Standard Chartered Bank of Kenya Plc – H1’2020

28th August, 2020

Valuation Summary

- We are of the view that Standard Chartered is a “***buy***” with a target price of Kshs 188.2 representing an upside of 25.3%, from the current price of Kshs 150.3 as of 28th August 2020, inclusive of a dividend yield of 10.0%,
- Standard Chartered Bank is currently trading at a P/TBV of 1.1x and a P/E of 7.6x vs an industry average of 0.9x and 5.4x, respectively.

Key Highlight H1’2020

- The bank recently restructured Kshs 22.0 bn to its customers, equivalent to 17.5% of its net loans which stood at Kshs 125.5 bn in Q1’2020. The restructuring involves a 3-month holiday for loan holders, 12-month extension on personal loans and mortgage and a 6–12 month credit card payment extension, and,
- Standard Chartered Bank recently extended Kshs 650.0 mn to companies with capital expenditure and working capital requirements at preferential rates in order to help the firms address the effects of COVID-19. The financing was extended to various sectors who have been at the forefront in tackling the pandemic such as healthcare providers, manufactures and distributers in the pharmaceutical industry etc.

Income Statement

- Core earnings per share declined by 31.3% to Kshs 9.4, from Kshs 13.7 in H1’2019, driven by a 5.2% decline in total operating income to Kshs 13.8 bn, from Kshs 14.6 bn in H1’2019, coupled with a 13.8% rise in total operating expenses to Kshs 8.7 bn, from Kshs 7.6 bn in H1’2019. The decline in core earnings per share was not in line with our expectations of a 19.6% decline, with the variance being attributable to the 328.8% rise Loan Loss Provisions to Kshs 1.6 bn, from Kshs 0.4 bn in H1’2019, against our expectations of a 224.4% increase,
- Total operating income declined by 5.2% to Kshs 13.8 bn, from Kshs 14.6 bn in H1’2019. This was driven by a 6.6% decline in Non-Funded Income (NFI) to Kshs 4.4 bn, from Kshs 4.7 bn in H1’2019, coupled with a 4.6% decline in Net Interest Income (NII) to Kshs 9.4 bn, from Kshs 9.8 bn in H1’2019,
- Interest income declined by 6.3% to Kshs 11.9 bn, from Kshs 12.7 bn in H1’2019. This was driven by a 12.7% decline in interest income from government securities to Kshs 4.8 bn from Kshs 5.4 bn in H1’2019, coupled with a 6.6% decline in interest income on loans and advances to Kshs 6.3 bn, from Kshs 6.7 bn in H1’2019. Consequently, the yield on interest-earning assets declined to 8.8% from 10.2% in H1’2019, attributable to the 6.3% decline in interest income, which was despite a 9.0% y/y growth in average interest-earning assets to Kshs 276.9 bn, from Kshs 254.1 bn in H1’2019,
- Interest expense declined by 12.1% to Kshs 2.5 bn, from Kshs 2.9 bn in H1’2019, following a 10.9% decline in interest expense on customer deposits to Kshs 2.3 bn from Kshs 2.6 bn in H1’2019 and a 34.9% decline in other interest expenses to Kshs 0.2 bn from Kshs 0.3 bn in H1’2019. Cost of funds, on the other hand, declined to 2.2%, from 3.2% in H1’2019, owing to a 12.1% decline in interest expense, despite a 20.2% growth in average interest-bearing liabilities. Net Interest Margin (NIM) declined to 6.9% from 7.6% in H1’2019, owing to a 4.6% decline in Net Interest Income (NII), despite a 9.0% growth in average interest-earning assets,
- Non-Funded Income (NFI) declined by 6.6% to Kshs 4.4 bn, from Kshs 4.7 bn in H1’2019. The decline was mainly driven by a 7.3% decline in Foreign Exchange Trading income to Kshs 1.5 bn from Kshs 1.6 bn coupled with a 12.8% decline in other Fees and Commission income to Kshs 2.1 bn from Kshs 2.4 bn in H1’2019. Fees and commissions on loans and advances also declined by 5.2% to Kshs 0.12 bn from Kshs 0.16 bn in H1’2019. The revenue mix remained unchanged at 68:32 funded to non-funded income owing to comparable declines both in Non-Funded Income (NFI) and Net Interest Income (NII),

- Total operating expenses grew by 13.8% to Kshs 8.7 bn, from Kshs 7.6 bn, largely driven by 328.8% rise in Loan Loss Provisions (LLP) to Kshs 1.6 bn in H1’2020, from Kshs 0.4 bn in H1’2019 on account of the poor operating environment brought about by COVID-19. Staff costs, on the other hand, recorded a 5.3% decline to Kshs 3.3 bn from Kshs 3.5 bn in H1’2019,
- Cost to Income Ratio (CIR) deteriorated to 63.0%, from 52.5% in H1’2019 owing to the 328.8% rise in Loan Loss Provisions (LLP) to Kshs 1.6 bn in H1’2020, from Kshs 0.4 bn in H1’2019. Without LLP, cost to income ratio deteriorated as well to 51.2%, from 49.9% in H1’2019, an indication of reduced efficiency levels, and,
- Profit before tax declined by 26.2% to Kshs 5.1 bn, from Kshs 6.9 bn in H1’2019. Profit after tax also declined by 31.3% to Kshs 3.2 bn in H1’2020, from Kshs 4.7 bn in H1’2019 with the effective tax rate increasing to 36.7% from 32.0% in H1’2019,

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 11.1% to Kshs 327.2 bn, from Kshs 294.5 bn in H1’2019. This growth was largely driven by an 11.9% growth recorded in the loan book to Kshs 134.3 bn, from Kshs 120.1 bn in H1’2019, coupled with a 7.3% increase in placements from banking institutions to Kshs 47.1 bn in H1’2020, from Kshs 43.9 bn in H1’2019. Investment in government and other securities increased by 2.1% to Kshs 104.7 bn, from Kshs 102.6 bn in H1’2019,
- Total liabilities rose by 11.2% to Kshs 275.5 bn, from Kshs 247.7 bn in H1’2019, driven by a 12.3% increase in customer deposits to Kshs 256.5 bn, from Kshs 228.5 bn in H1’2019. Deposits per branch rose by 6.0% to Kshs 7.1 bn from Kshs 6.7 bn in H1’2019, with the number of branches increasing by 2 to 36 from 34 branches,
- Loans to deposit ratio declined marginally to 52.4% from 52.5% in H1’2019, owing to the 12.3% growth in customer deposits which outpaced the 11.9% growth in net loans during the same period,
- Gross Non-Performing Loans (NPLs) increased by 5.6% to Kshs 20.9 bn in H1’2020, from Kshs 19.8 bn in H1’2019. The NPL ratio, however improved to 13.9%, from 14.6% in H1’2019, attributable to the faster 11.9% growth in gross loans, which outpaced the 5.6% growth in Gross Non-Performing Loans (NPLs),
- General Loan Loss Provisions increased by 2.5% to Kshs 8.1 bn, from Kshs 7.9 bn in H1’2019. The NPL coverage thus increased to 78.2%, from 75.9% in H1’2019, as the Interest in suspense increased by 16.0% to Kshs 8.3 bn, from Kshs 7.1 bn in H1’2019 outpacing the 5.6% rise in the Gross Non-Performing Loans to Kshs 20.9 bn, from Kshs 19.8 bn in H1’2019,
- Shareholders’ funds increased by 10.3% to Kshs 51.7 bn in H1’2020, from Kshs 52.5 bn in H1’2019, supported by a 47.8% increase in the proposed dividends to Kshs 2.6 bn, from Kshs 1.8 bn in H1’2019. coupled with a 8.2% growth in retained earnings to Kshs 3.2 bn, from Kshs 3.0 bn in H1’2019,
- Standard Chartered is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.8%, 5.3% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 18.4%, exceeding the statutory requirement by 3.9% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.8% while total capital to risk-weighted assets came in at 18.5%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.2%, and a Return on Average Equity (ROaE) of 13.7%.

Key Take-Outs:

1. **Asset Quality** – the bank’s asset quality improved owing to the 13.9% decline in the NPL ratio in H1’2020 from 14.6% recorded in H1’2019. The improvement of the NPL depicts the bank’s conservative lending strategies as well as the faster 11.9% growth in loans, which outpaced the 5.6% growth in Gross Non-Performing Loans (NPLs),
2. **Operating Efficiency** - There was a decline in the bank’s operating efficiency as the cost to income ratio without LLP deteriorated to 51.2%, from 49.9% in H1’2019. The deterioration was largely attributable to

the 8.9% increase in depreciation charges on property and equipment coupled with 24.1% rise in amortization charges. The bank continues to leverage on digital platforms with 80.0% of the transactions being carried out on digital platforms.

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) as well as aiding in improving operational efficiency levels, which deteriorated in H1’2020 as evidenced by the worsening of the cost to income ratio to 63.0% from 52.5% in H1’2019. Revenue expansion coupled with cost containment will be key in boosting the bank’s bottom line.

Below is a summary of the bank’s performance:

Balance Sheet Items	H1’2019	H1’2020	y/y change	H1’2020e	Projected y/y change	Variance in Growth Actual vs. Expected
Net loans	120.1	134.3	11.9%	125.8	4.8%	7.1%
Total Assets	**294.5**	**327.2**	**11.1%**	**318.4**	**8.1%**	**3.0%**
Customer Deposits	228.5	256.5	12.3%	248.4	8.7%	3.5%
Total Liabilities	247.7	275.5	11.2%	268.7	8.5%	2.7%
Shareholder's Funds	**46.9**	**51.7**	**10.3%**	**49.7**	**6.1%**	**4.3%**

Balance Sheet Ratios	H1’2019	H1’2020	y/y change
Loan to deposit ratio	52.5%	52.4%	(0.2%)
Return on Average Equity	18.2%	13.7%	(4.5%)
Return on Average Assets	2.8%	2.2%	(0.6%)

Income Statement	H1’2019	H1’2020	y/y change	H1’2020e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	9.8	9.4	(4.6%)	9.4	(4.3%)	(0.3%)
Net non-Interest Income	4.71	4.40	(6.6%)	4.2	(9.9%)	3.3%
Total Operating income	**14.6**	**13.8**	**(5.2%)**	**13.7**	**(6.1%)**	**0.9%**
Loan Loss provision	0.4	1.6	328.8%	1.2	224.4%	104.4%
Total Operating expenses	7.6	8.7	13.8%	8.3	8.1%	5.7%
Profit before tax	6.9	5.1	(26.2%)	5.4	(21.9%)	(4.4%)
Profit after tax	**4.7**	**3.2**	**(31.3%)**	**3.8**	**(19.6%)**	**(11.7%)**
Core EPS	**13.70**	**9.4**	**(31.3%)**	**11.02**	**(19.6%)**	**(11.7%)**

Income Statement Ratios	H1’2019	H1’2020	y/y change
Yield from interest-earning assets	10.2%	8.8%	(1.3%)
Cost of funding	3.2%	2.2%	(0.9%)
Net Interest Spread	7.0%	6.6%	(0.4%)
Net Interest Margin	7.6%	6.9%	(0.8%)
Cost of Risk	2.6%	11.8%	9.2%
Net Interest Income as % of operating income	67.6%	68.1%	0.5%
Non-Funded Income as a % of operating income	32.4%	31.9%	(0.5%)
Cost to Income Ratio	52.5%	63.0%	10.5%

Capital Adequacy Ratios	H1’2019	H1’2020

Core Capital/Total Liabilities	15.8%	15.6%
Minimum Statutory ratio	8.0%	8.0%
Excess	**7.8%**	**7.6%**
Core Capital/Total Risk Weighted Assets	15.6%	15.8%
Minimum Statutory ratio	10.5%	10.5%
Excess	**5.1%**	**5.3%**
Total Capital/Total Risk Weighted Assets	18.6%	18.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.1%**	**3.9%**
Liquidity Ratio	67.2%	66.8%
Minimum Statutory ratio	20.0%	20.0%
Excess	**47.2%**	**46.8%**
Adjusted core capital/ total deposit liabilities	15.9%	15.7%
Adjusted core capital/ total risk weighted assets	15.7%	15.8%
Adjusted total capital/ total risk weighted assets	18.6%	18.5%