Stanbic Holdings- H1’2020

14th **August, 2020**

Valuation Summary

We are of the view that Stanbic Holdings is an “Accumulate” with a target price of Kshs 82.8, representing an upside of 12.7%, from the current price of Kshs 73.5 as of 14th August 2020. Stanbic Holdings is currently trading at P/TBV of 0.7x and a P/E of 5.3x vs an industry average of 1.2x and 6.3x, respectively.

Key Highlights H1’2020

- In the wake of the COVID-19 pandemic, the bank has so far restructured loans worth Kshs 38.0 bn in a bid to protect both businesses and households following the enforcement of movement restrictions in the country. The bank also adopted fee waivers on its digital platforms in-line with directives from the Central Bank.

Income Statement

- Core earnings per share declined by 31.2% to Kshs 6.5, from Kshs 9.4 in H1’2019, which was a larger decline compared to our projections of a decline to Kshs 7.5. The performance was mainly driven by a 60.5% rise in loan loss provisions which came in at Kshs 2.0 bn, from Kshs 1.2 bn recorded in H1’2019, in a move to cater for the increasing loan defaults,
- Total operating income declined by 12.0% to Kshs 10.7 bn in H1’2020, from Kshs 12.2 bn in H1’2019. This was driven by an 18.8% decline in Non-Funded Income (NFI) to Kshs 4.7 bn, from Kshs 5.8 bn in H1’2019, coupled with a 5.9% decline in Net Interest Income (NII) to Kshs 6.0 bn, from Kshs 6.4 bn in H1’2019,
- Interest income declined by 4.8% to Kshs 9.6 bn, from Kshs 10.1 bn recorded in H1’2019, driven by a 15.5% decline in interest income from government securities to Kshs 2.0 bn, from Kshs 2.3 bn in H1’2019, coupled with the 6.3% decline in interest income from loans and advances to Kshs 7.1 bn, from Kshs 7.6 bn in H1’2019. There was however a 240.2% increase in interest income from other deposits to Kshs 0.5 bn, from Kshs 0.1 bn in H1’2019. The yield on interest-earning assets declined to 4.5% from 4.9% in H1’2019, this is attributable to the 16.8% growth in interest-earning assets compared to the 4.8% decline in Interest Income,
- Interest expense declined by 3.1% to 3.6 bn, from 3.7 bn in H1’2019 mainly due to the 63.1% decline in interest expense from deposits and placements from other banking institutions to Kshs 0.3 bn, from Kshs 0.8 bn in H1’2019, which was distracted by a 12.9% increase in interest expense from deposits to Kshs 2.8 bn, from Kshs 2.5 bn in H1’2019. The Net Interest Margin (NIM) declined to 4.5% from 4.9% in H1’2019. This is attributable to the faster growth in average interest-earning assets by 13.8% compared to the 3.3% growth in the bank’s trailing net interest income,
- Non-Funded Income (NFI) declined by 18.8% to Kshs 4.7 bn, from Kshs 5.8 bn in H1’2019, mainly driven by a 36.7% decline in fees and commissions on loans to Kshs 0.1 bn, from Kshs 0.2 bn in H1’2019, coupled with a 33.1% decline in other fees and commissions to Kshs 1.7 bn, from Kshs 2.5 bn in H1’2019, and a 13.1% decline in other income to Kshs 0.3 bn, from Kshs 0.4 bn in H1’2019. The revenue mix for H1’2020 shifted to 56:44, from 51:49, mainly due to the decline in non-funded income,
- Total operating expenses increased marginally by 1.3% to Kshs 6.8 bn, largely driven by an 83.6% increase in Loan Loss Provisions (LLP) to Kshs 1.7 bn in H1’2020, from Kshs 0.9 bn in H1’2019, which outweighed the 11.7% decline in staff costs to Kshs 5.2 bn, from Kshs 5.8 bn, in H1’2019,
- The cost to income ratio improved to 45.7%, from 58.3% in H1’2019. Without LLP, the Cost to income ratio improved to 28.1% from 48.0% in H1’2019, highlighting the increase in the cost of risk to 17.6%, from 9.9% in H1’2019 as a result of the increase in loan loss provisions, and,

- Profit before tax declined by 20.7% to Kshs 4.1 bn, down from Kshs 5.2 bn in H1’2019. Profit after tax declined by 31.2% to Kshs 2.6 bn in H1’2020, from Kshs 3.7 bn in H1’2019, highlighting the decline in the effective tax rate to 16.1%, from 28.7% in H1’2019.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 15.4% to Kshs 361.5 bn, from Kshs 313.3 bn in H1’2019. This growth was largely driven by a 32.8% increase in net loans and advances to Kshs 235.1 bn, from Kshs 177.1 bn in H1’2019, coupled with a 20.7% increase in derivative assets to Kshs 2.5 bn, from Kshs 2.0 bn in H1’2019. These increments we’re however weighed down by a 29.1% decline in property and equipment to Kshs 2.3 bn, from Kshs 3.3 bn in H1’2019 attributable to depreciation relating to Stanbic South Sudan based on restated amounts for the effects of hyperinflation, and, a 13.4% decline in investment securities to Kshs 81.5 bn in H1’2020, from Kshs 94.1 bn,
- Total liabilities rose by 17.1% to Kshs 312.2 bn, from Kshs 266.5 bn in H1’2019, driven by a 20.6% increase in total deposits to Kshs 287.0 bn, from Kshs 238.0 bn in H1’2019. On the other hand, borrowings declined by 41.3% to Kshs 5.4 bn, from Kshs 9.2 bn in H1’2019, which include payments to the parent company on syndicated borrowings,
- The faster growth in loans as compared to deposits led to an increase in the loan to deposit ratio to 81.9%, from 74.4% in H1’2018,
- Gross Non Performing Loans (NPLs) increased by 20.2% to Kshs 21.2 bn from Kshs 17.6 bn recorded in H1’2019. The Gross NPL ratio fell to 8.5%, from 9.4% in H1’2019, owing to a faster 32.4% growth in gross loans, compared to the 20.2% growth in gross non-performing loans. General provisions rose by 20.8% to Kshs 8.6 bn, from Kshs 7.1 bn in H1’2019. As a result, the NPL Coverage increased to 64.8% from 61.7% in H1’2019,
- Shareholders’ funds increased by 5.4% to Kshs 49.3 bn in H1’2020, from Kshs 46.8 bn in H1’2019, mainly driven by the 12.1% increase in retained earnings to Kshs 33.4 bn, from Kshs 29.8 bn in H1’2019,
- Stanbic Bank remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.4%, 4.9% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio stood at 17.9%, exceeding the statutory requirement by 3.4% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.9%, while total capital to risk-weighted assets came in at 18.4%,
- Stanbic Holdings currently has a return on average assets of 1.4% and a return on average equity of 10.0%.

Key Take-Outs:

i. The bank recorded relatively poor performance in both funded and NFI segments evidenced by the 12.0% decline in total operating income to Kshs 10.7 bn in H1’2020, from Kshs 12.2 bn in H1’2019. Non-funded income declined by 18.8% to Kshs 4.7 bn, from Kshs 5.8 bn in H1’2019, while net interest income declined by 5.9% to Kshs 6.0 bn, from Kshs 6.4 bn in H1’2019. This poor performance can be attributed to the current ongoing pandemic which led to the enforcement of movement restrictions which have adversely affected both businesses and households,

ii. The bank’s asset quality has deteriorated significantly with the gross non-performing loans (NPLs) increasing by 20.2% to Kshs 21.2 bn from Kshs 17.6 bn recorded in H1’2019. To curb this, the bank has had to increase its provisioning where general provisions rose by 20.8% to Kshs 8.6 bn, from Kshs 7.1 bn in H1’2019.

Going forward:

i. The bank has put in place plans to promote digitization on the bank's functions which we believe will improve efficiencies in the bank's activities in a cost-effective manner. They also intend to use the digital platforms to push their ecosystem and help increase adoption in their customer base,

Below is a summary of the bank's performance:

Balance Sheet	Q2'2019	H1'2020	y/y change	FY'2018e	Projected y/y change	Variance in growth vs projection
Net Loans	177.1	235.1	32.8%	228.2	28.8%	4.0%
Total Assets	**313.3**	**361.5**	**15.4%**	**306.3**	**(2.3%)**	**17.6%**
Deposits	238.0	287.0	20.6%	231.4	(2.8%)	23.4%
Total liabilities	**266.5**	**312.2**	**17.1%**	**261.3**	**(1.9%)**	**19.1%**
Shareholders' Funds	**46.8**	**49.3**	**5.4%**	**44.9**	**(4.1%)**	**9.4%**

Income Statement	Q2'2019	H1'2020	y/y change	FY'2018e	Projected y/y change	Variance in growth vs projection
Net interest Income	6.4	6.3	(0.7%)	7.8	22.2%	(23.0%)
Net non-interest income	6.1	5.0	(19.1%)	7.0	13.4%	(32.6%)
Total Operating income	**12.5**	**11.3**	**(9.8%)**	**14.7**	**17.9%**	**(27.7%)**
Loan loss provision	(1.2)	(2.0)	60.5%	-3.1	154.7%	(94.2%)
Total Operating expenses	**(7.3)**	**(5.2)**	**(29.2%)**	**-10.5**	**44.4%**	**(73.6%)**
Profit before tax	5.2	4.1	(20.7%)	4.2	(19.1%)	(1.6%)
Profit after tax	**3.7**	**2.6**	**(31.2%)**	**3.0**	**(20.5%)**	**(10.7%)**

Key Ratios	Q2'2019	H1'2020
Loan to Deposit ratio	74.4%	81.9%
Return on average equity	14.5%	10.9%
Return on average assets	2.2%	1.5%
Net Interest Margin	4.9%	4.8%
Cost to Income Without LLP	48.4%	28.1%
NII as a % of Operating Income	50.9%	56.0%
NFI as a % of Operating Income	49.1%	44.0%

Capital Adequacy Ratios	Q2'2019	H1'2020
Core Capital/Total Liabilities	16.6%	16.5%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.6%**	**8.5%**
Core Capital/Total Risk Weighted Assets	14.2%	14.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	**3.7%**	**4.1%**
Total Capital/Total Risk Weighted Assets	17.5%	17.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.0%**	**2.9%**
Liquidity Ratio	55.3%	57.9%
Minimum Statutory ratio	20.0%	20.0%
Excess	**35.3%**	**37.9%**
Adjusted Core Capital/Total Risk Weighted Assets	**15.3%**	**15.9%**
Adjusted Total Capital/Total Risk Weighted Assets	**18.6%**	**18.4%**