Barclays Bank Kenya Earnings Update – H1’2017
15th August, 2017

Valuation Summary

- We are of the view that Barclays Bank Kenya stock is an “Accumulate” with a target price of Kshs 12.3, representing an upside of 25.4%, from the current price of Kshs 10.5, as at 18th August, inclusive of a dividend yield of 9.6%
- Barclays Bank Kenya is currently trading at a P/TBv of 1.4x and a P/E of 8.3x, vs an industry average of 1.6x and 7.7x, respectively

Key highlights during H1’2017

- Barclays Bank of Kenya launched a financing model dubbed Enterprise and supply Chain Development (ESD) program that will see small businesses that supply goods and services to large corporates take loans without collateral
- 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 is set to see 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

Income Statement

- Core earnings per share (EPS) registered a 13.3% decline, coming in at Kshs 0.7 from Kshs 0.8 in H1’2016, driven by an 8.0% decline in operating income, that outpaced a decline of 6.0% in operating expenses in H1’2016,
- Total operating income declined by 8.0% to Kshs 14.9 bn from Kshs 16.2 bn in H1’2016, attributed to a 5.0% and a 14.4% decline in Net Interest Income (NII) and Non-Funded Income (NFI) growth, respectively,
- NII dropped by 5.0% to Kshs 10.5 bn from Kshs 11.1 bn in H1’2016, following a 5.5% decline in interest income to Kshs 13.1 bn from Kshs 13.9 bn, despite a 7.6% decline in interest expense to Kshs 2.6 bn from Kshs 2.8 bn in H1’2016. This resulted in the Net Interest Margin (NIM) declining to 10.1% from 10.7% in H1’2016,
- NFI declined by 14.4% to Kshs 4.4 bn from Kshs 5.1 bn in H1’2016, attributed to a 61.1% drop in fees and commissions on loans and advances to Kshs 0.3 bn from Kshs 0.8 bn in H1’2016. The current revenue mix shifted to 71:29 from 68:32 funded to non-funded income,
- Total operating expenses declined by 6.0% to Kshs 9.8 bn, from Kshs 10.4 bn in H1’2016, which was driven by a 32.6% drop in loan loss provision (LLP) to Kshs 1.4 bn from Kshs 2.0 bn in H1’2016, despite a 5.1% increase in staff costs to Kshs 5.1 bn from Kshs 4.9 bn in H1’2016,
- Cost to income ratio worsened to 65.5% from 64.1% in H1’2016. Without LLP, cost to income ratio stood at 56.5% from 51.8% in H1’2016,
- Profit before tax declined by 11.5% to Kshs 5.2 bn from Kshs 5.8 bn, while profit after tax declined by 13.3% to Kshs 3.5 bn from Kshs 4.1 bn in H1’2016.

Balance Sheet

- The balance sheet recorded an expansion in H1’2017, with total assets increasing by 4.7% to Kshs 268.2 bn, from Kshs 256.1 bn in H1’2016, driven by a rise of 6.8% in the loan book,
- The Loan book grew by 6.8% to Kshs 163.8 bn from Kshs 153.3 bn in H1'2016, underpinned by strong performance in the retail and SME segments of the business,
- Total liabilities increased by 4.8% to Kshs 227.4 bn from Kshs 217.0 bn in H1’2016, while shareholders’ funds increased by 4.3% to Kshs 40.8 bn, from Kshs 39.1 bn in H1’2016,
- Customer deposits grew by 3.2% to Kshs 188.7 bn from Kshs 182.9 bn in H1’2016. Consequently, the faster growth in loans compared to deposits resulted in the loan to deposit ratio increasing to 86.8% from 83.8% in H1’2016,
- Gross non-performing loans grew by 36.9% to Kshs 12.0 bn from Kshs 8.8 bn in H1’2016, leading to a rise in the Gross NPL ratio to 7.0%, from 5.6% in H1’2016,
- The yield on interest earning assets decreased to 12.7% from 13.5% in H1’2016, while the cost of funds came in at 3.0%, from 3.2% in H1’2016,
- Barclays Bank Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.7%, 5.2% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 3.3% to close the period at 17.8%,

- The bank currently has a return on assets of 2.8%, while return on equity stands at 17.2%, a decline from 3.2% and 21.1% in H1'2016, respectively.

Key Take outs:

a) The Board of Directors approved the payment of an interim dividend of Kshs 0.2 per share, with book closure on 13th September 2017 and payment to be made on 13th October 2017. The payment will translate into an interim dividend yield of 9.6%, at the current price of Kshs 12.3, as at 18th August 2017. This dividend payout translated into an interim dividend payout ratio of 30.7%,
b) Loan Loss Provision 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 percieved increase in risk levels as Barclays aggressively strives to grow their loan book,
c) Barclays Bank Ltd 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 as at half year, with NFI contribution to total revenue declining to 29.4% from 31.6% in H1'2016.

Going forward, we expect Barclays Bank Kenya growth to be propelled by;

i) Continued investment in the automation and digitization of systems, processes and solutions in a bid to enhance efficiency as well as to provide their customers with convenient access to products and solutions,
ii) Revenue diversification with new business lines such as Barclays Financial Services Limited (BFSL), Bancassurance and agency banking will see the bank leverage highly on this to spur growth.

Below is a summary of the key line items in the balance sheet and income statement;

Figures in Kshs bn unless otherwise stated

Balance Sheet	H1'2016	H1'2017	y/y change	H1'2017e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	47.6	52.6	10.7%	51.9	9.1%	1.6%
Net Loans and Advances	153.3	163.8	6.8%	170.5	11.2%	(4.4%)
Total Assets	**256.1**	**268.2**	**4.7%**	**267.3**	**4.4%**	**0.3%**
Customer Deposits	182.9	188.7	3.2%	185.3	1.4%	1.8%
Total Liabilities	217.0	227.4	4.8%	221.9	2.2%	2.5%
Shareholders Funds	**39.1**	**40.8**	**4.3%**	**45.4**	**16.1%**	**(11.8%)**

Balance sheet ratios	H1'2016	H1'2017	% y/y change
Loan to Deposit Ratio	83.8%	86.8%	3.0%
Return on average equity	21.1%	17.2%	(3.9%)
Return on average assets	3.2%	2.8%	(0.5%)

Income Statement	H1'2016	H1'2017	y/y change	H1'2017e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	11.1	10.5	(5.0%)	10.5	(5.5%)	0.5%
Net non-Interest Income	5.1	4.4	(14.5%)	5.0	(3.2%)	(11.3%)
Total Operating income	**16.2**	**14.9**	(8.0%)	**15.5**	(4.8%)	**(3.2%)**
Loan Loss provision	(2.0)	(1.4)	(32.6%)	(2.4)	20.9%	(53.5%)
Total Operating expenses	(10.4)	(9.8)	(6.0%)	(11.0)	5.9%	(11.9%)
Profit before tax	**5.8**	**5.2**	(11.5%)	**4.4**	(23.8%)	**12.2%**
Profit after tax	**4.1**	**3.5**	(13.3%)	**3.1**	(24.0%)	**10.7%**
Core EPS	**0.8**	**0.7**	(13.3%)	**0.6**	(24.0%)	**10.7%**

Income statement ratios	H1'2016	H1'2017	% y/y change
Yield from interest-earning assets	13.5%	12.7%	(0.7%)
Cost of funding	3.2%	3.0%	(0.2%)
Net Interest Margin	10.7%	10.1%	(0.5%)

Cost to Income	64.1%	65.5%	1.4%
Cost to Assets	3.3%	3.1%	(0.1%)
Net Interest Income as % of operating income	69.5%	71.7%	2.1%
Non-Funded Income as a % of operating income	31.6%	29.4%	(2.2%)

Capital Adequacy Ratios	H1'2016	H1'2017
Core Capital/Total Liabilities	20.3%	20.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.3%**	**12.3%**
Core Capital/Total Risk Weighted Assets	15.8%	15.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.3%**	**5.2%**
Total Capital/Total Risk Weighted Assets	18.0%	17.8%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.5%**	**3.3%**
Liquidity Ratio	36.6%	36.1%
Minimum Statutory ratio	20.0%	20.0%
Excess	**16.6%**	**16.1%**