Barclays Bank of Kenya – FY'2018

10th March, 2019

Valuation Summary

- We are of the view that Barclays Bank of Kenya is an "***accumulate***" with a target price of Kshs 12.5, representing an upside of 15.3%, from the current price of Kshs 11.8 as of 14th March 2019, inclusive of a dividend yield of 9.3%,
- Barclays Bank of Kenya is currently trading at a P/TBV of 1.5x and a P/E of 7.9x vs an industry average of 1.5x and 7.0x, respectively.

Key Highlights FY'2018

- Barclays Bank of Kenya also launched its mobile-lending app dubbed Timiza, which offers micro-loans of between Kshs 100 and Kshs 50,000 at a 1.2% monthly rate. The product was introduced to compete with existing offerings such as M-Shwari, M-Co-op Cash, Equitel and KCB M-Pesa. The app charges a one-off facilitation fee of 5.0% on loans, which are repayable in 30 days;
- Barclays Bank of Kenya PLC rebranded to ABSA Kenya on 31st May 2018, following the acquisition of Barclays Africa Group Limited by South African-based ABSA Group Limited. Barclays Africa Group Limited has provided a two-year allowance for the rebranding exercise, to its subsidiaries, until June 2020. The proposed change of name over the next two years was approved by shareholders of Barclays Bank Kenya in the annual general meeting held by the bank in 2018; and,
- The Bank was awarded several accolades such as (i) Best Bank in Property Development Financing (at the Real Estate Excellence Awards) by Business Vision, UK, (ii) Best Corporate Bank in East Africa at (Banker Africa awards), and, (iii) 1st Runner Up, Best Bank in Kenya (Think Business Awards).

Income Statement

- Core earnings per share increased by 7.1% to Kshs 1.37 from Kshs 1.28 in FY'2017, above our expectation of a 2.7% increase to Kshs 1.31. The performance was driven by a 4.7% increase in total operating income, despite the 5.8% increase in total operating expenses. The variance in core earnings per share growth against our expectations was largely due to the 24.3% increase in Loan Loss Provisions (LLP) to Kshs 3.9 bn from Kshs 3.1 bn in FY'2017, against our expectation of a 4.1% decline in LLP to Kshs 3.0 bn,
- Total operating income increased by 4.7% to Kshs 31.7 bn from Kshs 30.3 bn in FY'2017. This was due to a 0.9% increase in Net Interest Income (NII) to Kshs 22.0 bn from Kshs 21.8 bn in FY'2017, coupled with the 14.7% rise in Non-Funded Income (NFI) to Kshs 9.7 bn from Kshs 8.5 bn in FY'2017,
- Interest income increased by 7.0% to Kshs 29.1 bn, from Kshs 27.2 bn in FY'2017. This was driven by a 27.8% growth in interest income from government securities to Kshs 7.4 bn from Kshs 5.8 bn in FY'2017, and a 1.3% increase in interest income on loans and advances to Kshs 21.5 bn, from Kshs 21.3 bn in FY'2017. The yield on interest-earning assets however declined to 11.4% from 12.1% in FY'2017, attributed to a decline in yields on government securities as well as a decline in lending rates due to the two CBR cuts last year, coupled with the faster 19.2% y/y increase in interest earning assets to Kshs 276.9 bn from Kshs 232.2 bn,
- Interest expenses increased by 31.6% to Kshs 7.1 bn from Kshs 5.4 bn in FY'2017, following a 76.2% increase in the interest expense on placement liabilities to Kshs 0.9 bn from Kshs 0.5 bn in FY'2017, as the bank sought to support deposit growth amidst tight liquidity in the money market, coupled with the 26.7% rise in Interest expense on customer deposits to Kshs 6.1 bn from Kshs 4.8 bn in FY'2017, on the back of the strong deposit growth of 11.5% y/y experienced in 2018. As a consequence, the cost of funds thus rose to 3.5% from 2.9% in FY'2017. Thus, the Net Interest Margin (NIM) declined to 8.6%, from 9.1% in FY'2017,
- Non-Funded Income (NFI) rose by 14.7% to Kshs 9.7 bn, from Kshs 8.5 bn in FY'2017. The growth was mainly driven by a 65.5% growth in fees and commissions on loans to Kshs 1.1 bn from Kshs 0.6 bn in

FY’2017, coupled with the 14.5% rise in forex trading income to Kshs 3.3 bn from Kshs 2.9 bn, which outpaced the 1.4% decline in other fees and commissions to Kshs 4.57 bn from Kshs 4.64 bn. As a result, the revenue mix shifted to 69:31 funded to non-funded income from 72:28 in FY’2017, as NFI grew faster than NII,

- Total operating expenses increased by 5.8% to Kshs 21.1 bn from Kshs 19.9 bn, largely driven by a 24.3% increase in Loan Loss Provisions (LLP) to Kshs 3.9 bn in FY’2018, from Kshs 3.1 bn in FY’2017, coupled with an 11.1% increase in other operating expenses to Kshs 7.4 bn in FY’2018, from Kshs 6.7 bn in FY’2017, which outweighed the 3.4% decline in staff costs to Kshs 9.8 bn from Kshs 10.1 bn in FY’2017, with the bank having laid off 323 staff in 2017,
- Consequently, the Cost to Income Ratio (CIR) deteriorated albeit marginally to 66.4%, from 65.8% in FY’2017. Without LLP, the cost to income ratio improved to 54.2%, from 55.5% in FY’2017, highlighting the rise in the cost of risk to 12.2% from 10.3% in FY’2017,
- Profit before tax increased by 2.7% to Kshs 10.7 bn, up from Kshs 10.4 bn in FY’2017. Profit after tax grew by 7.1% to Kshs 7.4 bn in FY’2018, from Kshs 6.9 bn in FY’2017, due the effective tax rate declining to 30.0% from 33.0% in FY’2017,
- The bank recommends a final dividend of Kshs 0.9 per share, having already paid an interim dividend of Kshs 0.2 per share, translating to a total dividend payout of Kshs 1.1 per share, a 10.0% rise from Kshs 1.0 paid in FY’2017, which translates to a dividend yield of 9.3%.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 19.8% to Kshs 324.8 bn from Kshs 271.2 bn in FY’2017. This growth was largely driven by a 58.9% increase in government securities to Kshs 92.9 bn from Kshs 58.5 bn in FY’2017, coupled with a 5.3% increase in their loan book to Kshs 177.4 bn from Kshs 168.4 bn in FY’2017,
- Total liabilities rose by 23.6% to Kshs 280.6 bn from Kshs 227.1 bn in FY’2017, driven by a 73.5% increase in Placement liabilities to Kshs 5.3 bn from Kshs 3.1 bn in FY’2017 coupled with a 78.5% increase in other liabilities to Kshs 67.9 bn from Kshs 38.0 bn in FY’2017. Customer deposits also increased, as they rose by 11.5% to Kshs 207.4 bn from Kshs 186.0 bn in FY’2017. Deposits per branch increased by 20.8% to Kshs 2.5 bn from Kshs 2.0 bn in FY’2017, with the number of branches having reduced by 7 to 84 from 91 in FY’2017,
- The faster growth in deposits as compared to loans led to a decline in the loan to deposit ratio to 85.5% from 90.5% in FY’2017,
- Gross Non-Performing Loans (NPLs) rose by 10.3% to Kshs 13.9 bn in FY’2018 from Kshs 12.6 bn in FY’2017. The NPL ratio thus deteriorated to 7.4% in FY’2018 from 7.1% in FY’2017. General Loan Loss Provisions rose by 17.5% to Kshs 6.5 bn from Kshs 5.6 bn in FY’2017. However, The NPL coverage declined marginally to 69.2% in FY’2018 from 70.0% in FY’2017, as interest in suspense declined by 5.2% to Kshs 3.1 bn from Kshs 3.3 bn in FY’2017,
- Shareholders’ funds increased marginally by 0.2% to Kshs 44.2 bn in FY’2018 from Kshs 44.1 bn in FY’2017, as the 111.6% increase in the revaluation reserve to Kshs 0.5 bn from Kshs 0.3 bn in FY’2017, was weighed down by the 1.9% decline in retained earnings to Kshs 35.9 bn from Kshs 36.6 bn in FY’2017,
- Barclays Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.4%, 3.9% above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 16.4%, exceeding the statutory requirement by 1.9%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 14.7%, while total capital to risk-weighted assets came in at 16.7%,
- The bank currently has a Return on Average Assets (ROaA) of 2.7%, and a Return on Average Equity (ROaE) of 16.8%.

Key Take-Outs:

1. The bank's asset quality deteriorated albeit marginally, with the NPL ratio deteriorating to 7.4% from 7.1% in FY'2017, as the gross NPLs rose by 10.3%. This was attributed to the corporate, real estate and SME book, as various entities cited the delayed payments by government, and a relatively tougher operating environment in 2018. However the bank continued to demonstrate prudence, as the coverage remained relatively high, at 69.2%, albeit slightly lower than the 70.0% in FY'2017. With the ongoing economic recovery, the bank's asset quality is likely to continue improving, across the other segments such as SMEs and the real estate segments,
2. There was a rapid expansion of Non-Funded Income, as it expanded by 14.7% y/y. The growth was largely driven to increased usage of the Bank's digital application platform-"Timiza", which was launched in March 2018, and has already disbursed approximately Kshs 10.0 bn, to its approximately 3.0 mn client base. Furthermore, with increased transactions (70.0% of all transactions) being done via alternative channels, the bank benefited from higher transactional revenue, and,
3. The bank recorded a relatively strong growth in its balance sheet, as deposits grew by 11.5% y/y, and were channeled to Government Securities investments which grew by 58.9%, and loans and advances which grew by 5.3%y/y, the highest it has recorded in the rate cap era. The growth in interest earning assets helped support increased interest income revenue, despite the decline in yields of both the government securities and loans, with the Central Bank Rate (CBR) declining by 100 bps during the year.

We expect the bank's growth to be driven by:

1. Increased ***Channel diversification,*** which is likely to help the bank to continue improving its operational efficiency. The benefits of this are already being felt with "Timiza" already recording an accelerated growth, and consequently higher Non-Interest Revenue. This, coupled with the expansion of its agent banking network and product offerings such as banc assurance and fixed income trading will see the bank expand its topline revenue, going forward.

Below is a summary of the bank's performance:

Balance Sheet	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	58.5	92.9	58.9%	75.6	29.2%	29.7%
Net Loans and Advances	168.4	177.4	5.3%	177.1	5.2%	0.1%
Total Assets	**271.2**	**324.8**	**19.8%**	**331.6**	**22.3%**	**(2.5%)**
Customer Deposits	186.0	207.4	11.5%	224.2	20.6%	(9.0%)
Total Liabilities	227.1	280.6	23.6%	287.3	26.5%	(2.9%)
Shareholder's Funds	**44.1**	**44.2**	**0.2%**	**44.4**	**0.6%**	**(0.4%)**

Balance sheet ratios	FY'2017	FY'2018	% y/y change
Loan to Deposit Ratio	90.5%	85.5%	(5.0%)
Return on average equity	16.0%	16.8%	0.8%
Return on average assets	2.7%	2.7%	(0.0%)

Income Statement	FY'2017	FY'2018	y/y change	FY'2018e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	21.8	22.0	0.9%	22.6	3.7%	(2.8%)
Net non-Interest Income	8.5	9.7	14.7%	9.1	7.4%	7.4%
Total Operating income	**30.3**	**31.7**	**4.7%**	**31.7**	**4.7%**	**0.0%**
Loan Loss provision	(3.1)	(3.9)	24.3%	(3.0)	(4.1%)	28.3%
Total Operating expenses	(19.9)	(21.0)	5.8%	(20.9)	5.1%	0.7%
Profit before tax	10.4	10.6	2.7%	10.8	4.1%	(1.3%)
Profit after tax	6.9	7.4	7.1%	7.1	2.7%	4.3%
Core EPS	**1.28**	**1.37**	**7.1%**	**1.3**	**2.7%**	**4.3%**

Income statement ratios	FY'2017	FY'2018	% y/y change
Yield from interest-earning assets	12.1%	11.4%	(0.7%)
Cost of funding	2.9%	3.5%	0.6%
Net Interest Margin	9.7%	8.6%	(1.1%)
Cost to Income	65.8%	66.4%	0.7%
Cost to Assets	6.2%	5.3%	(0.9%)
Net Interest Income as % of operating income	72.1%	69.4%	(2.7%)
Non-Funded Income as a % of operating income	27.9%	30.6%	2.7%

Capital Adequacy Ratios	FY'2017	FY'2018
Core Capital/Total Liabilities	20.8%	18.2%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.8%**	**10.2%**
Core Capital/Total Risk Weighted Assets	15.9%	14.4%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.4%**	**3.9%**
Total Capital/Total Risk Weighted Assets	18.0%	16.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.5%**	**1.9%**
Liquidity Ratio	33.4%	35.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**13.4%**	**15.7%**
Adjusted Core Capital/Total Liabilities		**18.6%**
Adjusted Core Capital/Total RWA		**14.7%**
Adjusted Total Capital/Total RWA		**16.7%**