Barclays Bank Kenya Limited – Q1'2018

30th May, 2018

Valuation Summary

- We are of the view that Barclays Bank is an "Accumulate" with a target price of Kshs 13.7, representing an upside of 16.6%, from the current price of Kshs 11.8 as of 30th May, inclusive of a dividend yield of 8.5%,
- Barclays Bank is currently trading at P/TBV of 1.7x and a P/E of 9.8x vs an industry average of 1.7x and 10.3x, respectively.

Key Highlights Q1'2018

- Barclays Bank is set to rebrand to ABSA Kenya as from 31st May 2018, following the acquisition of Barclays Africa Group Limited by South African-based ABSA Group Limited. This is in line with a separation agreement between Barclays Plc and Barclays Africa Group Limited, which provides a two-year allowance for the rebranding exercise, until 2020. The proposed change of name over the next two years was approved by shareholders of Barclays 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 1.17% 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 7.7% to Kshs 0.35 from Kshs 0.32 in Q1'2017, in line with our expectation of a 7.1% increase to Kshs 0.34. Performance was driven by a 4.2% increase in total operating income, outpacing a 2.4% increase in the total operating expenses,
- Total operating income increased by 4.2% to Kshs 7.7 bn in Q1'2018 from Kshs 7.4 bn in Q1'2017. This was due to an 8.5% increase in Net Interest Income (NII) to Kshs 5.5 bn from Kshs 5.0 bn in Q1'2017, despite a 5.0% decrease in Non-Funded Income (NFI) to Kshs 2.3 bn from Kshs 2.4 bn in Q1'2017,
- Interest income increased by 8.1% to Kshs 6.9 bn from Kshs 6.4 bn in Q1'2017. The interest income on loans and advances increased by 2.7% to Kshs 5.2 bn from Kshs 5.1 bn in Q1'2017. Interest income on government securities increased by 29.7% to Kshs 1.7 bn in Q1'2018 from Kshs 1.3 bn in Q1'2017. The yield on interest earning assets however declined to 12.1% in Q1'2018 from 12.9% in Q1'2017, due to a 6.0%increase in the interest earning assets to Kshs 228.0 bn from Kshs 215.0 bn in Q1'2017,with the increase mainly being government securities that have a lower yield than loans,
- Interest expense increased by 6.8% to Kshs 1.5 bn from Kshs 1.4 bn in Q1'2017, as interest expense on customer deposits increased 9.6% to Kshs 1.3 bn from Kshs 1.2 bn in Q1'2017. Interest expense on deposits from other banking institutions declined 9.5% to Kshs 186.0 mn from Kshs 205.5 mn in Q1'2017. The cost of funds declined to 2.9% from 3.3%. Consequently, the Net Interest Margin declined to 9.6% from 9.7% in Q1'2017,
- Non-Funded Income decreased by 5.0% to Kshs 2.3 bn from Kshs 2.4 bn in Q1'2017. The decline in NFI was driven by a 6.7% decrease in total fees and commissions to Kshs 1.4 bn from Kshs 1.5 bn in Q1'2017, coupled with a 5.7% decrease in forex trading income to Kshs 759.6 mn from Kshs 805.2 mn in Q1'2017. The revenue mix shifted to 71:29 funded to non-funded income in Q1'2018 from 68:32 in Q1'2017, with the contribution of NFI to total income declining owing to the 5.0% decline in non-funded income coupled with the 8.5% increase in net interest income,
- Total operating expenses increased by 2.4% to Kshs 5.0 bn from Kshs 4.9 bn, largely driven by a 12.0% increase in staff costs to Kshs 2.8 bn in Q1'2018 from Kshs 2.5 bn in Q1'2017. Other operating expenses

also rose by 1.2% to Kshs 1.7 bn in Q1’2018 from Kshs 1.6 bn in Q1’2017. The Loan Loss Provisions (LLP) decreased by 25.7% to Kshs 0.6 bn from Kshs 0.8 bn in Q1’2017,

- The cost to income ratio improved to 64.8% from 66.0% in Q1’2017. Without LLP, however, the cost to income ratio worsened to 57.4% from 55.5% in Q1’2017,
- Profit before tax increased by 7.7% to Kshs 2.7 bn, up from Kshs 2.5 bn in Q1’2017. Profit after tax increased by 7.7% to Kshs 1.9 bn in Q1’2018 from Kshs 1.7 bn in Q1’2017,

Balance Sheet

- The balance sheet recorded an expansion with total assets increasing by 11.5% to Kshs 290.7 bn from Kshs 260.8 bn in Q1’2017. This growth was largely driven by a 35.3% increase in government securities to Kshs 67.0 bn from Kshs 49.5 bn in Q1’2017,
- The loan book declined by 1.9% to Kshs 165.5 bn in Q1’2018 from Kshs 168.7 bn in Q1’2017,
- Total liabilities rose by 13.7% to Kshs 246.4 bn from Kshs 216.7 bn in Q1’2017, driven by an 8.4% increase in total deposits to Kshs 198.7 bn from Kshs 183.2 bn in Q1’2017. Deposits per branch increased by 41.4% to Kshs 2.1 bn from Kshs 1.5 bn in Q1’2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 85.6% from 92.8% in Q1’2017,
- Gross non-performing loans increased by 7.8% to Kshs 12.6 bn in Q1’2018 from Kshs 11.7 bn in Q1’2017. Consequently, the NPL ratio deteriorated to 7.2% in Q1’2018 from 6.6% in Q1’2017. Loan loss provisions increased by 6.3% to Kshs 5.7 bn from Kshs 5.4 bn in Q1’2017.Consequently, the NPL coverage increased to 72.0% in Q1’2018 from 71.0% in Q1’2017. The increase in the non-performing loans could be attributed to loan defaults by private individuals, manufacturing and trading sectors,
- Shareholders’ funds increased marginally by 0.4% to Kshs 44.2 bn in Q1’2018 from Kshs 44.0 bn in Q1’2017,
- Barclays Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.1%, 4.6% above the statutory requirement. In addition, the total capital to risk weighted assets ratio came in at 17.2%, exceeding the statutory requirement by 2.7%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.2%, while total capital to risk weighted assets came in at 18.2%, indicating that the bank’s total capital relative to its risk-weighted assets increased by 1.0% due to implementation of IFRS 9,
- Barclays Bank currently has a return on average assets of 2.6% and a return on average equity of 16.0%.

Key Take-Outs:

a. Barclays Bank’s NFI currently stands at 29.2%, which is way below the industry average of 33.6%. The low NFI contribution to total income is an indication of lack of diversity in generating revenue from alternative sources other than interest income. Barclays should find avenues to increase its NFI so as to compete favorably with its peers in the wake of the rate cap legislation. The bank is currently venturing into virtual banking in addition to growing its bancassurance business to boost revenue lines from alternative channels.

b. The bank saw an improvement in its Cost-to-income ratio to 64.8% from 66.0% in Q1’2017. This is a pointer to the bank’s efforts to improve operational efficiencies in the company’s operations such as automation of processing centers, investment in alternative channels and branch rationalization programs.

c. The bank experienced a deterioration in asset quality, with gross non-performing loans (NPLs) rising by 7.8%, to Kshs 12.6 bn from Kshs 11.7 bn in Q1’2017. This was largely due to defaults by major clients in the private, manufacturing and trade sectors.

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

a. Non-Funded Income Growth Initiatives - Barclays’ NFI is way below with the industry average, coming in at 29.6%, while the industry average is at 33.6%. The bank has a number of initiatives to boost revenue going forward, including growing its bancassurance business and leveraging returns from Barclays Financial Services Ltd (BFSL).

b. The bank needs to put more focus on growing its agency banking network and expansion of its digital channels to improve efficiencies while increasing transactions. The bank is currently venturing into virtual banking to boost revenue lines from alternative channels with an objective of increasing usage of alternative channels from the current 64% to 80%,

Balance Sheet	Q1'2017	Q1'2018	y/y change	Q1'2018e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	49.5	67.0	35.3%	57.9	16.8%	18.5%
Net Loans and Advances	168.7	165.5	(1.9%)	168.8	0.1%	(1.9%
Total Assets	**260.8**	**290.7**	**11.5%**	**276.3**	**5.9%**	**5.5%**
Customer Deposits	181.8	193.3	6.3%	189.7	4.3%	2.0%
Total Liabilities	216.7	246.4	13.7%	230.3	6.3%	7.4%
Shareholders Funds	**44.0**	**44.2**	**0.4%**	**46.0**	**4.4%**	**(3.9%**

Balance sheet ratios	Q1'2017	Q1'2018	% y/y change
Loan to Deposit Ratio	92.8%	85.6%	(7.1%)
Return on average equity	16.1%	16.0%	(0.1%)
Return on average assets	2.8%	2.6%	(0.2%)

Income Statement	Q1'2017	Q1'2018	y/y change	Q1'2018e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	5.0	5.5	8.5%	5.6	11.8%	(3.3%)
Net non-Interest Income	2.4	2.3	(5.0%)	2.5	6.0%	(11.0%)
Total Operating income	**7.4**	**7.7**	**4.2%**	**8.1**	**9.9%**	**(5.8%)**
Loan Loss provision	(0.8)	(0.6)	(25.7%)	(1.0)	30.6%	(56.3%)
Total Operating expenses	(4.9)	(5.0)	2.4%	(5.5)	11.8%	(9.5%)
Profit before tax	**2.5**	**2.7**	7.7%	**2.7**	6.2%	**1.5%**
Profit after tax	**1.7**	**1.9**	7.7%	**1.9**	7.1%	**0.5%**
Core EPS	**0.3**	**0.3**	**7.7%**	**0.3**	**7.1%**	**0.5%**

Income statement ratios	Q1'2017	Q1'2018	% y/y change
Yield from interest-earning assets	12.9%	12.1%	(0.8%)
Cost of funding	3.3%	2.9%	(0.4%)
Net Interest Margin	2.3%	2.4%	0.0%
Cost to Income	66.0%	64.8%	(1.1%)
Cost to Assets	1.6%	1.5%	(0.1%)
Net Interest Income as % of operating income	68.0%	70.8%	2.8%
Non-Funded Income as a % of operating income	32.0%	29.2%	(2.8%)

Capital Adequacy Ratios	**Q1'2017**	**Q1'2018**
Core Capital/Total Liabilities	21.4%	19.6%
Minimum Statutory ratio	8.0%	8.0%
Excess	**13.4%**	**11.6%**
Core Capital/Total Risk Weighted Assets	15.7%	15.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.2%**	**4.6%**
Total Capital/Total Risk Weighted Assets	17.8%	17.2%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.3%**	**2.7%**
Liquidity Ratio	29.6%	36.2%
Minimum Statutory ratio	20.0%	20.0%
Excess	**9.6%**	**16.2%**
Adjusted Core Capital/Total Liabilities		**21.0%**
Adjusted Core Capital/Total RWA		**16.2%**
Adjusted Total Capital/Total RWA		**18.2%**