

Valuation Summary

- We recommend a **BUY** for the Standard Chartered stock with a target price of Kshs. 247.9, representing an upside of 14.2% from the current price of Kshs 217.0, as at 24th March 2016, with a dividend yield of 7.8%, giving a Total Potential Return of 22.0%
- Standard Chartered Bank is currently trading at a P/B of 1.7x and a P/E of 10.8x vs. an industry average of 1.7x and 8.3x, respectively

Key Highlights During the Year – 2015

- Standard Chartered Bank issued a profit warning for their FY'2015 results, stating that their earnings will be at least 25.0% lower than that of the previous year. They attributed the drop in earnings to (i) the rise in non-performing loans, and (ii) the Kshs. 1.5 bn one-off sale of land they booked in 2014
- Standard Chartered adopted a conservative stance on their loan disbursements as they set up risk management frameworks to address the high non-performing loans issue that have greatly affected their returns. This is a good initiative as they need to stick to their corporate niche and avoid venturing into the mass market where they can't compete with the likes of Equity Group Holdings and KCB Group

Earnings Update:

- Reported EPS declined by 39.2% y/y to Kshs. 20.2 per share from Kshs. 33.2 per share. Stripping out the one off item, the sale of land for Kshs 1.5 bn in 2014, core EPS declined by 28.7% to Kshs. 20.2 per share from Kshs. 28.3 per share in FY'2014
- FY'2015 PAT growth came in worse than our estimates (39.2% y/y decline to Kshs. 6.3 bn from Kshs. 7.4 bn compared to our projection of a 29.2% decline). The disparity was mainly due to operating expenses, which grew by 38.2% against our projection of a 1.4% decline. Operating revenue declined by 2.7% to Kshs 25.4 bn from Kshs 26.1 bn in 2014 resulting into a cost to income ratio of 63.9%, from 45% in FY'2014
- Operating revenue declined as a result of non-funded income, which declined by 11.3% to Kshs 7.2 bn from Kshs. 8.2 bn in FY'2014, lower than our projection of a 14.2% decline as a result of the one-off gain of the sale of land for Kshs. 1.5 bn they booked in 2014. Net interest income however rose by 1.2% y/y to Kshs 18.1 bn from Kshs. 17.9 bn in FY'2014, against our projections of a 15.6% decline. This was due to investment in government securities which grew by 15.6% to Kshs. 67.9 from Kshs. 58.8 bn in FY'2014
- Interest income recorded a growth of 3.4% to Kshs. 22.9 bn from Kshs. 22.1 bn in FY'2014, while interest expenses grew by 12.9% to Kshs. 4.8 bn from Kshs. 4.2 bn in FY'2014. The current revenue mix stands at 71%:29% funded to non-funded income, respectively
- The high growth in operating expenses of 38.2% to Kshs 16.2 bn from Kshs. 11.7 bn in FY'2014 was due to a 274.2% increment in loan loss provision to Kshs. 4.9 bn from Kshs. 1.3 bn in FY'2014, vs. our projection of a 54.5% increase
- The bank declared a final dividend per share of Kshs 12.5 and following an interim dividend of Kshs 4.5 earlier in the year, this gives a total dividend per share of Kshs 17.0 for 2015 translating into a dividend yield of 7.8%

Balance Sheet:

- Customer deposits increased by 11.7% y/y to Kshs 172.0 bn from Kshs. 154.0 bn in FY'2014, compared to our growth projection of a 12.5%. Deposit growth outpaced loan growth, which declined 6.2% to Kshs.

115.1 bn from Kshs. 122.8 bn in FY'2014, resulting into a loan to Deposit ratio of 66.9% from 79.7% in 2014.

- Loan growth declined as the bank adopted a conservative stance, as they put in place risk management frameworks on their loan disbursement mechanisms since they have been adversely affected by high non-performing loans
- The bank recorded a high increase in the non-performing loans, which rose by 36.7% to Kshs 14.7 bn from Kshs. 10.8 bn in FY'2014, leading to an increase in NPL ratio to 12.8% from 8.8% in FY'2014
- The yield from the bank's interest earning assets stood at 12.3%, while the cost of funds came in at 2.9%, resulting in a net interest margin of 9.4%, from 9.2% in 2014
- Total liabilities increased by 6.0% to Kshs 192.7 bn from Kshs. 181.8 bn in FY'2014. Shareholders' funds increased by 1.5% y/y to Kshs 41.3 bn from Kshs. 40.7 bn in FY'2014
- Return on equity declined to 15.5% from 27.2% in 2014, while return on assets came in at 2.9% from 4.7% in 2014 compared to an industry average of 19.8% vs 22.2% in FY'2014 underscoring the general poor performance of the overall banking sector
- The bank continues to be well capitalized with the total capital to risk weighted assets at 21.2%, which is 6.7% above the statutory requirement of 14.5%

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	FY2015e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	58.8	67.9	15.6%	62.4	6.2%	(9.4%)
Net Loans and Advances	122.7	115.1	(6.2%)	129.9	5.9%	12.1%
Total Assets	222.5	234.0	5.2%	238.9	7.4%	2.2%
Customer Deposits	154.1	172.0	11.7%	173.3	12.5%	0.8%
Total Liabilities	181.8	192.7	6.0%	199.6	9.8%	3.8%
Shareholders' Funds	40.7	41.3	1.5%	39.3	(3.3%)	(4.8%)

Balance Sheet Ratios	FY'2014	FY'2015
Loan to Deposit Ratio	79.7%	66.9%
Return on average equity	27.2%	15.5%
Return on average assets	4.7%	2.8%

Income Statement	FY'2014	FY'2015	y/y change	FY2015e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	17.9	18.1	1.2%	15.1	(15.6%)	(16.8%)
Net non-Interest Income	8.2	7.2	(11.3%)	7.0	(14.2%)	(2.9%)
Total Operating income	26.1	25.4	(2.7%)	22.1	(15.2%)	(12.4%)
Loan Loss provision	(1.3)	(4.9)	274.2%	(2.0)	54.5%	(219.7%)
Total Operating expenses	(11.7)	(16.2)	38.2%	(11.6)	(1.4%)	(39.6%)
Profit before tax	14.3	9.2	(36.1%)	10.6	(26.4%)	9.8%
Profit after tax	10.4	6.3	(39.2%)	7.4	(29.2%)	10.1%
Reported EPS	33.2	20.2	(39.2%)	23.5	(29.2%)	10.1%
Core EPS	28.3	20.2	(28.7%)	23.5	(20.4%)	8.3%

Income Statement Ratios	FY'2014	FY'2015
Yield from interest-earning assets	11.8%	12.3%
Cost of funding	2.6%	2.9%
Net Interest Spread	9.2%	9.4%
Net Interest Income as % of operating income	68.7%	71.4%
Non-Funded Income as a % of operating income	31.3%	28.6%
Cost to Income	45.0%	63.9%
Cost to Assets	5.3%	6.9%

Capital Ratios	FY'2014	FY'2015
Core Capital Liabilities Ratio	18.8%	19.3%
Minimum Statutory Requirement	10.5%	10.5%
Excess/(Deficit)	8.3%	8.8%
Core Capital Risk Weighted Assets Ratio	15.8%	17.5%
Minimum Statutory Requirement	10.5%	10.5%
Excess/(Deficit)	5.3%	7.0%
Total Capital Risk Weighted Ratio	19.8%	21.2%
Minimum Statutory Requirement	14.5%	14.5%
Excess/(Deficit)	5.3%	6.7%