

Valuation Summary

- We recommend a BUY for the NIC Bank stock with a target price of Kshs 36.1 representing an upside of 21.4%, from the current price of Kshs 30.5, as at Friday, 19th August 2016, given a dividend yield of 3.3%
- NIC Bank is currently trading at a P/B of 0.7x, versus an industry average of 1.3x

Key highlights during the Half

- NIC Bank was appointed by the KDIC to provide Imperial Bank Limited's (in Receivership) depositors with access to funds up to Kshs. 1.5 mn. Imperial Bank depositors will have access to funds of up to a maximum of Kshs. 1.5 mn, in addition to the Kshs. 1.0 mn already disbursed through KCB and DTB Banks. Imperial Bank depositors who had not lodged a claim through KCB or DTB Banks will be able to lodge a combined claim of up to Kshs. 2.5 mn through NIC Bank

Income Statement

- Core earnings per share increased by 2.9% to Kshs. 3.6 from Kshs. 3.5 in H1'2015. This is driven by the 26.3% growth in operating income despite the high growth in operating expenses of 51.5%, driven by a 267.9% increase in loan loss provision to Kshs. 2.2 bn from Kshs. 0.6 bn in H1'2015. Operating revenue grew by 26.3% to Kshs. 8.2 bn from Kshs. 6.5 bn in H1'2015, driven by both a 34.2% growth in net interest income and 8.2% increase in non-interest income. The 34.2% growth in net interest income was supported by a 27.4% growth in interest income to Kshs. 9.9 bn from Kshs. 7.7 bn in H1'2015 outpacing a 17.9% increase in interest expense to Kshs. 3.8 bn from Kshs. 3.2 bn. Net interest margin increased to 7.4% in H1'2016 from 6.3% in H1'2015. The 8.2% increase in non-interest income was driven by a 31.9% increase in other fees and commissions to Kshs. 0.4 bn from Kshs. 0.3 bn in H1'2015. The current revenue mix stands at 74:26 funded to non-funded income
- Operating expenses increased by 51.5% to Kshs. 5.0 bn from Kshs. 3.3 bn in H1'2015, driven by a 267.9% increase in loan loss provision to Kshs. 2.2 bn from Kshs. 0.6 bn in H1'2015. The faster growth in operating expenses than operating income resulted in an increase of the cost to income ratio to 60.9% from 50.7% in H1'2015
- The 26.3% growth in operating income led to an increase in reported PAT y/y by 2.9% to Kshs 2.3 bn from Kshs 2.2 bn in H1'2015 compared to our expectations of a 2.8% increase

Balance Sheet

- The balance sheet recorded an expansion with total assets increasing by 10.3% to Kshs. 169.1 bn from Kshs. 153.2 bn, driven by a 93.8% increase in placements to Kshs. 13.2 bn from Kshs. 6.8 bn. Total loans increased by 3.6% to Kshs. 112.2 bn from Kshs. 108.3 bn in H1'2015
- Total liabilities increased by 9.1% to Kshs. 140.8 bn from Kshs. 129.0 bn, driven by a 30.3% increase in borrowings to Kshs. 20.4 bn from Kshs. 15.7 bn in H1'2015. Customer deposits increased by 6.5% to Kshs. 112.0 from Kshs. 105.1 bn in H1'2015. The faster growth in deposits led to a decrease in the loan to deposit ratio to 100.1% from 103.0% in H1'2015, lower than the industry average of 82.5%
- Gross non-performing loans grew by 36.8% to Kshs 12.6 bn from Kshs 8.8 bn in H1'2015 which led to an increase in NPL ratio to 10.9% from 7.9% in H1'2015
- The yield on interest earning assets increased to 13.1% from 11.6% in H1'2015 with the cost of funds increasing to 5.7% from 5.4%
- NIC Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 14.6%, 4.1% above the statutory requirement with total capital to total risk weighted assets above the statutory requirement by 5.9%

NIC Bank's growth going forward will be propelled by:

- Managing their non-performing loans which are growing despite a slowdown in the loan book growth through more risk based loan supervision

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	H1'2015	FY'2015	H1'2016	y/y change	H1'2016e	Projected y/y Change	Variance from Actual
Government Securities	22.3	27.8	29.1	30.3%	27.8	24.8%	-5.5%
Net Loans and Advances	108.3	116.0	112.2	3.6%	115.9	7.0%	3.5%
Total Assets	153.2	165.8	169.1	10.3%	167.9	9.6%	-0.7%
Customer Deposits	105.1	112.4	112.0	6.5%	113.6	8.1%	1.6%
Borrowings	15.7	15.4	20.4	30.3%	15.2	-2.8%	-33.1%
Total Liabilities	129.1	139.4	140.8	9.1%	139.5	8.1%	-1.0%
Shareholder's Funds	23.7	25.9	27.8	17.5%	27.9	18.1%	0.6%

Ratios	H1'2015	H1'2016	y/y change
Loan to Deposit Ratio	103.0%	100.1%	(2.9%)
Return on average equity	20.4%	9.0%	(11.3%)
Return on average assets	3.1%	2.8%	(0.2%)

Income Statement	H1'2015	FY'2015	H1'2016	y/y change	H1'2016e	Projected y/y Change	Variance from Actual
Net Interest Income	4.5	9.7	6.1	34.2%	5.8	28.8%	(5.5%)
Net non-Interest Income	2.0	4.0	2.2	8.2%	2.4	19.9%	11.7%
Total Operating income	6.5	13.8	8.2	26.3%	8.2	26.1%	(0.2%)
Loan Loss provision	(0.6)	(1.7)	(2.1)	267.9%	(1.6)	173.0%	(94.9%)
Total Operating expenses	(3.3)	(7.4)	(5.0)	51.5%	(4.9)	49.0%	(2.6%)
Profit before tax	3.2	6.4	3.2	0.2%	3.3	2.4%	2.2%
Profit after tax	2.2	4.5	2.3	2.9%	2.3	2.8%	(0.1%)
EPS	3.5	7.0	3.6	2.9%	3.6	2.8%	(0.1%)

Ratios	H1'2015	H1'2016	y/y change
Yield from interest-earning assets	11.6%	13.1%	1.5%
Cost of funding	5.4%	5.7%	0.3%
Net Interest Margin	6.3%	7.4%	1.1%
Cost to Income	50.7%	60.9%	10.2%
Cost to Assets	2.2%	3.0%	0.8%
Net Interest Income as % of operating income	69.4%	73.8%	4.4%
Non-Funded Income as a % of operating income	30.6%	26.2%	(4.4%)

Capital Adequacy Ratios	H1'2015	H1'2016
Core Capital/Total Liabilities	22.5%	21.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	12.0%	11.4%

Core Capital/Total Risk Weighted Assets	16.7%	14.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	6.2%	4.1%

Total Capital/Total Risk Weighted Assets	22.8%	20.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	8.3%	5.9%

Liquidity Ratio	38.6%	29.6%
Minimum Statutory ratio	20.0%	20.0%
Excess	18.6%	9.6%