Stanbic Holdings Earnings Update – FY'2018

1st March, 2019

Valuation Summary

- We are of the view that Stanbic Holdings is a "Hold" with a target price of Kshs 92.6 representing an upside of 4.5%, inclusive of a dividend yield of 6.3%, from the current price of Kshs 94.3 as of 1st March 2019,
- Stanbic Holdings is currently trading at a P/TBv of 0.9x and a P/E of 5.9x, vs an industry average of 1.5x and 7.1x, respectively.

Key highlights during FY'2018

- Stanbic Holdings and Industrial Commercial Bank of China launched a new initiative dubbed "I Go Kenya- I Go China" to promote tourism between Kenya and China by offering incentives for travel, shopping and leisure to tourists visiting the two countries.
- Stanbic Holdings received a Kshs 10.0 bn dual-tranche syndicated loan from 14 banks led by Mashreq Bank, a leading financial institution in the United Arab Emirates. The loan had a two and three-year maturity for the two tranches. The proceeds of the loan were to be devoted towards new lending and general corporate purposes. The syndicated loan involved 14 financial institutions and was two and a half times oversubscribed.

Income Statement

- Core earnings per share increased by 45.7% to Kshs 15.9 from Kshs 10.9 in FY'2017, exceeding our expectations of a 12.8% increase to Kshs 12.3. The increase was driven by a 15.9% growth in total operating income, coupled with a 4.0% decline in total operating expenses,
- Total operating income rose 15.9% to Kshs 22.1 bn from Kshs 19.1 bn in FY'2017, driven by the 18.3% growth in Non-Funded Income (NFI), coupled with the 14.0% growth in Net Interest Income (NII),
- Interest income from the banking unit rose 13.8% to Kshs 18.9 bn from Kshs 16.6 bn in FY'2017. The rise in interest income was largely due to a 17.7% increase in interest income on loans and advances to Kshs 14.2 bn from Kshs 12.1 bn in FY'2017. Interest income on Government Securities remained relatively flat at Kshs 4.3 bn. The yield on interest-earning assets declined marginally to 7.9% from 8.0% in FY'2017;
- Interest expense increased by 19.2% to Kshs 7.2 bn from Kshs 6.0 bn in FY'2017. The rise in interest expense was due to a 21.2% rise in interest expense on customer deposits to Kshs 4.5 bn from Kshs 3.7 bn in FY'2017, coupled with the 11.3% rise in interest expense on deposits and placements from banking institutions to Kshs 1.9 bn from Kshs 1.7 bn in FY'2017. Consequently, the costs of funds rose marginally to 3.5% from 3.4% in FY'2017. The Net Interest Margin declined marginally to 5.0% from 5.1% in FY'2017;
- Non-funded income (NFI) rose by 18.3% to Kshs 10.0 bn from Kshs 8.4 bn in FY'2017, mainly driven by a 15.5% increase in other fees and commissions to Kshs 3.7 bn from Kshs 3.2 bn in FY'2017, coupled with a 14.0% y/y rise in foreign exchange income to Kshs 3.1 bn from Kshs 2.7 bn. Other income rose 27.5% to Kshs 2.4 bn from Kshs 1.8 bn. The current revenue mix shifted to 55:45 NII to NFI from 56:44 in FY'2017, owing to the faster rise in NFI;
- Total operating expenses declined by 4.0% to Kshs 13.2 bn from Kshs 13.7 bn in FY'2017, following a 25.2% decline in Loan loss provision (LLP) to Kshs 2.1 bn from Kshs 2.8 bn in FY'2017. Staff costs however rose by 2.9% to Kshs 5.6 bn from Kshs 5.4 bn in FY'2017. Without LLP, operating expenses increased by 1.7% to Kshs 11.1 bn from the Kshs 10.9 bn registered in FY'2017;
- The cost to income ratio improved to 59.5% from 71.7% in FY'2017. Without LLP, the cost to Income ratio also improved to 50.2% from 57.2% in FY'2017;
- Profit before tax increased by 65.7% to Kshs 8.9 bn from Kshs 5.4 bn, while profit after tax (PAT) increased by 45.7% to Kshs 6.3 bn from Kshs 4.3 bn in FY'2017, owing to an increase in the effective tax rate to 29.8% from 20.2% in FY'2017;
- The bank recommends a final dividend of Kshs 3.55 per share, having already paid an interim dividend of Kshs 2.25 per share, translating to a total dividend payout of Kshs 5.8 per share in 2018, a 10.5% increase from the Kshs 5.25 paid in 2017, which translates to a dividend payout of 36.5%, and a dividend yield of 6.2%;

Balance Sheet

- The balance sheet recorded an expansion in FY’2018, with total assets increasing by 16.8% to Kshs 290.6 bn from Kshs 248.7 bn in FY’2017, driven by a 22.1% rise in the loan book to Kshs 175.0 bn from Kshs 143.3 bn in FY'2017. Investment securities declined by 5.2% to Kshs 72.3 bn from Kshs 76.2 bn in FY’2017;
- Total liabilities increased by 19.5% to Kshs 246.0 bn from Kshs 205.8 bn in FY’2017, driven by the 13.5% growth in customer deposits to Kshs 219.5 bn from Kshs 193.4 bn in FY’2017, and the 77.1% growth in borrowings to Kshs 7.1 bn from Kshs 4.0 bn in FY’2017;
- The faster growth in loans compared to deposits led to a rise in the loan to deposit ratio to 79.7% from 74.1% in FY’2017;
- Gross Non-Performing Loans (NPLs) grew by 60.7% to Kshs 16.6 bn from Kshs 10.4 bn in FY’2017, faster than the growth in loans, which saw the NPL ratio worsen to 9.1% from 7.0% in FY’2017. Loan loss provisions (LLP) increased by 88.1% to Kshs 6.1 bn from Kshs 3.2 bn, leading to an improvement in the NPL Coverage to 53.4% up from 47.4% in FY’2017;
- Shareholders’ funds increased by 3.9% to Kshs 44.6 bn from Kshs 43.0 bn, as the revenue and other reserves account rose by 6.6% to Kshs 25.7 bn from Kshs 24.1 bn in FY’2017;
- Stanbic Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio at 14.6%, 4.1% above the statutory requirement, with total capital to total risk weighted assets exceeding statutory requirement by 2.9% to close the period at 17.4%, and,
- Stanbic Holdings currently has a return on average assets of 2.3% and a return on average equity of 14.3%.

Key Take outs:

a) Stanbic Holdings registered strong performance on NFI, which grew by 18.6%, underpinning the importance of revenue diversification, following the capping of interest rates. The bank has been aggressive in generating non-funded income, which now accounts for 45.1% of its operating income, given earnings from interest income is expected to remain depressed due to the interest rate cap,

b) The bank’s efficiency significantly improved with the cost to income ratio coming in at 59.5%, from 71.7% as at FY’2017. We note that revenue expansion and cost containment have been key in improving the bank’s efficiency. However, the decline in costs was largely driven by the decline in LLPs, which remains unsustainable in the long term, and,

c) The NPL ratio worsened to 9.1% with the gross non-performing loans growing by 60.7%, indicating a weakening in asset quality. We note that management’s focus should be on continuous risk assessment and management, mainly aimed at ensuring the bank’s asset quality improves.

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'2017	FY'2018	y/y change	FY'2018e	Projected y/y change	Variance in growth vs projection
Net Loans	143	175	22.1%	163	13.8%	8.3%
Total Assets	249	291	16.8%	280	12.6%	4.2%
Deposits	**193**	219	13.5%	**218**	12.7%	0.8%
Total liabilities	**206**	246	19.5%	**239**	16.0%	3.5%
Shareholders' Funds	**43**	**45**	3.9%	**41**	(3.6%)	7.5%

Income Statement	FY'2017	FY'2018	y/y change	FY'2018e	Projected y/y change	Variance in growth vs projection
Net interest Income	10.6	12.1	14.4%	11.56	9.1%	5.4%
Net non-interest income	8.4	10.0	18.6%	9.64	14.8%	3.8%

Total Operating income	**19.1**	**22.1**	**15.7%**	**21.2**	11.0%	4.7%
Loan loss provision	2.8	2.1	(26.4%)	2.6	(7.1%)	(19.3%)
Total Operating expenses	**13.7**	**13.2**	**(4.0%)**	**13.7**	0.0%	(4.0%)
Profit before tax	5.4	8.9	65.7%	6.85	26.9%	38.9%
Profit after tax	**4.3**	**6.3**	**46.0%**	**4.8**	11.6%	34.4%

Key Ratios	FY'2017	FY'2018
Loan to Deposit ratio	74.1%	79.7%
Return on average equity	10.4%	14.3%
Return on average assets	1.9%	2.3%
Net Interest Margin	5.1%	5.0%
Cost to Income (without LLP)	57.2%	50.2%
NII as a % of Operating Income	55.8%	54.9%
NFI as a % of Operating Income	44.2%	45.1%

Capital Adequacy Ratios	FY'2017	FY'2018
Core Capital/Total Liabilities	20.2%	16.5%
Minimum Statutory ratio	8.0%	8.0%
Excess	**12.2%**	**8.5%**
Core Capital/Total Risk Weighted Assets	15.4%	14.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.9%**	**4.1%**
Total Capital/Total Risk Weighted Assets	16.9%	17.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.4%**	**2.9%**
Liquidity Ratio	52.4%	57.9%
Minimum Statutory ratio	20.0%	20.0%
Excess	**32.4%**	**37.9%**
Adjusted Core Capital/Total Deposit Liabilities	0.0%	17.3%
Adjusted Core Capital/Total Risk Weighted Assets	0.0%	15.3%
Adjusted Total Capital/Total Risk Weighted Assets	0.0%	18.1%