KENYA BANKING SECTOR REPORT 2020

Against All Odds

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Banking Sector Report Summary

Cautious optimism on industry profitability

Profitability: of 7.1% registered in the transport sector was buoyed by road freight transportation which grew by 16.3% and 4.3% respectively. However, this growth was still lower compared to the growth of 9.0% registered in 3Q2018. The construction sector expanded by 6.6% compared to 7.7% recorded in 3Q2018. The suppressed growth was mirrored in cement consumption which eased by 4.5% y/y to 1,472,473 tonnes in 3Q2019.

Slow loan book growth expected

Loan book: We anticipate cautious lending on asset quality concerns. We do not expect loan book growth at pre-cap growth levels. We believe that some of factors that led to higher NPL ratios before the rate cap are still prevalent in the economy, notably government delayed payments.

NPLs set to increase

Asset quality: We expect asset quality to worsen in our forecast period. In 2020, we expect higher NPLs from economic shocks, notably the COVID-19 virus, which has disrupted global economic growth.

Rate cap repeal to benefit NIMS

NIMs: With the removal of the rate cap, we expect most banks to benefit from the improved pricing of risk. Banks whose loan books are biased to SMEs such as Equity bank are likely to benefit more from the rate cap removal in terms of the upside from repricing loans.

NFI to average at 35%

Non-funded income: We expect the listed banks' non-interest income contribution to average 35.3% for the period between 2020 and 2023. The improvement is partly due to NIC's merger with CBA. We also expect improvement in KCB, I&M and Absa and HF.

C/I set to improve

Cost to income ratio: We expect improvement in the listed banks' average cost to income ratio from 57.5% in 2018 to 47.9% in 2023. We attribute this to higher operating income growth compared to operating expenses.

Macroeconomic Overview

Locust invasion, Coronavirus to be a challenge

GDP Growth: We expect growth in the agricultural sector to be enhanced by favorable weather conditions, however, we remain wary of the desert locust invasion which may hamper growth. Furthermore, we expect to see weaker growth in tourism, influenced by travel restrictions that have been put in place to contain the spread of the coronavirus. Additionally, we expect the trade sector to be adversely affected by global supply chain disruptions due to the coronavirus outbreak.

Lower inflationary pressures in 2020

Inflation: In 2020, we expect low food and fuel inflationary pressures mainly due to expectations of sufficient rainfall during the MAM 2020 season and low international crude oil prices. While the infestation of desert locusts poses some risk towards agricultural production, we believe this risk could be mitigated by efforts to control the infestation. We do expect to see the effect of lower international crude oil prices on local oil prices in 2020 but, we are still uncertain of the extent of its impact due to the likelihood of a possible agreement by OPEC+ in the near future (supply cuts) that could result in a recovery in international oil prices.

Rate cap repeal to boost credit

Money supply: Given the removal of the interest rate caps, we expect continued recovery in credit growth to the private sector in 2020. However, this growth, may be hampered by credit flow to the trade sector owing to anticipated challenges in 2020.

Forex market to be affected by different factors

Forex market: We anticipate the current account balance to be affected by opposing forces. Strong diaspora remittances, lower imports of SGR related equipment and petroleum products should support the reduction in the current account balance. However, this may be offset by a higher goods import bill and lower receipts from tourism.

Expansionary policy for economic growth

Interest rates: We expect to see the CBK adopt an expansionary monetary policy in order to spur economic growth which, according to the CBK is operating below its potential level. We however, remain wary on the extent this policy will boost economic growth owing to the aforementioned shocks expected in 2020.

Sector Themes

Loan book growth will not be at pre-rate cap levels

Interest Rate Caps: With the repeal of the rate caps, we expect increased lending to segments that had been sidelined particularly SMEs. We expect banks focused on SME lending (esp. tier 3 banks) to have higher loan book growth. However, concerns on asset quality, CBK's directive on bank's charging high rates (likely sideline some risky borrowers) and increased government borrowing will likely deter banks from growing their loan books at pre-rate cap levels. With improved pricing of risk, we expect improvement in overall profitability.

Room for more M&A activity

Mergers and Acquisitions: We see room for M&A activity in Kenya and regionally for Kenyan banks driven by the need to comply with capital requirements, regulator support, low valuations (mostly tier 2 and 3 banks), large common shareholders, need for income diversification, and economies of scale.

NPL ratio at double digit level

Asset Quality: Asset quality has deteriorated consistently over the past seven years, with the non-performing loan (NPL) ratio rising to a double digit level in 2017 at 12.3% and further to 12.7% in 2018. The decline in asset quality is mainly attributed to delayed government payments, slowdown in economic activities, higher interest rates, poor weather conditions and low uptake of housing and commercial units.

Industry NFI growth

Income diversification: Between 2009 and 2018, total industry non-funded income (NFI) grew at a CAGR of 9.8%, driven by growth in fees on loans and advances and other income both at 11.0%, with other fees growing by 8.4%. Non-funded income growth has been driven by agency banking, mobile banking, other fees and commissions.

Technology enhancing operational efficiency

Technology: The adoption of digital banking services within the Kenyan banking sector has significantly impacted the banking sector by improving employee productivity, enhancing efficiency and fostering the rise in digital loans.

Banking Sector Recommendations

Bank	Market Price (KES)	Target Price (KES)	Upside/ Downside	Recommendation	FY2019F P/B (x)	FY2019F ROaE	FY2019F Dividend Yield	52 Week High (KES)	52 Week Low (KES)
KCB	49.50	51.70	4.5%	Neutral	1.20	18.8%	7.3%	55.50	36.00
Equity	49.10	53.13	8.2%	Neutral	1.72	22.6%	4.9%	55.50	32.50
Co-operative	14.80	17.50	18.2%	Buy	1.11	18.3%	6.5%	17.00	10.50
I&M	50.75	57.93	14.2%	Buy	0.84	18.2%	4.1%	70.58	43.10
NCBA	32.70	40.89	25.0%	Buy	0.70	12.6%	8.0%	40.00	25.25
Stanbic*	115.00	108.96	(5.2%)	Neutral	0.90	13.6%	6.1%	115.00	86.00
StanChart	202.25	181.50	(10.3%)	Sell	1.40	17.7%	10.0%	225.00	175.00
DTB	100.75	132.00	31.0%	Buy	0.40	12.1%	2.6%	148.00	97.00
Absa Kenya	13.10	13.91	6.2%	Neutral	1.56	17.5%	8.4%	14.20	10.00
HF Group	4.70	Not rated	N/A	Sell	0.18	(0.9%)	0.0%	7.90	3.46

*Stanbic FY2019A

KCB Group

Bloomberg: KNCB KN, Reuters: KCB.NR

10th March 2020

NEUTRAL, KES 51.70

Stability

We issue a **NEUTRAL** recommendation on KCB group, with a target price of **KES 51.7** representing an upside potential of 4.5% from the current market price of KES 49.50(4/3/2020). The stock is currently trading at trailing P/B 1.3x and forward P/B of 1.2x.
Our recommendation is based on the following:

NIM Expansion on Interest Rate Repeal: We expect KCB's NIM to benefit from repeal of the rate cap. Since KCB did not materially alter its lending strategy, we expect the NIM expansion to be driven mainly by repricing of loans (i.e. higher loan yields) rather than loan book growth. We expect NIM to range between 7.6% (2019) and 9.0% (2023) over our forecast period.

Strategic Partnerships and Investments in Digital channels: We expect strategic partnerships and investments in digital channels (particularly the mobile channel) to play an important role in growing NFI. Notable products from these partnerships include KCB MPESA (with Safaricom) and Fuliza (with Safaricom and NCBA).

We see the following risks in the company's strategy:

Regulation of digital lenders: A number of bodies including the CBK have called for a regulation of digital lenders over high costs of short term digital loans and unethical practices in loan recoveries. There has also been calls for protection of user data that is pertinent is credit scoring models used by the lenders.

Slowdown in Mortgage market: The mortgage segment accounted for 14.9% of KCB's loan book. More importantly, it's one of KCB's most profitable segments with a return of assets of 16.9%. Management indicated that it intends to slowdown lending to this segment due asset quality issues and difficulties in collateral monetization. This may have a significant impact o profitability.

Indicators	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS	5.5	6.4	6.4	6.4	7.8	7.8	8.6	11.0	13.1	15.0
DPS	2.0	2.0	3.0	3.0	3.5	3.6	4.0	5.3	6.4	7.5
BVPS	24.7	26.5	31.5	34.6	37.1	41.5	46.4	53.1	60.6	68.9
P/B	2.3	1.6	0.9	1.2	1.0	1.2	1.1	0.9	0.8	0.7
P/E	10.2	6.7	4.5	6.6	4.8	6.3	5.7	4.5	3.8	3.3
Net Interest Margin	9.9%	9.2%	9.7%	9.1%	8.4%	7.6%	8.1%	8.4%	8.7%	9.0%
ROaE	22.3%	24.2%	20.4%	18.6%	21.1%	18.8%	18.6%	20.7%	21.7%	21.8%
ROaA	3.4%	3.5%	3.3%	3.0%	3.4%	2.9%	2.9%	3.4%	3.9%	4.2%
Cost to Income Ratio (Excl. provisions)	51.3%	51.3%	47.7%	49.0%	48.3%	45.1%	46.6%	43.4%	40.7%	38.7%

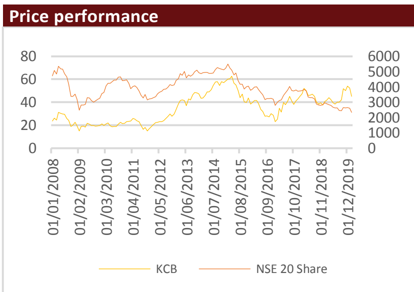
F – Faida Investment Bank forecasts

Key Data	
Market price (KES)	49.50
Upside	4.5%
No. of shares (mn)	3,214
Market Cap (KESmn)	159,066
Free float	73.2%
Free float (KESmn)	116,460
Free float (USDmn)	1,132

Dividend	
Div yield	6.8%
Ex-div	N/A

Major Shareholders	% of shares
Treasury	19.76
National Social Security	7.02
Stanbic Nominees Ltd A/C NR3530153-1	2.69
Standard Chartered Nimimees A/C 9688	1.42
Previous recomm.	**N/A**

Price performance



	NSE20	Company
1 month	-7.8%	-2.0%
3 months	-7.2%	-3.8%
6 months	-1.7%	25.3%
12 months	-17.7%	14.3%
Min 52 weeks KES		55.50
Max 52 weeks KES		36.0
10 Year Low		14.70
10 Year High		65.00
Av. turnover/day KES mn		82.5

Equity Group Holdings

Bloomberg: EQBNK KN, Reuters: EQTY.NR

NEUTRAL, KES 53.13

10th March 2020

We issue a **NEUTRAL** recommendation on Equity group Holdings, with a target price of KES **53.13** representing an 8.2% upside from the current market price KES 49.10 (as at 4/3/2020). The stock is currently trading at a trailing P/B of 1.97x forward P/B of 1.72x, with an upward trend in RoaE at an average of 24.0% between FY19F and FY23F. We forecast 15.3% y/y growth in FY19 EPS primarily driven by a rebound in interest income (+9.1% y/y) and a lower cost to income ratio (48.4% from 50.6%).

Our consideration for the stock is based on:

Key Drivers

- We expect a pick up in loan book growth especially within the SME sector. We also expect to see gradual reallocation of funds from liquid securities. Given the low cost of funds, (5 year average of 2.6%) we forecast NIMs to expand by 30-60bps p.a .
- The bank is expected to continue reaping the benefits of its digitization strategy and we should see an increase in non funded income. Aside from growth in credit related income, transaction and account related income show potential and flexibility for further growth (representing 23% of Equity's NFI). In our forecasted period, NFI is expected to grow at 14.2% p.a.
- We see potential for improved efficiency with more retail migration to alternative channels with 97% of transactions happening outside branches. Our cost to income ratio oscillates between 51% and 53% .

Key Risks

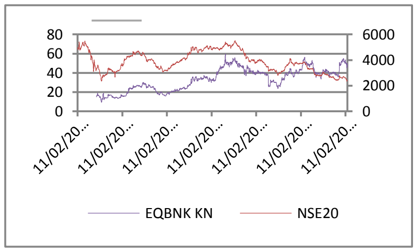
- With expected increased lending biased towards the SME segment , we anticipate asset quality pressures. Tanzania, South Sudan and Kenya contribute the highest to asset quality deterioration with the NPL ratio (3Q2019) at 27.5%, 23.5% and 8.0% respectively.
- While we are positive on business diversification through regional expansion, we remain concerned around: high cost to income ratios, potential dilution for existing shareholders, political &economic shocks and sustainability of these subsidiaries' profitabilities.

Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2022F
EPS	4.48	4.67	4.37	5.00	5.25	6.05	7.28	8.67	10.04	11.74
DPS	1.80	2.00	2.00	2.00	2.00	2.42	2.91	3.47	4.01	4.69
BVPS	17.22	19.21	21.54	24.48	24.93	28.56	32.93	38.13	44.15	51.19
P/B	2.85	2.56	2.28	2.01	1.97	1.72	1.49	1.29	1.11	0.96
P/E	10.96	10.51	11.24	9.82	9.35	8.11	6.74	5.66	4.89	4.18
Div Yield	3.7%	4.1%	4.1%	4.1%	4.1%	4.9%	5.9%	7.1%	8.2%	9.6%
ROaE	29.7%	25.5%	21.5%	21.6%	21.1%	22.6%	23.7%	24.4%	24.4%	24.6%
RoaA	5.5%	4.5%	3.7%	3.8%	3.6%	3.6%	3.8%	4.0%	4.1%	4.3%
C/I Ratio (excl. provisions)	52.0%	52.9%	50.7%	51.9%	50.6%	48.4%	46.5%	45.3%	44.3%	43.2%

Key Data	
Market price (KES)	49.10
Upside	8.2%
No. of shares (mn)	3,773
Market Cap (KESmn)	181.1
Free float	87.0%
Free float (KESmn)	162.5
Free float (USDmn)	1.6

Dividend	
Div yield	4.4%
Major Shareholders	**% of shares**
Arise B.V.	11.99
James Mwangi	3.39
Britam Limited	3.28
Equity Nominees	3.21

Price performance



	NSE20	Company
1 month	-7.8%	-5.7%
3 months	-7.2%	-4.3%
6 months	-1.7%	29.4%
12 months	-17.7%	17.6%
Min 52 weeks KES		32.50
Max 52 weeks KES		55.50
10 Year low		15.60
10 Year High		59.00
Average Turnover/Day (KES Mn)		131.5

Co-operative Bank

Bloomberg: COOP KN, Reuters: COOP.NR

BUY, KES 17.50

10th March 2020

We issue a **BUY** recommendation on Co-operative Bank, with a target price of KES **17.50** representing a **18.2%** upside from the current market price KES 14.80 (4/3/ 2020). The stock is currently trading at a trailing P/B of 1.25x forward P/B of 1.11x, with an upward trend in RoaE at an average of 20.6% between FY19F and FY23F.

Our consideration for the stock is based on:

Key Drivers

- We expect e-credit to be key in driving non-funded income. As at 3Q2019 Mco-op cash loan book stood at KES 48.0 billion representing 17.8% of the total loan book with mobile commissions contributing 21.0% (KES 3.3 billion) to PBT.
- Personal lending is expected to continue driving the loan book contributing 38.4% to the total loan book as at 3Q2019. We also anticipate renewed lending to the MSME sector, catalyzed by Co-op's partnership with IFC. Under the KES 15.0 billion project with IFC, MSMEs are set to benefit from unsecured credit facilities (largely E-credit) with add-on training and advisory services. As at 3Q2019 56,800 MSMEs MSMEs had been on boarded from 11,126 in FY2018.
- NIM expansion- With the expected loan growth, we forecast yield on interest earning assets to grow by 30-40bps y/y. We expect the bank to leverage on its alternative channels to mobilize growth in transactional deposits, reducing cost of funds.As a result, we expect NIMs to increase by 20-50bps p.a for the forecasted period.

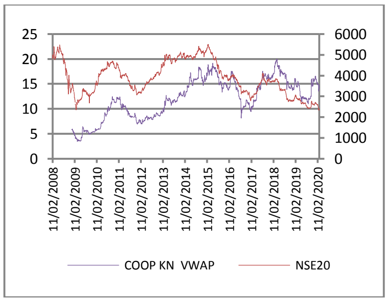
Key Risks

- NPLs continue to be a persistent challenge. The group's NPLs are attributed to exposure to trade and manufacturing sectors. We expect the NPL ratio to remain within 10.0%-10.5% for the forecasted period.

Key Data	
Market price (KES)	14.80
Upside	18.2%
No. of shares (mn)	5,867.2
Market Cap (KESmn)	85.0
Free float	32.4%
Free float (KESmn)	27.2
Free float (USDmn)	2.7

Dividend	
Div yield	7.4%
Major Shareholders	**% of shares**
Co-op Co-operatives	64.5
Dr. Gideon Muriuki	1.79
KCB Noiminees	0.77
NIC Custodial Sevices	0.63

Price performance



	NSE20	Company
1 month	-7.8%	-0.3%
3 months	-7.2%	-4.8%
6 months	-1.7%	22.3%
12 months	-17.7%	1.7%
Min 52 weeks KES		10.50
Max 52 weeks KES		17.00
10 Year Low		5.92
10 Year High		19.95

Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS	1.69	2.31	2.64	1.99	2.18	2.24	2.80	3.60	3.99	4.54
DPS	0.50	0.80	0.80	0.80	1.00	0.96	1.20	1.55	1.71	1.95
BVPS	7.29	8.47	10.37	11.78	11.83	13.34	15.08	17.40	19.93	22.81
P/B	2.03	1.75	1.43	1.26	1.25	1.11	0.98	0.85	0.74	0.65
P/E	8.76	6.41	5.61	7.44	6.79	6.62	5.29	4.11	3.71	3.26
Div Yield	3.4%	5.4%	5.4%	5.4%	6.8%	6.5%	8.1%	10.5%	11.6%	13.2%
ROaE	20.3%	25.3%	22.9%	17.6%	18.4%	18.3%	19.7%	22.2%	21.4%	21.2%
RoaA	3.1%	3.7%	3.7%	3.1%	3.2%	3.0%	3.4%	3.9%	3.9%	4.0%
C/I Ratio (excl. provisions)	63.2%	53.2%	52.2%	52.2%	54.8%	54.2%	50.7%	46.9%	46.4%	45.4%

Avg turnover per day (KES Mn)	12.5

NCBA

Bloomberg: NCBA KN, Reuters: NCBA.NR

BUY, KES 40.89

10th March 2020

We assign a **BUY** recommendation to NCBA with a Price Target of **KES 40.89**, representing a **25.0%** upside from the current price of KES 32.70 (as at 4th March 2020).

Given the repealing of interest rate caps, we expect the yields on loans to gradually rise from 10.9% in FY2018 to 12.5% in FY2023F. We believe the group's intention to delve into SME lending will partly support the rising yields and help lift the loan book by a CAGR of 9.6% over our forecast horizon (FY2018 to FY2023F).

CBA's strength in digital lending is anticipated to support non-funded income growth by a CAGR of 12.5% over our forecast period. However, we believe there's some regulatory risk (in Kenya) that could result in lower fees charged on M-Shwari and Fuliza in the short to medium term.

We also have some concerns about the group's asset quality which may be weighed down by NIC's loan book. We are however optimistic that in the long-term the group's diversified loan book (consisting of corporate, institutional, retail and SME clients) to mitigate against the asset quality issue.

In light of the foregoing, we expect the group's ROE to average of 15.8% over our forecast period. We opine that NCBA will lean more towards CBA's dividend policy as opposed to NIC's resulting in a dividend payout ratio of 44.4%.

We believe that the success of the merger will be hinged on the adoption of the right strategy that factors in the combined strengths of the two groups (asset finance, digital banking and corporate banking) while working to ameliorate risks (like the NPL issue). The key risk we see in strategy implementation is the merging of corporate cultures which could take some time.

Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS						5.86	6.85	9.51	11.81	11.96
DPS						2.60	3.04	4.22	5.24	5.31
BVPS						48.49	52.74	59.21	66.80	73.52
P/B						0.70	0.60	0.60	0.50	0.40
P/E						5.60	4.80	3.40	2.80	2.70
Div Yield						8.0%	9.3%	12.9%	16.0%	16.2%
ROaE	20.1%	18.0%	21.1%	16.0%	14.1%	12.6%	13.5%	17.0%	18.7%	17.0%
RoaA	2.5%	2.2%	2.8%	2.3%	2.0%	1.9%	2.0%	2.6%	3.0%	2.8%
C/I Ratio (excl. provisions)	48.2%	47.2%	40.6%	47.8%	48.2%	49.1%	47.0%	44.0%	41.9%	42.1%

Source: NCBA Actuals and Faida Investment Bank estimates

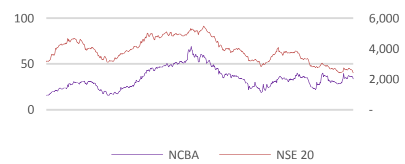
F - Faida Investment Bank forecasts

Key Data	
Market price (KES)	32.70
Upside	25.0%
No. of shares (mn)	1,498
Market Cap (KES mn)	49,976
Free float	N/A
Free float (KESmn)	N/A
Free float (USDmn)	N/A

Dividend	
Div yield	N/A

Major Shareholders	% of shares
N/A	-
N/A	-
N/A	-
N/A	-

Price performance



	NSE20	NCBA
1 month	-7.8%	-5.9%
3 months	-7.2%	1.3%
6 months	-1.7%	19.8%
12 months	-17.7%	-7.6%
Min 52 weeks KES		25.25
Max 52 weeks KES		40.00
10 Year Low		15.47
10 Year High		72.25
Av. turnover/day KES mn		3.75

I&M Holdings Plc

Bloomberg: IMH KN, Reuters: IMH.NR

BUY, KES 57.93

10th March 2020

We issue a **BUY** recommendation on I&M Holdings Plc, with a target price of KES **57.93** representing a **14.2% upside** from the current market price KES 50.75 (as at 4/3/20). The stock is currently trading at a trailing P/B of 0.98xand a forward P/B of 0.84x, with an upward trend in RoaE at an average of 19.1% between FY19F and FY23F. We forecast 6.2% y/y growth in FY19 EPS primarily driven by growth in non-funded income (+25.2% y/y).

Our consideration for the stock is based on:

Key Drivers

- We believe non-funded income will be a key driver for growth for I&M. In 5 years, the bank has grown its NFI contribution to total income from 27.0% to 32.0%, the fastest growth within our coverage. With the acquisition of Giro Bank, I&M Burbidge Capital and Youjays Insurance in the recent years, we are optimistic that these will boost non-credit related fee income. The bank has also invested in digital banking solutions to target its retail clients which we expect to grow fees and commissions. We forecast an average 20% y/y growth for NFI, with contribution growing from 32.0% in FY2018 to 38.3% in FY2023.
- The bank's regional expansion strategy hasmaintained a growth trajectory with continued profitability in the four subsidiaries (Kenya,Tanzania,Rwanda and Muaritius). Diversification has enabled spreading of risks with less reliance on the Kenyan subsidiary (77% PBT contribution as at FY2018).

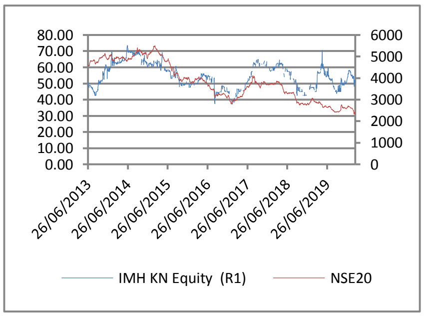
Key Risks

- Of concern to us is the group's rising NPLs and deteriorating the asset quality. The NPL ratio is at 12.6% against the industry average of 12.2%. We forecast a ratio of 12.5% for FY19, and thereafter an average of 11.9% between FY2020-FY2023 as 41% of the book is exposed to manufacturing and trade sectors.

Key Data	
Market price (KES)	50.75
Upside	14.2%
No. of shares (mn)	826.8
Market Cap (KESmn)	41.3
Free float	25.7%
Free float (KESmn)	10.3
Free float (USDmn)	1.0

Dividend	
Div yield	3.9%
Major Shareholders	**% of shares**
Minard Holdings	21.37
Tecoma Limited	18.39
Ziyungi Limited	17.79
Stanchart Nominees	10.13

Price performance



	NSE20	Company
1 month	-7.8%	-6.3%
3 months	-7.2%	4.0%
6 months	-1.7%	15.6%
12 months	-17.7%	15.6%
Min 52 weeks KES		43.10
Max 52 weeks KES		70.58
10 Year low		37.25
10 Year High		73.50
Avg turnover (KES Mn)		2.9

Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS	6.94	8.64	9.39	8.79	10.28	10.92	12.48	15.06	17.95	20.26
DPS	1.66	1.66	1.75	1.75	1.95	2.08	2.37	3.01	3.59	4.05
BVPS	29.73	36.32	43.04	49.37	52.00	60.67	70.58	82.41	96.52	114.25
P/B	1.71	1.40	1.18	1.03	0.98	0.84	0.72	0.62	0.53	0.44
P/E	7.32	5.87	5.41	5.78	4.93	4.65	4.07	3.37	2.83	2.50
Div Yield	3.3%	3.3%	3.4%	3.4%	3.8%	4.1%	4.7%	5.9%	7.1%	8.0%
ROaE	20.2%	21.4%	20.8%	15.9%	17.4%	18.2%	18.5%	19.4%	19.9%	19.3%
RoaA	3.3%	3.7%	3.7%	3.0%	2.9%	3.2%	3.1%	3.4%	3.6%	3.7%
C/I Ratio (excl. provisions)	37.4%	37.2%	35.4%	36.1%	35.9%	37.4%	37.3%	37.3%	37.3%	37.4%

F - Faida Investment Bank forecasts

Stanbic Holdings

Bloomberg: STANBIC KN, Reuters: SBIC.NR

NEUTRAL, KES 108.96

10th March 2020

We issue a **NEUTRAL** recommendation on Stanbic based on our Target Price of **KES 108.96** representing a **downside of 5.2%** from the current price of KES 115.00 (as at 4th March 2020).

We expect profitability to rise by a CAGR of 14.0% over the forecast horizon (FY2018 to FY2023F) driven by higher NIMs, rising non-funded income and improving efficiencies.

The NIM is anticipated to expand from 5.2% in FY2018 to 5.9% in FY2023F predominantly spurred by rising yield on loans, which we anticipate to rise post-rate cap and when combined with an expanding loan book (projected to rise by a CAGR of 9.9%) should provide a CAGR of 13.4% in net interest income. Over our forecast period, we project NFI to increase by a CAGR of 11.8%, underpinned by growth in fees and commission income (CAGR of 12.2%) and trading revenues (CAGR of 10.2%).

We expect the cost discipline measures (upgraded banking systems, improving efficiencies of banking processes, staff restructuring) adopted by Stanbic to result in lower growth in operating expenses (CAGR of 9.6%) vis a vis operating income (CAGR of 12.7% to KES 40.2 billion).

Given the profitability growth, we also anticipate Stanbic to post higher ROEs over our forecast period averaging 15.7% (from 13.1% between FY2014 and FY2018).

Our main concern is Stanbic's worsening asset quality which has been weakening since FY2011. In addition, the NPLs are concentrated on a few key borrowers.

Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS	14.38	12.41	11.18	10.90	15.88	16.14	17.68	22.80	26.90	30.64
DPS	6.15	6.15	5.25	5.25	5.80	7.05	7.92	10.21	12.05	13.72
BVPS	93.33	97.05	101.54	108.66	112.88	124.04	133.55	147.70	163.80	181.85
P/B	1.2	1.2	1.1	1.1	1.0	0.9	0.9	0.8	0.7	0.6
P/E	8.0	9.3	10.3	10.5	7.2	7.1	6.5	5.0	4.3	3.8
Div Yield	5.3%	5.3%	4.6%	4.6%	5.0%	6.1%	6.9%	8.9%	10.5%	11.9%
ROaE	16.4%	13.0%	11.3%	10.4%	14.3%	13.6%	13.7%	16.2%	17.3%	17.7%
RoaA	3.1%	2.5%	2.1%	1.9%	2.3%	2.1%	2.2%	2.5%	2.7%	2.7%
C/I Ratio (excl. provisions)	50.2%	51.2%	57.9%	57.2%	50.2%	56.2%	48.1%	46.4%	45.0%	44.0%

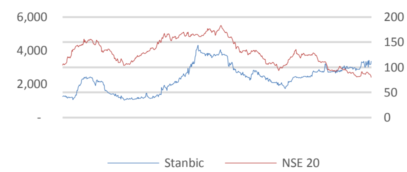
Source: Stanbic Actuals and Faida Investment Bank estimates
F - Faida Investment Bank forecasts

Key Data	
Market price (KES)	115.00
Downside	(5.2%)
No. of shares (mn)	395
Market Cap (KESmn)	45,462
Free float	56.6%
Free float (KESmn)	25,714
Free float (USDmn)	255

Dividend	
Div yield	6.1%
Cum-div	2/3/2020

Major Shareholders	% of shares
Stanbic Nominees Ltd A/C Nr00901	69.15
Standard Chartered Nominees Non- Resd. A/C 9866	7.38
Standard Chartered Nomineesltd Non Resd A/Cke11663	2.64
Stanbic Nominees Limited A/C Nr1031327	2.01

Price performance



	NSE20	Stanbic
1 month	-7.8%	4.5%
3 months	-7.2%	10.0%
6 months	-1.7%	14.6%
12 months	-17.7%	18.3%
Min 52 weeks KES		86.00
Max 52 weeks KES		115.00
10 Year Low		34.12
10 Year High		148.00
Av. turnover/day KES mn		6.3

Standard Chartered

Bloomberg: SBIC KN, Reuters: SCBK.NR

SELL, KES 181.50

10th March 2020

We assign a **SELL** recommendation to StanChart. Our Target Price of **KES 181.50** represents a **10.3%** downside from the current price of KES 202.25 (as at 4th March 2020).

We believe that the lifting of the interest rate caps will incentivize StanChart to grow its loan book over our FY2018 to FY2023F forecast horizon. The StanChart loan book, showed early signs of recovery in 3Q2019, rising by 6.8% y/y to KES 118.5 billion.

We project the group's loan book to advance at a CAGR of 8.8% over our forecast period and this is projected to deliver a CAGR of 5.8% in total interest income. Given the group's high liquidity levels (average of 56.4% over the last 5 years), we anticipate lower cost of funds (average of 2.5% over our forecast horizon).

The interplay of the aforementioned forces will provide an uplift to net interest income, which we envision rising by a CAGR of 8.1% supproting profitability growth, which we anticipate to rise by a CAGR of 6.5%.

We have significant concerns about the group's weak asset quality, evidenced by its rising NPL ratio which rose from 8.5% in FY2014 to 16.9% in FY2018. We believe that the weak asset quality remains a key risk which could significantly undermine our projected loan book growth.

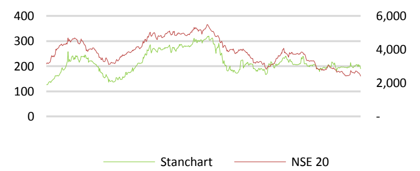
ROE is projected to remain relatively unchanged averaging 18.3% between FY2019F to FY2023F (FY2014 to FY2018: 18.8%). In terms of StanChart's dividend policy, we expect the high pay-out ratios to persist going forward; an average of 82.8% over our forecast horizon.

Key Data	
Market price (KES)	202.25
Downside	(10.3%)
No. of shares (million)	344
Market Cap (KESmillion)	69,574
Free float	24.7%
Free float (KESmillion)	17,191
Free float (USDmillion)	170

Dividend	
Div yield	10.0%

Major Shareholders	% of shares
Standard Chartered Holdings (Africa) Bv	73.89
Standard Chartered Kenya Nominees Ltd A/C KE002382	1.21
Kabarak Limited	1.03
Stanbic Nominees Limited A/C NR5551514	0.50

Price performance



	NSE20	StanChart
1 month	-7.8%	-2.8%
3 months	-7.2%	-0.6%
6 months	-1.7%	3.8%
12 months	-17.7%	0.9%
Min 52 weeks KES		175.00
Max 52 weeks KES		225.00
10 Year Low		136.19
10 Year High		319.50
Av. turnover/day KES million		2.95

Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS	33.21	17.97	25.85	19.64	23.09	24.46	22.92	27.28	30.02	31.84
DPS	17.00	17.00	20.00	17.00	19.00	20.26	18.98	22.60	24.87	26.37
BVPS	131.51	133.43	129.85	132.94	135.77	140.87	143.86	151.21	158.03	164.60
P/B	1.5	1.5	1.6	1.5	1.5	1.4	1.4	1.3	1.3	1.2
P/E	6.1	11.3	7.8	10.3	8.8	8.3	8.8	7.4	6.7	6.4
Div Yield	8.4%	8.4%	9.9%	8.4%	9.4%	10.0%	9.4%	11.2%	12.3%	13.0%
ROaE	26.7%	15.1%	20.7%	14.9%	17.2%	17.7%	16.1%	18.5%	19.4%	19.7%
RoaA	4.6%	2.7%	3.7%	2.5%	2.8%	2.8%	2.5%	2.8%	2.9%	2.9%
C/I Ratio (excl. provisions)	39.8%	44.6%	44.6%	48.0%	52.5%	52.7%	53.4%	52.7%	52.3%	52.5%

Source: StanChart Actuals and Faida Investment Bank estimates

F - Faida Investment Bank forecasts

Diamond Trust Bank

Bloomberg: DTKL KN, Reuters: DTK.NR

BUY, KES 132.00

10th March 2020

Oversold

We issue a BUY recommendation on DTB, with a target price of KES 132.0 representing an upside potential of 31.0% from the current market price of KES 100.75 (4/3/2020). The stock is currently trading at trailing P/B 0.5x and forward P/B of 0.4x.

Our recommendation is based on the following:

Improved lending to private Sector: Following the rate cap, DTB took a defensive strategy, preferring to lend to government rather than to the private sector. This exposed the bank to lower yields and net interest margin as yields on government securities begun to decline. This coupled with relatively low contribution of non-interest income led to lower profitability. On the rate cap removal we expect increased lending to the private sector. However, management guided more cautious lending on asset quality concerns and lower lending rates which are likely to sideline some borrowers. We therefore expect loan book growth and loan to deposit ratios to be closer to the rate cap period than to the pre-rate cap period.

NIM Expansion: With higher yields from private sector lending and relatively stable cost of funds, we expect NIM to range between 6.0% (2019) and 6.8 % (2023) over our forecast period.

Our biggest concern and risk to the company is that the company is lagging behind its peers in leveraging alternative channels (particularly the mobile channel). Its alternative channels are not well established compared to some tier 1 banks. In 2018, only 52.0% of the transactions were done via these alternative channels. The bank currently prefers to ride on other platforms such as Stawi rather than having its own initiatives. We see this as limiting in tapping new markets and opportunities.

Indicators	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS	20.4	23.6	27.6	24.8	25.3	27.0	26.3	30.1	34.3	40.0
DPS	2.1	2.2	2.5	2.6	2.6	2.8	2.8	3.1	3.5	4.1
BVPS	115.4	137.0	164.1	191.8	210.8	235.2	258.7	286.1	317.3	353.8
P/B	2.0	1.3	0.8	1.1	0.8	0.4	0.4	0.4	0.3	0.3
P/E	10.7	7.7	4.4	8.1	6.5	3.7	3.8	3.3	2.9	2.5
Net Interest Margin	7.9%	7.6%	7.9%	6.8%	6.5%	6.0%	6.3%	6.4%	6.6%	6.8%
ROaE	20.4%	18.7%	18.4%	13.9%	12.6%	12.1%	10.7%	11.1%	11.4%	11.9%
ROaA	3.0%	2.7%	2.6%	2.0%	1.9%	2.0%	1.9%	2.0%	2.0%	2.2%
Cost to Income Ratio(Excl. provisions)	42.8%	39.6%	36.1%	41.0%	44.0%	46.0%	45.0%	44.2%	43.4%	41.8%

F- Faida Investment Bank forecasts

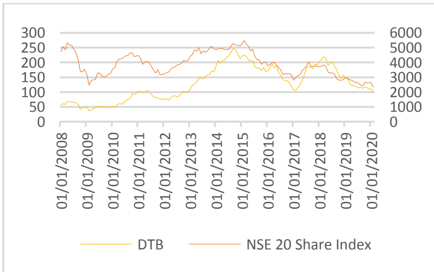
Key Data	
Market price (KES)	100.75
Upside	31.0%
No. of shares (mn)	279.6
Market Cap (KESmn)	28,170
Free float	53.6%
Free float (KESmn)	15,102
Free float (USDmn)	146.8

Dividend	
Div yield	2.6%
Ex-div	N/A

Major Shareholders	% of shares
Aghan Khan Foundation for Economic Development	16.50
Habib Bank	16.15
Jubilee Insurance Limited	9.95
Acaccia Partners	2.64

Previous recomm. **N/A**

Price performance



	NSE20	Company
1 month	-7.8%	-10.9%
3 months	-7.2%	-7.3%
6 months	-1.7%	-7.7%
12 months	-17.7%	-27.1%
Min 52 weeks KES		97.00
Max 52 weeks KES		148.00
10 Year Low		49.46
10 Year High		250.00
Av. turnover/day KES mn		12.3

HF Group

Bloomberg: HFCL KN, Reuters: HFCK.NR

SELL

10th March 2020

We recommend a **SELL** on HF Group. We base the recommendation on the bank's high non-performing loans and unsuccessful property development strategy.

Our consideration for the stock is based on:

Key Drivers

- We expect continued growth of non-funded income as a result of the banks digitization strategy supported by increase in fees and commissions on loans advanced and fees and commissions on transactions. We forecast non-funded income contribution to rise from in 31.1% FY19F to 45.2% in FY23F
- We see potential in affordable housing that the bank can tap into. This is especially with the establishment of the Kenya Mortgage Refinance Company (KMRC) which will provide cheaper long-term financing to mortgage loan providers.
- The bank is focused on recapturing mortgage leadership under the new two-year strategy (currently second after KCB).

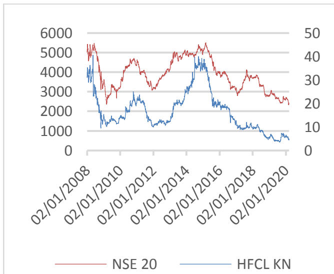
Key Risks

- Asset quality pressures are likely to increase from the real estate sector. We expect the bank to get a 3% profit margin on houses sold in FY2019F and FY2020F. We expect the margin to improve to 5% from FY2021F to FY2023F.
- We believe that the new strategy can achieve bottom line growth if the bank successfully diversifies revenue streams and reduces real estate focus. However, we note this is likely to be a challenge given that the bank's main business is real estate.

Key data	
Market price (KES)	4.70
No. of shares (mn)	384.6
Market Cap (KESmn)	1807
Free float	57.9%
Free float (KESmn)	1113
Free float (USDmn)	11
Net debt (KESmn)	9225

Dividend	
Div yield	0
Major Shareholders	**% of shares**
Britam Holdings PLC	48.10
Standard Chartered Nominess	4.06
Permanent Secretary Treasury	2.41

Price performance



	NSE20	Company
1 month	-7.8%	-17.7%
3 months	-7.2%	-14.4%
6 months	-1.7%	-15.4%
12 months	-17.7%	-19.7%
Min 52 weeks KES		3.46
Max 52 weeks KES		7.90
10 Year Low		3.50
10 Year High		39.97
Avg. Turnover/day (KES Mn)		0.58

Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2023F
EPS	3.35	3.12	2.35	0.33	-1.56	-0.23	0.38	0.61	0.37	0.23
DPS	1.19	1.18	0.45	0.32	0	0	0	0	0	0
BVPS	22.53	27.68	29.37	29.77	29.67	26.53	26.73	27.07	27.27	27.40
P/B	1.62	0.73	0.43	0.32	0.19	0.18	0.18	0.17	0.17	0.17
P/E	10.87	6.49	5.41	28.89	0	-20.40	12.47	7.64	12.86	20.26
Div Yield	3.8%	6.3%	4.6%	4.8%	5.7%	0	0	0	0	0
ROaE	15.7%	13.9%	8.3%	1.1%	-5.5%	-0.9%	1.4%	2.3%	1.3%	0.9%
RoaA	1.8%	1.8%	1.3%	0.2%	-0.9%	-0.2%	0.3%	0.4%	0.3%	0.2%
C/I Ratio (excl. provisions)	57.3%	61.0%	66.2%	91.1%	120.3%	104.5%	94.1%	90.5%	94.3%	96.5%

Absa Kenya

Bloomberg: ABSA KN, Reuters: BBK.NR

10th March 2020

NEUTRAL, KES 13.91

We recommend a **NEUTRAL** on Absa Kenya with a target price of KES 13.91, an upside of 6.2% from the current market price of KES 13.10 as at 5th March 2020. We base the recommendation on the bank's new strategy, declining market share and in our opinion a conservative approach.

Our consideration for the stock is based on:

Key Drivers

- We expect that if applied successfully, the new 5 year strategy would see the bank grow its non-funded income contribution to 33.5% in FY2019F
- We also expect the new strategy to boost operational efficiency to 50.5% cost to income ratio in FY2019F
- We note that the bank has the potential to maintain its market share as it pursues the new five-year strategy which partly focuses on increased lending.

Key Risks

- The bank's market share growth is dependent on the bank's ability to grow ahead of competition or at least not lose any more ground. Given the bank's conservative approach in the past, this is likely to be a challenge.

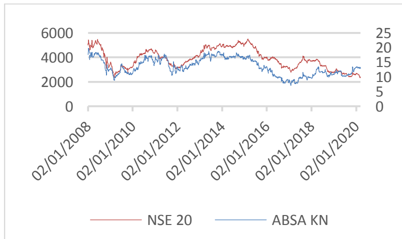
Key Metrics	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F	2022F
EPS	1.54	1.55	1.36	1.27	1.36	1.44	1.74	2.03	2.37	2.71
DPS	1.00	1.00	1.00	1.00	1.10	1.10	1.10	1.40	1.40	1.80
BVPS	7.03	7.31	7.8	8.12	8.14	8.42	8.76	9.45	9.91	10.84
P/B	2.38	1.86	1.17	1.18	1.35	1.56	1.50	1.39	1.32	1.21
P/E	10.84	8.77	6.69	7.50	7.99	9.07	7.54	6.45	5.52	4.83
Div Yield	3.0%	8.8%	8.9%	10.4%	8.2%	8.4%	8.4%	10.7%	10.7%	13.7%
ROaE	23.8%	21.6%	18.0%	16.0%	16.8%	17.5%	20.2%	22.3%	24.5%	26.1%
RoaA	3.9%	3.6%	3.0%	2.6%	2.5%	2.3%	2.5%	2.7%	3.0%	3.2%
C/I Ratio (excl. provisions)	52.0%	53.0%	53.0%	55.0%	54.0%	50.5%	46.6%	43.3%	40.0%	37.4%

Key Data	
Market price (KES)	13.10
Upside	6.2%
No. of shares (mn)	5,432
Market Cap (KESmn)	71,159
Free float	31.1%
Free float (KESmn)	22,119
Free float (USDmn)	221

Dividend	
Div yield	8.3%

Major Shareholders	% of shares
Absa Group Limited	68.5
Minority Shareholders	31.5

Price performance



	NSE20	Company
1 month	-7.8%	-0.4%
3 months	-7.2%	2.3%
6 months	-1.7%	22.0%
12 months	-17.7%	14.7
Min 52 weeks KES		10.00
Max 52 weeks KES		14.20
10 Year Low		7.15
10 Year High		18.75
Avg turnover/day (KES Mn)		9.6

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Glossary of Terms

Net Interest Margin (NIM) - Net interest margin is a measure of the difference between interest paid and interest received, adjusted for the total amount of interest-generating assets held by the bank. It is calculated as: Net Interest Income/Average Interest Earning Assets
Basis points (bps) – one hundredth of a percentage i.e. 1.0%=100bps or 1bps=0.01%
Target price – Analyst estimate of the fair value or intrinsic value of the company
Cost of Funds-This is the effective average interest rate paid on interest earning liabilities. It is calculated as Total Interest Expense/Average Interest Earning Liabilities
Loan Yield- This is the effective average interest rate received on average loans and advances. It is calculated as Interest on Loans and Advances/Average Loans and Advances
Cost of Risk – This ratio measures the amount of risk involved in lending. It is calculated as: Net Impairment Provisions/Average Gross Loans in the period
Non-performing loans-These are loans that have been classified as impaired. The CBK classifies loans into five categories i.e. Normal, Watch, Substandard, Doubtful and Loss depending on performance of the loan. The last three i.e. sub-standard, doubtful and loss are referred to as non-performing loans. Under IFRS, these classified as stage 3 loans.
Non-performing loans (NPL) Ratio - This is the proportion of NPLs in the loan book. It is calculated as Gross NPLs/Gross Loans
Non-funded/Non-Interest Income– This represents the income that is not classified as interest income.
Non-Funded/Non-Interest Income Ratio. This represents the proportion of total operating income that is not classified as interest income. It is calculated as Non-Interest Income/Total Operating Income
Composite market share (Market share Index) - This is a weighted composite index comprising of assets, deposits, capital size, number of deposit and loan accounts. The composite market share is used by CBK to classify banks into three groups:

- Tier 1(Large Size Bank); Composite market share of 5.0% and above
- Tier 2(Medium Size Bank); Composite market share of between 1.0% and 5.0%
- Tier 3(Small size Bank); Composite market share of less than 1.0%

Recommendation

BUY – Minimal risks to catalysts
SELL- Risks outweigh the catalysts
NEUTRAL – This is where the positives and negatives in a company almost balance out. You can accumulate for the long term.