Stanbic Holdings Earnings Update – FY’2017

5th March, 2018

Valuation Summary

- We are of the view that Stanbic Holdings stock is a “Lighten” with a target price of Kshs 79.0 representing an upside of 0.9%, from the current price of Kshs 84.0, as at , inclusive of a dividend yield of 5.2%,
- Stanbic Holdings is currently trading at a P/TBv of 1.1x and a P/E of 7.9x, vs an industry average of 1.6x and 9.1x, respectively.

Key highlights during FY’2017

- Stanbic Holdings launched its financial literacy programme for its SME customers, ‘BizConnect’, aimed at providing strategic solutions to SMEs in a bid to enhance operational efficiency,
- Stanbic Holdings launched a new electronic billing system called “e-Biller”, which processes invoices and generates payment instructions, with the platform aimed at streamlining the process of billing, reconciliation and payment, thus easing the deals for companies.

Income Statement

- Core earnings per share declined by 2.5% to Kshs 10.9 from Kshs 11.2 in FY’2016, driven by a 9.6% growth in operating expenses that outpaced a 3.0% rise in operating revenue,
- Total operating revenue rose 3.0% to Kshs 19.1 bn from Kshs 18.5 bn in FY’2016. This was supported by a 10.0% growth in Non-Funded Income, despite a 2.0% decline in Net Interest Income,
- Stanbic Bank’s interest income declined 3.0% to Kshs 16.6 bn from Kshs 17.1 bn in FY’2016, owing to an 8.9% decline in interest income on Government securities to Kshs 4.3 bn from Kshs 4.7 bn in FY’2016. Interest income on loans and advances remained relatively flat at Kshs 12.1 bn. As a result, the yield on interest-earning assets declined to 8.1% from 9.3% in FY’2016,
- Stanbic Bank’s interest expense decreased by 5.3% to Kshs 6.0 bn from Kshs 6.3 bn in FY’2016. The costs of funds also declined to 3.4% from 4.0% in FY’2016. The Group’s Net Interest Income (NII) declined by 2.0% to Kshs 10.6 bn from Kshs 10.9 bn in FY’2016. The Net Interest Margin thus declined to 5.2% from 5.9% in FY'2016,
- Non-funded income (NFI) recorded an increase of 10.0% to Kshs 8.4 bn from Kshs 7.7 bn in FY’2016. The increase in NFI was driven by a 31.5% y/y rise in foreign exchange income to Kshs 4.4 bn from Kshs 3.4 bn and a 43.6% increase in other fees and commissions to Kshs 3.2 bn from Kshs 2.2 bn in FY’2016. With the NFI rising while the NII declined, the proportion of NFI to total revenue increased, with the current revenue mix at 56:44 funded to non-funded income from 59:41 in FY’2016,
- Total operating expenses grew by 9.6% to Kshs 13.7 bn from Kshs 12.5 bn in FY’2016 following a 57.6% y/y growth in Loan loss provision (LLP) to Kshs 2.8 bn from Kshs 1.8 bn. Without LLP, operating expenses increased by 1.7% to Kshs 10.9 bn from Kshs 10.7 bn registered in FY’2016,
- Cost to income ratio worsened to 71.7% from 67.3% in FY’2016. Without LLP, the cost to Income ratio improved slightly to 57.2% from 57.9% in FY’2016,
- Profit before tax declined 10.7% to Kshs 5.4 bn from Kshs 6.1 bn while profit after tax (PAT) declined by 2.5% to Kshs 4.3 bn from Kshs 4.4 bn in FY’2016, owing to a decline in the effective tax yield to 20.2% from 27.0% in FY’2016.

Balance Sheet

- The balance sheet recorded an expansion in FY’2017, with total assets increasing by 15.9% to Kshs 248.7 bn from Kshs 214.7 bn in FY’2016, driven by a 42.6% increase in investment securities and a 8.1% rise in the loan book,
- The Loan book grew by 8.1% to Kshs 143.3 bn from Kshs 132.6 bn in FY'2016, while investment securities rose by 42.6% to Kshs 71.3 bn from Kshs 50.0 bn in FY’2016,
- Total liabilities increased by 17.9% to Kshs 205.8 bn from Kshs 174.5 bn in FY’2016, while shareholders’ funds increased by 7.0% to Kshs 43.0 bn from Kshs 40.1 bn,
- Customer deposits grew by 24.1% to Kshs 193.4 bn from Kshs 155.8 bn in FY’2016. Deposits per branch increased by 28.2% to Kshs 7.4 bn from Kshs 5.8 bn per branch. The faster growth in deposits compared to loans led to a decline in the loan to deposit ratio to 74.1% from 85.1% in FY’2016,
- Gross non-performing loans grew by 47.7% to Kshs 10.4 bn from Kshs 7.0 bn in FY’2016, faster than the growth in loans, which saw the NPL ratio worsen to 7.0% from 5.2% in FY’2016,

- Stanbic Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 15.4%, 4.9% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 2.4% to close the period at 16.9%,
- Stanbic Holdings currently has a return on average assets of 1.9% and a return on average equity of 10.4%.
- The bank recommends a final dividend of Kshs 4.0 per share, having already paid an interim dividend of Kshs 1.25 per share, translating to a total dividend payout of Kshs 5.25 per share, unchanged from 2016.

Key Take outs:

a) Costs increased significantly, owing mainly to credit impairment charges that grew by 57.6% y/y. The bank announced during the year that it will not resort to laying off staff in a bid to adjust to the recent developments, instead signalling that it will seek to redeploy and train staff,
b) Stanbic Holdings registered strong performance on NFI, which grew by 10.0%, underpinning the importance of revenue diversification, following the capping of interest rates. The bank will need to be aggressive in generating non-funded income, which now accounts for 44.2% of its operating income, given earning from interest income is expected to remain depressed due to the interest rate can.

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

(i) Cost efficiency, the cost to income ratio of 71.7% is worse than peer average of 60.3%,
(ii) Improvements in asset quality, with the increase in NPLs causing Stanbic's Gross Non-Performing Loans ratio to deteriorate to 7.0%, which is however still below peer average of 8.4%.

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	Projected y/y change	Variance in growth vs projection
Net Loans	132.6	143.3	8.1%	126.9	(4.3%)	12.4%
Total Assets	214.7	248.7	15.9%	223.7	4.2%	11.7%
Deposits	**155.8**	**193.4**	**24.1%**	**165.2**	**6.0%**	**18.1%**
Total liabilities	174.5	205.8	17.9%	180.9	3.7%	14.2%
Shareholders' Funds	**40.1**	**43.0**	**7.0%**	**42.8**	**6.6%**	**0.4%**

Income Statement	FY'2016	FY'2017	y/y change	FY'2017e	Projected y/y change	Variance in growth vs projection
Net interest Income	10.9	10.6	(2.0%)	9.9	(9.0%)	7.0%
Net non-interest income	7.7	8.4	10.0%	8.5	11.2%	(1.2%)
Total Operating income	**18.5**	**19.1**	**3.0%**	**18.4**	**(0.6%)**	**3.6%**
Loan loss provision	1.8	2.8	57.6%	3.0	74.0%	(16.4%)
Total Operating expenses	**12.5**	**13.7**	**9.6%**	**13.2**	**5.6%**	**4.0%**
Profit before tax	6.0	5.4	(10.7%)	5.2	(13.5%)	2.8%
Profit after tax	**4.4**	**4.3**	**(2.5%)**	**3.7**	**(17.1%)**	**14.6%**

Key Ratios	FY'2016	FY'2017

Loan to Deposit ratio	85.1%	74.1%
Return on average equity	11.3%	10.4%
Return on average assets	2.1%	1.9%
Net Interest Margin	5.9%	5.2%
Cost to Income (without LLP)	57.9%	57.2%
Cost to Assets	5.0%	4.4%
NII as a % of Operating Income	58.6%	55.8%
NFI as a % of Operating Income	41.4%	44.2%

Capital Adequacy Ratios	FY'2016	FY'2017
Core Capital/Total Liabilities	23.1%	20.2%
Minimum Statutory ratio	8.0%	8.0%
Excess	**15.1%**	**12.2%**
Core Capital/Total Risk Weighted Assets	15.9%	15.4%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.4%**	**4.9%**
Total Capital/Total Risk Weighted Assets	18.1%	16.9%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.6%**	**2.4%**
Liquidity Ratio	54.6%	52.4%
Minimum Statutory ratio	20.0%	20.0%
Excess	**34.6%**	**32.4%**