Standard Chartered Bank of Kenya Plc – FY'2020
26th March, 2021

Valuation Summary

- We are of the view that Standard Chartered is an "***Accumulate***" with a target price of Kshs 160.8 representing an upside of 18.1%, from the current price of Kshs 145.0 as of 26th March 2021, inclusive of a dividend yield of 7.2%,
- Standard Chartered Bank is currently trading at a P/TBV of 1.0x and a P/E of 9.2x vs an industry average of 0.9x and 7.5x, respectively.

Key Highlights

- During the year, the bank restructured loans worth Kshs 22.0 bn to its customers, equivalent to 18.1% of its net loans which stood at Kshs 121.5 bn in FY'2020. The restructuring involved a 3-month holiday for loan holders, 12-month extension on personal loans and mortgage and a 6–12-month credit card payment extension, and,
- Additionally, in June 2020, Standard Chartered Bank announced that it had extended Kshs 650.0 mn to companies with capital expenditure and working capital requirements at preferential rates in order to help the firms address the effects of COVID-19. The financing was extended to various sectors who have been at the forefront in tackling the pandemic such as healthcare providers, manufactures and distributers in the pharmaceutical industry etc.,

Income Statement

- Core earnings per share declined by 33.9% to Kshs 14.4, from Kshs 21.9 recorded in FY'2019, not in line with our projections of a 26.8% decline to Kshs 16.0. The decline was mainly driven by a 21.1% growth in total operating expenses to Kshs 20.0 bn, from Kshs 16.5 bn recorded in FY'2019, coupled with a 4.5% decline in total operating income to Kshs 27.4 bn, from Kshs 28.7 bn recorded in FY'2019. The decline in core earnings per share was higher than our expectations of a 26.8% decline, with the variance being attributable to the total operating income declining by 4.5% against our expectation of a 0.4% growth in FY'2020, coupled with the total operating expenses growing faster by 21.1% against our expectations of a 19.1% increase in FY'2020,
- Total operating income declined by 4.5% to Kshs 27.4 bn, from Kshs 28.4 bn recorded in FY'2019. This was driven by a 10.2% decline in Non-Funded Income (NFI) to Kshs 8.3 bn, from Kshs 9.2 bn in FY'2019, coupled with a 1.8% decline in Net Interest Income (NII) to Kshs 19.1 bn, from Kshs 19.5 bn in FY'2019,
- Interest income declined by 6.1% to Kshs 23.7 bn, from Kshs 25.3 bn in FY'2019 driven by an 8.2% decline in interest income on loans and advances to Kshs 12.3 bn, from Kshs 13.4 bn in FY'2019, coupled with a 9.7% decline in interest income from government securities to Kshs 9.6 bn, from Kshs 10.6 bn in FY'2019. The decline in interest income was however mitigated by a 33.4% growth in interest income from deposits and placements with banking institutions to Kshs 1.4 bn, from Kshs 1.1 bn in FY'2019. Consequently, the Yield on Interest-Earning Assets declined to 9.0%, from 9.6% in FY'2019 , as the average interest-earning assets grew by 7.1% to Kshs 280.5 bn, from Kshs 261.9 bn in FY'2019 but the trailing interest income declined by 6.1%. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense declined by 20.4% to Kshs 4.6 bn, from Kshs 5.8 bn in FY'2019, following an 18.2% decline in interest expense on customer deposits to Kshs 4.2 bn, from Kshs 5.2 bn in FY'2019, coupled with a 45.8% decline in other interest expenses to Kshs 0.3 bn from Kshs 0.6 bn in FY'2019. The decline in interest expense was, however, mitigated by a gain of 35.3% in interest expense on deposits and placements from banking institutions to Kshs 0.08 bn, from Kshs 0.06 bn recorded in FY'2019. Cost of funds, on the other hand, increased marginally by 0.1% points to 2.6%, from 2.5% in FY'2019, owing to the faster 8.5% growth in the trailing interest expense, which outpaced the 7.1% growth in average interest-bearing liabilities. Trailing interest expense refers to the performance of the interest expense

for the past 12 consecutive months. Net Interest Margin (NIM) declined to 6.8% from 7.4% in FY'2019, where despite a 7.1% growth in average interest-earning assets, the Net Interest Income (NII) declined by 1.8%,

- Non-Funded Income (NFI) declined by 10.2% to Kshs 8.3 bn, from Kshs 9.2 bn in FY'2019. The decline was mainly driven by a 17.9% decline in Foreign Exchange Trading income to Kshs 2.6 bn, from Kshs 3.2 bn coupled with a 12.9% decline in other Fees and Commission income to Kshs 4.3 bn, from Kshs 4.9 bn in FY'2019. Fees and commissions on loans and advances, on the other hand, increased by 6.1% to Kshs 0.27 bn, from Kshs 0.26 bn in FY'2019. The decline in NFI is partly attributable to the waiver on mobile banking fees seen during the year which saw the total fees and commission decline by 12.0% to Kshs 2.3 bn, from Kshs 2.6 bn in FY'2019. As a result, the revenue mix shifted to 70:30 from 68:32 in FY'2019, funded to non-funded income, owing to the faster 10.2% decline in Non-Funded Income (NFI), compared to a 1.8% decline in Net Interest Income (NII),
- Total operating expenses grew by 21.1% to Kshs 20.0 bn in FY'2020, from Kshs 16.5 bn in FY'2019, mainly attributable to a 578.0% increase in Loans Loss Provision (LLP) to Kshs 3.9 bn, from Kshs 0.6 bn recorded in FY'2019. The increased provision level was on account of the poor operating environment brought about by COVID-19 which has adversely affected individuals and businesses' ability to repay loans. Additionally, Staff Costs increased by 7.6% to Kshs 7.7 bn in FY'2020, from Kshs 7.1 bn recorded in FY'2019,
- Cost to Income Ratio (CIR) deteriorated to 73.0%, from 57.6% in FY'2019, owing to the 578.0% increase in Loans Loss Provision to Kshs 3.9 bn, from Kshs 0.6 bn recorded in FY'2019. Without LLP, cost to income ratio deteriorated as well to 58.8%, from 55.6% in FY'2019, an indication of reduced efficiency levels,
- Profit before tax declined by 39.2% to Kshs 7.4 bn, from Kshs 12.2 bn in FY'2019. Profit after tax declined by 33.9% to Kshs 5.4 bn in FY'2020, from Kshs 8.2 bn recorded in FY'2019 with the effective tax rate decreasing to 26.4% from 32.3% in FY'2019, on the back of the reduced Corporate Tax during most of 2020, and,
- The Board of Directors recommended a final Dividend per Share (DPS) of Kshs 10.5, translating to a total dividend payout of Kshs 3.6 bn. At the current price of Kshs 145.0, this translates to a dividend yield of 7.2%.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 7.8% to Kshs 325.6 bn, from Kshs 302.1 bn in FY'2019. This growth was largely driven by a 77.8% increase in placements from banking institutions to Kshs 70.3 bn, from Kshs 39.5 bn in FY'2019, coupled with a marginal increase of 0.2% in investment in government and other securities to Kshs 99.8, from Kshs 99.6 bn recorded in FY'2019. The loan book however decreased by 5.6% to Kshs 121.5 bn, from Kshs 128.7 bn recorded in FY'2019, partly attributable to the elevated credit risk on the back of the adverse of the ongoing pandemic on Kenyans' income levels and profitability of firms,
- Total liabilities rose by 8.0% to Kshs 274.7 bn, from Kshs 254.4 bn in FY'2019, driven by a 12.3% increase in customer deposits to Kshs 256.5 bn, from Kshs 228.4 bn in FY'2019. On the other hand, there was a decrease of 94.3% in placements held to Kshs 0.5 bn, from Kshs 8.0 bn in FY'2019. Deposits per branch rose by 12.3% to Kshs 7.1 bn, from Kshs 6.3 bn in FY'2019 with the number of branches remaining at 36,
- Loans to deposit ratio declined to 47.4% from 56.3% in FY'2019, owing to the faster 12.3% growth in customer deposits as compared to the 5.6% decline in loans during the same period,
- Gross Non-Performing Loans (NPLs) increased by 11.4% to Kshs 22.3 bn in FY'2020, from Kshs 20.1 bn recorded in FY'2019, taking the NPL ratio to 16.0% from 13.9% recorded in FY'2019. The NPL ratio deterioration is attributable to the 11.4% growth in Gross Non-Performing Loans (NPLs), coupled with a 3.4% decline in gross loans,
- General Loan Loss Provisions increased by 10.9% to Kshs 8.9 bn, from Kshs 8.0 bn in FY'2019. The NPL coverage thus increased to 80.6%, from 78.7% in FY'2019, as the provisions (after adding back interest suspense) increased by 14.0% in FY'2020 outpacing the 11.4% rise in the Gross Non-Performing Loans

during the same period. The increase in the NPL Coverage to 80.6% in FY'2020, from 78.7% in FY'2019 suggests sufficient provisioning,

- Shareholders' funds increased by 6.6% to Kshs 50.9 bn in FY'2020, from Kshs 47.8 bn in FY'2019, mainly supported by a 15.0% growth in retained earnings to Kshs 31.2 bn, from Kshs 27.1 bn in FY'2019,
- Standard Chartered is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.9%, 5.4% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 18.5%, exceeding the statutory requirement by 4.0% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.9% while total capital to risk-weighted assets came in at 18.5%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.7%, and a Return on Average Equity (ROaE) of 11.0%.

Key Take-Outs:

1. **Asset Quality** – the bank's asset quality deteriorated owing to the 2.1% points increase in NPL ratio to 16.0% in FY'2020, from 13.9% recorded in FY'2019. Notably, the FY'2020 NPL ratio is the highest it has been since FY'2018 at 16.3%. Given that the bank mainly focuses on retail banking, whose exposure as at FY'2019 stood at 56.2%, and the adverse effects of the pandemic in this sector, the bank adopted a conservative lending strategy in order to alleviate credit risk and as such gross loans declined by 3.4% to Kshs 139.5 bn, from Kshs 144.5 bn in FY'2019, and,
2. **Operating Efficiency** - There was a decline in the bank's operating efficiency as the cost to income ratio without LLP deteriorated as well to 58.8%, from 55.6% in FY'2019. The deterioration was largely attributable to the increase of Staff Costs by 7.6% to Kshs 7.7 bn in FY'2020, from Kshs 7.1 bn recorded in FY'2019.

Going forward, we expect the bank's growth to be driven by:

I. Continued focus on promoting the usage of the bank's alternative channels is likely to continue boosting the company's Non-Funded Income (NFI) as well as aiding in improving operational efficiency levels, which deteriorated in FY'2020 as evidenced by the worsening of the cost to income ratio to 73.0% from 57.6% in FY'2019. Revenue expansion coupled with cost containment will be key in boosting the bank's bottom line, and,

II. Possible decline in operating expenses - the bank intends to close one of its branches (Moi Avenue, Nairobi) by August 2021 as well as reduce the workforce as digital platforms continue to be the most preferred channels for customer. According to their FY'2020 recent investor briefing, 90.0% of Standard Chartered Bank Kenya's retail transactions are outside the branch network.

Below is a summary of the bank's performance:

Balance Sheet Items	FY'2019	FY'2020	y/y change	FY'2020e	Projected y/y change	Variance in Growth Actual vs. Expected
Net loans	128.7	121.5	(5.6%)	143.0	11.1%	(16.7%)
Total Assets	**302.1**	**325.6**	**7.8%**	**333.4**	**10.3%**	**(2.6%)**
Customer Deposits	228.4	256.5	12.3%	252.5	10.5%	1.7%
Total Liabilities	254.4	274.7	8.0%	280.0	10.1%	(2.1%)
Shareholder's Funds	**47.8**	**50.9**	**6.6%**	**53.3**	**11.7%**	**(5.1%)**

Balance Sheet Ratios	FY'2019	FY'2020	y/y change
Loan to deposit ratio	56.3%	47.4%	(8.9%)
Return on Average Equity	17.5%	11.0%	(6.5%)
Return on Average Assets	2.8%	1.7%	(1.1%)

Income Statement Items	FY'2019	FY'2020	y/y change	FY'2020e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	19.5	19.1	(1.8%)	20.2	3.9%	(5.7%)
Net non-Interest Income	9.2	8.3	(10.2%)	8.6	(7.0%)	(3.2%)
Total Operating income	**28.7**	**27.4**	**(4.5%)**	**28.8**	**0.4%**	**(4.9%)**
Loan Loss provision	0.6	3.9	578.0%	4.1	611.7%	(33.7%)
Total Operating expenses	16.5	20.0	21.1%	19.7	19.1%	2.0%
Profit before tax	12.2	7.4	(39.2%)	9.1	(25.0%)	(14.2%)
Profit after tax	**8.2**	**5.4**	**(33.9%)**	**6.0**	**(26.8%)**	**(7.1%)**
Core EPS	**21.9**	**14.4**	**(33.9%)**	**16.0**	**(26.8%)**	**(7.1%)**

Income Statement Ratios	FY'2019	FY'2020	% point change
Yield from interest-earning assets	9.6%	9.0%	(0.6%)
Cost of funding	2.5%	2.6%	0.1%
Net Interest Spread	7.1%	6.5%	(0.6%)
Net Interest Margin	7.4%	6.8%	(0.6%)
Cost of Risk	2.0%	14.2%	12.2%
Net Interest Income as % of operating income	67.8%	69.8%	2.0%
Non-Funded Income as a % of operating income	32.2%	30.2%	-2.0%
Cost to Income Ratio	57.6%	73.0%	15.4%
Equity to Assets Ratio	16.1%	15.7%	(0.4%)

Capital Adequacy Ratios	FY'2019	FY'2020
Core Capital/Total Liabilities	15.6%	15.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**7.6%**	**7.3%**
Core Capital/Total Risk Weighted Assets	14.7%	15.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.2%**	**5.4%**
Total Capital/Total Risk Weighted Assets	17.7%	18.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.2%**	**4.0%**
Liquidity Ratio	62.6%	71.5%
Minimum Statutory ratio	20.0%	20.0%
Excess	**42.6%**	**51.5%**
Adjusted core capital/ total deposit liabilities	15.7%	15.3%
Adjusted core capital/ total risk weighted assets	14.8%	15.9%
Adjusted total capital/ total risk weighted assets	17.8%	18.5%