Standard Chartered Bank of Kenya Plc – Q1’2019

24th May, 2019

Valuation Summary

- We are of the view that Standard Chartered is an “Accumulate” with a target price of Kshs 203.8, representing an upside of 19.5%, from the current price of Kshs 186.5 as of 24th May 2019, inclusive of a dividend yield of 10.2%,
- Standard Chartered Bank is currently trading at a P/TBV of 1.4x and a P/E of 7.9x vs an industry average of 1.3x and 6.7x, respectively.

Key Highlights Q1’2019

- 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 31.0% to Kshs 7.0 from Kshs 5.3 in Q1’2018, which was in line with our expectation of a 30.0% increase to Kshs 6.9. The performance was driven by a 3.7% increase in total operating income, coupled with an 11.8% decline in total operating expenses.
- Total operating income increased by 3.7% to Kshs 7.4 bn from Kshs 7.1 bn in Q1’2018. The rise was due to a 5.6% increase in Non-Funded Income(NFI) to Kshs 2.4 bn from Kshs 2.3 bn in Q1’2018, coupled with a 2.8% increase in Net Interest Income (NII) to Kshs 5.0 bn, from Kshs 4.8 bn in Q1’2018,
- Interest income declined by 6.4% to Kshs 6.4 bn, from Kshs 6.8 bn in Q1’2018. This was driven by a 12.4% decline in interest income from government securities to Kshs 2.7 bn, from Kshs 3.1 bn in Q1’2018. Interest on loans and advances however remained unchanged at Kshs 3.4 bn. Consequently, the yield on interest-earning assets declined to 10.6%, from 11.4% in Q1’2018,
- Interest expense declined by 28.8% to Kshs 1.4 bn, from Kshs 2.0 bn in Q1’2018, following a 23.3% decline in interest expense on customer deposits to Kshs 1.3 bn, from Kshs 1.7 bn in Q1’2018. Consequently, cost of funds declined to 3.4%, from 3.6% in Q1’2018, with the Net Interest Margin (NIM) also declining to 7.8%, from 8.0% in Q1’2018,
- Non-Funded Income (NFI) increased by 5.6% to Kshs 2.4 bn, from Kshs 2.3 bn in Q1’2018. The increase was mainly driven by a 37.2% rise in foreign exchange trading income to Kshs 817.8 mn, from Kshs 595.9 mn, coupled with a 5.8% rise in fees and commissions on loans and advances to Kshs 76.4 mn, from Kshs 72.2 mn. The revenue mix remained unchanged at to 68:32 funded to non-funded income,
- Total operating expenses declined by 11.8% to Kshs 3.8 bn, from Kshs 4.3 bn, largely driven by a 61.0% decline in loan loss provisions to Kshs 415.1 mn, from Kshs 1.1 bn in Q1’2018. The large decline in loan loss provisions was however mitigated by a 14.3% rise in staff costs to Kshs 1.8 bn, from Kshs 1.6 bn in Q1’2018,
- The Cost to Income Ratio (CIR) improved to 51.9%, from 61.0% in Q1’2018. Without LLP, the cost to income deteriorated albeit marginally to 46.3%, from 46.0% in Q1’2018, and,
- Profit before tax increased by 27.8% to Kshs 3.5 bn, from Kshs 2.8 bn in Q1’2018. Profit after tax grew by 31.2% to Kshs 2.4 bn in Q1’2019, from Kshs 1.8 bn in Q1’2018, as the effective tax rate declined to 31.6% from 33.7% in Q1’2018.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 2.5% to Kshs 301.4 bn, from Kshs 294.0 bn in Q1’2018. Growth was supported by a 13.9% growth in government securities to Kshs 142.3 bn, from Kshs 125.0 bn, coupled with the 3.3% increase in loan book to Kshs 117.6 bn, from Kshs 113.8 bn in Q1’2018,
- Total liabilities rose by 1.8% to Kshs 252.2 bn from Kshs 247.7 bn in Q1’2018, driven by the 0.3% increase in customer deposits to Kshs 232.8 bn from Kshs 232.0 bn in Q1’2018. Deposits per branch increased by

6.2% to Kshs 6.9 bn from Kshs 6.4 bn in Q1’2018, as the number of branches declined by 2 to 34 from 36 in Q1’2018. The bank does not have any borrowings,

- The fast growth in loans compared to the deposits loans led to a rise in the loan to deposit ratio to 50.5% from 49.1% in Q1’2018,
- Gross Non-Performing Loans (NPLs) increased by 19.2% to Kshs 21.2 bn in Q1’2019, from Kshs 17.8 bn in Q1’2018. The NPL ratio thus deteriorated to 15.9% in Q1’2019, from 14.0% in Q1’2018. Management attributed the deterioration in asset quality to players in the manufacturing sector, real estate and trade sectors. General Loan Loss Provisions increased by 15.6% to Kshs 8.0 bn, from Kshs 6.9 bn in Q1’2018. The NPL coverage however improved to 76.5% in Q1’2019, from 75.2% in Q1’2018, as the interest in suspense rose by 27.5% to Kshs 8.2 bn, from Kshs 6.4 bn in Q1’2018,
- Shareholders’ funds increased by 6.2% to Kshs 49.1 bn in Q1’2019, from Kshs 46.3 bn in Q1’2018, supported by a 7.3% increase in retained earnings to Kshs 30.3 bn, from Kshs 28.3 bn,
- Standard Chartered Bank Kenya remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 16.1%, 5.6% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 18.8%, exceeding the statutory requirement by 4.3% points. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 16.1%, while total capital to risk-weighted assets came in at 19.0%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.9%, and a Return on Average Equity (ROaE) of 18.2%.

Key Take-Outs:

1. There was a decline in the bank’s operating efficiency as the cost to income ratio without LLP deteriorated to 46.3%, from 46.0% in Q1’2018. The deterioration was largely attributable to a 14.3% rise in staff costs to Kshs 1.8 bn, from Kshs 1.6 bn in Q1’2018, as the bank incurred a one-off expense in its staff layoff program, and,
2. The bank’s asset quality deteriorated, with the NPL ratio rising to 15.9% from 14.0% in Q1’2018. The deteriorating NPL ratio is attributable to a 19.2% rise in gross non-performing loans to Kshs 21.2 bn from Kshs 17.8 bn in Q1’2018 due to recovery problems of loans made to key troubled sectors such as real estate and manufacturing. The bank’s increased allocation to government securities did not seem to bear fruit, as interest income from government securities declined by 12.4%, affected by the decline in government yields. The bank’s funded income recorded a growth, largely supported by the faster decline in interest expenses, with the bank presumably adjusting interest payable on deposits after a removal of the minimum payable amount in the Finance Act 2018.

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 continue boosting the company’s Non-Funded Income (NFI) as well as aiding in improving operational efficiency levels, which deteriorated in Q1’2019 as evidenced by the worsening of the cost to income ratio to 46.3% from 46.0% in Q1’2018. 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:

Balance Sheet Items	Q1'2018	Q1'2019	y/y change	Q1'2019e	Projected y/y change	Variance in Growth Actual vs. Expected
Net loans	113.8	117.6	3.3%	115.5	1.5%	1.8%
Total Assets	**294.0**	**301.4**	**2.5%**	**294.7**	**0.2%**	**2.3%**

Customer Deposits	232.0	232.8	0.3%	231.0	(0.4%)	0.8%
Total Liabilities	247.7	252.2	1.8%	245.6	(0.8%)	2.7%
Shareholder's Funds	**46.3**	**49.1**	**6.2%**	**49.0**	**6.0%**	**0.2%**

Balance Sheet Ratios	Q1'2018	Q1'2019	y/y change
Loan to deposit ratio	49.1%	50.5%	1.4%
Return on Average Equity	14.4%	18.2%	3.7%
Return on Average Assets	2.4%	2.9%	0.6%

Income Statement	Q1'2018	Q1'2019	y/y change	Q1'2019e	Projected y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	4.8	5.0	2.8%	5.2	8.0%	(5.2%)
Net non-Interest Income	2.3	2.4	5.6%	2.3	2.1%	3.6%
Total Operating income	**7.1**	**7.4**	**3.7%**	**7.5**	**6.1%**	**(2.4%)**
Loan Loss provision	1.1	0.4	(61.0%)	0.9	(15.1%)	(46.0%)
Total Operating expenses	4.3	3.8	(11.8%)	4.1	(6.5%)	(5.3%)
Profit before tax	2.8	3.5	27.8%	3.5	25.7%	2.1%
Profit after tax	**1.8**	**2.4**	**31.2%**	**2.4**	**29.7%**	**1.5%**
Core EPS	**5.3**	**7.0**	**31.2%**	**6.9**	**29.7%**	**1.5%**

Income Statement Ratios	Q1'2018	Q1'2019	y/y change
Yield from interest-earning assets	11.4%	10.6%	(0.8%)
Cost of funding	3.6%	3.4%	(0.2%)
Net Interest Spread	7.8%	7.2%	(0.6%)
Net Interest Margin	8.0%	7.8%	(0.2%)
Cost of Risk	15.0%	5.6%	(9.3%)
Net Interest Income as % of operating income	68.2%	67.6%	(0.6%)
Non-Funded Income as a % of operating income	31.8%	32.4%	0.6%
Cost to Income Ratio	61.0%	51.9%	(9.1%)