Barclays Bank Kenya Limited – H1’2018

14th August, 2018

Valuation Summary

- We are of the view that Barclays Bank is a “Buy” with a target price of Kshs 14.0, representing an upside of 25.0%, from the current price of Kshs 12.0 as of 17th August, inclusive of a dividend yield of 8.3%,
- Barclays Bank is currently trading at P/TBV of 1.5x and a P/E of 9.8x vs an industry average of 1.6x and 9.5x, respectively.

Key Highlights H1’2018

- Barclays Bank Kenya PLC rebranded to ABSA Kenya on 31st May 2018, following the acquisition of Barclays Africa Group Limited by South African-based ABSA Group Limited. Barclays Africa Group Limited has provided a two-year allowance for the rebranding exercise, to its subsidiaries, until June 2020. The proposed change of name over the next two years was approved by shareholders of Barclays Bank Kenya in the recent annual general meeting held by the bank,
- Barclays Bank Kenya also launched a new mobile-lending app dubbed Timiza, which offers micro-loans of between Kshs 100 and Kshs 50,000 at a 1.2% monthly rate. The product was introduced to compete with existing offerings such as M-Shwari, M-Co-op Cash, Equitel and KCB M-Pesa. The app will charge a one-off facilitation fee of 5.0% on loans, which are repayable in 30 days.

Income Statement

- Core earnings per share increased by 6.2% to Kshs 0.69 from Kshs 0.65 in H1’2017, which was lower than our expectation of a 12.7% increase to Kshs 0.73. Performance was driven by a 4.8% increase in total operating income, despite a 6.0% increase in the total operating expenses. Variance in core earnings per share growth against our expectation was due to a 26.9% increase y/y in Loan Loss Provisions (LLPs). We had expected a 20.9% decrease in LLPs to Kshs 1.1 bn, but came in at Kshs 1.7 bn,
- Total operating income increased by 4.8% to Kshs 15.7 bn from Kshs 14.9 bn in H1’2017. This was due to a 4.1% increase in Net Interest Income (NII) to Kshs 11.0 bn from Kshs 10.5 bn in H1’2017, and a 6.9% increase in Non-Funded Income (NFI) to Kshs 4.7 bn from Kshs 4.4 bn in H1’2017,
- Interest income increased by 7.6% to Kshs 14.1 bn from Kshs 13.1 bn in H1’2017. The interest income on loans and advances increased marginally by 0.6% to Kshs 10.6 bn from Kshs 10.5 bn in H1’2017. Interest income on government securities increased by 36.1% to Kshs 3.5 bn from Kshs 2.6 bn in H1’2017. The yield on interest earning assets however declined to 11.7% in H1’2018 from 12.7% in H1’2017, due to the relatively faster increase in the interest earning assets by 13.2% to Kshs 256.4 bn from Kshs 226.4 bn in H1’2017, with the increase mainly being government securities that have a lower yield than loans,
- Interest expense increased by 22.4% to Kshs 3.2 bn from Kshs 2.6 bn in H1’2017, as interest expense on customer deposits increased by 19.0% to Kshs 2.8 bn from Kshs 2.3 bn in H1’2017. Interest expense on deposits from other banking institutions rose by 50.6% to Kshs 416.1 mn from Kshs 276.4 mn in H1’2017. Consequently, the cost of funds increased to 2.6% from 2.5% in H1’2017.Thus,the Net Interest Margin declined to 9.0% from 9.8% in H1’2017,
- Non-Funded Income increased by 6.9% to Kshs 4.7 bn from Kshs 4.4 bn in H1’2017. The increase in NFI was driven by a 47.1% increase in fees and commissions income from loans and advances to Kshs 474.3 mn from Kshs 322.5 mn in H1’2017, coupled with a 10.9% increase in forex trading income to Kshs 1.6 bn from Kshs 1.5 bn in H1’2017. Other fees and commissions decreased by 4.2% to Kshs 2.3 bn from Kshs 2.4 bn in H1’2017. The revenue mix shifted to 70:30 funded to non-funded income in H1’2018 from 71:29 in H1’2017, due to the faster growth in NFI

- Total operating expenses increased by 6.0% to Kshs 5.0 bn from Kshs 4.9 bn, largely driven by a 26.9% increase in loan loss provision (LLP) to Kshs 1.7 bn in H1’2018 from Kshs 1.4 bn in H1’2017, coupled with a 7.6% increase in other operating expenses to Kshs 3.6 bn in H1’2018 from Kshs 3.3 bn in H1’2017. Staff costs decreased marginally by 0.4% to Kshs 5.10 bn in H1’2018 from 5.12 bn in H1’2017,
- The cost to income ratio deteriorated to 66.3% from 65.5% in H1’2017. Without LLP, however, the cost to income ratio improved to 55.3% from 56.5% in H1’2017,
- Profit before tax increased by 2.6% to Kshs 5.3 bn, up from Kshs 5.2 bn in H1’2017. Profit after tax increased 6.2% to Kshs 3.8 bn from Kshs 3.5 bn in H1’2017, with the effective tax rate being 33.6%,
- Barclays Bank declared an interim dividend of Kshs 0.2 per share, which is similar to H1’2017 interim dividend payout of Kshs 0.2 per share. We expect a final dividend per share of Kshs 0.8, taking the total dividend for 2018 to Kshs 1.0 per share, translating to a dividend yield of 8.3%.

Balance Sheet

- The balance sheet recorded an expansion with total assets increasing by 18.1% to Kshs 316.6 bn from Kshs 268.2 bn in H1’2017. This growth was largely driven by a 33.6% increase in government securities to Kshs 70.3 bn from Kshs 52.7 bn in H1’2017,
- The loan book increased by 7.5% to Kshs 176.1 bn from Kshs 163.8 bn in H1’2017,
- Total liabilities rose by 21.3% to Kshs 275.8 bn from Kshs 227.4 bn in H1’2017, driven by a 14.9% increase in total deposits to Kshs 216.8 bn from Kshs 188.7 bn in H1’2017. Deposits per branch increased by 14.3% to Kshs 2.4 bn from Kshs 2.1 bn in H1’2017, as the bank closed 2 branches in H2’2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 81.2% from 86.8% in H1’2017,
- Gross non-performing loans increased by 19.7% to Kshs 14.4 bn in H1’2018 from Kshs 12.0 bn in H1’2017. Consequently, the NPL ratio deteriorated to 7.7% in H1’2018 from 7.0% in H1’2017. General Loan loss provisions increased by 27.9% to Kshs 6.4 bn from Kshs 5.0 bn in H1’2017. The NPL coverage increased to 63.0% from 58.0% in H1’2017. The increase in the non-performing loans was attributed to large loan defaults by clients mainly in the retail business segment,
- Shareholders’ funds increased marginally by 0.5% to Kshs 40.81 bn from Kshs 40.79 bn in H1’2017,
- Barclays Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 14.7%, 4.2%above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 16.7%, exceeding the statutory requirement by 2.2%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 15.0%, while total capital to risk weighted assets came in at 16.9%, indicating that the bank’s total capital relative to its risk-weighted assets decreased by 0.2% due to the impact of IFRS 9,
- Barclays Bank currently has a return on average assets of 2.6% and a return on average equity of 17.5%.

Key Take-Outs:

a. Barclays Bank’s NFI currently stands at 30.0%, an improvement from 29.0% in H1’2017. The improvement in NFI contribution to total income is an indication of the bank’s efforts to diversify into alternative sources other than interest income in the wake of its transformation drive to rebrand to Absa. The bank is currently venturing into virtual banking, in addition to investing in alternative channels such as the mobile app dubbed Timiza, to boost revenue lines from alternative channels,
b. The bank experienced a deterioration in asset quality, with gross non-performing loans (NPLs) rising by 19.7%, to Kshs 14.4 bn in H1’2018 from Kshs 12.0 bn in H1’2017. This was largely due to defaults by clients in the retail and select corporate clients. Consequently, the NPL ratio deteriorated to 7.7% in H1’2018 from 7.0% in H1’2017.

Going forward, we expect the bank's growth to be further driven by:

- **a.** Non-Funded Income Growth Initiatives - Barclays' NFI is improving as the bank focuses on digital innovation and alternative banking channels in the wake of the rebranding move. These will go a long way to grow the bank's fee income, and,
- b. Cost Control – Barclays' cost to income ratio currently stands at 66.3%. The bank needs to manage any rising costs, such as those that may arise from poor asset qualities, leading to increasing provisioning, and other operational expenses, which strain its revenue. Emphasis on operational efficiency by, for example, adopting alternative channels will likely boost profitability.

Summary of the Performance

Balance Sheet	H1'2017	H1'2018	y/y change	H1'2018e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	52.6	70.3	33.6%	67.4	27.9%	5.7%
Net Loans and Advances	163.8	176.1	7.5%	165.0	0.7%	6.8%
Total Assets	**268.2**	**316.6**	**18.1%**	**294.4**	**9.8%**	**8.3%**
Customer Deposits	188.7	216.8	14.9%	195.2	3.5%	11.4%
Total Liabilities	216.7	246.4	13.7%	248.1	14.4%	(0.7%)
Shareholders Funds	**40.8**	**40.8**	**0.0%**	**46.4**	**13.7%**	**(13.6%)**

Balance sheet ratios	H1'2017	H1'2018	% y/y change
Loan to Deposit Ratio	86.8%	81.2%	(5.6%)
Return on average equity	17.2%	17.5%	0.4%
Return on average assets	2.8%	2.6%	(0.2%)

	H1'2017	H1'2018	y/y change	H1'2018e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	13.1	14.1	7.6%	14.1	7.3%	0.3%
Net non-Interest Income	4.4	4.7	6.9%	4.5	2.4%	4.5%
Total Operating income	**14.9**	**15.7**	**4.9%**	**15.8**	**5.6%**	**(0.8%)**
Loan Loss provision	(1.4)	(1.7)	26.9%	(1.1)	(20.9%)	47.8%
Total Operating expenses	(9.8)	(10.4)	6.0%	(10.1)	2.9%	3.1%
Profit before tax	**5.2**	**5.3**	2.6%	**5.7**	10.8%	**(8.2%)**
Profit after tax	**3.5**	**3.8**	6.2%	**4.0**	12.6%	**(6.4%)**
Core EPS	**0.7**	**0.7**	**6.2%**	**0.7**	**12.6%**	**(6.4%)**

Income statement ratios	H1'2017	H1'2018	% y/y change
Yield from interest-earning assets	12.7%	11.7%	(1.1%)
Cost of funding	3.0%	2.9%	(0.1%)
Net Interest Margin	4.9%	4.5%	(0.4%)
Cost to Income	65.5%	66.3%	0.7%
Cost to Assets	3.1%	2.7%	(0.4%)
Net Interest Income as % of operating income	87.9%	90.3%	2.3%
Non-Funded Income as a % of operating income	29.4%	30.0%	0.6%

Capital Adequacy Ratios	H1'2017	H1'2018
Core Capital/Total Liabilities	20.3%	17.6%

Minimum Statutory ratio	8.0%	8.0%
Excess	**12.3%**	**9.6%**
Core Capital/Total Risk Weighted Assets	15.7%	14.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.2%**	**4.2%**
Total Capital/Total Risk Weighted Assets	17.8%	16.7%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.3%**	**2.2%**
Liquidity Ratio	36.1%	38.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**16.1%**	**18.3%**
Adjusted Core Capital/Total Liabilities		**17.9%**
Adjusted Core Capital/Total RWA		**15.0%**
Adjusted Total Capital/Total RWA		**16.9%**