Stanbic Holdings Plc – H1’2018

10th August, 2018

Valuation Summary

- We are of the view that Stanbic Holdings is a “SELL” with a target price of Kshs 85.9, representing a downside of 7.2%, from the current price of Kshs 98.0 as of 10th August 2018, inclusive of a dividend yield of 6.4%,
- Stanbic Holdings Holdings is currently trading at P/TBV of 1.1x and a P/E of 9.0x vs an industry average of 1.7x and 9.2x, respectively.

Key Highlights H1’2018

- Stanbic Bank Kenya signed a memorandum of understanding with a Singapore-based fintech firm CCR manager, to boost its digital trade finance platform. The deal with CCR Manager is expected to facilitate the bank’s access to a wider global market. Stanbic joined more than 40 global banks across 17 countries, insurers and funds that are already on this web-based, secondary market platform

Income Statement

- Total operating income increased by 21.9% to Kshs 11.2 bn in H1’2018 from Kshs 9.2 bn in H1’2017. This was due to a 34.0% increase in Non-Funded Income (NFI) to Kshs 5.6 bn from Kshs 4.2 bn in H1’2017, coupled with an 11.9% increase in Net Interest Income (NII) to Kshs 5.6 bn from Kshs 5.0 bn in H1’2017,
- Total interest income increased by 15.4% to Kshs 9.1 bn from Kshs 7.9 bn in H1’2017. The interest income on loans and advances increased by 15.3% to Kshs 6.7 bn from Kshs 5.8 bn in H1’2017. Interest income on government securities increased by 20.2% to Kshs 2.3 bn in H1’2018 from Kshs 1.9 bn in H1’2017. The yield on interest earning assets however declined to 11.3% in H1’2018 from 11.8% in H1’2017, due to the relatively faster growth in the low-yielding government securities by 18.1% to Kshs 157.6 bn, from Kshs 133.5 bn in H1’2017,
- Interest expense increased by 21.7% to Kshs 3.5 bn from Kshs 2.9 bn in H1’2017, following a 27.7% increase in the interest expense on customer deposits to Kshs 2.2 bn from Kshs 1.7 bn in H1’2017. Other interest expenses increased by 24.1% to Kshs 0.32 bn in H1’2018 from Kshs 0.26 bn in H1’2017. The cost of funds thus increased slightly to 3.1% from 3.0% in H1’2017. Net Interest Margin declined to 4.9% from 5.3% in H1’2017,
- Non-Funded Income increased by 34.0% to Kshs 5.6 bn from Kshs 4.2 bn in H1’2017. The growth in NFI was largely driven by a 163.0% increase in other income to Kshs 1.6 bn from Kshs 0.6 bn in H1’2017, and a 12.0% increase in foreign exchange trading income to Kshs 1.7 bn from Kshs 1.5 bn in H1’2017. Fees and commissions on loans however declined by 25.7% to Kshs 0.1 bn from Kshs 0.2 bn in H1’2017. The current revenue mix stands at 50:50 funded to non-funded income as compared to 55:45 in H1’2017. The proportion of non-funded income to total revenue increased owing to the faster growth in NFI as compared to NII,
- Total operating expenses decreased by 14.0% to Kshs 6.0 bn from Kshs 7.0 bn, largely driven by an 86.7% decrease in Loan Loss Provisions (LLP) to Kshs 0.3 bn in H1’2018 from Kshs 1.9 bn in H1’2017. Staff costs increased by 16.2% to Kshs 2.8 bn in H1’2018 from Kshs 2.4 bn in H1’2017. Other operating expenses also increased by 1.3% to Kshs 1.9 bn in H1’2018 from Kshs 1.8 bn in H1’2017,
- The cost to income ratio improved to 53.5% from 75.9% in H1’2017. Without LLP, the Cost to income ratio also improved to 51.3% from 56.1% in H1’2017,
- Profit before tax increased by 135.3% to Kshs 5.2 bn, up from Kshs 2.2 bn in H1’2017. Profit after tax increased 104.5% to Kshs 3.6 bn in H1’2018 from Kshs 1.7 bn in H1’2017,

- The directors declared an interim dividend of Kshs 2.3 per share, which is 80.0% above the Kshs 1.3 per share interim dividend declared in H1'2017. We expect a final dividend per share of Kshs 4.0, taking the total dividend for 2018 to Kshs 6.3 per share, translating to a dividend yield of 6.4%.

Balance Sheet

- The balance sheet recorded an expansion with total assets increasing by 19.0% to Kshs 278.8 bn from Kshs 234.3 bn in H1'2017. This growth was largely driven by an 15.4% increase in net loans and advances to Kshs 154.0 bn from Kshs 133.5 bn in H1'2017, coupled with a 26.9% increase in investment government securities to Kshs 87.0 bn from Kshs 68.6 bn in H1'2017,
- Total liabilities rose by 22.3% to Kshs 236.6 bn from Kshs 193.5 bn in H1'2017, driven by a 21.3% increase in total deposits to Kshs 215.8 bn from Kshs 177.9 bn in H1'2017. Deposits per branch increased by 21.3% to Kshs 8.3 bn from Kshs 6.8 bn in H1'2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 71.4% from 75.1% in H1'2017,
- Gross non-performing loans increased by 62.7% to Kshs 10.6 bn in H1'2018 from Kshs 6.5 bn in H1'2017. Consequently, the NPL ratio deteriorated to 6.7% in H1'2018 from 4.7% in H1'2017 as NPLs grew faster than the loan book,
- Shareholders' funds increased by 3.5% to Kshs 42.2 bn in H1'2018 from Kshs 40.8 bn in H1'2017,
- Stanbic Holdings is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.6%, 5.1% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 18.3%, exceeding the statutory requirement by 3.8%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 14.7%, while total capital to risk weighted assets came in at 17.4%, indicating that the bank's total capital relative to its risk-weighted assets decreased by 0.9% due to implementation of IFRS 9,
- Stanbic Holdings currently has a return on average assets of 2.4% and a return on average equity of 14.8%.

Key Take-Outs:

i. The bank's asset quality has continued to deteriorate, with the gross NPLs increasing by 62.7% y/y to Kshs 10.6 bn from Kshs 6.5 bn in H1'2017. This is largely due to the effects of the tough operating environment experienced in 2017, whose effects have spilled over to the period under review. Main areas touted to that have contributed to the deteriorating asset quality include real estate, manufacturing and retail,
ii. The bank's NFI growth strategies are starting to boost the bank's revenue, with NFI increasing by 34.0% to Kshs 5.6 bn from Kshs 4.2 bn in H1'2017. Key NFI growth areas included other fees and commissions which increased by 7.7% to Kshs 1.8 bn from Kshs 1.7 bn in H1'2017. The bank's online platforms such as Till2bank, M-shares and Lipa360 payment solutions have contributed to an increase in the income., and,
iii. Increased investment in government securities contributed to a rise in the bank's interest income, with interest income from government securities increasing by 20.2% to Kshs 2.3 bn from Kshs 1.9 bn in H1'2017. This was largely due to the bank's effort to tame the rapidly deteriorating asset quality.

We expect the bank's growth to be further driven by:

a. Stanbic Holdings NFI, which is above the industry average, coming in at 50.0%, which is above the industry average of 33.6%. Increased adoption of alternative channels by the customers will improve operational efficiency, as well as increase the bank's transactional income. The bank is poised to see the commission and fee income from the online platforms increase in the future, as more customers increase their usage, and,

b. The bank has adopted increased measures to improve its asset quality. This include; (i) launch of a collaborative curing between businesses and the remedial department, and (ii) outsourcing of collection of loans.

Below is a summary of the bank’s performance:

Balance Sheet	H1'2017	H1'2018	y/y change	H1'2018e	Projected y/y change	Variance in growth vs projection
Net Loans	133.5	154.0	15.4%	160.2	20.0%	(4.6%)
Total Assets	234.3	278.8	19.0%	277.4	18.4%	0.6%
Deposits	**177.9**	**215.8**	**21.3%**	**218.5**	**22.9%**	**(1.5%)**
Total liabilities	193.5	236.6	22.3%	232.7	20.3%	2.0%
Shareholders' Funds	**40.8**	**42.2**	**3.5%**	**44.7**	**9.7%**	**(6.2%)**

Income Statement	H1'2017	H1'2018	y/y change	H1'2018e	Projected y/y change	Variance in growth vs projection
Net interest Income	5.0	5.6	11.9%	4.6	(9.1%)	21.0%
Net non-interest income	4.2	5.6	34.0%	4.6	9.5%	24.5%
Total Operating income	**9.2**	**11.2**	**21.9%**	**9.1**	**(0.7%)**	**22.6%**
Loan loss provision	(1.8)	(0.3)	(86.1%)	(1.7)	(8.2%)	(77.9%)
Total Operating expenses	**(7.0)**	**(6.0)**	**(14.0%)**	**(6.6)**	**(5.4%)**	**(8.7%)**
Profit before tax	2.2	5.2	135.3%	2.5	14.2%	121.1%
Profit after tax	**1.7**	**3.6**	**104.5%**	**2.0**	**14.6%**	**102.9%**

Key Ratios	H1'2017	H1'2018
Loan to Deposit ratio	75.1%	71.4%
Return on average equity	10.6%	14.8%
Return on average assets	1.9%	2.4%
Net Interest Margin	5.3%	4.9%
Cost to Income	56.1%	51.3%
Cost to Assets	2.2%	2.1%
NII as a % of Operating Income	54.7%	50.2%
NFI as a % of Operating Income	45.3%	49.8%

Capital Adequacy Ratios	H1'2017	H1'2018
Core Capital/Total Liabilities	20.8%	18.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.8%**	**10.3%**
Core Capital/Total Risk Weighted Assets	15.4%	14.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.9%**	**4.2%**
Total Capital/Total Risk Weighted Assets	17.2%	17.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.7%**	**2.9%**

Liquidity Ratio	52.6%	56.9%
Minimum Statutory ratio	20.0%	20.0%
Excess	**32.6%**	**36.9%**
Adjusted Core Capital/Total Risk Weighted Assets		**15.6%**
Adjusted Core Capital/Total Risk Weighted Assets		**18.3%**