Barclays Bank Kenya Earnings Note– Q1'2019

29th May, 2019

Valuation Summary

- We are of the view that Barclays Bank Kenya is a "***buy***" with a target price of Kshs 13.1, representing an upside of 39.2%, from the current price of Kshs 10.2 as of 31st May 2019, inclusive of a dividend yield of 10.8%,
- Barclays Bank Kenya is currently trading at a P/TBV of 1.4x and a P/E of 7.5x vs an industry average of 1.2x and 6.3x, respectively.

Income Statement

- Barclays Bank Kenya released their financial results with core earnings per share increasing by 13.8% to Kshs 0.39 from Kshs 0.35 in Q1'2018, slower than our expectation of a 19.0% increase to Kshs 0.41. The performance was driven by the 3.1% growth in total operating income to Kshs 8.0 bn, from Kshs 7.7 bn in Q1'2018, coupled with the 1.5% decline in total operating expenses to Kshs 4.9 bn, from Kshs 5.0 bn in Q1'2018. However, the growth in core EPS was after stripping the exceptional items expense of Kshs 0.2 bn. The variance in core EPS growth against our expectation was due to the slower than expected growth in total operating income. We had anticipated an 11.3% growth in total operating income to Kshs 8.6 bn,
- Total operating income rose by 3.1% to Kshs 8.0 bn, from Kshs 7.7 bn in Q1'2018, driven by the 14.0% growth in Non-Funded Income (NFI) to Kshs 2.6 bn, from Kshs 2.3 bn in Q1'2018, which outpaced the 1.3% decline in Net Interest Income (NII) to Kshs 5.4 bn, from Kshs 5.5 bn in Q1'2018,
- Interest income rose by 7.1% to Kshs 7.4 bn, from Kshs 6.9 bn in Q1'2018, driven by the 15.9% increase in interest income from government securities to Kshs 1.9 bn, from Kshs 1.7 bn in Q1'2018, the 3.6% increase in interest income from loans to Kshs 5.4 bn, from Kshs 5.2 bn in Q1'2018, and the 250.1% increase in interest income from placement assets to Kshs 63.6 mn, from Kshs 18.2 mn in Q1'2018. The yield on interest-earning assets however declined to 11.8%, from 12.1% in Q1'2018, due to the 100 bps decline in the Central Bank Rate (CBR) which consequently reduced the yields on loans,
- Interest expenses rose by 38.8% to Kshs 2.0 bn, from Kshs 1.5 bn in Q1'2018, following a 38.2% increase in the interest expense on customer deposits to Kshs 1.8 bn, from Kshs 1.3 bn in Q1'2018, coupled with the 43.0% rise in interest expense on placement liabilities to Kshs 0.3 bn, from Kshs 0.2 bn in Q1'2018. The cost of funds thus rose to 3.6% from 2.9% in Q1'2018. The Net Interest Margin (NIM) declined to 8.7%, from 9.7% in Q1'2018,
- Non-Funded Income (NFI) increased by 14.0% to Kshs 2.6 bn, from Kshs 2.3 bn in Q1'2018. The increase was mainly driven by an 11.6% rise in total fees and commission income to Kshs 1.5 bn, from Kshs 1.4 bn in Q1'2018 coupled with the 107.9% growth in other income to Kshs 0.3 bn, from Kshs 0.1 bn in Q1'2018, and the 2.1% rise in forex trading income to Kshs 0.78, from Kshs 0.76 in Q1'2018. As a result of the performance, the revenue mix shifted to 68:32 from 71:27, due to the fast growth in NFI coupled with the decline in NII,
- Total operating expenses declined by 1.5% to Kshs 4.9 bn, from Kshs 5.0 bn, largely driven by the 15.2% decline in staff costs to Kshs 2.3 bn in Q1'2019, from Kshs 2.8 bn in Q1'2018, which outweighed the 10.6% rise in Loan Loss Provisions (LLP) to Kshs 0.64 bn, from Kshs 0.58 bn in Q1'2018, and the 16.9% rise in other operating expenses to Kshs 2.0 bn, from Kshs 1.7 bn in Q1'2018,
- Due to the decline of total operating expenses coupled with the increase in total operating income, the Cost to Income Ratio (CIR) improved to 61.9%, from 64.8% in Q1'2018. Without LLP, the cost to income ratio improved to 53.9%, from 57.4% in Q1'2018, and,
- Profit before tax increased by 2.7% to Kshs 2.8 bn, up from Kshs 2.7 bn in Q1'2018. Profit after tax grew by 0.9% to Kshs 1.90 bn in Q1'2019, from Kshs 1.88 bn in Q1'2018 as the effective tax rate increased to 31.8% from 30.6% in Q1'2018.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 18.8% to Kshs 345.4 bn, from Kshs 290.7 bn in Q1’2018. This growth was largely driven by a 24.0% increase in investments in securities to Kshs 83.2 bn, from Kshs 67.0 bn in Q1’2018, coupled with a 41.8% increase in other assets to Kshs 54.0 bn, from Kshs 38.1 bn in Q1’2018,
- The loan book rose by 9.0% to Kshs 180.5 bn, from Kshs 165.5 bn in Q1’2018, attributed to an increase in the corporate loan book segment, increased SME lending, and increased lending via the bank’s timiza mobile lending platform,
- Total liabilities rose by 21.5% to Kshs 299.4 bn, from Kshs 246.4 bn in Q1’2018, driven by a 15.9% increase in deposits to Kshs 224.0 bn, from Kshs 193.3 bn in Q1’2018, coupled with a 36.3% increase in placement liabilities to Kshs 7.2 bn, from Kshs 5.3 bn in Q1’2018. Deposits per branch increased by 17.2% to Kshs 2.6 bn, from Kshs 2.2 bn in Q1’2018, with the number of branches having reduced to 88 from 89 in Q1’2018,
- The faster growth in deposits compared to loans led to a decline in the loan to deposit ratio to 80.6%, from 85.6% in Q1’2018,
- Gross Non-Performing Loans (NPLs) rose by 22.1% to Kshs 15.4 bn in Q1’2019, from Kshs 12.6 bn in Q1’2018. The NPL ratio thus deteriorated to 8.1%, from 7.2% in Q1’2018. General Loan Loss Provisions rose by 30.4% to Kshs 7.5 bn, from Kshs 5.7 bn in Q1’2018. However, the NPL coverage declined to 67.8%, from 71.7% in Q1’2018, as interest in suspense declined by 10.1% to Kshs 3.0 bn, from Kshs 3.3 bn in Q1’2018,
- Shareholders’ funds increased by 4.1% to Kshs 46.1 bn in Q1’2019, from Kshs 44.2 bn in Q1’2018, as retained earnings grew by 2.3% y/y to Kshs 194.0 mn, from Kshs 175.9 mn in Q1’2018, and other reserves rose by 10.3% to Kshs 194.0 mn, from Kshs 175.9 mn in Q1’2018,
- Barclays Bank Kenya is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 14.6%, 4.1% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 16.5%, exceeding the statutory requirement by 2.0% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 14.8%, while total capital to risk-weighted assets came in at 16.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.5%, and a Return on Average Equity (ROaE) of 16.5%.

Key Take-Outs:

1. The bank’s improved performance was weighed down by the separation costs, as the bank transitions its systems to that of ABSA. The bank’s management highlighted that the spending should continue to affect the bank’s earnings, with expenditure expected to be focused on advertising, rebranding ATMs, cards and branches to Absa brand, the purchase of new IT hardware, and software upgrades,

2. Asset quality continued to experience a deterioration, as highlighted by the rise in the NPL ratio to 8.1% from 7.2% in Q1’2018. Main sectors experiencing challenges were trade, manufacturing and retail. The additional provisioning expenses weighed down on the improved efficiency,

3. Barclays Bank benefited from the restructuring exercise it conducted in 2017, and it is the only bank to record a decline in staff costs y/y, which reduced by 15.2% y/y, and,

4. The bank recorded a relatively strong balance sheet growth, as the deposit base grew by 15.9% to Kshs 224.0 bn. Consequently, the bank utilized the additional funding by investing in government securities which recorded a growth of 24.0% increase to Kshs 83.2 bn, and growing its loan book which grew 9.0% to Kshs 180.5 bn. This aided the bank in growing its interest income, which was however weighed down by the decline in yields. However, the fast deposit growth came at a cost, as highlighted by the rise in the cost of funding to 3.6% from 2.9% in Q1’2018. This consequently weighed down the performance of funded income, as NII declined by 1.3% y/y.

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	Q1'2018	Q1'2019	y/y change	Q1'2019e	Expected y/y change	Variance in Actual Growth vs. Expected
Government Securities	67.0	83.1	24.0%	84.6	26.3%	(2.3%)
Net Loans and Advances	165.5	180.5	9.0%	177.7	7.3%	1.7%
Total Assets	**290.7**	**345.4**	**18.8%**	**331.2**	**13.9%**	**4.9%**
Customer Deposits	193.3	224.0	15.9%	211.6	9.5%	6.4%
Total Liabilities	246.4	299.4	21.5%	284.8	15.5%	5.9%
Shareholders' Funds	**44.2**	**46.1**	**4.1%**	**46.4**	**5.0%**	**(0.9%)**

Balance sheet ratios	Q1'2018	Q1'2019	% y/y change
Loan to Deposit Ratio	85.6%	80.6%	(5.1%)
Return on average equity	16.0%	16.5%	0.5%
Return on average assets	2.6%	2.5%	(0.0%)

Income Statement	Q1'2018	Q1'2019	y/y change	Q1'2019e	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	5.5	5.4	(1.3%)	6.1	11.6%	(13.0%)
Net non-Interest Income	2.3	2.6	14.0%	2.5	10.5%	3.4%
Total Operating income	**7.7**	**8.0**	**3.1%**	**8.6**	**11.3%**	**(8.2%)**
Loan Loss provision	(0.6)	(0.6)	10.6%	(0.5)	(10.5%)	21.2%
Total Operating expenses	(5.0)	(4.9)	(1.5%)	(5.4)	7.7%	(9.2%)
Profit before tax	**2.7**	**2.8**	2.7%	**3.2**	18.0%	**(15.3%)**
Profit after tax	**1.9**	**1.9**	0.9%	**2.2**	19.0%	**(18.1%)**
Core EPS	**0.35**	**0.35**	**0.9%**	**0.41**	**19.0%**	**(18.1%)**

Income statement ratios	Q1'2018	Q1'2019	% y/y change
Yield from interest-earning assets	12.1%	11.8%	(0.4%)
Cost of funding	2.9%	3.6%	0.7%
Net Interest Margin	9.7%	8.7%	(1.0%)
Cost to Income	64.8%	61.9%	(2.9%)
Cost to Assets	1.5%	1.2%	(0.3%)
Net Interest Income as % of operating income	70.8%	67.8%	(3.1%)
Non-Funded Income as a % of operating income	29.2%	32.2%	3.1%

Capital Adequacy Ratios	Q1'2018	Q1'2019
Core Capital/Total Liabilities	19.6%	17.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	**11.6%**	**9.3%**
Core Capital/Total Risk Weighted Assets	15.1%	14.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.6%**	**4.1%**
Total Capital/Total Risk Weighted Assets	17.2%	16.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.7%**	**2.0%**
Liquidity Ratio	36.2%	41.1%
Minimum Statutory ratio	20.0%	20.0%
Excess	**16.2%**	**21.1%**
Adjusted Core Capital/Total Liabilities		**17.5%**
Adjusted Core Capital/Total RWA		**14.8%**
Adjusted Total Capital/Total RWA		**16.7%**