Bank***	63.5	69.3	9.1%	(36.5%)	109.0	105.1	3.9%	55.7%	**0.3x**	Buy
Sanlam	11.0	12.7	15.0%	(26.5%)	17.2	18.4	0.0%	45.5%	**1.2x**	Buy
I&M Holdings***	46.0	46.0	0.0%	(14.8%)	54.0	60.1	5.5%	36.2%	**0.7x**	Buy
KCB Group***	36.7	37.0	0.8%	(31.5%)	54.0	46.0	9.5%	33.8%	**0.8x**	Buy
Liberty Holdings	7.1	7.5	5.6%	(27.5%)	10.4	9.8	0.0%	30.7%	**0.6x**	Buy
Equity Group***	35.1	35.0	(0.1%)	(34.6%)	53.5	43.0	5.7%	29.7%	**0.8x**	Buy
Britam	7.2	7.2	0.0%	(20.0%)	9.0	8.6	3.5%	22.9%	**0.8x**	Buy
Co-op Bank***	11.6	11.7	0.9%	(28.4%)	16.4	14.5	8.5%	22.2%	**0.8x**	Buy
Stanbic Holdings	79.3	75.3	(5.0%)	(31.1%)	109.3	84.9	9.4%	22.2%	**0.7x**	Buy
ABSA Bank***	9.8	9.6	(2.0%)	(28.4%)	13.4	10.5	11.5%	21.3%	**1.1x**	Buy
Jubilee Holdings	270.0	270.0	0.0%	(23.1%)	351.0	313.8	3.3%	19.5%	**0.5x**	Accumulate
Standard Chartered***	149.5	150.0	0.3%	(25.9%)	202.5	153.2	8.3%	10.5%	**1.2x**	Accumulate
NCBA***	22.9	23.3	1.7%	(36.8%)	36.9	25.4	1.1%	10.1%	**0.6x**	Accumulate
CIC Group	2.1	2.1	(2.8%)	(23.1%)	2.7	2.1	0.0%	1.9%	**0.7x**	Lighten
HF Group	3.3	3.1	(7.8%)	(52.3%)	6.5	3.0	0.0%	(2.6%)	**0.2x**	Sell

***Target Price as per Cytonn Analyst estimates**
****Upside/ (Downside) is adjusted for Dividend Yield**
*****For Disclosure, these are banks in which Cytonn and/ or its affiliates are invested in**

We are "Neutral" on equities for investors because, despite the sustained price declines, which have seen the market P/E decline to below its historical average presenting investors with attractive valuations in the market. The economic outlook remains grim.

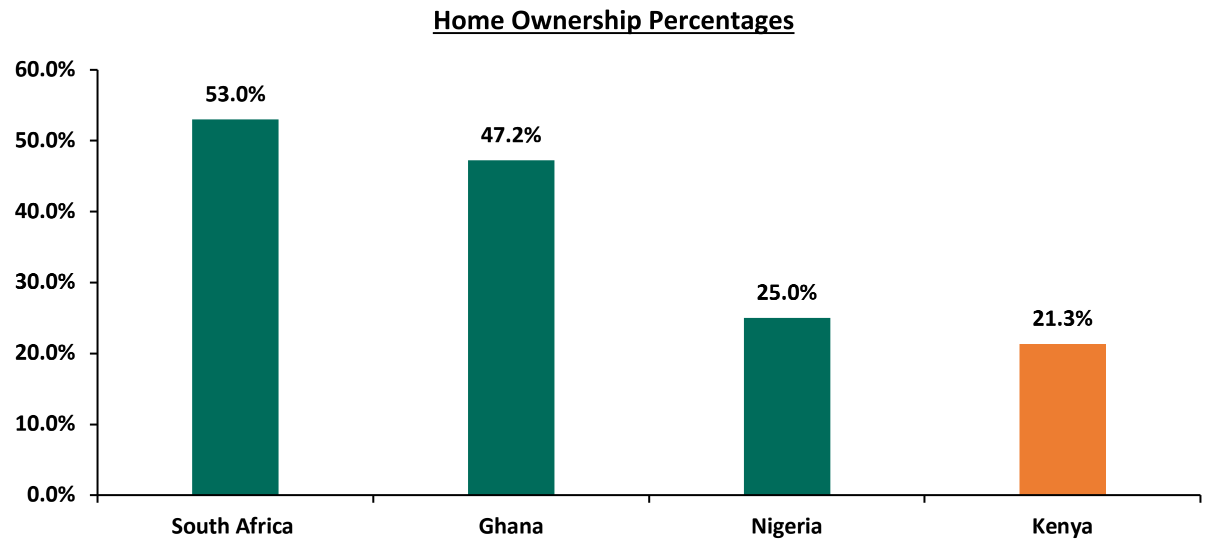
Real Estate

I. Residential Sector

During the week, the government of Kenya raised Kshs 536.5 mn in deposits from the sale of its low-cost houses on Park Road project in Nairobi, following the floating of the first lot of 488 completed units for sale to the public on 2nd December 2020, with the sale having taken one-week. Buyers were required to commit 12.5% of the house value as a deposit, and outline how they intend to pay the balance in cash or mortgage. Demand for affordable housing units have been on an upward trajectory evidenced by the relatively high number of approximately 300,000 individuals who have registered through the boma yangu portal, coupled by the amount the government has already received from the recent sale. However, the implementation of affordable housing projects has been sluggish and the initiative is expected to fall short of its 2022 target of delivering 500,000 housing units having delivered only approximately 650 units through Park Road project and Pangani Estate renewal project so far. The delivery has been crippled by; (i) Lack of a supportive capital markets regulatory framework, which would enable fundraising for housing development, (ii) bureaucracy and slow project approval processes especially in the case of Public-Private Partnerships, (iii) the pending operationalization of the Integrated Project Delivery Unit which was tasked with being a single point of regulatory approval for developments, infrastructure provision and developer incentives, (iv) failure to fast track incentives provided in support of the affordable housing initiative, (v) ineffectiveness of Public-Private Partnerships, and, (vi) the current economic slowdown due to the ongoing pandemic.

We expect the affordable housing programme to continue taking shape with the delivery of ongoing projects thus encouraging more potential homeowners to join the boma yangu platform, with other projects such as Shauri Moyo, Makongeni and Starehe houses in the pipeline and are set to deliver approximately 30,000 housing units. In our view, the government collection from buyers might be channelled towards implementation of affordable housing projects hence help facilitate delivery of the remaining housing units in the ongoing projects, in the wake of reduced budgetary allocation on affordable housing from Kshs 11.4 bn in 2019 to Kshs 6.9 bn in 2020, according to the National Treasury. This coupled with provision of incentives to buyers is expected to result in improved home ownership levels with Kenya currently lagging behind at approximately 21.3%, compared to other developed countries such as South Africa and Ghana at 53.1 and 47.2%, respectively.

The graph below shows the home ownership percentage of Kenya in comparison to other countries;



Source: Centre of Affordable Housing Africa

I. Listed Real Estate

The Capital Markets Authority (CMA) approved the issuance of The Development Real Estate Investment Trust (D-REIT) and Investment Real Estate Investment Trust (I-REIT) by real estate developer Acorn Holdings. This follows the licensing of Acorn Investment Management Limited, a subsidiary of Acorn Holdings, as a REIT Manager in November 2020. The fund size for the two REITS is estimated at Kshs 4.0 bn for the D-Reit and Kshs 4.1 bn for the I-Reit in the initial fundraising. Acorn is seeking for investors to invest a total of 24.0% equity on the development of student accommodation D-Reit, and up to 67.0% in the I-Reit. So far, the firm has secured Kshs 1.0 bn equity investment from one of its anchor investor, InfraCo, a Private Infrastructure Development Group. The REITS will be able to offer stable and long-term returns to investors and will for now only be offered to institutional and sophisticated investors through a restricted public offer.

The D-REIT market in Kenya has failed to take off despite the regulations having come into force in 2013. The Fushion Capital D-Reit, which was issued in 2016, failed due to low subscription rates; the Cytonn D-REIT faced delays in approvals given the high levels of capital required for a Corporate Trustee, of at least Kshs. 100m, leading the promoter to discontinue the effort. The poor performance of the D-REITs is attributed to several factors: (i) the high minimum investment amounts set at Kshs 5.0 mn, high minimum capital requirement for a trustee at Kshs 100.0 mn, and, lengthy approval process. At a minimum capital of Kshs. 5 m, that is over 100x the median income in Kenya. (ii) the high levels of capital required of a Trustee at Kshs. 100m reduces the pool of approved REIT Trustees, which is currently just three, namely; Housing Finance, Cooperative Bank and KCB Bank. Without addressing these two regulatory frameworks, DREITs will continue to be a mirage and there will be continued lack of capital to support housing development. On the other hand, the only listed I-REIT, Fahari I-REIT is currently trading at an average price of Kshs 5.4 in December, a 73.0% drop from its issuance price of Kshs 20.0 in November 2015. This poor performance is mainly attributable to potential investors' lack of knowledge about the products. Other challenges facing the REIT market include; lack of institutional development capacity as most of the real estate that is currently under development is not institutional-grade thus does not have the capacity to take up specialized funding, and the sluggish growth in select sectors within the real estate market.

Nevertheless, developers continue to seek alternative ways of raising funds for their real estate projects especially in the wake of bank dominance whose cost of funding has remained relatively high. This is evidenced by the growing popularity of structured financing options such as real estate structured notes, which may include project notes, real estate-backed medium term notes and other high yield loan notes, and, Real Estate Investment Trusts (REITS). Through the REITs, we expect that Acorn will gain access to a pool of investor capital that wishes to take specific real estate exposure, with the D-REIT expected to finance the student hostels, having announced that it is set to build two hostels next to the University of Nairobi Chiromo Campus under the Qwetu and Qejani brands, whereas I-REIT will be used to acquire property for rental income.

The real estate sector is expected to record increased activities fuelled by the continued implementation of government affordable housing projects, in addition to the exploring of alternative financing for real estate projects by developers.

Focus of the Week: Kenya Listed Banks Q3’2020 Report

Following the release of the Q3’2020 results by Kenyan listed banks, the Cytonn Financial Services Research Team undertook an analysis on the financial performance of the listed banks and identified the key factors that shaped the performance of the sector, and our expectations of the banking sector for the rest of the year.

Core Earnings per Share recorded a weighted decline of 32.4% in Q3’2020, compared to a weighted growth of 8.7% recorded in Q3’2019. As reported by most of the banks, the decline in the earnings was mainly attributable to the increased provisioning levels, as they covered for downgraded facilities, with the expectations of an increase in defaults across sectors on the back of the COVID-19 pandemic.

Asset quality for listed banks deteriorated in Q3’2020, with the gross NPL ratio rising by 2.6% points to 12.4% from 9.8% in Q3’2019, and higher than the 5-year average of 8.5%. The banking sector was also keen on restructuring loans in order to offer relief for their customers against the effects of COVID-19. The loan restructuring involved placing moratoriums on both interest and principal payments for three months to one year. As at the end of October 2020, the total amount of loan restructured stood at Kshs 1.4 tn representing 46.5% of the banking sector loan book.

The report is themed “Erosion of the Banking Sector’s Asset Quality amid the COVID-19 Operating Environment” where we assess the key factors that influenced the performance of the banking sector in Q3’2020, the key trends, the challenges banks faced, and areas that will be crucial for growth and stability of the banking sector going forward. As such, we shall address the following:

i. Key Themes That Shaped the Banking Sector Performance in Q3’2020,
ii. Summary of The Performance of the Listed Banking Sector in Q3’2020,
iii. The Focus Areas of the Banking Sector Players Going Forward, and,
iv. Brief Summary and Ranking of the Listed Banks based on the Outcome of Our Analysis.

Section I: Key Themes That Shaped the Banking Sector Performance in Q3’2020

Below, we highlight the key themes that shaped the banking sector in Q3’2020 which include regulation, monetary policy, consolidation, asset quality, and capital conservation:

1. **Regulation** :

a) **Guidance on Loan Restructuring:** On March 27th 2020, the Central Bank of Kenya provided commercial banks and mortgage finance companies with guidelines on loan reclassification, and provisioning of extended and restructured loans as per the Banking Circular No 3 of 2020. The loan restructuring involved placing moratoriums on both interest and principal payments between three to twelve months, in effect giving reprieve to borrowers who found it difficult to repay their loans due to the impact caused by the pandemic. Following this guidance, the banking sector has seen a total of Kshs 1.1 tn, representing 38.6% of the total Kshs 2.9 tn banking sector loan book, being restructured as at August 2020, according to data from the September 2020 Monetary Policy Committee (MPC) Meeting.

The table below highlights some of the major banks that have disclosed the amount of loans they have restructured so far;

No.	Bank	Amount Restructured (Kshs bn)	% of restructured loans to total loans	Q3'2020 y/y Change in Loan loss provision
1	Kenya Commercial Bank	105.0	18.2%	242.5%
2	Equity Group Holdings	92.0	20.2%	686.1%
3	Diamond Trust Bank	64.0	31.1%	232.1%
4	NCBA Group	58.0	23.2%	210.6%
5	Absa Bank Kenya	63.0	30.1%	146.7%
6	Co-operative Bank of Kenya	39.2	13..8%	89.4%
7	Standard Chartered Bank of Kenya	22.0	16.7%	274.2%
	Total	**443.2**	**23.3%**	**268.8%**

2. **Consolidation**: Consolidation activity remained one of the key highlights witnessed in Q3'2020, in line with our expectations, as players in the sector were either acquired or merged, leading to the formation of relatively larger, well capitalized, and possibly more stable entities. The following were the major M&A's activities witnessed during the third quarter of 2020:

    a. On 25th August 2020, Co-operative Bank Kenya completed the 90.0% acquisition of Jamii Bora Bank and rebranded it to Kingdom Bank Limited. The transaction that had started in March for a 100.0% purchase of the Bank at Kshs 1.1 bn, was completed in August after receiving all the approvals, with I&M varying its initial offer of 100.0% stake to a 90.0% stake. For more information on the transaction, see Cytonn Weekly #35/2020, Cytonn Weekly #32/2020 and Cytonn Weekly #26/2020,

    b. Equity Group Holdings completed the 66.5% stake acquisition of the Banque Commerciale Du Congo (BCDC) at a cost of USD 95.0 mn (Kshs 10.3 bn). Initially, the deal was to cost USD 105.0 mn (Kshs 11.4 bn), however factoring in the adverse effects of the COVID-19 pandemic on the two economies, the two parties agreed to reduce the amount to USD 95.0 mn (Kshs 10.3 bn). For more information on the transaction, see Cytonn Weekly #33/2020, and,

    c. I&M Holdings plc issued a cautionary statement to its shareholders on its intention to acquire 90.0% of the share capital of Orient Bank Limited Uganda (OBL). Subsequently in the fourth quarter, the shareholders have given the approval to proceed with the acquisition. Read more on the same here.

Other mergers and acquisitions activities announced after Q3'2020 include;

i. On 25th November 2020, KCB Group disclosed that it had entered into an agreement with Atlas Mara Limited (ATMA) to acquire 62.1% stake in Banque De Populaire du Rwanda (BPR) in Rwanda and 100.0% stake in African Banking Corporation Ltd Tanzania (ABC Tanzania). Key to note, Equity Group had previously entered into a binding agreement in April 2019 with Atlas Mara on the acquisition of banking assets in four countries (Rwanda, Tanzania, Zambia and Mozambique); 62.0% of the share capital of Banque Populaire du Rwanda (BPR); 100.0% of the share capital of

Africa Banking Corporation Zambia (ABCZam) Ltd; 100.0% of the share capital of Africa Banking Corporation Tanzania (ABCTz); and, 100.0% of the share capital of Africa Banking Corporation Mozambique Ltd (ABCMoz). In the 62.1% BPR acquisition, KCB will pay a cash consideration based on the net asset value of the BPR at completion of the transaction using a price to book multiple of 1.1x. Key to note, according to the latest BPR financials, the bank had a book value of Rwf 46.6 bn (Kshs 5.2 bn), and thus at the trading multiple of 1.1x, we estimate KCB will have to part with Kshs 5.7 bn. The Group also separately intends to make an offer to acquire the remaining shares from the respective shareholders. Read more on the same here.

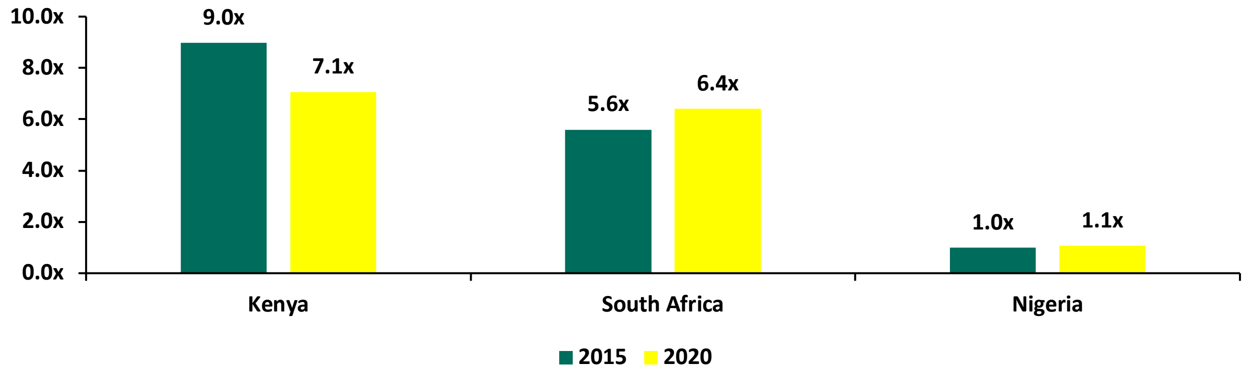
Below is a summary of the deals in the last 5-years that have either happened, been announced or expected to be concluded:

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs. Bns)	Transaction Stake	Transaction Value	P/Bv Multiple	Date
KCB Group	Banque Commerciale Du Congo	5.2	62.1%	5.7	1.1x	Nov-20*
KCB Group	ABC Tanzania	Unknown	100.0%	Undisclosed	0.4x	Nov-20*
Co-operative Bank	Jamii Bora Bank	3.4	90.0%	1	0.3x	Aug-20
I&M Holdings	Orient Bank Ltd	3.5	90.0%	3.6	1.1x	Jul-20*
Commercial International Bank	Mayfair Bank Limited	1	51.0%	Undisclosed	N/D	May-20*
Access Bank PLC (Nigeria)	Transnational Bank PLC.	1.9	100.0%	1.4	0.7x	Feb-20*
Equity Group **	Banque Commerciale Du Congo	8.9	66.5%	10.3	1.2x	Nov-19*
KCB Group	National Bank of Kenya	7	100.0%	6.6	0.9x	Sep-19
CBA Group	NIC Group	33.5	53%:47%	23	0.7x	Sep-19
Oiko Credit	Credit Bank	3	22.8%	1	1.5x	Aug-19
CBA Group**	Jamii Bora Bank	3.4	100.0%	1.4	0.4x	Jan-19
AfricInvest Azure	Prime Bank	21.2	24.2%	5.1	1.0x	Jan-18
KCB Group	Imperial Bank	Unknown	Undisclosed	Undisclosed	N/A	Dec-18
SBM Bank Kenya	Chase Bank Ltd	Unknown	75.0%	Undisclosed	N/A	Aug-18
DTBK	Habib Bank Kenya	2.4	100.0%	1.8	0.8x	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.8	100.0%	2.8	1.6x	Nov-16
M Bank	Oriental Commercial Bank	1.8	51.0%	1.3	1.4x	Jun-16
I&M Holdings	Giro Commercial Bank	3	100.0%	5	1.7x	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.2	75.0%	2.6	2.3x	Mar-15
Centum	K-Rep Bank	2.1	66.0%	2.5	1.8x	Jul-14
GT Bank	Fina Bank Group	3.9	70.0%	8.6	3.2x	Nov-13
Average			**74.7%**		**1.2x**	

*** Announcement Date**
**** Deals that were dropped**

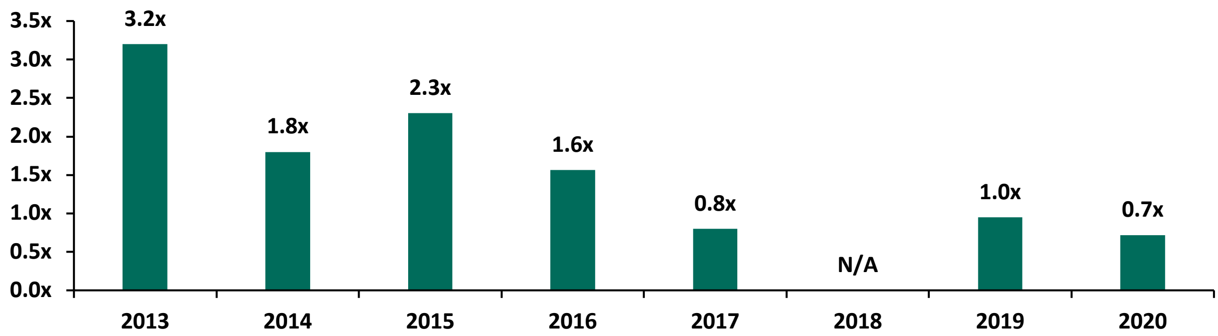
The number of commercial banks in Kenya has now reduced to 38, compared to 43 banks 5-years ago. The ratio of the number of banks per 10 million population in Kenya now stands at 7.1x, which is a reduction from 9.0x 5-years ago, demonstrating continued consolidation of the banking sector. However, despite the ratio improving, Kenya still remains overbanked as the number of banks remains relatively high compared to the population. For more on this see our topical

Commercial Banks / Per Population of 10 million People

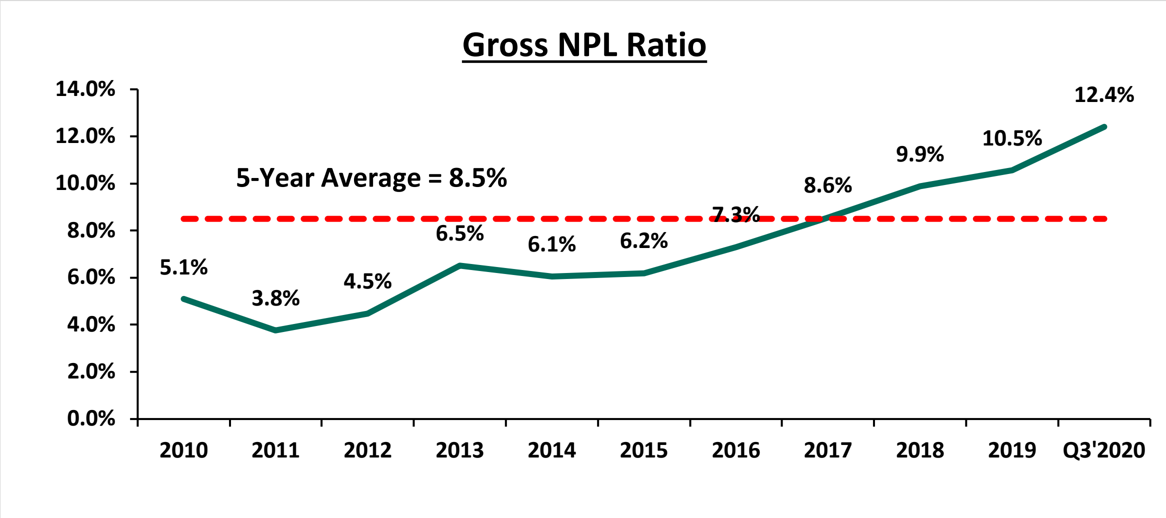


Additionally, the acquisition valuation for banks has come down significantly, from an average acquisition multiple of 3.2x price to book value in 2013, to 0.7x price to book value in 2020, as highlighted in the chart below;

Kenya Banking Sector: Yearly Average Price to Book Acquisition Multiple



3. **Asset Quality** - Asset quality for listed banks deteriorated in Q3'2020 with the Gross NPL ratio rising by 2.6% points to 12.4% from 9.8% in Q3'2019. This was high compared to the 5-year average of 8.5%. The deterioration in asset quality was due to the coronavirus-induced downturn in the economy, which led to an uptick in the non-performing loans. Consequently, the NPL coverage rose to 59.2% in Q3'2020 from 57.8% recorded in Q3'2019, in accordance with IFRS 9, where banks are expected to provide both for the incurred and expected credit losses. We expect higher provisional requirements to subdue profitability during the year across the banking sector on account of the tough business environment. According to the data from the November 2020 MPC Meeting, high levels of NPLs were witnessed in sectors such as Tourism, Real Estate, Hospitality as well as Transport and Communication mainly due to the disruption of business and operations caused by the pandemic. Notably, recoveries and repayments in the trade, manufacturing and construction sectors offset the increase in the NPL levels.
The chart below highlights the asset quality trend:



The table below highlights the asset quality for the listed banking sector:

Bank	Q3'2019 NPL Ratio	Q3'2020 NPL Ratio	Q3'2019 NPL Coverage	Q3'2020 NPL Coverage	% point change in NPL Ratio	% point change in NPL Coverage
HF Group	28.2%	25.4%	44.4%	58.2%	(2.8%)	13.8%
KCB Group	8.3%	15.3%	56.5%	58.5%	7.0%	2.0%
NCBA Group	12.4%	14.1%	60.2%	58.3%	1.7%	(1.0%)
SCBK	14.9%	14.8%	77.0%	78.2%	(0.1%)	1.2%
CO-OP	10.5%	13.2%	55.5%	50.1%	2.7%	(5.4%)
Stanbic Bank	10.9%	12.3%	58.9%	61.8%	1.4%	2.9%
I&M Holdings	12.7%	11.2%	62.5%	66.8%	(1.5%)	4.3%
Equity Group	8.4%	10.8%	45.8%	52.0%	2.4%	6.2%
DTB-K	8.9%	7.8%	48.0%	62.5%	(1.1%)	14.5%
ABSA Bank Kenya	6.8%	7.6%	78.6%	64.9%	0.8%	(13.7%)
Mkt Weighted Average	**9.8%****	**12.4%***	**57.8%****	**59.2%***	**2.6%**	**1.4%**
*Market cap weighted as at 01/12/2020 **Market cap weighted as at 29/11/2019						

4. **Capital Preservation:** The Central Bank of Kenya on 14th August 2020, directed that Banks will have to get approval before declaring dividends for the current financial year, in a bid to ensure that the banks have enough capital that will enable them to respond appropriately to the COVID-19 pandemic. The Central Bank gave guidance to lenders asking them to revise their ICAAP (Internal Capital Adequacy Assessment Process) based on the pandemic as highlighted in the Banking Circular No 11 of 2020. Subject to the submission of the revised Internal Capital Adequacy Assessment Process, (ICAAP), CBK will determine if it will endorse the board's decision to pay out dividends. A similar trend has been mirrored globally by both financial and non-financial businesses frantically seeking ways to save money with several regulators encouraging companies to cease the discretionary payments of dividends to shareholders. For instance, in the United Kingdom (UK), the seven largest banks sought to cancel dividend pay-outs despite having solid capital bases, due to fears of an economic recession. Additionally, the Central Bank of most countries have offered guidelines to the banks on dividend payments with for instance, the Federal Reserve announcing on 25th June 2020 that it would cap dividend payments and prevent share repurchases up to the end of 2020. Closer home, on 6th April 2020, the South African Reserve Bank's Prudential Authority advised banks not to pay out dividends this year and that the bonuses for senior executives should also be put on hold during this period as well. The authority highlighted that this directive would ensure banks conserve their capital and as such, enable the banks to fulfil their fundamental roles.

Following the release of the Q3'2020 results, as expected, most banks did not declare any interim dividends for Q3'2020 in a bid to preserve their capital amid the subdued environment. Below are some of the banks that declared an interim dividend in Q3'2019:

#	Bank	Dividends per share (Kshs)	Amount (Kshs bn)
1	Standard Chartered Bank	5.00	1.7
2	NIC Bank	0.25	0.2
		Total	**1.9**

Section II: Summary of the Performance of the Listed Banking Sector in Q3'2020:

The table below highlights the performance of the banking sector, showing the performance using several metrics, and the key take-outs of the performance.

Bank	Core EPS Growth	Interest Income Growth	Interest Expense Growth	Net Interest Income Growth	Net Interest Margin	Non-Funded Income Growth	NFI to Total Operating Income	Growth in Total Fees & Commissions	Deposit Growth	Growth in Government Securities	Loan to Deposit Ratio	Loan Growth	Return on Average Equity
NCBA	(67.3%)	4.8%	4.1%	5.3%	3.2%	11.8%	48.7%	47.7%	8.1%	12.5%	63.0%	0.4%	3.9%
ABSA	(65.4%)	1.4%	0.8%	1.6%	7.1%	4.5%	32.7%	(10.7%)	4.7%	13.1%	84.9%	7.8%	15.2%
KCB	(43.2%)	23.0%	20.8%	23.7%	7.8%	1.5%	30.8%	(14.2%)	31.7%	83.9%	74.7%	18.7%	13.1%
I&M	(30.8%)	3.0%	8.9%	(1.7%)	5.3%	1.1%	38.1%	(5.9%)	7.0%	70.9%	73.4%	6.7%	2.4%
SCBK	(30.4%)	(5.8%)	(17.3%)	(2.4%)	7.0%	(8.8%)	31.1%	(9.7%)	8.0%	7.6%	1.5%	11.2%	12.9%
Stanbic	(30.2%)	(5.4%)	(3.1%)	(7.3%)	5.9%	(18.4%)	44.5%	(33.3%)	18.2%	103.8%	70.3%	7.5%	12.0%
DTBK	(27.8%)	(3.4%)	(8.9%)	0.9%	5.5%	15.3%	26.6%	17.7%	1.8%	5.1%	71.4%	7.1%	9.2%
Equity	(13.9%)	21.7%	21.6%	21.8%	7.6%	10.1%	38.7%	(1.3%)	44.5%	37.2%	65.7%	30.1%	16.9%
Co-op	(10.2%)	7.1%	(3.5%)	11.7%	8.0%	(3.5%)	36.5%	(31.7%)	16.4%	50.5%	75.7%	5.7%	16.4%
HF Group	N/A	(12.2%)	(16.9%)	(1.1%)	4.2%	(62.2%)	20.0%	11.8%	9.9%	65.6%	98.8%	(4.1%)	(7.6%)
Q3'20 Mkt Weighted Average*	**(32.4%)**	**10.8%**	**8.2%**	**11.7%**	**7.0%**	**2.1%**	**35.9%**	**(7.9%)**	**23.1%**	**47.4%**	**65.6%**	**15.0%**	**13.0%**
Q3'19Mkt Weighted Average**	**8.7%**	**4.5%**	**4.3%**	**4.9%**	**7.7%**	**15.8%**	**37.9%**	**22.6%**	**11.0%**	**3.3%**	**75.7%**	**11.6%**	**19.3%**

*Market cap weighted as at 01/12/2020

**Market cap weighted as at 29/11/2019

Key takeaways from the table above include:

i. For the third quarter of 2020, core Earnings Per Share (EPS) recorded a weighted (32.4%) decline, compared to a weighted growth of 8.7% in Q3'2019,
ii. The sector recorded a weighted average deposit growth of 23.1%, faster than the 11.0% growth recorded in Q3'2019,
iii. Interest expense, on the other hand, grew faster by 8.2%, compared to 4.3% in Q3'2019. Cost of funds, however, declined, coming in at a weighted average of 2.9% in Q3'2020, from 3.1% in Q3'2019, owing to the faster growth in average interest-bearing liabilities, an indication that the listed banks were able to mobilize cheaper deposits,
iv. Average loan growth came in at 15.0%, faster than the 11.6% recorded in Q3'2019, but slower than the 47.4% growth in government securities, an indication of the banks preference of investing in Government securities as opposed to lending due to the elevated credit risk occasioned by the pandemic,
v. Interest income rose by 10.8%, compared to a growth of 4.5% recorded in Q3'2019. Despite the rise in interest income, the Yield on Interest Earning Assets (YIEA) declined to 9.5% from the 10.3% recorded in Q3'2019, an indication of the increased allocation to lower-yielding government securities by the sector. The decline in the YIEA can also be attributed to the reduced lending rates

for customers by the sector, in line with the Central Bank Rate cuts. Consequently, the Net Interest Margin (NIM) now stands at 7.0%, 0.7% points lower than the 7.7% recorded in Q3'2019 for the whole listed banking sector, and,

vi. Non-Funded Income grew by 2.1% y/y, slower than 15.8% growth recorded in Q3'2019. The performance in NFI was on the back of declined growth in fees and commission of (7.9%), which was slower than the 22.6% growth recorded in Q3'2019. The poor performance of the growth in fees and commission can be attributed to the waiver on fees on mobile transactions below Kshs 1,000 and the free bank-mobile money transfer. Banks with a large customer base who rely heavily on mobile money transactions are likely to take the biggest hit.

Section III: Outlook of the banking sector:

Based on the current tough operating environment, we believe 2020 performance in the banking sector will be shaped by the following key factors

i. **Increased Liquidity due to lower Cash Reserve Ratio (CRR)**: The Monetary Policy Committee (MPC) during their 29th April 2020 meeting lowered the Cash Reserve Ratio (CRR), which is a fraction of total customer deposits that the commercial banks have to hold with the Central Bank, by 100 bps to 4.25% from 5.25%. The reduction is projected to have injected approximately Kshs. 35.2 bn in additional liquidity, to commercial banks for onward lending to distressed borrowers. The reduction was a first one since July 2009. The MPC during their November 2020 MPC Meeting highlighted that Kshs 32.6 bn, representing 92.7% of the 35.2 bn had been utilized by the banking sector to offer reprieve to their customers as well as support lending in the sectors that have been hard hit by the pandemic such as Tourism, Manufacturing as well as Real Estate. We expect the low CRR ratio to improve the banking sectors liquidity and as such, banks with have more money to loan to businesses and individuals as well as invest in other businesses. Additionally, given that a low CRR translates to a low amount held in the CBK at no interest, we expect this to lead to a decline in the interest rates charged on loans by the sector,

ii. **Lower profitability:** With the large amount of restructuring and reclassification of loans witnessed in Q3'2020, we expect the bank's core source of revenue which is interest income, to be negatively affected in the short term. Given the relaxation of the loan interest payments and the borrowers preference to long term tenor extensions on their loan holiday to between 9-12 months, the banks interest income is set to drop. Banks are also not lending aggressively due to higher credit risk. We foresee a slower growth in loans in FY'2020 and thereafter if the pandemic is to persist further with banks turning to less risky investments such as government securities which rose by 47.4% faster than the 15.0% rise in loans in Q3'2020,

iii. **Lower Net Interest Margins (NIM):** The increased investments by banks in government securities as opposed to lending, coupled with the increased liquidity in the money market has seen the yield curve readjust downwards. As such, we foresee the sector's Yield on Interest Earning Assets (YIEA) continue to decline in tandem with the decline in the yields on government securities. Additionally, we foresee a continued decline in the sector's NIMs in the FY'2020, most especially for banks reducing their lending rates for customers in line with the CBR cuts,

iv. **High Loan Provisioning**- The risk of loan defaults remains elevated despite an improvement in the operating environment in line with the relaxation of Coronavirus measures. We foresee increased provisioning in the sector as compared to FY'2019, given the lagged recovery process from the pandemic. Additionally, we expect the higher provisioning requirements as per the IFRS guidelines to further subdue the profitability of the banking sector during the year,

v. **Cost Rationalization**: Given the expected low revenues and increased automation, banks are expected to continue pursuing their cost rationalization strategies. A majority of banks have been riding on the digital revolution wave to improve their operational efficiency. Increased adoption of alternative channels of transactions such as mobile, internet, and agency banking, has led to increased transactions carried out via alternative channels and out of bank branches, which have been reduced to handling high-value transactions and other services such as advisory. Banks reduced front-office operations, thereby cutting the number of staff required and by extension, reducing operating expenses and hence, improving operational efficiency,

vi. **Lower Non-Funded Income –** With the new regulations put in place by the Central bank to cushion citizens against the effects of the COVID-19 pandemic, banks' non-interest income was depressed during Q3'2020, growing at a weighted average growth of 2.1%, slower than 15.8% growth recorded in Q3'2019. Notably, the CBK announced in June 2020 that the measures put in place to facilitate mobile transactions such as the free bank-mobile money transfer and the waiver on fees on mobile transactions below Kshs 1,000 had been extended to 31st December 2020. As such, we foresee the sectors NFI growth to be muted in FY'2020 and to be outperformed by the interest income growth in the short term. Key to note, historically, the sectors NFI growth outperformed that of interest income, thus, allowing the banks to remain profitable amid a rigid regulatory environment, and,

vii. **Expansion and Further Consolidation -** With the Microfinance-Bill 2019 of increasing the minimum on core capital requirements still at its pilot stage more mergers and acquisitions would enable the unprofitable and/or smaller banks to manage the requirement and be able to increase profitability through cost efficiency and deposits growth.

Section IV: **Brief Summary and Ranking of the Listed Banks:**

As per our analysis on the banking sector from a franchise value and a future growth opportunity perspective, we carried out a comprehensive ranking of the listed banks. For the franchise value ranking, we included the earnings and growth metrics as well as the operating metrics shown in the table below in order to carry out a comprehensive review of the banks:

Bank	Loans to Deposits Ratio	Cost to Income Ratio	Return on Average Capital Employed	Deposit/Branch (Kshs bns)	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non-Funded Income/Revenue
Coop Bank	75.7%	63.0%	16.4%	2.4	13.2%	50.1%	15.5%	36.5%
KCB Group	74.7%	75.2%	13.1%	2.1	15.3%	58.5%	13.4%	30.8%
DTBK	71.4%	65.2%	9.2%	2.0	7.8%	54.7%	15.8%	26.6%
Equity Bank	65.7%	70.6%	16.9%	2.3	10.8%	52.0%	13.1%	38.7%
I&M Holdings	73.4%	57.9%	14.5%	3.8	11.2%	66.8%	16.2%	38.1%
NCBA Group	63.0%	86.5%	3.9%	5.9	14.1%	58.3%	12.6%	48.7%
Absa Bank	84.9%	79.0%	15.2%	2.9	7.6%	64.9%	11.4%	32.7%
SCBK	54.2%	68.2%	12.9%	6.7	14.8%	78.2%	15.1%	30.7%
Stanbic Bank	70.3%	48.1%	12.0%	8.7	12.3%	61.8%	12.5%	44.5%
HF Group	98.8%	133.2%	(7.6%)	1.8	25.4%	58.2%	16.2%	20.0%
Weighted Average Q3'2020	**70.6%**	**70.1%**	**13.9%**	**3.4**	**12.4%**	**59.0%**	**13.7%**	**35.9%**

The overall ranking was based on a weighted average ranking of Franchise value (accounting for 60%) and intrinsic value (accounting for 40%). The Intrinsic Valuation is computed through a combination of valuation techniques, with a weighting of 40.0% on Discounted Cash-flow Methods, 35.0% on Residual Income and 25.0% on Relative Valuation, while the Franchise ranking is based on banks operating metrics, meant to assess efficiency, asset quality, diversification, and profitability, among other metrics. The overall Q3'2020 ranking is as shown in the table below:

Bank	Franchise Value Score	Intrinsic Value Score	Weighted Score	Q3'2020 Rank	H1'2020 Ranking

I&M Holdings	1	2	1.6	**1**	1
DTBK	4	1	2.2	**2**	**5**
Co-operative Bank of Kenya Ltd	2	5	3.8	**3**	2
Equity Group Holdings Ltd	4	4	4.0	**4**	4
KCB Group Plc	7	3	4.6	**5**	3
Stanbic Bank/Holdings	4	6	5.2	**6**	**6**
ABSA	3	8	6.0	**7**	**7**
NCBA Group Plc	9	7	7.8	**8**	8
SCBK	8	9	8.6	**9**	9
HF Group Plc	10	10	10.0	**10**	10

Major Changes from the Q3'2020 Ranking are:

1. KCB Group recorded a decline in the franchise value ranking, coming in 5th mainly on the back of the deterioration of their asset quality as evidenced by the group's high Non- Performing Loans (NPL) ratio of 15.3% against a weighted average of 12.4%. Additionally, the group recorded a deterioration in the cost to income ratio to 75.2%, from 71.5% in H1'2020,
2. Diamond Trust Bank whose rank improved to Position 2 from Position 5 in H1'2020 mainly due to an improvement in NPL Ratio to 7.8% in Q3'2020 from 8.3% in H1'2020, in turn, improving its franchise value score, and,
3. Co-operative Bank whose rank declined to Position 3 from Position 2 in H1'2020 mainly due to a deterioration in the asset quality as evidenced by the high NPL ratio 13.2% in Q3'2020, from 11.8% in H1'2020.

For more information, see our Cytonn Q3'2020 Listed Banking Sector Review