

**Valuation Summary**

- National Bank is currently trading at a P/B of 0.4x vs. an industry average of 1.7x

**Key Highlights during the Year**

- National Bank of Kenya suspended the C.E.O and other 6 senior executives, citing a pending internal audit
- They also released a profit warning following the suspension, citing that their FY'2015 earnings will be 25% less than the previous. Key to note is that as at Q320'15, NBK had reported profit after tax growth of 123.0%. The reason for the profit warning was indicated as a sharp increment in the non-performing loans in Q4'2015 and the sale of one key low yielding asset was not completed in the year

**Earnings Update:**

- Core EPS declined by 232.5% y/y to a loss of Kshs. 3.8 per share from Kshs. 2.8 per share in FY'2014
- FY'2015 PAT growth came in worse than our estimates (232.5% y/y decline to a loss of Kshs. 1.2 bn from Kshs. 0.9 bn compared to our projection of a 132.6 increase). The disparity was mainly due to an increase in operating expenses by 49.2% y/y to Kshs 11.2 bn from Kshs 7.5 bn in FY'2014 (compared to our projections of a 5.5%) far outpacing operating revenue that declined 3.8% to Kshs 9.6 bn from Kshs 9.9 bn in FY'2014 (compared to our projection of an 8.8% increase)
- The increase in operating expenses was as a result of a 608.0% increase in loan loss provision to Kshs. 3.7 bn from Kshs. 0.5 bn in FY'2014, against our projections of a 60.2% increase. This resulted into an increase in the Cost to Income ratio to 117.1% from 75.5% in FY'2014
- The decline in operating revenue was driven by a 5.9% decline in net interest income to Kshs 6.4 bn from Kshs 6.8 bn in FY'2014. The decline in net interest income was driven by an interest expense growth of 50.0% y/y to Kshs. 5.9 bn from Kshs. 3.9 bn in FY'2014, outpacing interest income growth of 14.5% to Kshs. 12.2 bn from Kshs. 10.7 bn in FY'2014. The higher interest expense growth is attributed to a faster growth in deposits by 5.6% y/y than loan growth which grew by 3.3% y/y. The current revenue mix stands at 71%:29% funded to non-funded income, respectively
- The bank did not declare a dividend payout

**Balance Sheet:**

- Customer deposits increased by 5.6% y/y to Kshs 110.6 bn from Kshs. 104.7 bn in FY'2014, compared to our growth projection of a 9.8% decline. Deposit growth outpaced loan growth, which grew by 3.3% to Kshs. 67.8 bn from Kshs. 65.6 bn in FY'2014, resulting into a loan to Deposit ratio of 61.3% from 62.8% in 2014.
- The bank recorded a high increase in the non-performing loans, which rose by 62.5% to Kshs 11.8 bn from Kshs. 7.2 bn in FY'2014, leading to an increase in NPL ratio to 17.6% from 11.0% in FY'2014
- The yield from the bank's interest earning assets stood at 12.8%, while the cost of funds came in at 5.3%, resulting in a net interest margin of 7.6%, from 8.5% in 2014
- Total liabilities increased by 3.2% to Kshs 114.4 bn from Kshs. 110.9 bn in FY'2014. Shareholders' funds declined by 9.6% y/y to Kshs 11.1 bn from Kshs. 12.2 bn in FY'2014
- Return on equity declined to -9.9% from 7.2% in 2014 against an industry average of 19.8%, while return on assets came in at -0.9% from 0.8% in 2014 against an industry average of 22.2%
- The bank is currently undercapitalized with its total capital risk weighted ratio below the statutory requirement by 0.4% an indication that they will be looking to shore up capital in the near future.

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 Items	FY'2014	FY'2015	y/y change	FY'2015e	% y/y change	Variance in Growth Actual vs. Expected
Government Securities	30.26	27.32	(9.73%)	27.39	(9.48%)	(0.25%)
Net Loans and Advances	65.64	67.80	3.29%	74.62	13.67%	(10.38%)
Total Assets	123.09	125.44	1.91%	120.02	(2.50%)	4.41%
Customer Deposits	104.73	110.62	5.62%	94.45	(9.82%)	15.44%
Total Liabilities	110.87	114.39	3.17%	106.73	(3.73%)	6.90%
Shareholders' Funds	12.22	11.05	(9.58%)	13.28	8.67%	(18.24%)

Balance Sheet Ratios	FY'2014	FY'2015
Loan to Deposit Ratio	62.67%	61.29%
Return on average equity	7.22%	-9.91%
Return on average assets	0.81%	-0.93%

Income Statement	FY'2014	FY'2015	y/y change	FY'2015e	% y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	6.8	6.4	(5.9%)	6.5	(5.1%)	(0.8%)
Net non-Interest Income	3.1	3.2	0.7%	4.4	38.8%	(38.2%)
Total Operating income	9.9	9.6	(3.8%)	10.8	8.8%	(12.6%)
Loan Loss provision	0.5	3.7	608.0%	0.8	60.2%	547.8%
Total Operating expenses	7.5	11.2	49.2%	7.9	5.5%	43.7%
Profit before tax	1.3	(1.6)	(225.7%)	2.9	122.0%	(347.7%)
Profit after tax	0.9	(1.2)	(232.5%)	2.0	132.6%	(365.1%)
Core EPS	2.8	(3.8)	(232.5%)	6.6	132.6%	(365.1%)

Income Statement Ratios	FY'2014	FY'2015
Yield from interest-earning assets	12.3%	12.8%
Cost of funding	3.8%	5.3%
Net Interest Spread	8.5%	7.6%
Net Interest Income as % of operating income	68.4%	67.0%
Non-Funded Income as a % of operating income	31.6%	33.0%
Cost to Income	75.5%	117.1%
Cost to Assets	6.1%	8.9%

Capital Ratios	FY'2014	FY'2015
Core Capital Liabilities Ratio	9.90%	8.80%
Minimum Statutory Requirement	8.00%	8.00%
<b>Excess/(Deficit)</b>	<b>1.90%</b>	<b>0.80%</b>
Core Capital Risk Weighted Assets Ratio	12.90%	13.00%
Minimum Statutory Requirement	10.50%	10.50%
<b>Excess/(Deficit)</b>	<b>2.40%</b>	<b>2.50%</b>
Total Capital Risk Weighted Ratio	13.90%	14.00%

Minimum Statutory Requirement	14.50%	14.50%
<b>Excess/(Deficit)</b>	<b>(0.60%)</b>	<b>(0.50%)</b>

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