Barclays Bank Kenya – Q3’2017
25th November, 2017

Valuation Summary

- We are of the view that BBK stock is a “buy”, with a target price of Kshs 12.5 representing an upside of 36.2%, from the current price of Kshs 9.9, as at 24th November, inclusive of a dividend yield of 10.0%,
- BBK is currently trading at a P/TBV of 1.3x and a P/E of 8.1x, vs an industry average of 1.5x and 8.5x, respectively.

Key highlights during Q3’2017

- 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.

Income Statement

- Core earnings per share declined by 12.0%, in line with our projections of a 9.4% decline, to Kshs 1.0 from Kshs 1.1 in Q3’2016, attributable to a 7.5% drop in operating revenue, despite a 5.3% decline in operating expenses,
- Total operating revenue declined by 7.5% y/y to Kshs 22.6 bn from Kshs 24.4 bn, driven by a 14.8% decline in Non-Funded Income (NFI) to Kshs 6.5 bn from Kshs 7.6 bn in Q3'2016, and a 4.2% decline in Net Interest Income (NII) to Kshs 16.1 bn from Kshs 16.9 bn,
- Interest Income declined by 4.6% to Kshs 20.1 bn from Kshs 21.1 bn in Q3’2016, despite the loan book recording a 5.3% growth, implying that the decline was an effect of the interest rate cap. The decline in interest income is attributable to 97.9% y/y decline in other interest income to Kshs 0.03 bn from Kshs 1.31 bn, and a 2.2% y/y decline on loans and advances to Kshs 15.9 bn from Kshs 15.6 bn, while interest income on government securities grew by a marginal 0.5% y/y to Kshs 4.1 bn from Kshs 4.0 bn. As a result, the yield on interest-earning assets declined to 12.1% from 13.8% in Q3’2016,
- Interest expense decreased by 6.3% to Kshs 4.0 bn from Kshs 4.2 bn in Q3’2016, following a 100.0% decline in other interest expenses. The Net Interest Income declined by 4.2% to Kshs 16.1 bn from Kshs 16.9 bn in Q3’2016. The Net Interest Margin thus declined to 9.7% from 10.9% in Q3'2016,
- Non-Funded Income (NFI) recorded a drop of 14.8% to Kshs 6.5 bn from Kshs 7.6 bn in Q3'2016. The decline in NFI was driven by a 54.5% drop in fees and commissions on loans to Kshs 0.5 bn from Kshs 1.1 bn in Q3’2016, and an 8.7% decline in other fees and commissions to Kshs 3.5 bn from Kshs 3.8 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 71:29 funded to non-funded income from 69:31 in Q3’2016,
- Total operating expenses declined by 5.3% to Kshs 14.8 bn from Kshs 15.7 bn, attributable to a 25.6% drop in loan loss provisions (LLP) to Kshs 2.3 bn from Kshs 3.1 bn in Q3’2016 despite a 9.8% growth in staff costs to Kshs 8.1 bn from Kshs 7.4 bn in Q3’2016. 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 a faster decline in operating revenue than in operating expenses, the Cost to Income ratio worsened to 65.9% from 64.3% in Q3'2016. Without LLP, the Cost to Income ratio worsened to 55.6% from 51.5% in Q3'2016,
- Profit before tax declined by 11.5% to Kshs 7.7 bn from Kshs 8.7 bn. Profit after tax declined by 12.0% to Kshs 5.3 bn from Kshs 6.1 bn in Q3’2016.

Balance Sheet

- Total assets increased by 5.3% to Kshs 278.0 bn from Kshs 264.0 bn in Q3'2016. This growth was driven by a 5.3% growth in the loan book to Kshs 167.2 bn from Kshs 158.8 bn in Q3’2016. Investment in government increased marginally by 1.6% to Kshs 57.6 bn from Kshs 56.7 bn in Q3'2016,
- The 5.3% loan book growth was supported by strong performance in lending to the consumer and SME segments of the business,
- Total liabilities rose by 5.8% to Kshs 235.4 bn from Kshs 222.5 bn in Q3'2016, driven by a 10.8% increase in deposits to Kshs 200.4 bn from Kshs 180.9 bn in Q3'2016. The increase in deposits was driven by an increase in transactional accounts following the launch of new products such as the Twin Account
- Shareholders’ funds increased by 2.6% to Kshs 42.5 bn from Kshs 41.5 bn in Q3’2016, due to a 2.8% y/y increase in retained earnings to Kshs 39.4 bn from Kshs 38.3 bn in Q3’2016,

- The faster growth in deposits compared to the loan book led to a drop in the loan to deposit ratio to 83.5% from 87.8% in Q3'2016,
- Gross non-performing loans increased by 14.6% to Kshs 11.9 bn from Kshs 10.4 bn. The NPL ratio thus rose to 6.8% from 6.3% in Q3'2016, due to the slower growth of the loan book,
- The yield on interest earning assets declined to 13.8% from 12.1% in Q3'2016, while the cost of funds declined to 2.8% from 3.3% in Q3'2016,
- 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 2.6% and a return on average equity of 15.9%, compared to 3.3% and 20.6%, respectively, in Q3'2016.

Key Take Out:

- Non Funded Income registered a significant decline than that of Interest Income, attributed to a 54.5% drop in fees and commissions on loans during the quarter. 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 as at half year, with NFI contribution to total revenue declining to 28.6% from 31.0% in H1'2016.
- 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 their investments in innovation, technology, introduction of new products, review of their existing products, their Customer Life-cycle Management (CLM) analysis and diversification of their revenue streams to increase their non-funded income contribution to total operating income, which currently standing at 28.6%.

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	Q3'2016	Q3'2017	y/y change	Q3'2017e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	56.7	57.6	1.6%	53.8	(5.2%)	6.8%
Net Loans and Advances	158.8	167.2	5.3%	167.1	5.2%	0.1%
Total Assets	**264.0**	**278.0**	**5.3%**	**273.6**	**3.6%**	**1.7%**
Customer Deposits	180.9	200.4	10.8%	192.0	6.2%	4.6%
Total Liabilities	222.5	235.4	5.8%	231.0	3.8%	2.0%
Shareholders' Funds	**41.5**	**42.5**	**2.6%**	**42.7**	**3.0%**	**(0.4%)**

Balance sheet ratios	Q3'2016	Q3'2017	% y/y change
Loan to Deposit Ratio	87.8%	83.5%	(4.4%)
Return on average equity	20.6%	15.9%	(4.7%)
Return on average assets	3.3%	2.6%	(0.7%)

Income Statement	Q3'2016	Q3'2017	y/y change	Q3'2017e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	16.9	16.1	(4.2%)	16.7	(1.1%)	(3.1%)
Net non-Interest Income	7.6	6.5	(14.8%)	7.0	(7.1%)	(7.7%)
Total Operating income	**24.4**	**22.6**	**(7.5%)**	**23.7**	**(3.0%)**	**(4.5%)**
Loan Loss provision	(3.1)	(2.3)	(25.6%)	(2.4)	(22.1%)	(3.6%)
Total Operating expenses	(15.7)	(14.9)	(5.3%)	(15.9)	0.9%	(6.2%)
Profit before tax	**8.7**	**7.7**	**(11.5%)**	**7.8**	**(10.0%)**	**(1.5%)**
Profit after tax	**6.1**	**5.3**	**(12.0%)**	**5.5**	**(9.4%)**	**(2.6%)**
Core EPS	**1.1**	**1.0**	**(12.0%)**	**1.0**	**(9.4%)**	**(2.6%)**

Income statement ratios	Q3'2016	Q3'2017	% y/y change
Yield from interest-earning assets	13.8%	12.1%	(1.6%)
Cost of funding	3.3%	2.8%	(0.5%)
Net Interest Margin	10.9%	9.7%	(1.2%)
Cost to Income	64.3%	65.9%	1.6%
Cost to Assets	4.8%	4.5%	(0.2%)
Net Interest Income as % of operating income	68.6%	72.4%	3.9%
Non-Funded Income as a % of operating income	31.0%	28.6%	(2.5%)

Capital Adequacy Ratios	Q3'2016	Q3'2017
Core Capital/Total Liabilities	21.3%	19.4%
Minimum Statutory ratio	8.0%	8.0%
Excess	**13.3%**	**11.4%**
Core Capital/Total Risk Weighted Assets	16.5%	15.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.0%**	**5.4%**
Total Capital/Total Risk Weighted Assets	18.7%	18.0%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.2%**	**3.5%**
Liquidity Ratio	34.5%	38.0%
Minimum Statutory ratio	20.0%	20.0%
Excess	**14.5%**	**18.0%**