Standard Chartered Bank Kenya Earnings Update – H1'2017

3rd September, 2017

Valuation Summary

- We are of the view that Standard Chartered Bank Kenya stock is a "**Sell**" with a target price of Kshs 209.3, representing a downside of 5.0%, from the current price of Kshs 231.0, as at 1st September, inclusive of a dividend yield of 4.4%
- Standard Chartered Bank Kenya is currently trading at a P/TBV of 1.6x and a P/E of 11.2x, vs an industry average of 1.6x and 8.7x, respectively

Key highlights during H1'2017

- Standard Chartered Bank launched a Business Banking customer campaign targeting to loan more than Kshs 12.0 bn to small businesses operating in the key trading sectors. The bank recently announced it has set aside Kshs 10.0 bn to loan to its retail customers through unsecured loans in 45 days

Income Statement

- Core earnings per share (EPS) registered a 34.4% decline, coming in at Kshs 10.0 from Kshs 15.2 in H1'2016, driven by a 7.2% decline in operating income and a 20.7% increase in operating expenses,
- Total operating income declined by 7.2% to Kshs 13.5 bn from Kshs 14.5 bn in H1'2016, attributed to an 8.1% and a 5.3% decline in Net Interest Income (NII) and Non-Funded Income (NFI) growth, respectively,
- NII dropped by 8.1% to Kshs 9.2 bn from Kshs 10.0 bn in H1'2016, following a 2.3% decline in interest income to Kshs 12.7 bn from Kshs 13.0 bn, coupled with a 16.1% increase in interest expense to Kshs 3.6 bn from Kshs 3.1 bn in H1'2016 as a result of increased interest expense in deposits and placements from banking institutions by 26.3% to Kshs 0.99 bn from Kshs 0.78 bn in H1''2016. This resulted in the Net Interest Margin (NIM) declining to 8.4% from 9.5% in H1'2016,
- NFI declined by 5.3% to Kshs 4.3 bn from Kshs 4.5 bn in H1'2016, attributed to a 29.8% drop in fees and commissions on loans and advances to Kshs 0.08 bn from Kshs 0.12 bn in H1'2016. The current revenue mix shifted marginally to 68:32 from 69:31 funded to non-funded income,
- Total operating expenses increased by 20.7% to Kshs 8.5 bn from Kshs 7.0 bn in H1'2016, which was driven by a 68.5% increase in Loan Loss Provision (LLP) to Kshs 2.3 bn from Kshs 1.4 bn in H1'2016. Staff costs grew by 8.2% to Kshs 3.3 bn from Kshs 3.1 bn in H1'2016,
- Cost to income ratio worsened to 63.0% from 48.4% in H1'2016. Without LLP, cost to income ratio stood at 45.8% from 39.0% in H1'2016,
- Profit before tax declined by 33.4% to Kshs 5.0 bn from Kshs 7.5 bn, while profit after tax declined by 34.4% to Kshs 3.4 bn from Kshs 5.2 bn in H1'2016
- The Board of Directors approved the payment of an interim dividend of Kshs 4.5 per share, compared to Kshs 6.0 per share approved over the same period last year, with book closure on 21st September 2017 and payment to be made on or after 19th October 2017. The payment translates into a projected full year dividend of Kshs 15.0 and dividend yield of 6.5%, at the current price of Kshs 231.0, as at 1st September 2017. The dividend payment represents an expected full year dividend pay-out of 72.9% in 2017, compared to 75.9% recorded in 2016.

Balance Sheet

- The balance sheet recorded an expansion in H1'2017, with total assets increasing by 12.9% to Kshs 289.1 bn from Kshs 255.9 bn in H1'2016, driven by a rise of 23.6% in government securities despite a 1.1% decline in the loan book to Kshs 113.0 bn from Kshs 114.2 bn in H1'2016,
- Total liabilities increased by 15.6% to Kshs 245.5 bn from Kshs 212.4 bn in H1'2016, while shareholders' funds maintained at Kshs 43.6 bn, the same as in H1'2016,
- Customer deposits grew by 17.6% to Kshs 224.5 bn from Kshs 190.9 bn in H1'2016. Consequently, the faster growth in deposits compared to loans resulted in the loan to deposit ratio declining to 50.4% from 59.9% in H1'2016,
- Gross non-performing loans grew by 10.1% to Kshs 16.9 bn from Kshs 15.4 bn in H1'2016, leading to a marginal rise in the Gross NPL ratio to 13.1%, from 12.8% in H1'2016,

- The yield on interest earning assets decreased to 11.5% from 12.4% in H1'2016, while the cost of funds came in at 3.2%, same as in H1'2016,
- Standard Chartered Bank Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 16.7%, 6.2% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 5.6% to close the period at 20.1%,
- The bank currently has a return on assets of 2.7%, while return on equity stands at 16.6%, a decline from 3.2% and 18.4% in H1'2016, respectively.

Key Take outs:

a) Despite the dismal performance, the Board of Directors approved the payment of an interim dividend of Kshs 4.5 per share, with book closure on 21st September 2017 and payment to be made on or after 19th October 2017. The payment will translate into an interim dividend yield of 1.9%, at the current price of Kshs 231.0, as at 1st September 2017. This dividend payout translates into an interim dividend payout ratio of 45.1%,
b) Standard Chartered has performed worse than our expectations of a 15.0% decline in core EPS, mainly attributed to the 7.2% decline in operating income compared to our projection of a 0.8% increase coupled with a faster growth in operating expenses of 20.7% compared to our projection of a 15.0% increase,

Going forward, we expect Standard Chartered Bank Kenya will thrive on;

a) Continued investment in digital infrastructure through its Digital by Design strategy that aims to migrate over 80% of transactions to non-branch channels by 2020. This is expected to promote efficiency and enhance risk management. In 2016 the bank introduced a mobile app, a revamped online platform, fingerprint log-in technology, video banking and cash deposit machines all aimed at achieving its Digital by Design strategy target,

b) Growth in deposits via revamped mobile and online banking products, particularly targeting SME and retail business.

c) The bank's aggressive lending to the retail customers is likely to drive their interest income if the credit analysis is done in a prudent manner. This however poses a risk of increase in non-performing loans in case customers default in repayment.

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 Items	H1'2016	H1'2017	y/y change	H1'2017e	Projected y/y change	Variance in Growth Actual vs. Expected
Government Securities	85.9	106.1	23.5%	94.2	9.6%	13.9%
Net loans	114.3	113.0	(1.1%)	129.8	13.6%	(14.6%)
Total Assets	**255.9**	**289.1**	**12.9%**	**281.2**	**9.9%**	**3.1%**
Customer Deposits	190.9	224.5	17.6%	209.3	9.7%	7.9%
Total Liabilities	212.4	245.5	15.6%	232.3	9.4%	6.2%
Shareholder's Funds	**43.6**	**43.6**	**0.0%**	**48.8**	**12.1%**	**(12.1%)**

Balance Sheet Ratios	H1'2016	H1'2017	y/y change
Loan to deposit ratio	59.9%	50.4%	(9.5%)
Return on Average Equity	18.4%	16.6%	(1.7%)
Return on Average Assets	3.2%	2.7%	(0.5%)
Yield from interest-earning assets	12.4%	11.5%	(0.9%)
Cost of funding	3.2%	3.2%	0.0%
Net Interest Margin	9.5%	8.4%	(1.1%)
Cost to Income	48.4%	63.0%	14.6%

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Income Statement	H1'2016	H1'2017	y/y change	H1'2017e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	10.0	9.2	(8.1%)	10.0	0.3%	(8.4%)
Net non-Interest Income	4.5	4.3	(5.3%)	4.6	1.7%	(7.0%)
Total Operating income	14.5	13.5	(7.2%)	14.6	0.8%	(8.0%)
Loan Loss provision	(1.4)	(2.3)	68.5%	(1.6)	19.7%	48.9%
Total Operating expenses	(7.0)	(8.5)	20.7%	(8.1)	15.0%	5.7%
Profit before tax	7.5	5.0	(33.4%)	6.5	(12.6%)	(20.8%)
Profit after tax	**5.2**	**3.4**	**(34.4%)**	**4.4**	**(15.0%)**	**(19.4%)**
Core EPS	**15.2**	**10.0**	**(34.4%)**	**12.9**	**(15.0%)**	**(19.4%)**

Income Statement Ratios	H1'2016	H1'2017	y/y change
Yield from interest-earning assets	12.4%	11.5%	(0.9%)
Cost of funding	3.2%	3.2%	0.0%
Net Interest Income as % of operating income	68.7%	68.1%	-0.6%
Non-Funded Income as a % of operating income	31.3%	31.9%	0.6%
Cost to Income Ratio	48.4%	63.0%	14.6%
CIR without provisions	39.0%	45.8%	6.8%
Cost to Assets	2.3%	2.3%	(0.1%)

Capital Adequacy Ratios	H1'2016	H1'2017
Core Capital/Total Liabilities	18.2%	15.7%
Minimum Statutory ratio	8.0%	8.0%
Excess	**10.6%**	**7.7%**
Core Capital/Total Risk Weighted Assets	17.9%	16.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	**7.1%**	**6.2%**
Total Capital/Total Risk Weighted Assets	21.6%	20.1%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.8%**	**5.6%**
Liquidity Ratio	61.9%	69.1%
Minimum Statutory ratio	20.0%	20.0%
Excess	**40.7%**	**49.1%**