Standard Chartered Bank of Kenya Plc – H1’2019
30th August, 2019

Valuation Summary

- We are of the view that Standard Chartered is an “Accumulate” with a target price of Kshs 200.6, representing an upside of 19.5%, from the current price of Kshs 195.0 as of 30th August 2019, inclusive of a dividend yield of 10.2%,
- Standard Chartered Bank is currently trading at a P/TBV of 1.5x and a P/E of 8.0x vs an industry average of 1.3x and 6.3x, respectively.

Key Highlights H1’2019

- Standard Chartered Bank Kenya launched its innovation hub in Nairobi dubbed “eXellerator”. The innovation hub is aimed at supporting financial technology startups to scale up and generate ideas that will solve banking problems.

Income Statement

- Core earnings per share increased by 5.4% to Kshs 13.7 from Kshs 13.0 in H1’2018, which was not in line with our expectation of a 13.9% increase to Kshs 14.8. The performance was driven by a 5.6% decline in total operating expenses, which offset the 0.7% decline in total operating income. The variance in core earnings per share growth was largely due to the 0.7% decline in total operating income which was not in line with our expectations of a 1.4% growth,
- Total operating income declined by 0.7% to Kshs 14.6 bn from Kshs 14.7 bn in H1’2018. The decline was due to a 2.2% decline in Non-Funded Income (NFI) to Kshs 4.7 bn from Kshs 4.8 bn in H1’2018. Net Interest Income (NII) however remained flat at Kshs 9.8 bn,
- Interest income declined by 7.3% to Kshs 12.7 bn, from Kshs 13.7 bn in H1’2018. This was driven by a 15.2% decline in interest income on government securities to Kshs 5.4 bn from Kshs 6.4 bn in H1’2018. Interest on loans and advances also declined marginally by 0.2% to Kshs 6.73 bn from Kshs 6.74 bn in H1’2018. Consequently, the yield on interest-earning assets declined to 10.2%, from 11.3% in H1’2018,
- Interest expense declined by 26.0% to Kshs 2.9 bn from Kshs 3.9 bn in H1’2018, following a 22.5% decline in interest expense on customer deposits to Kshs 2.6 bn, from Kshs 3.4 bn in H1’2018. Consequently, cost of funds declined to 3.2%, from 3.5% in H1’2018, with the Net Interest Margin (NIM) also declining to 7.6%, from 8.0% in H1’2018,
- Non-Funded Income (NFI) declined by 2.2% to Kshs 4.7 bn, from Kshs 4.8 bn in H1’2018. The increase was mainly driven by a 14.7% rise in foreign exchange trading income to Kshs 1.6 bn from Kshs 1.4 bn, coupled with a 26.3% rise in fees and commissions on loans and advances to Kshs 160.9 mn, from Kshs 127.4 mn. The growth in NFI was however mitigated by a 14.6% decline in other fees to Kshs 2.4 bn from Kshs 2.8 bn. The revenue mix shifted to 68:32 funded to non-funded income, from 67:33 in H1’2018, largely due to the 2.2% decline in NFI despite net interest income (NII) remaining unchanged,
- Total operating expenses declined by 5.6% to Kshs 7.6 bn from Kshs 8.1 bn in H1’2018, largely driven by a 70.1% decline in loan loss provisions to Kshs 378.9 mn, from Kshs 1.3 bn in H1’2018. The large decline in loan loss provisions was however mitigated by a 6.1% rise in staff costs to Kshs 3.5 bn, from Kshs 3.3 bn in H1’2018,
- The Cost to Income Ratio (CIR) improved to 52.5%, from 55.2% in H1’2018. Without LLP, the cost to income deteriorated to 49.9%, from 46.6% in H1’2018, and,
- Profit before tax increased by 5.3% to Kshs 6.9 bn from Kshs 6.6 bn in H1’2018. Profit after tax grew by 5.4% to Kshs 4.7 bn in H1’2019, from Kshs 4.5 bn in H1’2018, as the effective tax rate remained unchanged at 32.0%.
- Following the results, the Board of Directors approved a payment of an interim dividend of KShs 5.0 per share. Assuming a final dividend payout of Kshs 19.0 the dividend yield translates to 10.2%

Balance Sheet

- The balance sheet recorded a contraction as total assets declined by 0.5% to Kshs 294.5 bn, from Kshs 296.0 bn in H1’2018. The decline was driven by a 52.1% decline in cash to Kshs 2.8 bn, from Kshs 5.8 bn in H1’2018, coupled with a 15.2% decline in Government securities to Kshs 102.6 bn from, Kshs 120.9 bn in H1’2018. The declines were mitigated by the 7.4% expansion of the loan book to Kshs 120.1 bn, from Kshs 111.8 bn in H1’2018,
- Total liabilities declined by 1.5% to Kshs 247.7 bn, from Kshs 251.3 bn in H1’2018, driven by the 1.0% decline in customer deposits to Kshs 228.5 bn, from Kshs 230.8 bn in H1’2018. Deposits per branch increased by 4.8% to Kshs 6.7 bn, from Kshs 6.4 bn in H1’2018, as the number of branches declined by 2 to 34 from 36 in H1’2018. The bank does not have any borrowings,
- The growth in loans coupled with the decline in deposits led to a rise in the loan to deposit ratio to 52.5% from 48.4% in H1’2018,
- Gross Non-Performing Loans (NPLs) increased by 6.7% to Kshs 19.8 bn in H1’2019, from Kshs 18.5 bn in H1’2018. The NPL ratio however improved to 14.6% in H1’2019, from 14.8% in H1’2018, due to the faster growth in gross loans that outpaced the growth in the gross Non-performing Loans (NPLs). General Loan Loss Provisions increased by 10.9% to Kshs 7.9 bn, from Kshs 7.1 bn in H1’2018. Consequently, the NPL coverage improved to 75.9% in H1’2019, from 75.0% in H1’2018, as the interest in suspense rose by 4.8% to Kshs 7.1 bn, from Kshs 6.8 bn in H1’2018,
- Shareholders’ funds increased by 5.0% to Kshs 46.9 bn in H1’2019, from Kshs 44.6 bn in H1’2018, supported by a 3.5% increase in retained earnings to Kshs 30.1 bn, from Kshs 29.1 bn, coupled with a 36.8% rise in other reserves to Kshs 1.8 bn from Kshs 1.3 bn in H1’2019
- Standard Chartered Bank Kenya remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.6%, 5.1% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 18.6%, exceeding the statutory requirement by 4.1% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 15.7%, while total capital to risk-weighted assets came in at 18.6%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.8%, and a Return on Average Equity (ROaE) of 18.2%.

Key Take-Outs:

1. The bank registered a decline in operating revenue, following the 2.2% decline in NFI to Kshs 4.7 bn, from Kshs 4.8 bn in H1’2018. This has bucked the trend of similar Tier I banks that have generally reported an expansion in NFI, with Standard Chartered bank’s NFI contribution to total revenue at 32%, lower than the industry average of 37.3%, and,
2. The bank’s asset quality improved, with the NPL ratio declining to 14.6%, from 14.8% in H1’2018. This was despite the 6.7% rise in gross non-performing loans to Kshs 19.8 bn from Kshs 18.5 bn in H1’2018. The improvement was mainly driven by the faster growth in gross loans that outpaced the growth in non-performing loans.

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

1. Continued focus on promoting the usage of the bank’s alternative channels is likely to boost the company’s Non-Funded Income (NFI) as well as aiding in improving operational efficiency levels, which deteriorated in H1’2019 as evidenced by the worsening of the cost to income ratio to 49.9%, from 46.6% in H1’2018. 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:

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Balance Sheet Items	H1'2018	H1'2019	y/y change	H1'2019e	Projected y/y change	Variance in Growth Actual vs. Expected
Net loans	111.7	120.1	7.4%	119.2	6.7%	0.7%
Total Assets	**296.0**	**294.5**	**(0.5%)**	**302.9**	**2.3%**	**(2.8%)**
Customer Deposits	230.8	228.5	(1.0%)	229.3	(0.7%)	(0.3%)
Total Liabilities	251.3	247.7	(1.5%)	251.1	(0.1%)	(1.4%)
Shareholder's Funds	**44.6**	**46.9**	**5.0%**	**51.8**	**16.1%**	**(11.1%)**

Balance Sheet Ratios	H1'2018	H1'2019	y/y change
Loan to deposit ratio	48.4%	52.5%	4.1%
Return on Average Equity	18.0%	18.2%	0.2%
Return on Average Assets	2.7%	2.8%	0.1%

Income Statement	H1'2018	H1'2019	y/y change	H1'2019e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	9.8	9.8	0.0%	8.0	(18.6%)	18.7%
Net non-Interest Income	4.8	4.7	(2.2%)	6.9	42.2%	(44.5%)
Total Operating income	**14.7**	**14.6**	**(0.7%)**	**14.9**	**1.4%**	**(2.1%)**
Loan Loss provision	1.3	0.4	(70.1%)	0.4	(71.8%)	1.7%
Total Operating expenses	8.1	7.6	(5.6%)	7.6	(6.1%)	0.5%
Profit before tax	6.6	6.9	5.3%	7.3	10.6%	(5.3%)
Profit after tax	**4.5**	**4.7**	**5.4%**	**5.1**	**13.9%**	**(8.5%)**
Core EPS	**13.0**	**13.7**	**5.4%**	**14.8**	**13.9%**	**(8.5%)**

Income Statement Ratios	H1'2018	H1'2019	y/y change
Yield from interest-earning assets	11.3%	10.2%	(1.1%)
Cost of funding	3.5%	3.2%	(0.3%)
Net Interest Spread	7.8%	7.0%	(0.8%)
Net Interest Margin	8.0%	7.6%	(0.3%)
Cost of Risk	8.6%	2.6%	(6.0%)
Net Interest Income as % of operating income	67.1%	67.6%	0.5%
Non-Funded Income as a % of operating income	32.9%	32.4%	(0.5%)
Cost to Income Ratio	55.2%	52.5%	(2.7%)

Capital Adequacy Ratios	H1'2018	H1'2019
Core Capital/Total Liabilities	15.8%	15.1%
Minimum Statutory ratio	8.0%	8.0%
Excess	**7.8%**	**7.1%**
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%	18.6%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.1%**	**4.1%**
Liquidity Ratio	67.2%	71.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**47.2%**	**51.3%**
Adjusted core capital/ total deposit liabilities	15.9%	15.3%
Adjusted core capital/ total risk weighted assets	15.7%	16.1%

Adjusted total capital/ total risk weighted liabilities	18.6%	19.0%