NIC Bank Kenya Earnings Update – FY'2016

10th March, 2017

Valuation Summary

- We recommend a "Buy" for the NIC stock with a target price of Kshs 30.8 representing an upside of 30.8%, from the current price of Kshs 24.5, as at 10th March, inclusive of a dividend yield of 5.1%
- NIC Bank is currently trading at a P/B of 1.1x and a P/E of 6.4x, vs an industry average of 0.8x and 5.4x, respectively.

Key highlights during FY'2016

- NIC Bank shareholders approved the reorganisation of NIC's business to create a Non-Operating Holding Company, which will be known as NIC Group Plc, and include the creation of a new wholly owned subsidiary, NIC Bank Kenya Plc
- NIC Bank opened 6 new branches, raising its branch network in Kenya to 33 from 27 in 2015
- NIC Bank partnered with Delights Kenya Limited, a leading second hand vehicle importer and dealer, in a move that will see NIC Bank finance 80% of the vehicle landed cost, and the vehicle insured under NIC Bank Insurance Agents, with customers depositing the remaining 20% once they receive their offer letter from the bank
- The High Court ruled that Imperial Bank (IR) former depositors could access their deposits over the previously accessible Kshs 1.0 mn from NIC Bank
- Global Credit Ratings (GCR), a South Africa-based rating company, accorded NIC's outlook as "negative" due to the increasing Non-Performing Loans (NPLs) and rising bad debts.

Income Statement

- Core earnings per share (EPS) declined by 3.3% to Kshs 6.8 from Kshs 7.0 in FY'2015 in line with our expectations of a 4.9% decline. The drop in EPS was driven by a 35.8% growth in total operating expenses which outpaced a 17.5% growth in total operating revenue,
- Total operating revenue grew by 17.5% to Kshs 16.2 bn from Kshs 13.8 bn in FY'2015, faster than our estimate of a 13.6% growth. This was supported by a 24.9% growth in Net Interest Income, despite a 0.3% decline in Non Funded income,
- Interest Income grew by 11.8% to Kshs 19.0 bn from Kshs 17.0 bn in FY'2015, while Interest expense declined 5.8% to Kshs 6.9 bn from Kshs 7.3 bn in FY'2015. The Net Interest Margin thus increased to 8.0% from 6.9% in FY'2015,
- Non-funded income (NFI) remained flat recording a decline of 0.3% to Kshs 4.0 bn, below our expectation of a 0.3% increase. The decline in NFI was driven by a decline in forex income by 22.8% to Kshs 1.1 bn from Kshs 1.4 bn in FY'2015. The current revenue mix stands at 75:25 funded to non-funded income from 71:29 in FY'2015,
- Total operating expenses grew by 35.8% to Kshs 10.0 bn from Kshs 7.4 bn in FY'2015 following a 126.9% y/y growth in Loan loss provision (LLP) to Kshs 3.8 bn from Kshs 1.7 bn. Without LLP, operating expenses grew by 9.6% to Kshs 6.3 bn from Kshs 5.7 bn registered in FY'2015. Staff costs grew marginally by 14.4% to Kshs 3.2 bn from Kshs 2.8 bn In FY'2015
- Cost to Income ratio deteriorated to 61.9% from 53.6% in FY'2015. Without LLP, Cost to Income ratio improved to 38.7% from 41.6% in FY'2015
- Profit after tax declined by 3.3% to Kshs 4.3 bn from Kshs 4.5 bn in FY'2015.

Balance Sheet

- The balance sheet recorded an expansion in FY'2016, with total assets increasing by 2.2% to Kshs 169.5 bn from Kshs 165.8 bn in FY'2015 driven by a rise in holdings of government securities of 9.5%,
- The Loan book shrunk by 1.3% to Kshs 114.5 bn from Kshs 116.0 bn in FY'2015, lower than our expectations of a 1.8% expansion,
- Total liabilities declined by 0.2% to Kshs 139.1 bn from Kshs 139.4 bn in FY'2015, while shareholders' funds increased by 15.4% to Kshs 29.8 bn from Kshs 25.9 bn,
- Customer deposits declined by 0.5% to Kshs 111.8 bn from Kshs 112.4 bn in FY'2015, despite the bank's efforts to strengthen its network channels through opening up an additional 6 new branches and 181 service outlets across the country to boost its deposit mobilisation capabilities,
- The loan to deposit ratio remained relatively the same at 102.4% from 103.2% in FY'2015,
- Gross non-performing loans declined by 5.3% to Kshs 13.6 bn from Kshs 14.4 bn in FY'2015, which led to an improvement in the NPL ratio to 11.9% from 12.4% in FY'2015,

- The yield on interest earning assets increased to 12.5% from 12.1% in FY'2015, while the cost of funds declined to 5.0% from 5.7%.
- NIC Bank Kenya is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 18.7%, 8.2% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 8.5% to close the period at 23.0%
- NIC Bank currently has a return on average assets of 2.6% and a return on average equity of 15.5%

Key Take Outs:

a) NIC Bank's cost to income ratio has risen significantly to 61.9% from 53.6% in FY'2015, driven by the faster growth of operating expenses by 35.8% as compared to the 17.5% growth in operating revenue. This has seen the bank resort to retrenching 32 employees in senior positions in a bid to reduce costs
b) Loan loss provision continues to remain high for NIC as it is for the industry, thus resulting in depressed earnings growth for the bank.

Moving forward, NIC will thrive on:

a) Increased efficiency through cutting down of costs by: (i) reducing redundant roles across all branches thus cutting down on staff costs, and (ii) exploring technology as a more cost effective measure in deposit collection and loan disbursement through automation of its services on digital platforms
b) Reducing non-performing loans through improved credit risk management and loan recovery efforts.

Below is a summary of the key line items in the balance sheet and income statement

Figures in Kshs billions unless otherwise stated

Balance Sheet	FY'2015	FY'2016	y/y change	FY'2016e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	27.8	30.5	9.5%	37.3	33.8%	(24.4%)
Net Loans and Advances	116.0	114.5	(1.3%)	118.05	1.8%	(3.1%)
Total Assets	**165.8**	**169.5**	**2.2%**	**173.8**	**4.8%**	**(2.6%)**
Customer Deposits	112.4	111.8	(0.5%)	114.6	2.0%	(2.5%)
Total Liabilities	139.4	139.1	(0.2%)	143.9	3.2%	(3.5%)
Shareholders' Funds	**25.9**	**29.8**	**15.4%**	**29.3**	**13.3%**	**2.1%**

Balance sheet ratios	FY'2015	FY'2016	% y/y change
Loan to Deposit Ratio	103.2%	102.4%	(0.9%)
Return on average equity	18.4%	15.5%	(2.8%)
Return on average assets	2.9%	2.6%	(0.3%)

Income Statement	FY'2015	FY'2016	y/y change	FY'2016e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	9.7	12.2	24.9%	11.6	19.1%	5.8%
Net non-Interest Income	4.0	4.0	(0.3%)	4.0	0.3%	(0.6%)
Total Operating income	**13.8**	**16.2**	**17.5%**	**15.6**	**13.6%**	**3.9%**
Loan Loss provision	1.7	3.7	126.9%	3.5	112.5%	14.4%
Total Operating expenses	**7.4**	**10.0**	**35.8%**	**9.6**	**29.6%**	**6.2%**
Profit before tax	6.4	6.2	(3.6%)	**6.1**	(4.9%)	1.3%
Profit after tax	**4.5**	**4.3**	(3.3%)	**4.3**	(4.9%)	1.6%

Income statement ratios	FY'2015	FY'2016	% y/y change
Yield from interest-earning assets	12.1%	12.5%	0.3%
Cost of funding	5.7%	5.0%	(0.6%)
Net Interest Margin	6.9%	8.0%	1.0%
Cost to Income	53.6%	61.9%	8.3%
Cost to Assets	4.4%	5.9%	1.5%
Net Interest Income as % of operating income	70.7%	75.2%	4.4%
Non-Funded Income as a % of operating income	29.3%	24.8%	(4.4%)

Capital Adequacy Ratios	FY'2015	FY'2016
Core Capital/Total Liabilities	20.9%	25.9%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.9%**	**17.9%**
Core Capital/Total Risk Weighted Assets	14.9%	18.7%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.4%**	**8.2%**
Total Capital/Total Risk Weighted Assets	20.6%	23.0%
Minimum Statutory ratio	14.5%	14.50%
Excess	**6.1%**	**8.5%**
Liquidity Ratio	29.2%	38.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**9.2%**	**18.7%**