Valuation Summary

We are of the view that Stanbic Holdings is an “Accumulate” with a target price of Kshs 111.9, representing an upside of 16.7%, from the current price of Kshs 100.0 as of 9th August 2019, inclusive of a dividend yield of 4.8%,

Stanbic Holdings is currently trading at P/TBV of 1.1x and a P/E of 6.0x vs an industry average of 1.3x and 6.6x, respectively.

Key Highlights H1’2019

- The bank has initiated a voluntary early retirement scheme to help in the reduction of about 200 jobs, aimed at increasing efficiency

Income Statement

- Core earnings per share increased by 14.4% to Kshs 10.3, from Kshs 9.0 in H1’2018, driven by a 14.8% increase in total operating income, despite the 21.6% increase in total operating expenses,

- Total operating income increased by 14.8% to Kshs 12.8 bn in H1’2019, from Kshs 11.2 bn in H1’2018. This was driven by a 19.5% increase in Net Interest Income (NII) to Kshs 6.7 bn, from Kshs 5.6 bn in H1’2018, coupled with a 10.1% increase in Non-Funded Income (NFI) to Kshs 6.1 bn, from Kshs 5.6 bn in H1’2018,
- Interest income increased by 10.5% to 10.1 bn, from 9.1 bn recorded in H1’2018, driven by the 12.9% increase in interest income from loans and advances to Kshs 7.6 bn, from Kshs 6.7 bn in H1’2018, coupled with the 64.5% increase in interest income from deposit placements to Kshs 147.2 mn, from Kshs 89.5 mn in H1’2018, and the 1.4% increase in interest income from government securities to Kshs 2.32 bn, from Kshs 2.28 bn in H1’2018. The yield on interest earning assets however declined to 7.9%, from 8.4% in H1’2018, owing to the decline in yield on loans as a result of the 50 bps decline of the Central Bank Rate (CBR) from 9.5% to 9.0% in Q2’2018 as well as the decline in yields on government securities,
- Interest expense increased by 5.2% to 3.7 bn, from 3.5 bn in H1’2018, caused by the 11.6% increase in interest expense from customer deposits to Kshs 2.5 bn, from Kshs 2.2 bn in H1’2018, coupled with the 31.6% increase in other interest expenses to Kshs 0.4 bn, from Kshs 0.3 bn in H1’2018, and offset slightly by the 17.8% decline in interest expenses on placement liabilities to Kshs 0.8 bn, from Kshs 1.0 bn. Cost of funds declined marginally to 3.0%, from 3.1% in H1’2018, as a result of a decline in deposits costs after the removal of the 70.0% of the CBR minimum interest payable on deposits in the Finance Act 2018, as interest bearing liabilities increased faster by 12.3% to Kshs 254.7 bn, from Kshs 226.8 bn in H1’2018.The Net Interest Margin (NIM) rose marginally to 5.1%, from 4.9% in H1’2018,
- Non-Funded Income (NFI) increased by 10.1% to Kshs 6.1 bn, from Kshs 5.6 bn in H1’2018, mainly driven by a 53.2% increase in fees and commissions on loans to Kshs 0.2 bn, from Kshs 0.1 bn in H1’2018, coupled with a 37.5% increase in other fees and commissions to Kshs 2.5 bn, from Kshs 1.8 bn in H1’2018, and a 59.4% increase in Forex trading gains to Kshs 2.7 bn, from Kshs 1.7 bn in H1’2018. The increase in NFI was however weighed down by the 76.7% decline in other income to Kshs 0.4 bn, from Kshs 1.6 bn in H1’2018,

- Total operating expenses increased by 21.6% to Kshs 7.3 bn, from Kshs 6.0 bn, largely driven by a 387.6% increase in Loan Loss Provisions (LLP) to Kshs 1.2 bn in H1'2019, from Kshs 0.3 bn in H1'2018, and a 3.2% increase in staff costs to Kshs 2.9 bn, from Kshs 2.8 bn, in H1'2018,
- The cost to income ratio thus deteriorated to 56.7%, from 53.5% in H1'2018 as a result of the faster growth in operating expenses Without LLP, the Cost to income ratio improved to 47.1% from 51.3% in H1'2018, highlighting the increase in cost of risk to 9.6%, from 2.3% in H1'2018,
- Profit before tax increased by 7.1% to Kshs 5.6 bn, up from Kshs 5.2 bn in H1'2018. Profit after tax increased 14.4% to Kshs 4.1 bn in H1'2019, from Kshs 3.6 bn in H1'2018, highlighting the decline in the effective tax rate to 26.9%, from 31.6% in H1'2018, and,
- The bank declared an interim dividend of Kshs 1.25, a 45.7% decline from the Kshs 2.3 interim dividend declared in H1'2018. Assuming a similar final dividend payout of Kshs 3.6, it translates to a dividend yield of 4.8%.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 12.4% to Kshs 313.3 bn, from Kshs 278.8 bn in H1'2018. This growth was largely driven by a 15.0% increase in net loans and advances to Kshs 177.1 bn, from Kshs 154.0 bn in H1'2018, coupled with an 8.1% increase in investment securities to Kshs 94.1 bn, from Kshs 87.0 bn in H1'2018,
- Total liabilities rose by 12.6% to Kshs 266.5 bn, from Kshs 236.6 bn in H1'2018, driven by a 10.3% increase in total deposits to Kshs 238.0 bn, from Kshs 215.8 bn in H1'2018, coupled with the 30.6% increase in borrowings to Kshs 9.2 bn, from Kshs 7.0 bn in H1'2018,
- Deposits per branch increased by 10.3% to Kshs 9.2 bn, from Kshs 8.3 bn in H1'2018, as the number of branches remained unchanged at 26,
- The faster growth in loans as compared to deposits led to an increase in the loan to deposit ratio to 74.4%, from 71.4% in H1'2018,
- Gross Non Performing Loans (NPLs) increased by 69.7% to Kshs 17.9 bn from Kshs 10.6 bn recorded in H1'2018, and consequently the Gross NPL ratio rose to 9.6%, from 6.6% in H1'2018. General provisions rose by 100.7% to Kshs 6.5 bn, from Kshs 3.3 bn in H1'2018. As a result, the NPL Coverage increased by 11.5% points to 57.5%, from 51.5% in H1'2018,
- Shareholders' funds increased by 10.9% to Kshs 46.8 bn in H1'2019, from Kshs 42.2 bn in H1'2018, driven by the 19.8% increase in revenue and other reserves to Kshs 28.0 bn, from Kshs 23.3 bn in H1'2018,
- Stanbic Bank remains sufficiently capitalized with a core capital to risk weighted assets ratio of 14.2%, 3.7% points above the statutory requirement of 10.5%. In addition, the total capital to risk weighted assets ratio stood at 17.5%, exceeding the statutory requirement by 3.0% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 15.3%, while total capital to risk weighted assets came in at 18.6%, and,
- Stanbic Holdings currently has a return on average assets of 2.3% and a return on average equity of 15.3%.

Key Take-Outs:

- The bank recorded a relatively strong performance in both funded and NFI segments. The bank's aggressive lending has led to increased interest income, as well as the associated fees and commissions. The increased lending has however came at a cost as asset quality deteriorated, as shown by the rise in the NPL ratio to 9.6%, from 6.6% in H1'2018. Consequently, impairment costs rose by 387.6%, which saw the cost of risk rise to 9.6% from 2.3% in H1'2018.

Below is a summary of the bank’s performance:

Balance Sheet	H1'2018	H1'2019	y/y change	H1'2019e	Projected y/y change	Variance in growth vs projection
Net Loans	154.0	177.1	15.0%	175.7	14.0%	0.9%
Total Assets	**278.8**	**313.3**	**12.4%**	**315.0**	**13.0%**	**(0.6%)**
Deposits	215.8	238.0	10.3%	240.4	11.4%	(1.1%)
Total liabilities	**236.6**	**266.5**	**12.6%**	**266.8**	**12.8%**	**(0.1%)**
Shareholders' Funds	**42.2**	**46.8**	**10.9%**	**48.2**	**14.2%**	**(3.2%)**

Income Statement	H1'2018	H1'2019	y/y change	H1'2019e	Projected y/y change	Variance in growth vs projection
Net interest Income	5.6	6.7	19.5%	6.4	14.5%	5.0%
Net non-interest income	5.6	6.1	10.1%	5.8	4.0%	6.2%
Total Operating income	**11.2**	**12.8**	**14.8%**	**12.2**	**9.2%**	**5.6%**
Loan loss provision	(0.3)	(1.2)	387.6%	(1.0)	275.1%	112.5%
Total Operating expenses	**(6.0)**	**(7.3)**	**21.6%**	**(7.1)**	**18.7%**	**3.0%**
Profit before tax	5.2	5.6	7.1%	5.1	(1.6%)	8.7%
Profit after tax	**3.6**	**4.1**	**14.4%**	**3.6**	**0.5%**	**13.9%**

Key Ratios	H1'2018	H1'2019
Loan to Deposit ratio	71.4%	74.4%
Return on average equity	14.8%	15.3%
Return on average assets	2.4%	2.3%
Net Interest Margin	4.9%	5.1%
Cost to Income Without LLP	51.3%	47.1%
Cost to Assets	2.1%	1.9%
NII as a % of Operating Income	50.2%	52.2%
NFI as a % of Operating Income	49.8%	47.8%

Capital Adequacy Ratios	H1'2018	H1'2019
Core Capital/Total Liabilities	18.3%	16.6%
Minimum Statutory ratio	8.0%	8.0%
Excess	**10.3%**	**8.6%**
Core Capital/Total Risk Weighted Assets	14.7%	14.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.2%**	**3.7%**
Total Capital/Total Risk Weighted Assets	17.4%	17.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.9%**	**3.0%**
Liquidity Ratio	56.9%	55.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**36.9%**	**35.3%**
Adjusted Core Capital/Total Risk Weighted Assets	**15.6%**	**15.3%**
Adjusted Total Capital/Total Risk Weighted Assets	**18.3%**	**18.6%**