Standard Chartered Bank of Kenya Plc – Q1’2022

20th May 2022

Below is a summary of Standard Chartered Bank of Kenya Plc Q1’2022 performance;

Balance Sheet Items (Kshs bn)	Q1’2021	Q1’2022	y/y change
Net loans	117.9	128.1	8.7%
Government Securities	102.4	101.4	(1.0%)
Total Assets	**339.3**	**340.9**	**0.5%**
Customer Deposits	265.2	265.4	0.0%
Deposits per Branch	7.4	12.1	63.7%
Total Liabilities	**286.4**	**285.3**	**(0.4%)**
Shareholder's Funds	**52.9**	**55.6**	**5.2%**

Balance sheet ratios	Q1’2021	Q1’2022	y/y change
Loan to Deposit Ratio	44.4%	48.3%	3.8%
Return on average equity	11.3%	17.4%	6.0%
Return on average assets	1.8%	2.8%	1.0%

Income Statement (Kshs bn)	Q1’2021	Q1’2022	y/y change
Net Interest Income	4.6	4.9	7.2%
Net non-Interest Income	2.5	2.5	0.1%
Total Operating income	**7.1**	**7.4**	**4.7%**
Loan Loss provision	(0.4)	0.1	(120.8%)
Total Operating expenses	**(3.7)**	**(3.5)**	**(5.4%)**
Profit before tax	3.4	3.9	15.7%
Profit after tax	**2.4**	**2.8**	**15.6%**
Core EPS	**6.3**	**7.3**	**15.6%**

Income Statement Ratios	Q1’2021	Q1’2022	y/y change
Yield from interest-earning assets	8.1%	7.4%	(0.7%)
Cost of funding	1.6%	1.2%	(0.4%)
Net Interest Spread	6.5%	6.2%	(0.3%)
Net Interest Margin	6.7%	6.3%	(0.4%)
Cost of Risk	5.8%	(1.2%)	(7.0%)
Net Interest Income as % of operating income	64.9%	66.4%	1.5%
Non-Funded Income as a % of operating income	35.1%	33.6%	(1.5%)
Cost to Income Ratio	52.0%	47.0%	(5.0%)
Cost to Income Ratio without LLP	46.2%	48.1%	2.0%
Cost to Assets	1.0%	1.0%	0.0%

Capital Adequacy Ratios	Q1’2021	Q1’2022	% points change
Core Capital/Total Liabilities	15.1%	15.6%	0.5%
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	**7.1%**	**7.6%**	**0.5%**
Core Capital/Total Risk Weighted Assets	15.9%	15.4%	(0.5%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	**5.4%**	**4.9%**	**(0.5%)**
Total Capital/Total Risk Weighted Assets	18.3%	17.6%	(0.7%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	**3.8%**	**3.1%**	**(0.7%)**
Liquidity Ratio	74.7%	71.6%	(3.1%)
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	**54.7%**	**51.6%**	**(3.1%)**

Adjusted Core Capital/Total Liabilities	**15.1%**	**15.6%**	**0.5%**
Adjusted Core Capital/Total RWA	**16.0%**	**15.4%**	**(0.6%)**
Adjusted Total Capital/Total RWA	**18.4%**	**17.7%**	**(0.7%)**

Income Statement

- Core earnings per share increased by 15.6% to Kshs 7.3, from Kshs 6.3 recorded in Q1'2021, higher than our projections of a 6.0% increase to Kshs 6.7. The performance was driven by a 4.7% increase in total operating income to Kshs 7.4 bn, from Kshs 7.1 bn recorded in Q1'2021, coupled with a 5.4% decline in total operating expenses to Kshs 3.5 bn, from Kshs 3.7 bn recorded in Q1'2021. The variance in core earnings per share increase to Kshs 7.3 against our expectations of Kshs 6.7 was largely due to the 5.4% decline in the total operating expenses to Kshs 3.5 bn in Q1'2022, from Kshs 3.7 bn in Q1'2021, compared to our 0.1% projected increase,
- Total operating income rose by 4.7% to Kshs 7.4 bn, from Kshs 7.1 bn recorded in Q1'2021 driven by a 7.2% growth in Net Interest Income (NII) to Kshs 4.9 bn, from Kshs 4.6 bn in Q1'2021 coupled with a marginal 0.1% gain in Non - Funded Income (NFI) to Kshs 2.49 bn, from Kshs 2.48 bn in Q1'2021,
- Interest income increased by 1.8% to Kshs 5.7 bn, from Kshs 5.6 bn in Q1'2021, driven by a 5.1% increase in interest income from Loans & Advances to Kshs 3.0 bn, from Kshs 2.9 bn in Q1'2021, coupled with a 1.2% increase in interest income from Government Securities to Kshs 2.32 bn in Q1'2022, from Kshs 2.30 bn in Q1'2021. However, Interest income from placements in other banks declined by 20.0% to Kshs 0.4 bn, from 0.3 bn in Q1'2021 as placements due from banking institutions, outside the Standard Chartered group, declined by 95.3% to Kshs 0.2 bn from Kshs 3.7 bn in Q1'2022, Consequently, the Yield on Interest-Earning Assets (YIEA) declined to 7.4%, from 8.1% in Q1'2021, attributable to a 3.4% decline in the trailing interest income, coupled with a 6.5% increase in the average interest earning assets. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense declined by 23.6% to Kshs 0.7 bn, from Kshs 1.0 bn in Q1'2021, following a 24.9% decline in interest expense on customer deposits to Kshs 0.7 bn, from Kshs 0.9 bn in Q1'2021 coupled with a 16.2% decline in other interest expenses to Kshs 63.7 mn from Kshs 76.0 mn in Q1'2021. The bank was able to mobilize cheaper deposits with the Cost of funding declining by 0.4% points to 1.2%, from 1.6% in Q1'2021, owing to the 22.7% decline in trailing interest expense and the 4.2% increase in the average interest-bearing liabilities. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) declined to 6.3%, from 6.7% in Q1'2021 attributable to a slower 0.8% gain in the trailing Net Interest Income (NII) compared to the 6.5% growth in average interest-earning assets,
- Non-Funded Income (NFI) increased marginally by 0.1% to Kshs 2.49 bn, from Kshs 2.48 bn in Q1'2021. The increase was mainly driven by a 27.0% rise in Foreign Exchange Trading income to Kshs 1.0 bn in Q1'2022, from Kshs 0.8 bn in Q1'2021. However, the performance was weighed down by the 10.3% decrease in income from other Fees and Commission to Kshs 1.2 bn, from Kshs 1.3 bn in Q1'2021. The bank's total fees and commissions also declined by 11.0% to Kshs 1.2 bn, from Kshs 1.4 bn in Q1'2021. As a result, the revenue mix shifted to 66:34 from 65:35 in Q1'2021, funded to non-funded income, owing to the 7.2% increase in Net Interest Income (NII), compared to a 0.1% increase in Non - Funded Income (NFI),
- Total operating expenses declined by 5.4% to Kshs 3.5 bn in Q1'2022, from Kshs 3.7 bn in Q1'2021, mainly attributable to a 120.8% decline in Loan Loss Provisions (LLPs) to a negative provision of Kshs (0.1 bn) in Q1'2022, from Kshs 0.4 bn in Q1'2021 as a result of a reduction in management provisions primarily related to COVID-19, given the reduced uncertainty in the business environment. However, Staff Costs increased by 1.4% to Kshs 1.7 bn, from Kshs 1.6 bn recorded in Q1'2021,
- Cost to Income Ratio (CIR) improved to 47.0%, from 52.0% in Q1'2021 owing to a 5.4% decline in total operating expenses coupled with a 4.7% growth in total operating income. Without LLP, Cost to Income ratio deteriorated to 48.1%, from 46.2% in Q1'2021, an indication of reduced efficiency levels and resulting from the negative provisioning during the quarter, and,

- Profit before tax increased by 15.7% to Kshs 3.9 bn, from Kshs 3.4 bn in Q1'2021. Profit after tax increased by 15.6% to Kshs 2.8 bn in Q1'2022, from Kshs 2.4 bn recorded in Q1'2021 with the effective tax rate remaining unchanged at 29.6%.

Balance Sheet

- The balance sheet recorded a marginal expansion as total assets grew by 0.5% to Kshs 340.9 bn in Q1'2022, from Kshs 339.3 bn in Q1'2021. This growth was largely driven by an 8.7% increase in net loans to Kshs 128.1 bn, from Kshs 117.9 bn in Q1'2021. However, the increase was weighed down by a 1.0% decline in investments government and other securities to Kshs 101.4 bn, from Kshs 102.4 bn recorded in Q1'2021. The increase in the loan book marks the largest y/y growth since Q3'2020 and is partly indicative of the reduced credit risk in the business environment as the economy gradually recovers from the effects of the pandemic,
- Total liabilities declined by 0.4% to Kshs 285.3 bn, from Kshs 286.4 bn in Q1'2021 driven by a 74.0% decline in placements to Kshs 0.3 bn, from Kshs 1.2 bn in Q1'2021. Customer deposits remained largely unchanged at 265.4 bn in Q1'2022, from Kshs 265.2 bn in Q1'2021. Deposits per branch rose by 63.7% to Kshs 12.1 bn, from Kshs 7.4 bn in Q1'2021 with the number of branches reducing to 22 from 36 in Q1'2021. The reduced number of branches is attributable to cost cutting measures undertaken by Standard Chartered Bank,
- The faster 8.7% growth in net loans compared to the 0.01% increase in customer deposits led to an increase in the loans to deposit ratio to 48.3%, from 44.4% recorded in Q1'2021,
- Gross Non-Performing Loans (NPLs) increased by 1.2% to Kshs 22.6 bn in Q1'2022, from Kshs 22.3 bn recorded in Q1'2021. Non-Performing loans continue to increase given that the bank lends to sectors like manufacturing which are yet to fully recover from the effects of the pandemic. As of December 2021, the manufacturing sector accounted for 20.0% of the loan book. The NPL ratio however declined to 15.4%, from 16.4% recorded in Q1'2021. The improvement in asset quality is attributable to the faster 7.8% growth in Gross loans, as compared to the relatively slower 1.2% increase in Gross Non-Performing Loans (NPLs),
- General Loan Loss Provisions increased by 9.2% to Kshs 9.6 bn, from Kshs 8.8 bn in Q1'2021. The NPL coverage thus increased to 81.8%, from 81.1% in Q1'2021, as the provisions (after adding back interest suspense) increased by 2.1% in Q1'2022, outpacing the 1.2% rise in the Gross Non-Performing Loans during the same period. The increase in the NPL Coverage to 81.8% in Q1'2022, from 81.1% in Q1'2021 suggests sufficient provisioning,
- Shareholders' funds increased by 5.2% to Kshs 55.6 bn, from Kshs 52.9 bn recorded in Q1'2021. The increase can be attributed to the 3.0% increase in Retained earnings to Kshs 34.5 bn, from Kshs 33.5 bn in Q1'2021,
- Standard Chartered is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 15.4%, 4.9% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio was 17.6%, exceeding the statutory requirement of 14.5% by 3.1% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 15.4% while total capital to risk-weighted assets came in at 17.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.8%, and a Return on Average Equity (ROaE) of 17.4%.

Key Take-Outs:

1. **Asset Quality** – The bank's asset quality improved slightly with the NPL ratio declining to 15.4% in Q1'2022, from 16.4% recorded in Q1'2021. The improvement in the asset quality is attributable to the 7.8% growth in Gross loans, which outpaced the 1.2% increase in Gross Non-Performing Loans (NPLs). The increase in NPLs is partly attributable to increased defaults from the Commercial sector, which is yet to fully recover from the effects of the pandemic,
2. **Expansion of the loan book –** The bank's net loans and advances increased by 8.7% to Kshs 128.1 bn from Kshs 117.9 bn in Q1'2021 as the bank resumed lending to customers on the back of reduced

credit risk during the period following improvement of business the environment. Notably, investment in government securities, which are perceived to be less riskier, declined by 1.0% to Kshs 101.4 bn, from Kshs 102.4 bn in Q1’2021, and,

3. **Operating Efficiency** - There was a reduction in the bank’s operating efficiency as the Cost to Income ratio without LLP deteriorated to 48.1%, from 46.2% in Q1’2021. The deterioration was largely attributable to the 1.4% increase in Staff Costs to Kshs 1.7 bn, from Kshs 1.6 bn recorded in Q1’2021.

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

I. **Revenue Diversification** – The bank is expected to leverage on its digitization strategy which is likely to boost the company’s Non-Funded Income (NFI). Notably, other fees and commissions remain the largest contributor to NFI, having contributed 47.6% in Q1’2022. However, Non-Funded Income (NFI) recorded minimal growth of 1.0% in Q1’2021, and as such we expect the bank to focus more on promoting the usage of alternative channels in a bid to boost the bank’s revenue diversification. Revenue expansion coupled with cost containment will be key in boosting the bank’s bottom line.

Valuation Summary

- We are of the view that Standard Chartered is an “***Accumulate***” with a target price of Kshs 141.2 representing an upside of 13.9%, from the current price of Kshs 124.0 as of 20th May 2022, inclusive of a dividend yield of 11.3%,
- Standard Chartered Bank is currently trading at a P/TBV of 0.9x and a P/E of 5.0x vs an industry average of 0.8x and 4.4x, respectively.