Standard Chartered Bank of Kenya Plc – FY'2018

21st March, 2019

Valuation Summary

- We are of the view that Standard Chartered is a "hold" with a target price of Kshs 196.3, representing an upside of 6.6%, from the current price of Kshs 202.0 as of 22nd March 2019, inclusive of a dividend yield of 9.4%,
- Standard Chartered Bank is currently trading at a P/TBV of 1.5x and a P/E of 8.6x vs an industry average of 1.5x and 7.0x, respectively.

Key Highlights FY'2018

- On 29th September 2018, Standard Chartered launched a mobile app, whose main aim is to facilitate fees payment, for students in private schools. Schools will directly invoice parents and guardians through the app to make payments on the platform.
- On 6th November 2018, Standard Chartered Bank Kenya, in partnership with Sanlam General Insurance, launched a Mobile platform that will enable its clients to purchase motor and home insurance via the existing Bank's Mobile App. The move is aimed at simplifying insurance procurement by introducing an end-to-end digital process thus considerably reducing the turnaround time to minutes.

Income Statement

- Core earnings per share increasing by 17.1% to Kshs 23.6 from Kshs 20.1 in FY'2017, in line with our expectation of a 16.0% increase to Kshs 23.3. The performance was driven by a 4.6% increase in total operating income, coupled with a 3.0% decline in total operating expenses. The variance in core earnings per share growth against our expectations was due to the 3.0% decline in total operating expenses to Kshs 16.8 bn, from Kshs 17.3 bn in FY'2017, which slightly exceeded our expectation of a 2.0% decline,
- Total operating income increased by 4.6% to Kshs 28.6 bn from Kshs 27.3 bn in FY'2017. The rise was due to a 4.9% increase in Non-Funded Income (NFI) to Kshs 9.2 bn from Kshs 8.8 bn in FY'2017, coupled with a 4.5% increase in Net Interest Income (NII) to Kshs 19.4 bn, from Kshs 18.6 bn in FY'2017,
- Interest income rose by 2.3% to Kshs 26.9 bn, from Kshs 26.3 bn in FY'2017. This was driven by a 9.9% growth in interest income from government securities to Kshs 12.5 bn, from Kshs 11.3 bn in FY'2017. There was however a 3.2% decline in interest income on loans and advances to Kshs 13.1 bn, from Kshs 13.6 bn in FY'2017, attributable to the 6.7% decline in the loan book, coupled with the decline in yields on loans due to the two Central Bank Rate (CBR) cuts in 2018. The yield on interest-earning assets however declined to 10.5%, from 11.2% in FY'2017, attributed to a decline in yields on government securities as well as the decline in lending rates,
- Interest expense declined by 3.0% to Kshs 7.5 bn, from Kshs 7.7 bn in FY'2017, following a 10.0% decline in other interest expenses to Kshs 976.3 mn from Kshs 1.1 bn in FY'2017. Interest expense on customer deposits however rose marginally by 0.4% to Kshs 6.44 bn from Kshs 6.41 bn in FY'2017. Consequently, cost of funds declined to 3.3% from 3.7% in FY'2017, with the Net Interest Margin (NIM) declining to 7.5%, from 7.9% in FY'2017,
- Non-Funded Income (NFI) increased by 4.9% to Kshs 9.2 bn, from Kshs 8.8 bn in FY'2017. The increase was mainly driven by a 16.4% rise in other fees and commissions to Kshs 5.1 bn, from Kshs 4.4 bn in FY'2017, coupled with a 6.9% rise in forex trading income to Kshs 2.8 bn, from Kshs 2.7 bn. The revenue mix remained unchanged at 68:32 funded to non-funded income, owing to a comparable increase in NII and NFI,
- Total operating expenses declined by 3.0% to Kshs 16.8 bn, from Kshs 17.3 bn, largely driven by a 53.9% decline in loan loss provisions to Kshs 1.9 bn from Kshs 4.2 bn. The large decline in loan loss provisions was

however offset by a 9.5% rise in staff costs to Kshs 7.4 bn from Kshs 6.7 bn in FY'2017, and a 17.3% rise in other operating expenses to Kshs 7.5 bn from Kshs 6.4 bn,

- The Cost to Income Ratio (CIR) improved to 58.6%, from 63.2% in FY'2017. Without LLP, the cost to income deteriorated to 51.8%, from 47.9% in FY'2017,
- Profit before tax increased by 17.6% to Kshs 11.9 bn, from Kshs 10.1 bn in FY'2017. Profit after tax grew by 17.1% to Kshs 8.1 bn in FY'2018, from Kshs 6.9 bn in FY'2017, as the effective tax rate increased marginally to 31.6% from 31.3% in FY'2017,
- The bank recommends a first and final dividend of Kshs 19.0 per share; this is an 11.8% rise from the Kshs 17.0 per share paid in FY'2017, which translates to a dividend yield of 9.4%, and a payout ratio of 80.6%.

Balance Sheet

- The balance sheet recorded a slight contraction as total assets declined by 0.1% to Kshs 285.4 bn, from Kshs 285.7 bn in FY'2017. This decline was largely driven by a 10.7% decline in government securities to Kshs 98.7 bn, from Kshs 110.5 bn in FY'2017, coupled with a 6.1% decline in net loans and advances to customers to Kshs 118.7 bn from Kshs 126.3 bn in FY'2017. The decline was however mitigated by a 74.8% increase in placements to Kshs 37.5 bn, from Kshs 21.5 bn in FY'2017,
- Total liabilities declined marginally by 0.5% to Kshs 238.8 bn from Kshs 240.1 bn in FY'2017. This was driven by a 98.8% decline in placements to Kshs 0.2 bn, from Kshs 12.7 bn in FY'2017, possibly due to the bank opting to reduce placement liabilities and consequently the associated interest expenses, on the back of a removal of the floor of interest payable on deposits, as they seek to utilize the relatively cheaper deposit funding. This was however mitigated by a 5.1% rise in deposits to Kshs 224.2 bn, from Kshs 213.4 bn in FY'2017. Deposits per branch increased by 11.1% to Kshs 6.6 bn, from Kshs 4.9 bn previously, with the number of branches as at the end of 2018 being 34, a decline from 36 as at end of 2017,
- The rise in deposits coupled with the decline in loans led to a decline in the loan to deposit ratio to 52.9%, from 59.2% in FY'2017,
- Gross Non-Performing Loans (NPLs) increased by 22.9% to Kshs 21.7 bn in FY'2018, from Kshs 17.6 bn in FY'2017. Consequently, the NPL ratio deteriorated to 16.3% in FY'2018 from 12.6% in FY'2017. The NPL coverage declined to 67.0% in FY'2018, from 74.4% in FY'2017, as provisions declined despite the rise in NPLs, as the bank utilized the shareholders equity for the impairments, as allowed in the initial year of implementation of the new IFRS 9 accounting framework,
- Shareholders' funds increased by 2.1% to Kshs 46.6 bn in FY'2018 from Kshs 45.7 bn in FY'2017, attributable to a 2.3% rise in capital grants to Kshs 1.93 bn, from Kshs 1.89 bn in FY'2017,
- Standard Chartered Bank is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.5%, 6.0% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio was 19.5%, exceeding the statutory requirement of 14.5% by 5.0% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.6%, while total capital to risk-weighted assets came in at 19.7%,
- The bank currently has a Return on Average Assets (ROaA) of 2.8%, and a Return on Average Equity (ROaE) of 17.5%.

Key Take-Outs:

1. There was a decline in efficiency levels as the cost to income ratio without LLP worsened to 51.8% from 47.9% in FY'2017. The deterioration was largely attributable to a 9.5% rise in staff costs coupled with a 17.3% rise in other operating expenses, which depressed the bottom line. The rising inefficiency was largely due to the bank's investment in the development of robust ICT systems so as to enhance service delivery to clients,

2. The bank's asset quality deteriorated, with the NPL ratio rising to 16.3%, from 12.6% in FY'2017. The deteriorating NPL ratio is attributable to a 22.9% rise in gross non-performing loans to Kshs 21.7 bn, from Kshs 17.6 bn in FY'2017m due to recovery problems of loans made to key troubled sectors such as real estate and manufacturing, and,
3. There was an 11.4% rise in NFI to Kshs 9.2 bn, from Kshs 8.8 bn in FY'2017, despite the implementation of the Effective Interest Rate (EIR) under IFRS 9, which has seen the bank amortize fees charged on loans over future period of a loan's tenor leading to a decline in NFI's in FY'2018. Fees and commissions on loans and advances recorded a 112.5% rise to Kshs 326.1 mn from Kshs 153.4 mn in FY'2017.

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

1. 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'2018 as evidenced by the worsening of the cost to income ratio to 51.8% from 47.9% in FY'2017. 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:

Balance Sheet Items	FY'2017	FY'2018	y/y change	FY'2018e	Projected y/y change	Variance in Growth Actual vs. Expected
Net loans	126.3	118.7	(6.1%)	111.8	(11.4%)	5.4%
Total Assets	**285.7**	**285.4**	**(0.1%)**	**286.8**	**0.4%**	**(0.5%)**
Customer Deposits	213.3	224.3	5.1%	215.1	0.8%	4.3%
Total Liabilities	240.1	238.8	(0.5%)	237.8	(0.9%)	0.4%
Shareholder's Funds	**45.7**	**46.6**	**2.1%**	**48.9**	**7.2%**	**(5.0%)**

Balance Sheet Ratios	FY'2017	FY'2018	y/y change
Loan to deposit ratio	59.2%	52.9%	(6.3%)
Return on Average Equity	15.4%	17.5%	2.1%
Return on Average Assets	2.6%	2.8%	0.3%

Income Statement	FY'2017	FY'2018	y/y change	FY'2018e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	18.6	19.4	4.5%	19.4	4.3%	0.2%
Net non-Interest Income	8.8	9.2	4.9%	9.2	4.6%	0.2%
Total Operating income	**27.3**	**28.6**	**4.6%**	**28.5**	**4.4%**	**0.2%**
Loan Loss provision	4.2	1.9	(53.9%)	3.0	(28.9%)	(25.0%)
Total Operating expenses	17.3	16.8	(3.0%)	17.1	(1.0%)	(2.0%)
Profit before tax	10.1	11.8	17.6%	11.5	13.8%	3.9%
Profit after tax	**6.9**	**8.1**	**17.1%**	**8.0**	**16.0%**	**1.2%**
Core EPS	**20.1**	**23.6**	**17.1%**	**23.3**	**16.0%**	**1.2%**

Income Statement Ratios	FY'2017	FY'2018	y/y change
Yield from interest-earning assets	11.2%	10.5%	(0.7%)
Cost of funding	3.7%	3.3%	(0.4%)
Net Interest Spread	7.5%	7.1%	(0.3%)
Net Interest Margin	7.9%	7.5%	(0.3%)
Cost of Risk	15.3%	6.8%	(8.6%)
Net Interest Income as % of operating income	67.9%	67.8%	(0.1%)

Non-Funded Income as a % of operating income	32.1%	32.2%	0.1%
Cost to Income Ratio	63.2%	58.6%	(4.6%)

Capital Adequacy Ratios	FY'2017	FY'2018
Core Capital/Total Liabilities	16.7%	15.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.7%**	**7.8%**
Core Capital/Total Risk Weighted Assets	15.6%	16.5%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.1%**	**6.0%**
Total Capital/Total Risk Weighted Assets	18.5%	19.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.0%**	**5.0%**
Liquidity Ratio	58.7%	66.6%
Minimum Statutory ratio	20.0%	20.0%
Excess	**38.7%**	**46.6%**
Adjusted core capital/ total deposit liabilities		15.9%
Adjusted core capital/ total risk weighted assets		16.6%
Adjusted total capital/ total risk weighted liabilities		19.7%