Barclays Bank of Kenya Earnings Update – Q3’2016
20th November 2016

Valuation Summary

- We recommend an Accumulate for Barclays Bank of Kenya stock with a target price of Kshs 9.2 representing an upside of 13.1%, from the current price of Kshs 8.9, as at 17th November 2016, inclusive of a dividend yield of 9.7%
- Barclays Bank of Kenya is currently trading at a P/B of 1.2x versus an industry average of 1.0x, and a P/E of 6.0x versus an industry average of 5.6x

Key highlights during the Quarter

- Barclays Bank of Kenya launched brokerage subsidiary Barclays Financial Services Limited (BFSL). The brokerage subsidiary is part of Barclays Africa Group (BAGL) with a Pan-African stock brokerage operation of over 330 staff. Barclays Bank of Kenya intends to use BFSL to bring a range of new investment products and services to the country’s vibrant financial market

Income Statement

- Core Earnings Per Share declined by 5.1% to Kshs 1.12 from Kshs 1.18 in Q3'2015 driven by a 24.7% growth in Operating expenses which outpaced the 12.5% growth in Operating income
- Total Operating revenue grew by 12.5% to Kshs 24.4 bn from Kshs 21.7 bn registered in Q3’2015, faster than our estimate of 7.6%. This was supported by a 10.9% growth in Net Interest Income (NII) and 16.3% growth in Non-Funded Income (NFI)
- Interest Income grew by 13.8% to Kshs 21.1 bn from Kshs 18.5 bn in Q3’2015, slower than Interest expense which grew by 27.2% to Kshs 4.3 bn from Kshs 3.3 bn in Q3’2015. Net Interest Margin remained unchanged at 10.9%
- Non-Funded Income grew by 16.3% to Kshs 7.6 bn from Kshs 6.5 bn recorded in Q3’2015, largely in line with our expectation of a 16.8% growth. The growth in NFI was driven by an increase in foreign exchange trading income which recorded a 38.5% growth to Kshs 2.0 bn from Kshs 1.4 bn in Q3’2015. The revenue mix remained unchanged at 69:31 NII to NFI. We believe Barclays Bank of Kenya’s entry into investment banking and insurance business space will help the bank grow NFI to diversify revenue streams
- Total Operating expenses grew by 24.7% to Kshs 15.7 bn from Kshs 12.6 bn in Q3’2015. The growth in operating expenses was driven by a 217.8% rise in Loan Loss Provision (LLP) to Kshs 3.1 bn from Kshs 1.0 bn registered in Q3’2015. Without LLP, operating expenses grew by 8.3% to Kshs 12.6 bn from Kshs 11.6 bn. Staff costs grew by 5.7% to Kshs 7.4 bn from Kshs 7.0 bn registered in Q3’2015. Cost to income ratio increased to 64.3% from 58.0% registered in Q3’2015. Without LLP, cost to income ratio improved to 51.5% from 53.5% in the same period last year
- The growth in Operating expenses led to a decline in reported PAT y/y by 5.1% to Kshs 6.1 bn from Kshs 6.4 bn registered in Q3’2015 compared to our expectations of a 4.3% growth

Balance Sheet

- The balance sheet recorded an expansion in Q3’2016 with total assets rising by 19.6% to Kshs 264.0 bn from Kshs 220.8 bn in Q3’2015. The growth in total assets was driven by a 14.3% growth in the loan book and a 26.0% increase on investment in government securities. The bank’s loan book stood at Kshs 158.8 bn from Kshs 139.0 bn in Q3’2015, while investment in government securities came in at Kshs 56.7 bn from Kshs 45.0 bn registered in Q3’2015
- Total liabilities increased by 21.0% to Kshs 222.5 bn from Kshs 183.9 bn in Q3’2015 compared to our projection of a 20.4% growth, while shareholders’ funds increased by 12.5% to Kshs 41.5 bn from Kshs 36.9 bn compared to our expectation of a 13.1% increase
- Customer deposits grew 13.4% to Kshs 180.9 bn from Kshs 159.4 bn registered in Q3’2015 driven by the bank’s efforts to strengthen its network channels through opening up an additional 181 service outlets across the country in a bid to boost its deposit mobilisation capability. Loans to deposit ratio increased to 87.8% from 87.2% in Q3’2015
- Gross non-performing loans grew by 49.3% to Kshs 10.4 bn from Kshs 7.0 bn registered in Q3’2015 which led to an increase in the NPL ratio to 6.4% from 5.0% in Q3’2015
- The Return on Average Equity (ROaE) decreased to 20.6% from 23.6% in Q3’2015 with the Return on Average Assets (ROaA) decreasing to 3.3% from 3.9% in Q3’2015

- The yield on interest earning assets increased to 13.8% from 13.0% in Q3'2015 with the cost of funds rising to 3.3% from 2.7% in Q3'2015
- Barclays Bank of Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 16.5%, 6.0% above the statutory requirement with total capital to total risk weighted assets exceeding the statutory requirement by 4.2% to close the period at 18.7%

Going forward, Barclays Bank's growth will be propelled by:

i. The bank's renewed focus on SME Banking with the recent roll out of the 'Wezesha Biashara na Barclays' campaign which offers SMEs secured loans at preferential rates and financial seminars which has reached over 6,000 people in 11 counties and continues to grow
ii. The launch of its stock brokerage arm as part of its diversification strategy. The brokerage arm will be bringing a range of new investment products and services to the country's vibrant financial market. This will boost customer value proposition and enable the bank to offer full suite of financial products under one roof. The new brokerage is also planning to launch Exchange Traded Funds (ETFs), working closely with the Capital Markets Authority and the Nairobi Securities Exchange under the new NSE rules
iii. The bank became the first international bank in Kenya to launch Agency Banking in partnership with the Postal Corporation of Kenya, opening an additional 181 service outlets across the country and this should serve to boost their revenue streams

Below is a summary of the key line items in the balance sheet and income statement

Figures in Kshs billions unless otherwise stated

Balance Sheet	FY'2015	Q3'2015	Q3'2016	y/y change	Q3'2016e	Projected y/y change	Variance in Actual Growth vs. Expected
Government Securities	48.1	45.0	56.7	26.0%	53.6	19.1%	7.0%
Net Loans and Advances	145.4	139.0	158.8	14.3%	151.5	9.0%	5.3%
Total Assets	240.9	220.8	264.0	19.6%	263.1	19.2%	0.4%
Customer Deposits	165.1	159.4	180.9	13.4%	184.7	15.8%	(2.4%)
Total Liabilities	201.2	183.9	222.5	21.0%	221.4	20.4%	0.6%
Shareholders' Funds	39.7	36.9	41.5	12.5%	41.7	13.1%	(0.6%)

Balance sheet ratios	Q3'2015	Q3'2016	%y/y change
Loan to Deposit Ratio	87.2%	82.0%	(5.2%)
Return on average equity	23.6%	20.6%	(3.0%)
Return on average assets	3.9%	3.3%	(0.6%)

Income Statement	FY'2015	Q3'2015	Q3'2016	y/y change	Q3'2016e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	20.4	15.2	16.9	10.9%	15.8	3.6%	7.2%
Net non-Interest Income	9.1	6.5	7.6	16.3%	7.6	16.8%	(0.5%)
Total Operating income	**29.5**	**21.7**	**24.4**	**12.5%**	**23.4**	**7.6%**	**4.9%**
Loan Loss provision	(1.8)	(1.0)	(3.1)	217.8%	(2.6)	164.9%	52.9%
Total Operating expenses	(17.4)	(12.6)	(15.7)	24.7%	(13.9)	10.0%	14.8%

Profit before tax	**12.1**	**9.1**	**8.7**	**(4.4%)**	**9.5**	**4.3%**	**(8.7%)**
Profit after tax	**8.4**	**6.4**	**6.1**	**(5.4%)**	**6.7**	**3.9%**	**(9.3%)**
Core EPS	**1.5**	**1.18**	**1.12**	**(5.4%)**	**1.23**	**3.9%**	**(9.3%)**

Income statement ratios	Q3'2015	Q3'2016	%y/y change
Yield from interest-earning assets	13.0%	13.5%	0.5%
Cost of funding	2.7%	3.3%	0.6%
Net Interest Margin	10.9%	10.9%	(0.0%)
Cost to Income	58.0%	64.3%	6.3%
Cost to Assets	5.3%	4.8%	(0.5%)
Net Interest Income as % of operating income	70.0%	69.0%	(1.0%)
Non-Funded Income as a % of operating income	30.0%	31.0%	1.0%

Capital Adequacy Ratios	Q3'15	Q3'16
Core Capital/Total Liabilities	22.0%	21.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**14.0%**	**13.3%**
Core Capital/Total Risk Weighted Assets	16.3%	16.5%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.8%**	**6.0%**
Total Capital/Total Risk Weighted Assets	19.1%	18.7%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.6%**	**4.2%**
Liquidity Ratio	34.7%	34.5%
Minimum Statutory ratio	20.0%	20.0%
Excess	**14.7%**	**14.5%**