Cytonn INVESTMENTS

Standard Chartered Bank of Kenya Plc – Q3'2020

20th November, 2020

Valuation Summary

- We are of the view that Standard Chartered is a "***buy***" with a target price of Kshs 187.9 representing an upside of 34.8%, from the current price of Kshs 149.3 as of 20th November 2020, inclusive of a dividend yield of 10.1%,
- Standard Chartered Bank is currently trading at a P/TBV of 1.2x and a P/E of 8.9x vs an industry average of 0.9x and 6.4x, respectively.

Income Statement

- Core earnings per share declined by 30.4% to Kshs 11.5, from Kshs 16.5 in Q3'2019, driven by a 12.9% growth in total operating expenses to Kshs 14.1 bn, from Kshs 12.5 bn in Q3'2019, coupled with a 4.5% decline in total operating income to Kshs 20.7 bn, from Kshs 21.6 bn in Q3'2019. The decline in core earnings per share was not in line with our expectations of a 21.8% decline, with the variance being attributable to the 274.2% rise Loan Loss Provisions to Kshs 2.7 bn, from Kshs 0.7 bn in Q3'2019, against our expectations of a 160.1% increase,
- Total operating income declined by 4.5% to Kshs 20.7 bn, from Kshs 21.6 bn in Q3'2019. This was driven by an 8.8% decline in Non-Funded Income (NFI) to Kshs 6.3 bn, from Kshs 7.0 bn in Q3'2019, coupled with a 2.4% decline in Net Interest Income (NII) to Kshs 14.3 bn, from Kshs 14.7 bn in Q3'2019,
- Interest income declined by 5.8% to Kshs 17.9 bn, from Kshs 19.1 bn in Q3'2019. This was driven by a 10.7% decline in interest income from government securities to Kshs 7.2 bn from Kshs 8.1 bn in Q3'2019, coupled with a 6.8% decline in interest income on loans and advances to Kshs 9.4 bn, from Kshs 10.1 bn in Q3'2019. The interest income from deposits and placements however increased by 30.5% to Kshs 1.0 bn, from Kshs 0.8 bn helping to cushion the declines in interest income. Consequently, the yield on interest-earning assets declined to 8.9% from 9.9% in Q3'2019, attributable to the 5.6% decline in interest income, which was despite a 5.4% y/y growth in average interest-earning assets to Kshs 272.3 bn, from Kshs 258.2 bn in Q3'2019,
- Interest expense declined by 17.3% to Kshs 3.6 bn, from Kshs 4.4 bn in Q3'2019, following a 15.2% decline in interest expense on customer deposits to Kshs 3.3 bn from Kshs 3.9 bn in Q3'2019, coupled with a 43.5% decline in other interest expenses to Kshs 0.3 bn from Kshs 0.4 bn in Q3'2019. Cost of funds, on the other hand, declined to 2.1%, from 3.0% in Q3'2019, owing to a 17.3% decline in interest expense, despite a 13.6% growth in average interest-bearing liabilities. Net Interest Margin (NIM) declined to 7.0% from 7.5% in Q3'2019, owing to a 2.4% decline in Net Interest Income (NII), despite a 5.4% growth in average interest-earning assets,
- Non-Funded Income (NFI) declined by 8.8% to Kshs 6.3 bn, from Kshs 7.0 bn in Q3'2019. The decline was mainly driven by a 19.9% decline in Foreign Exchange Trading income to Kshs 1.9 bn from Kshs 2.4 bn coupled with a 10.8% decline in other Fees and Commission income to Kshs 3.2 bn from Kshs 3.6 bn in Q3'2019. Fees and commissions on loans and advances, on the other hand, increased by 9.5% to Kshs 0.22 bn from Kshs 0.20 bn in Q3'2019. The decline in non-funded income is partly attributable to the waiver on mobile banking fees which saw total fees and commission decline by 9.7%. As a result, the revenue mix shifted to 69:31 from 68:32 in Q3'2019, funded to non-funded income, owing to a higher decline in Non-Funded Income (NFI) as compared to that of Net Interest Income (NII),
- Total operating expenses grew by 12.9% to Kshs 14.1 bn, from Kshs 12.5 bn, largely driven by 274.2% rise in Loan Loss Provisions (LLP) to Kshs 2.7 bn in Q3'2020, from Kshs 0.7 bn in Q3'2019 on account of the poor operating environment brought about by COVID-19 which has which has adversely affected individuals and businesses ability to repay loans. Staff costs, on the other hand, recorded a 2.5% decline to Kshs 5.4 bn from Kshs 5.6 bn in Q3'2019,
- Cost to Income Ratio (CIR) deteriorated to 68.2%, from 57.7% in Q3'2019 owing to the 274.2% rise in Loan Loss Provisions (LLP) to Kshs 2.7 bn in Q3'2020, from Kshs 0.7 bn in Q3'2019. Without LLP, cost to

income ratio deteriorated as well to 55.0%, from 54.4% in Q3’2019, an indication of reduced efficiency levels, and,

- Profit before tax declined by 28.2% to Kshs 6.6 bn, from Kshs 12.2 bn in Q3’2019. Profit after tax declined by 30.4% to Kshs 4.3 bn in Q3’2020, from Kshs 6.2 bn in Q3’2019 with the effective tax rate increasing to 36.7% from 32.0% in Q3’2019,

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 8.2% to Kshs 314.4 bn, from Kshs 290.6 bn in Q3’2019. This growth was largely driven by an 11.1% growth recorded in the loan book to Kshs 131.7 bn, from Kshs 118.5 bn in Q3’2019, coupled with a 12.0% increase in placements from banking institutions to Kshs 46.6 bn in Q3’2020, from Kshs 41.6 bn in Q3’2019. Investment in government and other securities also increased by 7.6% to Kshs 106.2 bn, from Kshs 98.7 bn in Q3’2019,
- Total liabilities rose by 8.9% to Kshs 264.2 bn, from Kshs 242.7 bn in Q3’2019, driven by an 8.0% increase in customer deposits to Kshs 242.8 bn, from Kshs 224.8 bn in Q3’2019, coupled with a 260.8% increase in the placements held to Kshs 2.0 bn, from Kshs 0.6 bn in Q3’2019. Deposits per branch rose by 8.0% to Kshs 7.3 bn from Kshs 6.7 bn in Q3’2019 with the number of branches remaining at 36,
- Loans to deposit ratio increased to 54.2% from 52.7% in Q3’2019, owing to the 11.1% growth in net loans which outpaced the 8.0% growth in customer deposits during the same period,
- Gross Non-Performing Loans (NPLs) increased by 10.3% to Kshs 22.0 bn in Q3’2020, from Kshs 19.9 bn in Q3’2019. The NPL ratio, however improved marginally to 14.8%, from 14.9% in Q3’2019, attributable to the faster 11.2% growth in gross loans, which outpaced the 10.3% growth in Gross Non-Performing Loans (NPLs),
- General Loan Loss Provisions increased by 6.1% to Kshs 8.4 bn, from Kshs 7.9 bn in Q3’2019. The NPL coverage thus increased to 78.2%, from 77.0% in Q3’2019, as the provisions (after adding back interest suspense) increased in Q3’2019 outpacing the 10.3% rise in the Gross Non-Performing Loans,
- NPL Coverage ratio increased to 78.2% in Q3’2020, from 77.0% in Q3’2019 which could suggest sufficient provisioning,
- Shareholders’ funds increased by 4.7% to Kshs 50.2 bn in Q3’2020, from Kshs 47.9 bn in Q3’2019, mainly supported by an 11.3% growth in retained earnings to Kshs 34.9 bn, from Kshs 31.4 bn in Q3’2019,
- Standard Chartered is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.1%, 5.6% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 18.7%, exceeding the statutory requirement by 4.2% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.1% while total capital to risk-weighted assets came in at 18.8%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.1%, and a Return on Average Equity (ROaE) of 12.9%.

Key Take-Outs:

1. **Asset Quality** – the bank’s asset quality improved marginally owing to the decline in NPL ratio to 14.8% in Q3’2020, from 14.9% recorded in Q3’2019. The improvement of the NPL depicts the bank’s conservative lending strategies as well as the faster 11.2% growth in loans, which outpaced the 10.3% growth in Gross Non-Performing Loans (NPLs),
2. **Operating Efficiency** - There was a decline in the bank’s operating efficiency as the cost to income ratio without LLP deteriorated to 55.0%, from 54.4% in Q3’2019. The deterioration was largely attributable to the 9.6% increase in depreciation charges on property and equipment coupled with 38.5% rise in amortization charges. The bank continues to leverage on digital platforms with 80.0% of the transactions being carried out on digital platforms.

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 Q3'2020 as evidenced by the worsening of the cost to income ratio to 68.2% from 57.7% in Q3'2019. Revenue expansion coupled with cost containment will be key in boosting the bank's bottom line.

Below is a summary of the bank's performance:

Standard Chartered Bank Q3'2020 Key Highlights

Balance Sheet

Balance Sheet Items	Q3'2019	Q3'2020	y/y change	Q3'2020e	Projected y/y change	Variance in Growth Actual vs. Expected
Net loans	118.5	131.7	11.1%	134.0	13.1%	(2.0%)
Total Assets	**290.6**	**314.4**	**8.2%**	**332.1**	**14.3%**	**(6.1%)**
Customer Deposits	224.8	242.8	8.0%	260.3	15.8%	(7.8%)
Total Liabilities	242.7	264.2	8.9%	279.9	15.4%	(6.5%)
Shareholder's Funds	**47.9**	**50.2**	**4.7%**	**52.1**	**8.8%**	**(4.1%)**

Balance Sheet Ratios	Q3'2019	Q3'2020	y/y change
Loan to deposit ratio	52.7%	54.2%	1.5%
Return on Average Equity	16.9%	12.9%	(4.0%)
Return on Average Assets	2.8%	2.1%	(0.7%)

Income Statement

Income Statement Items	Q3'2019	Q3'2020	y/y change	Q3'2020e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	14.7	14.3	(2.4%)	14.5	(1.1%)	(1.3%)
Net non-Interest Income	7.0	6.3	(8.8%)	5.8	(16.7%)	7.9%
Total Operating income	**21.6**	**20.7**	**(4.5%)**	**20.3**	**(6.1%)**	**1.6%**
Loan Loss provision	0.7	2.7	274.2%	1.9	160.1%	114.1%
Total Operating expenses	12.5	14.1	12.9%	13.3	6.5%	6.3%
Profit before tax	9.1	6.6	(28.2%)	7.0	(23.3%)	(4.8%)
Profit after tax	**6.2**	**4.3**	**(30.4%)**	**4.4**	**(28.8%)**	**(1.6%)**
Core EPS	**16.5**	**11.5**	**(30.4%)**	**12.91**	**(21.8%)**	**(8.6%)**

Income Statement Ratios	Q3'2019	Q3'2020	y/y change
Yield from interest-earning assets	9.9%	8.9%	(1.0%)
Cost of funding	3.0%	2.1%	(0.8%)
Net Interest Spread	7.0%	6.7%	(0.2%)
Net Interest Margin	7.5%	7.0%	(0.5%)
Cost of Risk	3.4%	13.2%	9.8%
Net Interest Income as % of operating income	67.8%	69.3%	1.5%
Non-Funded Income as a % of operating income	32.2%	30.7%	(1.5%)
Cost to Income Ratio	57.7%	68.2%	10.5%
Equity to Assets Ratio	16.3%	16.2%	(0.1%)

Capital Adequacy Ratios

Capital Adequacy Ratios	Q3'2019	Q3'2020

Core Capital/Total Liabilities	15.8%	16.7%
Minimum Statutory ratio	8.0%	8.0%
Excess	**7.8%**	**8.7%**
Core Capital/Total Risk Weighted Assets	15.7%	16.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.2%**	**5.6%**
Total Capital/Total Risk Weighted Assets	18.9%	18.7%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.4%**	**4.2%**
Liquidity Ratio	67.5%	65.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**47.5%**	**45.7%**
Adjusted core capital/ total deposit liabilities	15.9%	16.8%
Adjusted core capital/ total risk weighted assets	15.8%	16.1%
Adjusted total capital/ total risk weighted assets	18.9%	18.8%