Standard Chartered Bank – FY'2017

23rd March, 2018

Valuation Summary

- We are of the view that Standard Chartered Bank of Kenya limited is a "Sell" with a target price of Ksh 201.1, representing a downside of 2.3%, from the current price of Kshs 223 as of 23th March, inclusive of a dividend yield of 7.6%,
- Standard Chartered Bank is currently trading at P/TBV of 1.8x and a P/E of 11.1x vs an industry average of 1.7x and 9.6x, respectively.

Key highlights FY'2017

- Standard Chartered Bank embarked on aggressive lending to the retail segment, whose access to credit was affected by the interest rate cap law. The bank allocated Kshs 10.0 bn, from which a customer can borrow up to a maximum of Kshs 7.0 mn,
- Standard Chartered issued a profit warning for the full year ending December 2017, citing the effects a cap on interest rates and unpaid loans in a sluggish economy. Earnings were expected to drop by 25% from FY'2016 to Kshs 6.75 bn, however, they recorded earnings of Kshs 6.9 bn surpassing their expectation by 2.2%

Income Statement

- Total operating income declined by 2.1% to Kshs 27.4 bn from Kshs 28.0 bn, as a result of a decrease in the Net Interest Income (NII) by 4.1% to Kshs 18.6 bn from Kshs 19.4 bn, while Non-Funded Income (NFI) increased by 2.3% to Kshs 8.6 bn from Kshs 8.8 bn,
- Interest income increased by 1.9% to Kshs 26.3 bn from Kshs 25.8 bn in FY'2016. The interest income on loans and advances declined by 8.1% to Kshs 13.6 bn from 14.8 bn, while interest income on government securities increased by 11.9% to Kshs 11.3 bn from Kshs 10.1 bn. As a result, the yield on interest-earning assets declined to 8.4% from 9.7% in FY'2016,
- Interest expense increased by 20.3% to Kshs 7.7 bn from Kshs 6.4 bn in FY'2016, following a 12.3% increase in the interest expense on customer deposits to Kshs 6.4 bn from Kshs 5.7 bn in FY'2016, and an increase in other interest expenses by 83.3% to Kshs 1.1 bn from Kshs 0.6 bn in FY'2016. Consequently, the cost of funds increased to 3.7% from 3.5% in FY'2016. The Net Interest Income declined by 4.1% to Kshs 18.6 bn from 19.4 bn, and as a consequence the Net Interest Margin declined to 8.4% from 9.7%,
- Non-Funded Income (NFI) increased by 2.3% to Kshs 8.8 bn from Kshs 8.6 bn in FY'2016. The growth in NFI was driven by a 33.3% increase in other income to Kshs 1.6 bn from Kshs 1.2 bn in FY'2016. Forex income decreased by 3.6% from Kshs 2.8 bn to Kshs 2.7 bn. Income from fees and commissions remained flat at Kshs 4.6 bn. The revenue mix currently stands at 68:32 Funded to Non-Funded Income from the 69:31 recorded in FY'2016, owing to an increase in NFI coupled with a decline in NII,
- Total operating expenses increased by 17.7% to Kshs 17.3 bn from Kshs 14.7 bn, largely driven by a 90.9% increase in the loan loss provision to Kshs 4.2 bn from Kshs 2.2 bn in FY'2016. The higher provisioning was as a result of aggressive lending to the retail segment, whose access to credit was affected by the interest rate cap law,
- The cost to income ratio worsened to 63.2% from 52.5% in FY'2016, due to the rise in loan loss provisioning in 2017. Without LLP, the Cost to income ratio also worsened, albeit marginally from 44.7% in FY' 2016 to 47.9% in FY' 2017,
- Profit before tax declined by 24.3% to stand at Kshs 10.1 bn from Kshs 13.3 bn. Profit after tax declined by 24.0% to Kshs 6.9 bn from Kshs 9.0 bn in FY'2016,

- The bank recommends a final dividend of Kshs 17 per share, subject to shareholders' approval translating to a dividend yield of 7.3%. The proposed dividend per share declined by 15% from Kshs 20 in FY'2016,

Balance Sheet

- Total assets increased by 14.1% to Kshs 285.7 bn from Kshs 250.5 bn in FY'2016. This growth was largely driven by an increase in investment in government securities by 26.7% to stand at Kshs 104 bn from Kshs 81.7 bn in FY'2016. Also there was a 2.9% increase in the loan book to Kshs 126.3 bn from Kshs 122.7 bn,
- Total liabilities rose by 16.6% to Kshs 240.1 bn from Kshs 205.9 bn in FY'2016, driven by a 14.3% increase in total deposits to Kshs 213.3 bn in FY'2017 from Kshs 186.6 bn in FY'2016. Deposits per branch closed the year at Kshs 5.6 bn up by 14.3% from Kshs 4.9 bn in FY'2016,
- The faster increase in the deposits as compared to the loans resulted to a decrease in the loan to deposit ratio to 59.2% in FY'2016 from 65.8% in FY 2017,
- Gross non-performing loans increased by 17.3% to Kshs 17.6 bn from Kshs 15.0 bn. The NPL ratio deteriorated to 12.6% in FY'2017 from 11.3% in FY'2016 as NPLs increased at a higher rate than the loan book,
- Shareholders' funds increased by 2.5% from Kshs 44.6 bn in FY'2016 to Kshs 45.7 bn in FY'2017. This is largely due to a 4.5% increase in retained earnings to Kshs 28.0 bn from 26.8 bn.
- Standard Chartered Bank is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 15.6%, 5.1% above the statutory requirement. In addition, the total capital to risk weighted assets ratio stands at 18.5%, exceeding the statutory requirement by 4.0%.

Key Take out:

Going forward, we expect Standard Chartered Bank's growth to be propelled by;

(i) Channel diversification to more efficient and customer convenient channels such as mobile and digital channels that allow for more transactional fee-based income, thus increasing its Non-Funded Income,

(ii) Improvements in asset quality, with the increase in NPLs causing Standard Chartered bank's Gross Non-Performing Loans ratio to deteriorate to 12.6%, which is way above peer average of 8.2%.

Below is a summary of the key line items in the balance sheet and income statement
Figures in Ksh billions unless otherwise stated

Balance Sheet Items	FY'2016	FY'2017	y/y change	FY'2017e	Projected y/y change	Variance in Growth Actual vs. Expected
Government Securities	82.2	103.5	25.9%	121.5	47.8%	(21.9%)
Net loans	122.7	126.3	2.9%	119.8	(2.3%)	5.3%
Total Assets	**250.5**	**285.7**	**14.1%**	**327.3**	**30.7%**	**(16.6%)**
Customer Deposits	186.6	213.3	14.3%	239.7	28.5%	(14.1%)
Total Liabilities	205.9	240.1	16.6%	284.2	38.0%	(21.4%)
Shareholder's Funds	**44.6**	**45.7**	**2.4%**	**43.1**	**(3.3%)**	**5.7%**

Balance Sheet Ratios	FY'2016	FY'2017	y/y change
Loan to deposit ratio	65.8%	59.6%	(6.2%)
Return on Average Equity	21.1%	15.3%	(5.8%)
Return on Average Assets	3.8%	2.6%	(1.2%)

Income Statement	FY'2016	FY'2017	y/y change	FY'2017e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	19.4	18.6	(4.1%)	18.0	(7.1%)	3.0%
Net non-Interest Income	8.6	8.8	2.3%	8.7	1.6%	0.7%
Total Operating income	**28.0**	**27.4**	**(2.1%)**	**26.8**	**(4.4%)**	**2.3%**
Loan Loss provision	2.2	4.2	90.9%	4.4	100.7%	(9.8%)
Total Operating expenses	14.7	17.3	17.7%	17.8	21.2%	(3.5%)
Profit before tax	13.3	10.1	(24.3%)	9.0	(32.7%)	8.4%
Profit after tax	**9.0**	**6.9**	**(23.2%)**	**6.1**	**(32.4%)**	**9.2%**
Core EPS	**25.9**	**19.6**	**(24.0%)**	**17.7**	**(31.4%)**	**7.4%**

Income Statement Ratios	FY'2016	FY'2017	y/y change
Yield from interest-earning assets	9.7%	8.4%	(1.3%)
Cost of funding	3.5%	3.7%	0.2%
Net Interest Spread	6.2%	4.7%	(1.6%)
Net Interest Margin	9.7%	8.4%	(1.3%)
Cost of Risk	7.9%	15.3%	7.4%
Net Interest Income as % of operating income	69.3%	67.9%	(1.4%)
Non-Funded Income as a % of operating income	30.7%	32.1%	1.4%
Cost to Income Ratio	52.5%	63.2%	10.6%

Capital Adequacy Ratios	FY'2016	FY'2017
Core Capital/Total Liabilities	18.9%	16.7%
Minimum Statutory ratio	8.0%	8.0%
Excess	**10.9%**	**8.7%**
Core Capital/Total Risk Weighted Assets	17.5%	15.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	**7.0%**	**5.1%**
Total Capital/Total Risk Weighted Assets	20.9%	18.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**6.4%**	**4.0%**
Liquidity Ratio	56.9%	58.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**36.9%**	**38.7%**