Barclays Bank Kenya – FY'2017

1st March, 2018

Valuation Summary

- We are of the view that BBK stock is a "Buy", with a target price of Kshs 12.8 representing an upside of 22.7%, from the current price of Kshs 11.3, as at 1st March, inclusive of a dividend yield of 8.9%,
- BBK is currently trading at a P/TBV of 1.4x and a P/E of 8.8x, vs an industry average of 1.5x and 8.6x, respectively.

Key highlights during 2017

- As part of the Bank's optimization strategy to enhance efficiency in a challenging operating environment, the bank introduced a voluntary employee exit program, which saw 145 of its employees leave the bank by October this year. Also, the bank has merged seven of its branches in the Nairobi Central Business District (CBD), to cut on expenses and enhance customer experience.
- The Bank is changing its Brand and corporate name to Absa Group (Barclays Africa Group), following Barlcays Plc selling down its stake in Absa Group Limited.

Income Statement

- Core earnings per share declined by 6.4%, better than our projections of an 11.0% decline, to Kshs 1.3 from Kshs 1.4 in FY'2016, attributable to a 4.5% drop in operating revenue, despite a similar 4.5% decline in operating expenses,
- Total operating revenue declined by 4.5% y/y to Kshs 30.3 bn from Kshs 31.7 bn, driven by a 9.5% decline in Non-Funded Income (NFI) to Kshs 8.5 bn from Kshs 9.4 bn in FY'2016, and a 2.4% decline in Net Interest Income (NII) to Kshs 21.8 bn from Kshs 22.3 bn,
- Interest Income declined by 3.4% to Kshs 27.2 bn from Kshs 28.1 bn in FY'2016, attributable to 98.9% y/y decline in other interest income to Kshs 0.02 bn from Kshs 1.8 bn, despite a growth in interest income from government securities rising by 3.4% y/y to Kshs 5.8 bn from Kshs 5.6 bn. As a result, the yield on interest-earning assets declined to 12.1% from 13.2% in FY'2016,
- Interest expense decreased by 7.2% to Kshs 5.4 bn from Kshs 5.8 bn in FY'2016. The Net Interest Income declined by 2.4% to Kshs 21.8 bn from Kshs 22.3 bn in FY'2016. The Net Interest Margin thus declined to 9.7% from 10.5% in FY'2016,
- Non-Funded Income (NFI) recorded a drop of 9.5% to Kshs 8.5 bn from Kshs 9.4 bn in FY'2016. The decline in NFI was driven by a 33.7% drop in fees and commissions on loans to Kshs 0.6 bn from Kshs 0.96 bn in FY'2016, and a 3.6% decline in other fees and commissions to Kshs 4.6 bn from Kshs 4.8 bn. With the decline in NFI faster than the decline in NII, the proportion of NFI to total revenue also declined, with the current revenue mix at 72:28 funded to non-funded income from 70:30 in FY'2016,
- Total operating expenses declined by 4.5% to Kshs 19.9 bn from Kshs 15.7 bn, attributable to a 20.7% drop in loan loss provisions (LLP) to Kshs 3.1 bn from Kshs 3.9 bn in FY'2016. Staff costs rose 3.9% to Kshs 10.1 bn from Kshs 9.7 bn in FY'2016. The growth in staff costs is attributed to the voluntary employee buyout programme that the bank rolled out and saw 145 employees leave the firm as at October this year,
- Following the decline in operating revenue matched by a similar decline in operating costs, the Cost to Income ratio remained stable at 65.8%, compared to 65.7% in FY'2016. Without LLP, the Cost to Income ratio worsened to 55.5% from 53.4% in FY'2016,
- Profit before tax declined by 4.5% to Kshs 10.4 bn from Kshs 10.9 bn. Profit after tax declined by 6.4% to Kshs 6.9 bn from Kshs 7.4 bn in FY'2016.

Balance Sheet

- Total assets increased by 4.4% to Kshs 271.2 bn from Kshs 259.7 bn in FY'2016. This growth was driven by a 20.1% growth in government securities to Kshs 58.5 bn from Kshs 48.7 bn in FY'2016. The loan book remained relatively flat at Kshs 168.4 bn compared to Kshs 168.5 bn in FY'2016,
- Total liabilities rose by 4.5% to Kshs 227.1 bn from Kshs 217.3 bn in FY'2016, driven by a 4.4% increase in deposits to Kshs 186.0 bn from Kshs 178.2 bn in FY'2016. The increase in deposits was driven by the retail and business banking segments that benefitted from an increase in transactional accounts following the launch of new products such as the Twin Account and the award winning Zidisha account. Deposits per branch grew by 18.7% to Kshs 2.1 bn from Kshs 1.8 bn in FY'2016,

- Shareholders' funds increased by 4.0% to Kshs 44.1 bn from Kshs 42.4 bn in FY'2016, due to a 4.0% y/y increase in retained earnings to Kshs 36.6 bn from Kshs 35.2 bn in FY'2016,
- The faster growth in deposits compared to the loan book led to a drop in the loan to deposit ratio to 90.5% from 94.6% in FY'2016,
- Gross non-performing loans increased by 10.0% to Kshs 12.6 bn from Kshs 11.5 bn. The NPL ratio thus rose to 7.1% from 6.5% in FY'2016, due to the slower growth of the loan book,
- The yield on interest earning assets declined to 12.1% from 13.2% in FY'2016, while the cost of funds declined to 2.7% from 3.3% in FY'2016,
- Barclays Bank Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.9%, 5.4% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 3.5%,
- Barclays Bank Kenya currently has a return on average assets of 2.7% and a return on average equity of 16.0%, compared to 3.0% and 18.0%, respectively, in FY'2016.
- The bank maintained its dividend payout of Kshs 1 per share, same as in FY'2016.

Key Take Out:

- Non Funded Income registered a bigger decline than the decline in Interest Income, attributed to an 8.6% drop in fees and commissions on loans during the year. Barclays Bank Kenya has taken initiatives to diversify its revenue streams to tap into non-funded income and we expect NFI to be the key revenue driver for the bank as its interest margins have been impacted negatively, mainly from the retail business segment. However, the non-funded segment has yet to pick up, with the current revenue mix at 72:28 funded to non-funded income from 70:30 in FY'2016,
- Loan Loss Provision (LLP) charge declined despite an increase in gross non-performing loans as the bank continues to undertake the adoption of IFRS 9. The decrease in provisions highlights a perceived increase in risk levels as Barclays Bank Kenya strives to grow its loan book,

Despite the decreased profitability, going forward, we expect BBK's growth to be propelled by;

(i) Product diversification to more fee income businesses such as bank assurance, brokerage and fixed income trading to increase its Non Funded Income. The Funded to Non Funded Income ratio of 72:28 is way below peer average of 66:34 in terms of NFI contribution to total revenue,

(ii) Cost efficiency, the cost to income ratio of 65.8% is worse than peer average of 60.8%,

(iii) Improve deposit mobilization, with the LDR ratio of 95%, which is above peer average of 74.8%.

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	FY'2016	FY'2017	y/y change	FY'2017e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	48.7	58.5	18.3%	57.1	17.3%	1.0%
Net Loans and Advances	168.5	168.4	(0.7%)	173.4	2.9%	(3.6%)
Total Assets	**259.7**	**271.2**	**7.0%**	**283.7**	**9.3%**	**(2.2%)**
Customer Deposits	178.2	186.0	12.5%	204.0	14.5%	(2.0%)
Total Liabilities	217.3	227.1	8.3%	245.2	12.8%	(4.5%)
Shareholders' Funds	**42.4**	**44.1**	**0.4%**	**38.5**	**(9.1%)**	**9.5%**

Balance sheet ratios	FY'2016	FY'2017	% y/y change
Loan to Deposit Ratio	94.6%	90.5%	(4.0%)
Return on average equity	18.0%	16.0%	(2.0%)
Return on average assets	3.0%	2.7%	(0.3%)

Income Statement	FY'2016	FY'2017	y/y change	FY'2017e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	22.3	21.8	(2.4%)	21.7	(2.7%)	0.3%

Net non-Interest Income	9.3	8.5	(9.5%)	8.5	(8.7%)	(0.9%)
Total Operating income	**31.7**	**30.3**	(4.5%)	**30.3**	(4.4%)	**(0.1%)**
Loan Loss provision	(3.9)	(3.1)	(20.7%)	(3.4)	(12.9%)	(7.7%)
Total Operating expenses	(20.8)	(19.9)	(4.5%)	(20.9)	0.2%	(4.7%)
Profit before tax	**10.9**	**10.4**	(4.5%)	**9.4**	(13.3%)	**8.8%**
Profit after tax	**7.4**	**6.9**	(6.4%)	**6.6**	(11.0%)	**4.6%**
Core EPS	**1.4**	**1.3**	**(6.4%)**	**1.2**	**(11.0%)**	**4.6%**

Income statement ratios	**FY'2016**	**FY'2017**	**% y/y change**
Yield from interest-earning assets	13.2%	12.1%	(1.1%)
Cost of funding	3.3%	2.7%	(0.6%)
Net Interest Margin	10.5%	9.7%	(0.8%)
Cost to Income	65.7%	65.8%	0.0%
Cost to Assets	6.5%	6.2%	(0.3%)
Net Interest Income as % of operating income	70.5%	72.1%	1.6%
Non-Funded Income as a % of operating income	29.5%	27.9%	(1.6%)

Capital Adequacy Ratios	**FY'2016**	**FY'2017**
Core Capital/Total Liabilities	21.1%	20.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	**13.1%**	**12.8%**
Core Capital/Total Risk Weighted Assets	15.7%	15.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.2%**	**5.4%**
Total Capital/Total Risk Weighted Assets	17.9%	18.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.4%**	**3.5%**
Liquidity Ratio	28.3%	33.4%
Minimum Statutory ratio	20.0%	20.0%
Excess	**8.3%**	**13.4%**