Standard Chartered Bank of Kenya Plc - Q1'2021

28st May 2021

Below is a summary of Standard Chartered Bank of Kenya Plc Q1'2021 performance;

Balance Sheet Items (Kshs bn)	Q1'2020	Q1'2021	y/y change
Net loans	125.5	117.9	(6.1%)
Total Assets	**311.5**	**339.3**	**8.9%**
Customer Deposits	243.6	265.2	8.9%
Total Liabilities	261.6	286.4	9.4%
Shareholder's Funds	**49.8**	**52.9**	**6.1%**

Balance sheet ratios	Q1'2020	Q1'2021	y/y % point change
Loan to Deposit Ratio	51.5%	44.4%	(7.1%)
Return on average equity	15.8%	11.3%	(4.5%)
Return on average assets	2.6%	1.8%	(0.8%)

Income Statement (Kshs bn)	Q1'2020	Q1'2021	y/y change
Net Interest Income	4.7	4.6	(2.8%)
Net non-Interest Income	2.2	2.5	11.1%
Total Operating income	**7.0**	**7.1**	**1.7%**
Loan Loss provision	0.4	0.4	(3.5%)
Total Operating expenses	4.0	3.7	(9.0%)
Profit before tax	2.9	3.4	16.6%
Profit after tax	**2.0**	**2.4**	**18.9%**
Core EPS	**5.3**	**6.3**	**18.9%**

Income Statement Ratios	Q1'2020	Q1'2021	y/y % points change
Yield from interest-earning assets	9.4%	8.1%	(1.3%)
Cost of funding	2.4%	1.6%	(0.8%)
Net Interest Spread	7.0%	6.5%	(0.5%)
Net Interest Margin	7.2%	6.7%	(0.6%)
Cost of Risk	6.2%	5.8%	(0.3%)
Net Interest Income as % of operating income	67.9%	64.9%	(3.0%)
Non-Funded Income as a % of operating income	32.1%	35.1%	3.0%
Cost to Income Ratio	58.1%	52.0%	(6.1%)

Capital Adequacy Ratios	Q1'2020	Q1'2021
Core Capital/Total Liabilities	15.1%	15.1%
Minimum Statutory ratio	8.0%	8.0%
Excess	**7.1%**	**7.1%**
Core Capital/Total Risk Weighted Assets	15.0%	15.9%
Minimum Statutory ratio	10.5%	10.5%
Excess	**4.5%**	**5.4%**
Total Capital/Total Risk Weighted Assets	18.0%	18.3%
Minimum Statutory ratio	14.5%	14.5%
Excess	**3.5%**	**3.8%**
Liquidity Ratio	67.6%	74.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**47.6%**	**54.7%**
Adjusted Core Capital/Total Liabilities	15.2%	15.1%
Adjusted Core Capital/Total RWA	15.0%	16.0%

Adjusted Total Capital/Total RWA	18.1%	18.4%

Key Highlights

- In the year so far, SCBK mainly focused on ways on increasing its Non-Funded income through community engagement activities, partnerships, and initiatives such as the Women in Tech initiative it launched in April 2021.

Income Statement

- Core earnings per share increased by 18.9% to Kshs 6.3, from Kshs 5.3 recorded in Q1’2020, not in line with our projections of a 29.2% increase to Kshs 6.9. The increase was mainly driven by a 9.0% decline in total operating expenses to Kshs 3.7 bn, from Kshs 4.0 bn recorded in Q1’2020, coupled with a 1.7% increase in total operating income to Kshs 7.1 bn, from Kshs 7.0 bn recorded in Q1’2020. The increase in core earnings per share was lower than our expectations of a 29.2% increase, with the variance being attributable to the total operating income growing slower by 1.7% against our expectation of a 25.7% growth in Q1’2021,
- Total operating income rose by 1.7% to Kshs 7.1 bn, from Kshs 7.0 bn recorded in Q1’2020. This was driven by an 11.1% increase in Non-Funded Income (NFI) to Kshs 2.5 bn, from Kshs 2.2 bn in Q1’2020, which was weighed down by a 2.8% decline in Net Interest Income (NII) to Kshs 4.6 bn, from Kshs 4.7 bn in Q1’2020,
- Interest income declined by 9.0% to Kshs 5.6 bn, from Kshs 6.1 bn in Q1’2020 driven by a 9.0% decline in interest income on loans and advances to Kshs 2.9 bn, from Kshs 3.2 bn in Q1’2020, coupled with a similar 9.0% decline in interest income from government securities to Kshs 2.3 bn, from Kshs 2.5 bn in Q1’2020. The decline in interest income was however mitigated by a 10.1% growth in interest income from deposits and placements with banking institutions to Kshs 0.4 bn, from Kshs 0.3 bn in Q1’2020. Consequently, the Yield on Interest-Earning Assets (YIEA), declined to 8.1%, from 9.4% in Q1’2020, attributable to the faster 7.4% growth in the average interest-earning assets, which outpaced the 7.3% decline in the trailing interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense declined by 30.2% to Kshs 1.0 bn, from Kshs 1.4 bn in Q1’2020, following a 26.5% decline in interest expense on customer deposits to Kshs 0.9 bn, from Kshs 1.2 bn in Q1’2020, coupled with a 53.4% decline in other interest expenses to Kshs 0.1 bn, from Kshs 0.2 bn in Q1’2020. Cost of funds, on the other hand, declined by 0.8% points to 1.6%, from 2.4% in Q1’2020, owing to a 7.0% growth in average interest-bearing liabilities coupled with a 27.4% decline in the trailing interest expense. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) declined to 6.7% from 7.2% in Q1’2020, attributable to a 7.4% growth in average interest-earning assets, coupled with a decline of 1.2% in the trailing Net Interest Income (NII),
- Non-Funded Income (NFI) increased by 11.1% to Kshs 2.5 bn, from Kshs 2.2 bn in Q1’2020. The increase was mainly driven by a 15.9% rise in Foreign Exchange Trading income to Kshs 0.8 bn in Q1’2021, from Kshs 0.7 bn in Q1’2020 coupled with a 13.1% increase in other Fees and Commission income to Kshs 1.3 bn, from Kshs 1.2 bn in Q1’2020. Fees and commissions on loans and advances, on the other hand, declined by 10.7% to Kshs 65.6 mn, from Kshs 73.5 mn in Q1’2020. The bank’s total fees and commission also increased by 11.7% to Kshs 1.4 bn, from Kshs 1.2 bn in Q1’2020. As a result, the revenue mix shifted to 65:35 from 68:32 in Q1’2020, funded to non-funded income, owing to the 11.1% increase in Non-Funded Income (NFI), compared to a 2.8% decline in Net Interest Income (NII),
- Total operating expenses declined by 9.0% to Kshs 3.7 bn in Q1’2021, from Kshs 4.0 bn in Q1’2020, mainly attributable to a 5.3% decline in Staff costs to Kshs 1.6 bn in Q1’2021, from Kshs 1.7 bn in Q1’2020. Additionally, Loans Loss Provisions (LLPs) declined by 3.5% to Kshs 0.41 bn, from Kshs 0.43 bn recorded in Q1’2020 partly attributable to the improved business environment,
- Cost to Income Ratio (CIR) improved to 52.0%, from 58.1% in Q1’2020, owing to the 1.7% growth in total operating income compared to the 9.0% decline in total operating expenses. Without LLP, cost

to income ratio improved as well to 46.2%, from 52.0% in Q1’2020, an indication of improved efficiency levels, and,

- Profit before increased by 16.6% to Kshs 3.4 bn, from Kshs 2.9 bn in Q1’2020. Profit after tax increased by 18.9% to Kshs 2.4 bn in Q1’2021, from Kshs 2.0 bn recorded in Q1’2020 with the effective tax rate decreasing to 29.6% from 31.0% in Q1’2020.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 8.9% to Kshs 339.3 bn, from Kshs 311.5 bn in Q1’2020. This growth was largely driven by a 62.7% increase in placements from banking institutions to Kshs 78.7 bn, from Kshs 48.4 bn in Q1’2020, coupled with a 7.8% growth in investment in government and other securities to Kshs 102.4 bn, from Kshs 95.0 bn recorded in Q1’2020. The loan book, however, decreased by 6.1% to Kshs 117.9 bn, from Kshs 125.5 bn recorded in Q1’2020, indicating the bank’s risk averseness and hesitancy to lend due to the credit risks involved,
- Total liabilities rose by 9.4% to Kshs 286.4 bn, from Kshs 261.6 bn in Q1’2020, driven by an 8.9% increase in customer deposits to Kshs 265.2 bn, from Kshs 243.6 bn in Q1’2020, coupled with an increase of 69.0% in placements held to Kshs 1.2 bn in Q1’2021, from Kshs 0.7 bn in Q1’2020. Deposits per branch rose by 8.9% to Kshs 7.4 bn, from Kshs 6.8 bn in Q1’2020 with the number of branches remaining unchanged at 36,
- The faster 8.9% growth in customer deposits compared to the 6.1% decline in loans led to a decline in the loans to deposit ratio to 44.4%, from 51.5% recorded in Q1’2020,
- Gross Non-Performing Loans (NPLs) increased by 11.3% to Kshs 22.3 bn in Q1’2021, from Kshs 20.0 bn recorded in Q1’2020. Consequently, the NPL ratio rose to 16.4%, from 14.2% recorded in Q1’2020. The asset quality deterioration is attributable to the 11.3% growth in Gross Non-Performing Loans (NPLs), coupled with a 3.7% decline in gross loans,
- General Loan Loss Provisions increased by 12.5% to Kshs 8.8 bn, from Kshs 7.8 bn in Q1’2020. The NPL coverage thus increased to 81.1%, from 78.1% in Q1’2020, as the provisions (after adding back interest suspense) increased by 15.7% in Q1’2021, outpacing the 11.3% rise in the Gross Non-Performing Loans during the same period. The increase in the NPL Coverage to 81.1% in Q1’2021, from 78.1% in Q1’2020, suggests sufficient provisioning,
- Shareholders’ funds increased by 6.1% to Kshs 52.9 bn in Q1’2021, from Kshs 49.8 bn in Q1’2020, mainly supported by a 16.9% growth in retained earnings to Kshs 34.5 bn, from Kshs 29.5 bn in Q1’2020,
- Standard Chartered is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.9%, 5.4% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 18.3%, exceeding the statutory requirement by 3.8% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 16.0% while total capital to risk-weighted assets came in at 18.4%, and,
- The bank currently has a Return on Average Assets (ROaA) of 1.8%, and a Return on Average Equity (ROaE) of 11.3%.

Key Take-Outs:

1. **Asset Quality** – the bank’s asset quality deteriorated owing to the increase in NPL ratio to 16.4% in Q1’2021, from 14.2% recorded in Q1’2020 and at the highest level since FY’2007. The NPL ratio has also been increasing q/q for the last 4 quarters. The NPL ratio deterioration is attributable to the 11.3% growth in Gross Non-Performing Loans (NPLs), coupled with a 3.7% decline in gross loans. The gross loans level has declined by 9.8% from H1’2020 to Q1’2021 indicating the bank’s increasing risk averseness,
2. **Provisions** – the bank’s Loans Loss Provisions (LLPs) declined by 3.5% to Kshs 0.41 bn, from Kshs 0.43 bn recorded in Q1’2020 attributable to the improved business environment coupled with the fact that they have taken on minimal new risks as their loan book shrunk by 6.1% to Kshs 117.9 bn, from Kshs 125.5 bn recorded in Q1’2020, indicating the bank’s risk averseness, and,

3. **Operating Efficiency** - There was an increase in the bank’s operating efficiency as the cost to income ratio without LLP improved to 46.2%, from 52.0% in Q1’2020. The improvement was largely attributable to the decrease of Staff Costs by 5.3% to Kshs 1.6 bn in Q1’2021, from Kshs 1.7 bn recorded in Q1’2020.

Going forward, we expect the bank’s growth to be driven by:

I. Continued focus on promoting the usage of the bank’s alternative channels is likely to continue boosting the company’s Non-Funded Income (NFI). Revenue expansion coupled with cost containment will be key in boosting the bank’s bottom line.
II. We also expect the bank’s conservatism in lending to continue as the credit risk in Kenya remains high as evidenced by the deterioration in the Kenyan banking sector to 14.6% in Q1’2021 from 12.5% in Q1’2020, according to the Commercial Banks’ Credit Survey Report. SCBK’s loan book decreased by 6.1% to Kshs 117.9 bn, from Kshs 125.5 bn recorded in Q1’2020.

Valuation Summary

- We are of the view that Standard Chartered is an “***Buy***” with a target price of Kshs 150.9 representing an upside of 25.3%, from the current price of Kshs 130.0 as of 28th May 2021, inclusive of a dividend yield of 9.2%,
- Standard Chartered Bank is currently trading at a P/TBV of 1.0x and a P/E of 8.4x vs an industry average of 1.0x and 7.9x, respectively.