Standard Chartered Bank Kenya Earnings Update – H1’2016

21st August 2016

Valuation Summary

- We recommend a HOLD for the Standard Chartered Bank stock with a target price of Kshs 208.6 representing an upside of 8.5%, from the current price of Kshs 208.0, as at Thursday, 18th August 2016, given a dividend yield of 8.2%
- Standard Chartered Bank is currently trading at a P/B of 2.2x, versus an industry average of 1.3x

Key highlights during H1’2016

- Standard Chartered rolled out its online/mobile banking platform to enable its customers to access banking services, other than deposit placement and loan access, at the customer’s convenience. This is aimed at reducing the number of traffic to the physical branches as customers will only go to branches to access core banking services. This marks as the first phase of its “Digital by Design” business model

Income Statement

- Core earnings per share increased by 34.8% to Kshs. 15.2 from Kshs. 11.3 in H1'2015. This was driven by a faster growth in operating income of 18.9% than operating expenses of 6.5%, driven by 32.1% growth in non-interest income to Kshs. 4.5 bn from Kshs. 3.4 bn in H1’2015
- Operating revenue grew by 18.9% to Kshs. 14.5 bn from Kshs. 12.2 bn in H1'2016, driven by both a 13.8% growth in net interest income and 32.1% increase in non-interest income. The 13.8% growth in net interest income was supported by a 20.9% growth in interest income to Kshs. 13.0 bn from Kshs. 10.8 bn in H1’2015 despite a 51.3% increase in interest expense to Kshs. 3.1 bn from Kshs. 2.0 bn. Net interest margin increased to 9.5% in H1’2016 from 9.3% in H1’2015. The 32.1% increase in non-interest income was driven by a 48.8% increase in forex income to Kshs. 1.5 bn from Kshs. 1.1 bn I n H1’2015. The current revenue mix stands at 69:31 funded to non-funded income
- Operating expenses increased by 6.5% to Kshs. 7.0 bn from Kshs. 6.6 bn in H1'2015, driven by a 6.4% increase in staff costs to Kshs. 2.9 bn from Kshs. 3.1 bn in H1'2015. The faster growth in operating income than operating expense resulted in a decline of the cost to income ratio to 48.4% from 54.1% in H1’2015
- The faster growth in operating income led to a increase in reported PAT y/y by 34.8% to Kshs 5.2 bn from Kshs 3.9 bn in H1’2015 compared to our expectations of a 28.5% increase

Balance Sheet

- The balance sheet recorded an expansion with total assets increasing by 12.2% to Kshs. 255.9 bn from Kshs. 228.2 bn, driven by an 80.9% increase in placements to Kshs. 20.7 bn from Kshs. 11.5 bn. Total loans declined by 7.3% to Kshs. 114.3 bn from Kshs. 123.3 bn in H1'2015
- Total liabilities increased by 12.9% to Kshs. 212.4 bn from Kshs. 188.1 bn, driven by a 16.9% increase in customer deposits to Kshs. 190.8 bn from Kshs. 163.2 bn in H1'2015. The decline in the loan book led to a decrease in the loan to deposit ratio to 59.9% from 75.5% in H1’2015, lower than the industry average of 82.5%
- Gross non-performing loans grew by 84.0% to Kshs 15.4 bn from Kshs 8.3 bn in H1’2015 which led to an increase in NPL ratio to 13.3% from 5.3% in H1’2015
- The yield on interest earning assets increased to 12.4% from 11.5% in H1’2015 with the cost of funds increasing to 3.2% from 2.6%
- Standard Chartered Bank Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 17.9%, only 7.4% above the statutory requirement with total capital to total risk weighted assets above the statutory requirement by 7.1%

Standard Chartered Bank’s growth going forward will be propelled by:

- Managing their non-performing loans which are growing despite a decline in the loan book growth through more risk based loan supervision
- Growing core business as forex income and other income growth may not be sustainable going forward

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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	H1'2016	y/y change	H1'2016e	Projected y/y change	Variance from Actual
Government Securities	64.5	92.8	43.9%	74.2	15.0%	(28.9%)
Net Loans and Advances	123.3	114.3	(7.3%)	112.9	(8.4%)	(1.1%)
Total Assets	**228.2**	**255.9**	**12.2%**	**255.8**	**12.1%**	**(0.1%)**
Customer Deposits	163.2	190.9	16.9%	188.2	15.3%	(1.6%)
Total Liabilities	**188.1**	**212.4**	**12.9%**	**209.5**	**11.4%**	**(1.5%)**
Shareholder's Funds	**40.1**	**43.6**	**8.6%**	**46.3**	**15.2%**	**6.7%**

Ratios	H1'2015	H1'2016	y/y change
Loan to Deposit Ratio	75.5%	59.9%	(15.7%)
Return on average equity	21.2%	18.4%	(2.8%)
Return on average assets	3.6%	3.2%	(0.4%)

Income Statement	H1'2015	H1'2016	y/y change	H1'2016e	Projected y/y change	Variance from Actual
Net Interest Income	8.8	10.0	13.8%	10.3	17.4%	3.7%
Net non-Interest Income	3.4	4.5	32.1%	4.1	19.5%	(12.6%)
Total Operating Income	**12.2**	**14.5**	**18.9%**	**14.4**	**18.0%**	**(0.9%)**
Loan Loss provision	(1.3)	(1.4)	5.9%	(1.4)	5.7%	(0.2%)
Total Operating Expenses	(6.6)	(7.0)	6.5%	(7.3)	10.1%	3.6%
Profit before tax	**5.6**	**7.5**	**33.6%**	**7.1**	**27.3%**	**(6.3%)**
Profit after tax	**3.9**	**5.2**	**34.8%**	**5.0**	**28.5%**	**(6.3%)**
Core EPS	11.3	15.2	34.8%	14.5	28.5%	(6.3%)

Ratios	H1'2015	H1'2016	y/y change
Yield from interest-earning assets	11.5%	12.4%	0.9%
Cost of funding	2.6%	3.2%	0.6%
Net Interest Margin	9.3%	9.5%	0.2%
Cost to Income	54.1%	48.4%	(5.7%)
Cost to Assets	2.9%	2.7%	(0.1%)
Net Interest Income as % of operating income	71.8%	68.7%	(3.1%)
Non-Funded Income as a % of operating income	28.2%	31.3%	3.1%

Capital Adequacy Ratios	H1'2015	H1'2016
Core Capital/Total Liabilities	20.0%	18.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**9.5%**	**7.7%**
Core Capital/Total Risk Weighted Assets	17.3%	17.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.8%**	**7.4%**
Total Capital/Total Risk Weighted Assets	21.5%	21.6%
Minimum Statutory ratio	14.5%	14.5%
Excess	**7.0%**	**7.1%**
Liquidity Ratio	48.0%	61.9%
Minimum Statutory ratio	20.0%	20.0%
Excess	**28.0%**	**41.9%**