Cytonn Financial Services Daily Note 15th November, 2017

In today's trading session, the Financial Services sector stocks were on an upward trend with the sector's capitalization increasing by 0.5% to Kshs 768.0 bn from Kshs 764.0 bn recorded yesterday. This performance was driven by gains in select large cap banking stocks such as KCB Group, Equity Group, and Co-operative Bank, which gained 2.5%, 1.9% and 0.6%, respectively. Standard Chartered Bank is the top loser today, losing 3.1% after the bank announced poor Q3'2017 results and issued a profit warning for the expected FY'2017 results.

Standard Chartered Bank and Diamond Trust Bank released Q3'2017 results today, with both banks posting declines in core Earnings per Share (EPS).

Standard Chartered recorded a 39.1% decline in core EPS to Kshs 13.7 from Kshs 22.5 in Q3'2016 attributed to a 27.1% y/y increase in operating expenses to Kshs 13.2 bn from Kshs 10.5 bn, and a 6.5% y/y decline in operating revenue Kshs 20.2 bn from Kshs 21.6 bn. The increase in operating expenses was driven by an 104.5% y/y increase in Loan Loss Provision (LLP) to Kshs 3.7 bn from Kshs 1.8 bn. Standard Chartered Bank has issued a profit warning for FY'2017 earnings, implying that the FY'2017 earnings will be at least 25.0% lower than FY'2016 earnings, which was attributed to 2 factors:

- The bank's Non-Performing Loans (NPL) have increased during the year, and no turnaround on the accounts is expected before the year-end. Gross NPLs currently stand at Kshs 17.0 bn, a 15.4% growth from Kshs 14.7 bn in Q3'2016, with the gross NPL ratio increasing to 13.4% from 11.6% in Q3'2016, and
- The effects of interest rate cap coupled with a slowdown in economic activity in the country that has resulted in a decline in private sector credit growth.

Going forward, Standard Chartered Bank is expected to benefit from its continued investment in digital infrastructure through its Digital by Design strategy, which aims to migrate over 80% of transactions to non-branch channels by 2020. This is expected to promote cost efficiency and improve the bank's cost to income ratio, which currently stands at 66.0% from 48.5% in Q3'2016.

Diamond Trust Bank recorded a 3.5% y/y decline in core EPS to Kshs 18.3 from Kshs 19.0, attributed to a 2.5% increase in operating expenses, and a 0.2% decline in total operating income. The increase in operating expenses was driven by a 44.2% y/y increase in amortization charges to Kshs 277.0 mn from Kshs 192.2 mn, owing to an 18.0% increase in the value of intangible assets; a 19.8% increase in rental charges, and a 14.2% increase in depreciation charges as the value of property & equipment increased by 21.8% following the completion of the acquisition of HBLK. Going forward, the Bank is leveraging on its heavy investment in technology to boost its growth and increase its profitability by reducing its operating costs. By Q3'2017, 91.1% of the bank's transaction were handled through alternative channels such as mobile, internet, merchant and agency banking with the remaining 8.9% being ATMs and Branch transactions. In our view, the investment in digital platforms made by the bank over the last 5 years should enable the bank achieve the much needed efficiency in this era of compressed Net Interest Margins and hence support profitability going forward.

Below is a summary of top gainers and losers for the day.

Top Gainers		Top Losers	
KCB Group	**2.5%**	Standard Chartered	**(3.1%)**
Equity Group	**1.9%**	NIC Bank	**(0.7%)**
Co-operative Bank	**0.6%**	National Bank	**(0.5%)**