STERLING CAPITAL LIMITED

Kenya Banks

HY2019 Earnings Update

September 2019

"Listed Banks' modest performance"

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Executive Summary

- Our 2019 half year banking sector report titled **"Listed Banks' modest performance"** is a review of major influences impacting the banking sector in the first half of 2019 and our expectations for the remainder of the 2019 financial year.
- The report also provides a brief summary of the individual bank's financial performance during the period in review also providing investors with our take on what they should expect in terms of financial performance FY2019.
- Both commercial bank and domestic debt interest rates declined during the period under review.
- The banking industry reported record highs in liquidity and indication of low private sector lending that is also reflected in slow loan book growth in the banks we cover.
- Our focus banks recorded an average loan book growth of 7.8% during the period in focus with Stanbic being the top performer in loan growth (18.6%).
- A common theme amongst the banks we covered is the continuous growth in holdings of Government securities with only Diamond Trust Bank and Standard Chartered recording a decline.
- We remain concerned about the continuous deterioration in asset quality with all our focus banks recording an increase in Non-Performing Loans (NPLs) during the period in focus.
- NIC Bank Group reported a NPL ratio of 13.3% well above the sector's average 12.7%.
- Most macro-economic variables remained virtually unchanged during the period in review with the Kenya Shilling recording a marginal depreciation during this period.
- Most notable during the period was the issuance of a US$2.1Bn (KES.216.3Bn) Eurobond in May whose impact was the country's forex reserves hitting an all-time high of US$10Bn (KES.1Tn).
- A merger by two banks and a takeover of one bank by another was reported in the first half of 2019 a signal that the sector is alive to consolidation. We however do not see any similar corporate action in the second half of the year.
- In a bid to rid the country off illegal financial proceeds, the Central Bank of Kenya has been overseeing a demonetization process whose impact has been mainly felt in demand for foreign currency.
- On the individual performance of banks, Stanbic bank has been the star performer in 2019 in terms of profitability growth, although Equity Bank Group posted the best overall performance.
- We do not expect significant deviations in the performance of our focus banks H2 2019 with focus being on improving asset quality and reducing operational expenditure in the face of relatively poor interest and Non Funded earnings.
- It is for this reason that we have a neutral view on the performance of the sector barring any positive developments in legislation related to interest rate caps.

1) H1 2019 Banking Industry Review

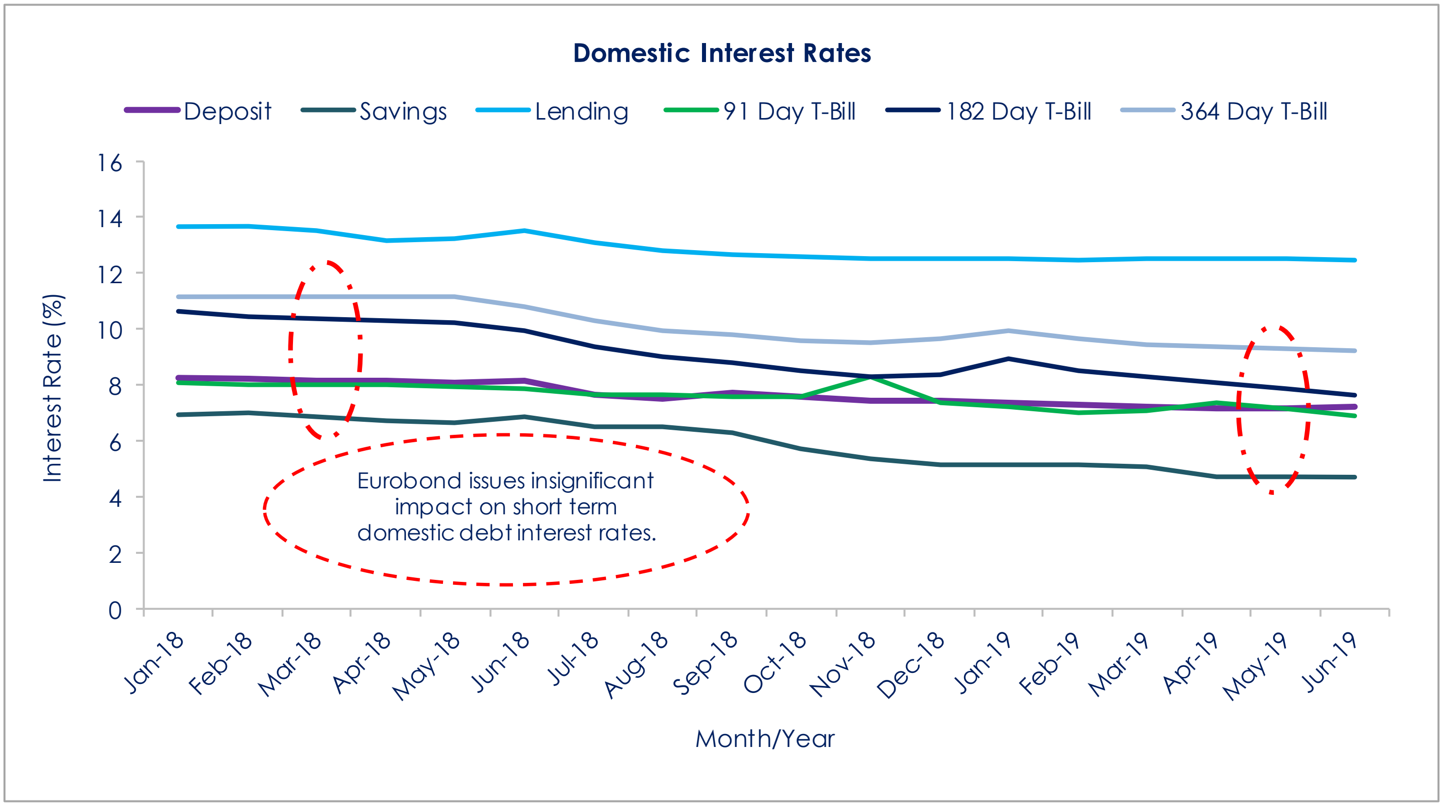
Key themes in banking in H1 2019 were interest rates, asset quality, credit growth, consolidation and demonetization.

- Kenya banking sector profitability recorded modest growth in the first half of 2019 with mixed performance reported by our focus banks.
- The main determinants of the sector's performance during the period were interest rates, asset quality, private sector credit growth, consolidation and demonetization.
- We review these factors in brief also providing an outlook for the second half of the financial year.

A) Interest Rates - Commercial and domestic debt interest rates declined steadily

- Commercial Bank and domestic debt interest rates declined during the period under review through a combination of legislative and monetary influences (Fig.1 and Table.1).

Fig.1: Domestic interest rates downward trend in H1 2019



Source: Central Bank of Kenya

- Interest rates on domestic debt declined during the period under consideration with the 182 Day T-Bill recording the biggest drop at 22.3% to an average of 7.6% in June 2019 (Table.1).

- Commercial bank savings rates declined sharply following the October 2018 enactment of the Finance Act 2018 that scraped the floor on commercial bank deposits. (Commercial banks were mandated to pay at least 70% of the Central Bank Rate (CBR).
- Focus will be on the outcome of the high court's ruling in March 2019 on the constitutionality of the interest rate capping law.
- The National Treasury reiterated the Government's position on interest rates caps calling for a repeal of the law once again in the June 2019 fiscal budget reading.
- Our position on both commercial bank lending rates and interest rates on domestic debt remains unchanged - that a repeal of the capping law remains unlikely with a moderate chance of an upward revision of lending rates.

Commercial bank and domestic debt interest rates declined in H1 2019.

Table.1: Commercial loans and domestic debt interest rates declined

Interest Rate	June-2018	June-2019	%
Commercial Bank interest Rates			
Deposit	8.2	7.2	-10.9
Savings	6.9	4.7	-32.2
Lending	13.5	12.5	-7.7
Domestic Debt			
91 Day	7.9	6.9	-12.5
182 Day	9.9	7.6	-22.3
364 Day	10.8	9.2	-14.3

Source: Central Bank of Kenya

B) Private sector credit exhibits modest growth but remains relatively low

- Private sector credit continued to feel full impact of the introduction of interest rate caps in 2016 (Fig.2).
- Although there has been an increase in H1 2019 to 4.2% compared to 2.9% during the previous period, deterioration of asset quality and heightened Government borrowing in the domestic debt market continued to direct capital away from the private sector.

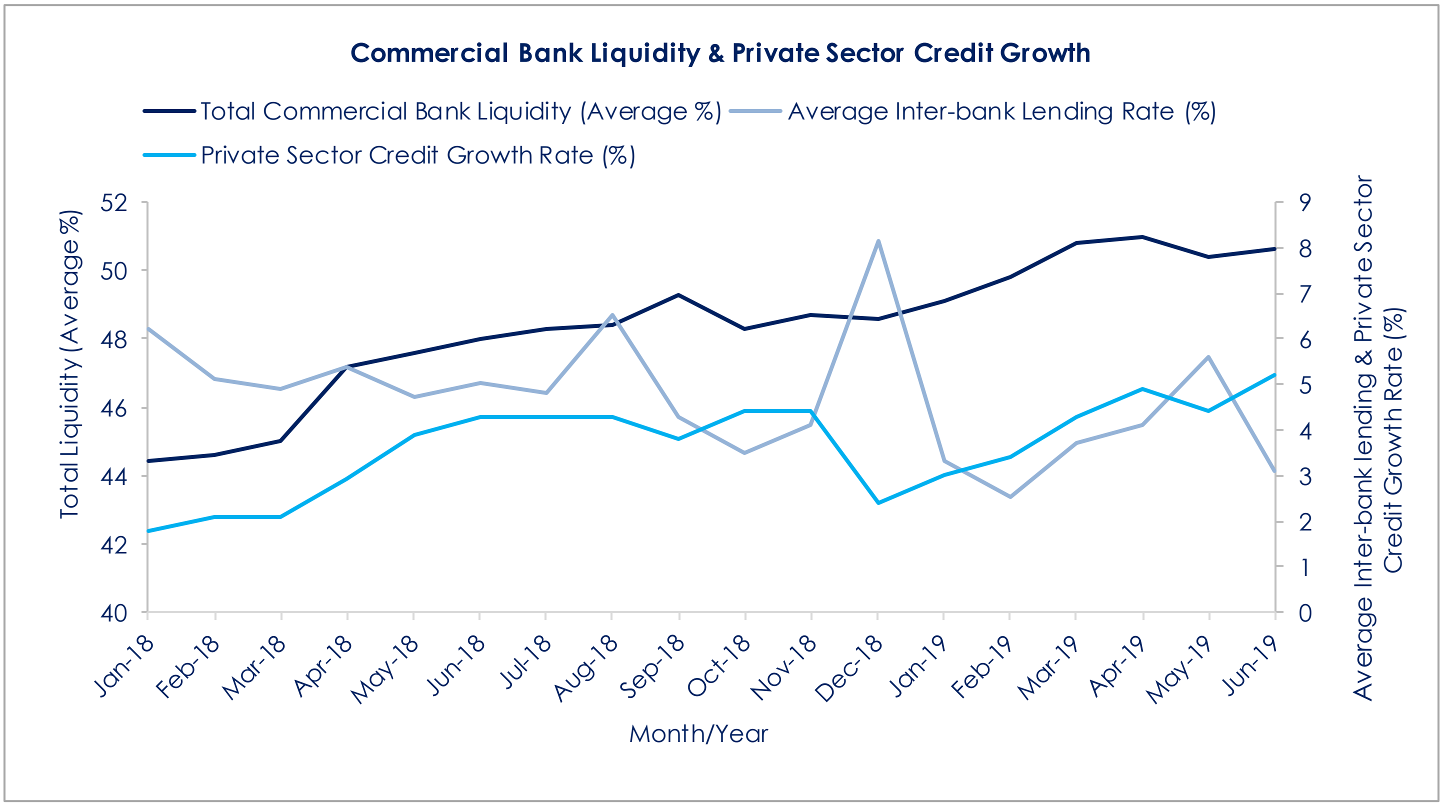
Private sector credit growth remains low in spite of high market liquidity. Some commercial banks maintain a preference for Government securities.

C) Commercial Bank liquidity at record highs

- Data released by the CBK shows a significant increase in average commercial bank liquidity to 50.3% in H1 2019 compared to 46.1% over a similar period in 2018 (Fig.2).
- This high liquidity is clearly evident in high subscription rates in domestic debt securities' auctions compared to low private sector credit growth; 4.2%.
- At the same time, inter-bank lending rates often used as a measure of market liquidity have remained relatively low at an average of 3.7% in H1 2019 compared to 5.2% in H1 2018.

- We expect bank liquidity to remain relatively high in the second half of 2019 with banks adopting different investment strategies.
- We should see a gradual increase in private sector credit growth as banks lend due to a combination of high liquidity and significantly low rates on domestic debt.

Fig.2: High commercial bank liquidity impact on inter-bank lending and private sector credit



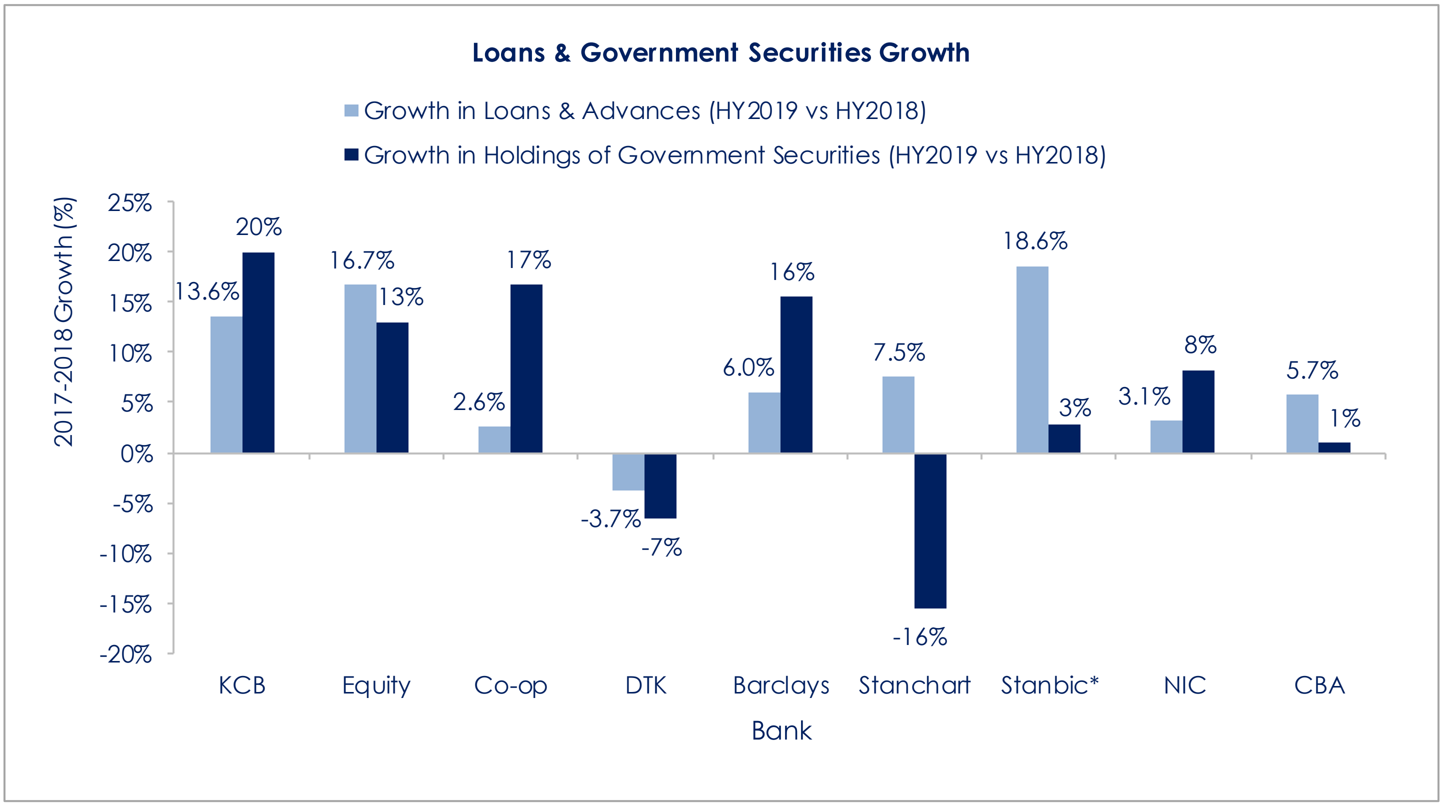
Source: Central Bank of Kenya

Stanbic, Equity and KCB Banks recorded notable loan book growth rates.

DTB and Standard Chartered recording a decline in holdings of Government securities.

- Stanbic, Equity and KCB adopted more aggressive approaches to lending with loan book growth rates of 18.6%, 16.7% and 13.6% respectively, while Diamond Trust, Co-op and NIC either shed off or grew their books at modest rates (-3.7%, 2.6% and 3.1% respectively).
- Our analysis of the respective bank's performance (Fig.3) shows contrasting investment strategies with all our focus banks growing their holdings of Government securities apart from Diamond Trust and Standard Chartered.
- Diamond Trust Bank also appears to have taken a conservative stance to private sector lending during the period reporting a shrinking loan book.

Fig.3: Banks's contrasting investment strategies



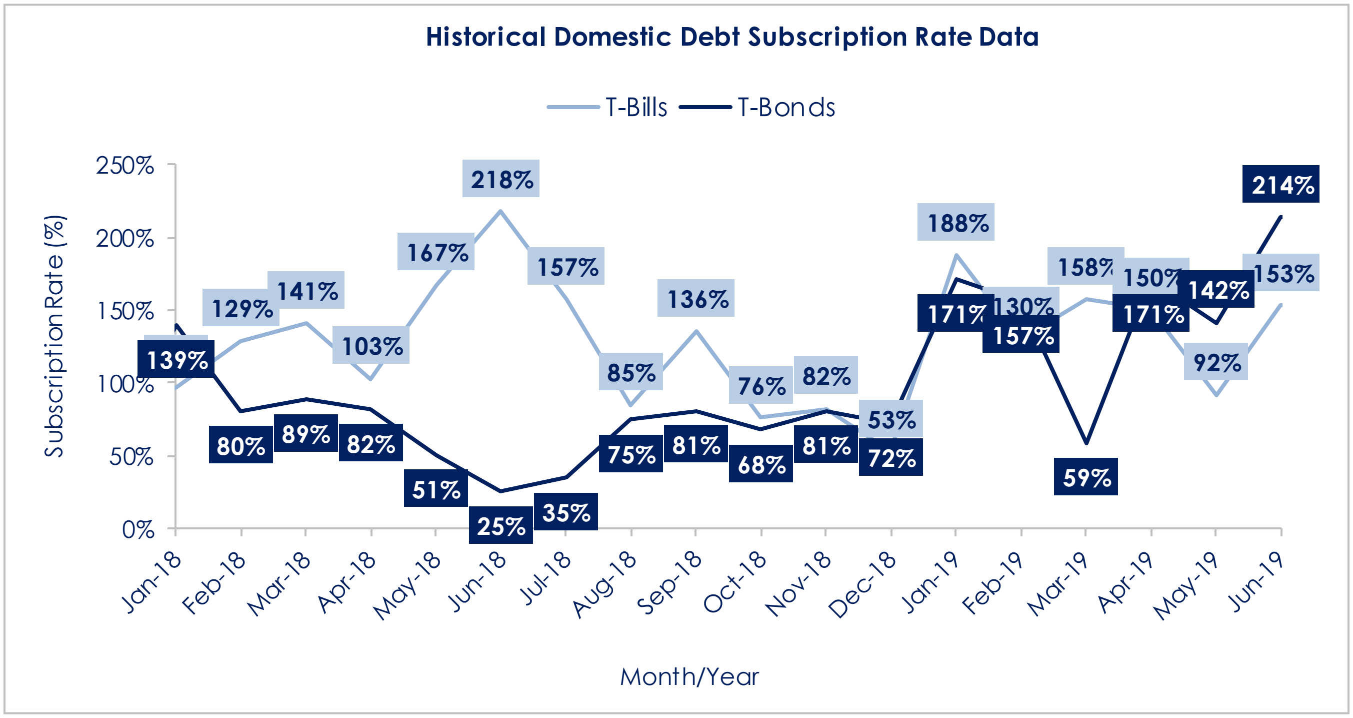
Source: Central Bank of Kenya

D) Banks demand for domestic debt remained high

Banks remain the biggest buyers of Government debt which has been compounded by asset quality deterioration and inability to price risk in lending rates.

- Analysis of domestic debt demand over the last 1 year shows high subscription rates for both T-Bills and short and medium term T-Bonds in primary auctions (Fig.4).
- T-Bills and T-Bonds auctions during this period recorded average subscription rates of 131.1% and 111.9% respectively as banks, the biggest buyers of domestic debt, invested in Government securities.
- We expect this trend to continue in H2 2019 baring an upward revision or complete repeal of rate capping law which would lead to an increase in domestic interest rates.

Fig.4: High investor demand for domestic debt



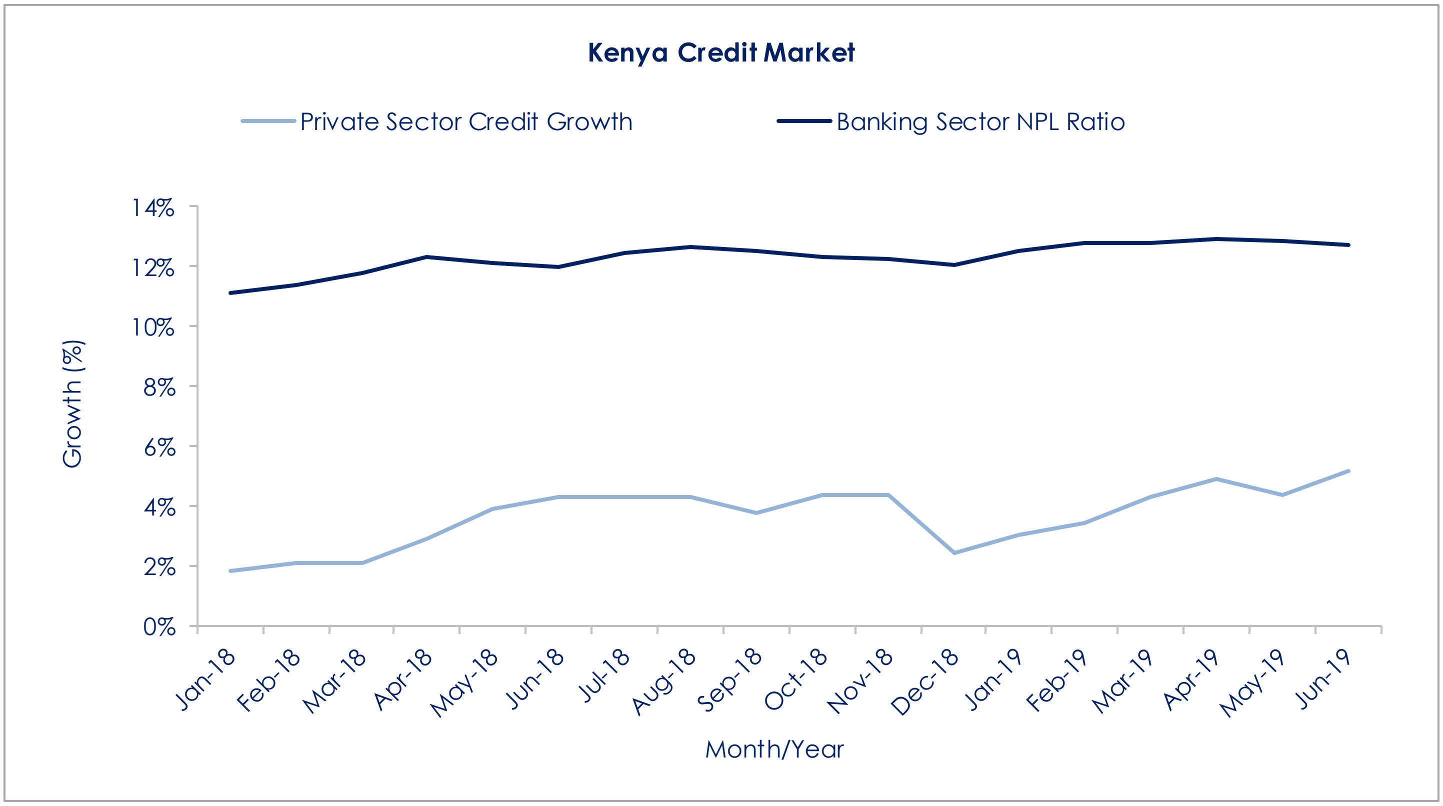
Source: Central Bank of Kenya

E) Asset quality deterioration still a concern

Bank sector average NPL at 12.7% as at June 2019 compared to 12% H1 2018.

- Asset quality deteriorated further in the period under review with the sector's average NPL ratio rising to 12.7% in June 2019 compared to 12% over the same period in June 2018.
- This deterioration is contributed to by the increase in loan book growth (Fig.5).
- We expect sector NPLs to remain high in H2 2019 as poor economic performance continues to affect debt repayments especially in the Small and Medium Sector enterprises and selected sectors such as construction and manufacturing.

Fig.5: Asset quality deterioration has negatively impacted private sector credit growth



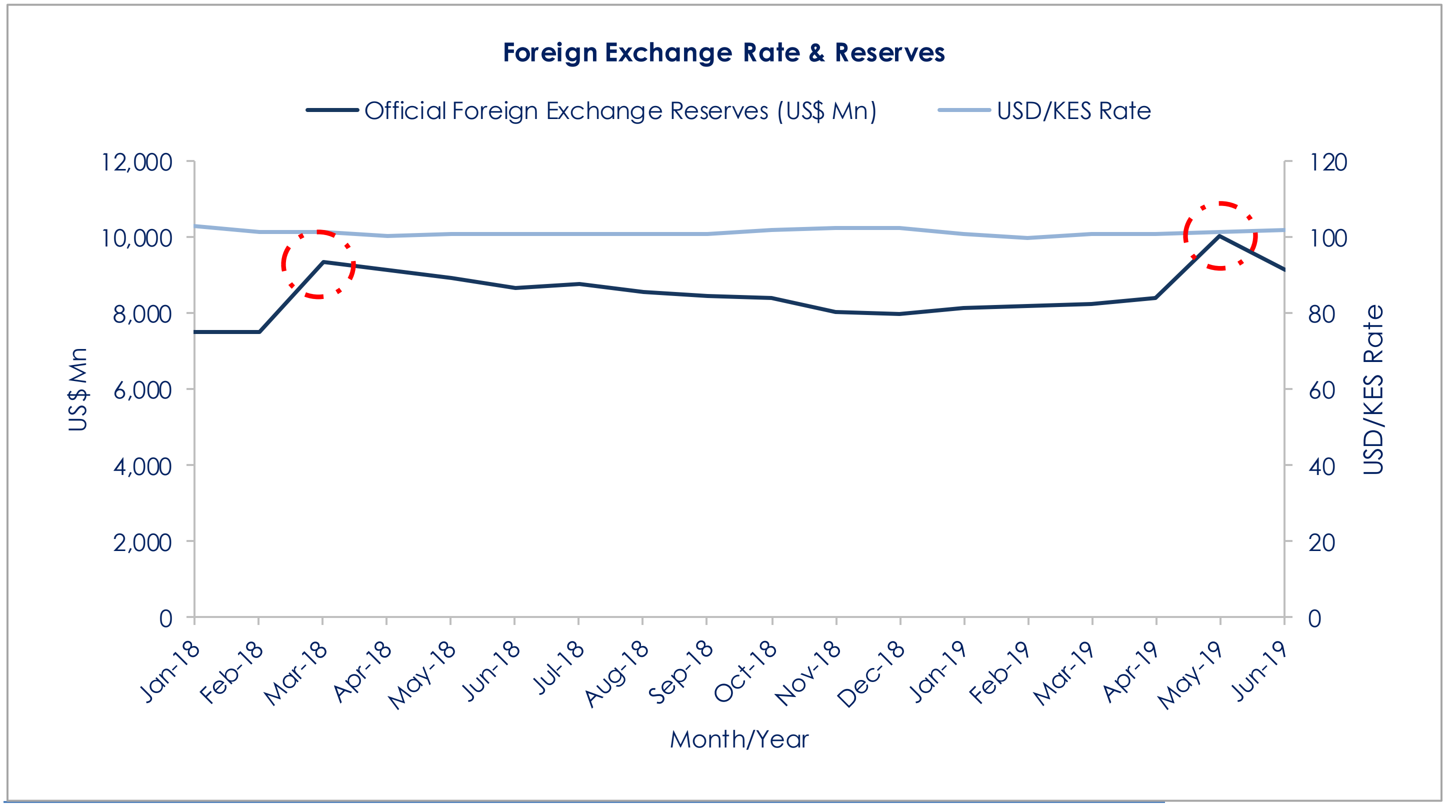
Source: Central Bank of Kenya

F) Foreign Exchange Rate stable, reserves at record high

Kenya Shilling depreciated 2% H1 2019 while foreign exchange reserves peaked at US$10Bn after the issuance of Eurobond.

- The Kenya Shilling depreciated 0.7% between June 2018 and June 2019 (Fig.6).
- Currency stability was supported by growth in diaspora remittances, tea and horticultural imports as tourism earnings.
- The biggest risk to the stability of the local currency in the short term in our view is demonetization which has led to increased demand for foreign currency.
- In addition, rising fuel and food imports could exert pressure on the Shilling in spite of rising foreign currency inflows from the diaspora and the horticulture industry.
- The country recorded its highest levels of forex reserves in May (US$10.1Bn) equivalent to 6.4 months of import cover, following the issuance of the US$2.1Bn Eurobond (Fig.6).
- The issue had little impact on foreign exchange which remained virtually unchanged.
- Forex reserves have since fallen to US$9.4Bn with the repayment of the principal amount of US$750Mn in June the main reason for the decline.

Fig.6: Kenya Shilling relatively stable in H1 2019 in spite of forex reserves at record high



Source: Central Bank of Kenya

G) Consolidation

NIC Bank & CBA Group merger, KCB takeover of NBK - consolidation cases in H1 2019.

No new consolidations in the industry expected in H2 2019.

- In December 2018 Commercial Bank of Africa Ltd and NIC Bank Group Plc announced a proposed merger between the two entities.
- The proposed merger received the approval of the respective shareholders in March and April 2019 with the Competition Authority giving its approval in May 2019.
- In the case of the NIC-CBA merger, we see strategic benefits being the driving force between the two banks.
- In April 2019, KCB announced a proposed takeover of National Bank of Kenya (NBK).
- Our outlook on this proposed takeover is clouded by performance of NBK and in particular its asset quality which we believe will have a bearing in the bigger bank's books.
- We believe that consolidation of the banking sector is becoming an increasingly popular solution for commercial banks struggling with capital requirements or looking for strategic business benefits.
- We do not have sight of other consolidation cases in H2 2019.

H) Demonitisation and the issuance of new generation notes

Demonitisation has an impact on foreign currency exchange rate and resulted in an increase in new capital inflows.

- The demonitisation of the old generation KES.1, 000 currency notes beginning 1st October 2019 a move aimed at containing illicit cash flows and counterfeit currency, is expected to have an impact on the country's financial system.
- The CBK also announced the issuance of new generation currency notes of lower denominations.
- We expect the biggest impact to be felt on the foreign exchange rate with a high probability of increased demand for foreign currency and in particular the United States Dollar (US$).
- We do not see a significant impact of demonitisation on inflation and expect it to remain well within the CBK's lower and upper medium term ranges 2.5% and 7.5% respectively.

2) Kenya Banks HY2019 Financial Performance Highlights

1. KCB Group Ltd

- **Profit After Tax** - Reported a 5% growth in PAT to KES12.7Bn for the period ending H12019.
- **Asset Growth** - Total assets edged up 12% to KES.747Bn attributable to 14% **loan book** growth to KES.478.7Bn, attributable to a surge in mobile lending.
- **Customer deposits** increased by 7.3% to KES.563.2Bn.
- **Government Securities** – Government securities holdings went up by 18.1% to KES.132.9Bn. Government securities as a % of total assets increased from 16.8% to 17.8%.
- **Interest income** – Interest income from loans and advances went up by 4.7% to KES.26.8Bn and increased by 4.8% from government securities to KES.6.6Bn.
- **Mobile Lending** - Loans disbursed via mobile channels increased from KES.20Bn to KES.103.1Bn.
- KCB M-Pesa recorded the highest growth to KES.66.7Bn from KES.14.9Bn while Fuliza and KCB Mobi disbursed KES.27.4Bn and KES.9.0Bn respectively.
- **NFI** - up14.8% to KES.13.2Bn due to a 51.3% increase in fees and commissions from loans.
- **Asset Quality** - NPLs up 4.5% compared to a similar period in 2018 to KES.34.6Bn. While the NPL ratio improved to 7.8% from 8.4% HY2018, below industry average of 12.7% for the period.
- **Operating expenses** - Increased 11.4% mainly because of a 275% jump in the loan loss provisions to KES.3.Bn this in turn a result of NPLs in the manufacturing and trade sectors as well as the rise in mobile lending.
- **Dividend** - Directors approved an interim dividend of KES.1.00 per share to be paid on 15th November, 2019. This is similar to the same period in 2018.

Financial Performance

Financial Summary	FY2018	HY2018	HY2019	% Change
Balance Sheet (KES.Bn)				
Loans & Advances	455.9	421.5	478.7	13.6
Government Securities	120.1	112.5	132.9	18.1
Total Assets	714.3	667.7	746.5	11.8
Customer Deposits	537.5	524.9	563.2	7.3
Shareholders' Funds	113.7	98.1	117.5	19.8
Total Liabilities	600.7	568.7	629.0	10.6
Income Statement (KES.Bn)				
Interest Income	66.3	32.2	33.6	4.3
Interest income from loans & advances	52.7	25.6	26.8	4.7
Interest income from Gov't Securities	13.0	6.3	6.6	4.8
Non-Funded Income	23.0	11.5	13.2	14.8
Total Income	89.3	35.6	38.6	8.4
Total Interest expense	17.5	8.1	8.2	1.2
Total NPLs	28.6	33.1	34.6	4.5
Loan Loss Provisions	2.9	0.8	3.0	275.0
Total Operating Expenses	37.9	18.5	20.6	11.4
Profit After Tax	24.0	12.1	12.7	5.0
Ratios (%)				
Cost to Income Ratio	48.3	48.2	45.7	2.5
Loan to Deposit Ratio	84.8	85.5	89.2	3.7
NFI/Total Income	32.0	32.3	34.1	1.8
NPL Ratio	6.9	8.4	7.8	0.6
Liquidity Ratio	33.3	35.3	34.9	0.4
Government securities/Total Assets	16.8	16.8	17.8	1.0

Source: Company Filings

FY2019 Outlook

- We maintain a **BUY** recommendation guided by our fair value estimate of KES.53 with P/E and P/B multiples of 5.2x and 1.1x respectively against the industry averages of 6.1x and 1.0x.
- Our fair value estimate is an upside of 31.2% based on the current share price of KES.40.40.
- We are positive on the performance and valuation with an expected FY2019 PAT of KES.25Bn.
- We expect KCB to deliver strong performance even with the negative impact of interest rate caps on interest income from loans and advances and lower yields on Government securities.
- Mobile lending will remain a key loan book growth driver even in the face of increased concerns over asset quality.
- NFI growth will remain positive through increased fees and commission income. The lender recently increased fees on loans on the KCB M-Pesa platform from 4.04% to 7.5%.
- We are not overly concerned about the short and medium impact of KCB's purchase of National Bank as the two banks will operate as separate entities for 2 years.
- However in the long-run we are concerned that the combined Bank's entity will be negatively affected mainly through NBK's operational inefficiencies and high NPLs.

2. Equity Group Holdings Ltd

Key Financial Performance highlights

- **Profitability** - PAT up 8.9% over the same period in 2018 to KES.11.9Bn, mainly driven by a 25% increase in NFI to KES.16.5Bn and 9.2% growth interest income to KES.27.7Bn.
- **Asset Book Growth** - 16.7% growth in loans and advances to KES.320.9Bn supported by the Group's aggressive return to SMEs lending, while investment in Government securities increased 13% to KES.179.6Bn.
- **Interest income** – interest income from loans and advances recorded a growth of 9.2% while income from Government securities advanced by 7.9%
- **Non-Funded Income** - NFI was driven mainly by a 20% growth in merchant commissions from KES.876Mn to KES.1.1Bn and Swift & RTGS commissions which grew 15% to KES.413Mn.
- **Subsidiary contribution** – remained stable at 19% with Rwanda reporting the largest growth in PAT (+55%)
- **Operating expenses** – UP 19.4% attributable to 30% increase in other operating expenses.
- **Asset Quality** - Total NPLs rose 20% to KES.25.7Bn as a result of increased SME lending.
- **NPL ratio** deteriorated to 8.6% (HY 2018 – 8.4%), however, this remained below the industry average of 12.7%.

Financial Performance

Financial Summary	FY2018	HY2018	HY2019	% Change
Balance Sheet (KES.Bn)				
Loans & Advances	297.2	275.0	320.9	16.7
Government Securities	161.0	158.9	179.6	13.0
Total Assets	573.4	542.0	638.7	17.8
Customer Deposits	422.8	393.7	458.6	16.5
Shareholders' Funds	95.0	86.3	102.7	19.0
Total Liabilities	478.4	455.7	536.0	17.6
Income Statement (KES.Bn)				
Interest Income	53.2	25.4	27.7	9.2
Interest income from loans & advances	36.4	17.1	18.6	8.9
Interest income from Gov't Securities	16.3	7.9	8.5	7.9
Non-Funded Income	25.9	13.2	16.5	25.6
Total Income	67.3	32.8	37.6	14.8
Total Interest expense	11.8	5.8	6.6	14.3
Total NPLs	21.1	21.4	25.7	20.0
Total Operating Expenses	38.8	17.3	20.6	19.4
Loan Loss Provision	3.7	0.8	0.9	16.7
Profit After Tax	19.8	11.0	11.9	8.9
Ratios				
Cost to Income Ratio	52.2	52.6	52.9	0.3
Loan to Deposit Ratio	70.3	69.9	70.0	0.1
NFI/Total Income	38.5	40.2	43.9	3.7
NPL Ratio	7.6	8.4	8.6	0.2
Liquidity Ratio	54.1	57.1	56.5	0.6

Source: Company Filings

FY2019 Outlook

- We maintain a **BUY** position on Equity Bank with a **fair value estimate of KES.50.00,** an upside of 26.10% from the current price of KES.39.65 on account increased SME lending, improved earnings and diversification.
- We expect interest income from loans and advances to record double digit growth due to SME lending.
- Capital expenditure is expected to increase significantly in the short run following the launch of Equity Afya medical centers. The bank intends to open a clinic in every county.
- We expect subsidiaries to increase their contribution to overall Group performance as a result of improved macro-economic conditions in DRC and South Sudan.

3. Co-op Bank Ltd

Key Financial Performance highlights

- **Profitability** - PAT up 5% to KES.7.5Bn driven by 19.6% and 25.7% growth in interest income from Government securities and NFI to KES.14.7Bn and KES.8.8Bn respectively.
- **Interest income** – Interest income from loans and advances declined 8.7% to KES.14.7Bn despite the increase in loan book. This was attributed to a decline in the yield on loans.
- **Interest expense** - Up 3.0% to KES.6.2Bn owing to 8.3% growth in customer deposits to KES.325.1Bn.
- **Non-funded income (NFI)** - Rose 25.7% to KES.8.8Bn mainly attributable to a 33.2% and 39.0% increase in fees and commissions on loans and advances and other fees and commissions to KES.1.1Bn and KES.6.0Bn respectively.
- **Asset Book Growth** - Total assets went up 7.8% to KES.429.2Bn mainly driven by 16.7% increase in holdings of Government securities to KES.97.0Bn.
- **Loan book** grew by a modest 2.6% to KES.257.6Bn boosted by E-credit lending through mobile phones.
- **Asset quality** - Deteriorated as Gross NPLs increased 8.5% to KES.30.6Bn. Manufacturing, trade and agriculture sectors recorded the highest NPLs at 47%, 24% and 20% respectively. NPL ratio remained flat at 10.9% and below the industry average of 12.7%.
- **Subsidiary Performance** - South Sudan unit Profit before Tax (PBT) declined 19% to KES.92.5Mn compared to a KES.114.6Mn in HY2018.
- **Operating expenses** - Up 5.0% to KES.12.6Bn due to a 7.0% (KES.5.7Bn) and 8.0% (KES.1.2Bn) increase in staff costs and loan loss provision respectively.
- **Efficiency** - Cost to Income ratio (CIR) declined marginally to 49.6% compared to 49.9% HY2018.

Financial Performance

Financial Summary	FY2018	HY2018	HY2019	% Change
Balance Sheet (KES.Bn)				
Loans & Advances	245.4	251.1	257.6	2.6
Government Securities	80.3	83.1	97.0	16.7
Total Assets	413.4	398.4	429.2	7.8
Customer Deposits	306.6	300.2	325.1	8.3
Shareholders' Funds	69.9	68.0	71.0	4.4
Total Liabilities	342.2	329.6	357.2	8.4
Income Statement (KES.Bn)				
Total Interest Income	43.0	20.8	20.4	1.9
Interest income from loans & advances	32.9	16.1	14.7	8.7
Interest income from Gov't Securities	9.8	4.6	5.5	19.6
Non-Funded Income	12.9	7.0	8.8	25.7
Total Income	43.7	21.8	23.0	5.5
Total Interest expense	12.2	6.0	6.2	3.0
Total NPLs	25.2	28.2	30.6	8.5
Loan Loss Provision	1.8	1.1	1.2	8.0
Total Operating Expenses	25.7	12.0	12.6	5.0
Profit After Tax	12.7	7.1	7.5	5.0
Ratios (%)				
Cost to Income Ratio	54.6%	49.9	49.6	0.3
Loan to Deposit Ratio	80.1%	83.7	79.0	4.7
NFI/Total Income	28.2%	32.1	38.0	5.9
NPL Ratio	11.2%	10.9	10.9	0
Liquidity Ratio	41.1%	38.0	45.0	7.0

Source: Company Filings

FY2019 Outlook

- We maintain a **BUY** on **Co-op Bank** with a fair value of **KES.15.08** per share which represents a 32.3% upside from the current price (KES.11.40 as at 30th Aug, 2019).
- The bank trades on a forward P/E of 5.2x and a P/B of 1.0x against sector average P/E of 6.1x and P/B of 1.0x.
- We expect loan book growth to improve H2 2019 as the bank focuses on mobile lending. Co-op is currently disbursing over KES.4.0Bn monthly with a target of KES.10Bn per month by end of FY2019.
- Digitization and investment in alternative banking channels to drive NFI and increase efficiency through average operational expenses with a positive impact on Cost to Income Ratio (CIR). 88% of the bank's transactions are on alternative channels.
- Proactive monitoring of credit performance to improve asset quality by reducing the NPLs.

4. Diamond Trust Bank Ltd

Key Financial Performance highlights

- **Profitability** - PAT up 10% to KES.4.Bn driven mainly by 8.5% growth in NFI to KES.3.0Bn.
- **Total assets** – Almost unchanged at KES.375.9Bn driven by decline in both loan book and holdings of Government securities.
- **Interest income** - Dipped by 6.6% to KES.16.3Bn attributable to a shrink in the loan book (-3.8%), reduced holdings of Government securities (-6.6%), coupled with declining yields.
- **Customer Deposits** - Up marginally 0.5% to KES.283Bn.
- **NFI** - Up 8.5% compared to HY2018 attributable to growth in foreign exchange trading income as well as fees and commissions income.
- **Operating expenses** - Down 14.4% to KES.6.2Bn mainly attributable to a decline in the bank's loan loss provisions to -KES.101.1Mn. Negative provisions indicate that the bank's loss allowance estimate at half-year is lower than the allowance estimate at full year. This could be as a result of a decline in the bank's adversely classified loans.
- **Asset Quality -** NPLs down 0.5% to KES.12.9Bn. NPL ratio 7.9% (HY2018 - 7.7%) below the industry average (12.7%).

Financial Performance

Financial Summary	FY2018	HY2018	HY2019	% Change
Balance Sheet (KES.Bn)				
Loans & Advances	193.1	198.2	190.8	3.8
Government Securities	117.3	129.2	120.7	6.6
Total Assets	377.7	376.1	375.9	0.04
Customer Deposits	282.9	281.7	283.1	0.5
Shareholders' Funds	53.7	54.9	56.9	13.9
Total Liabilities	318.8	321.1	313.4	2.4
Income Statement (KES.Bn)				
Interest Income	35.3	17.5	16.3	6.6
Non-Funded Income	5.4	2.7	3.0	8.5
Total Income	25.5	12.7	12.2	4.0
Total Interest expense	15.2	7.6	7.2	5.5
Interest income from loans & advances	22.0	11.1	9.9	10.4
Interest income from Gov't Securities	13.0	6.3	6.3	0.6
Total NPLs	12.1	12.9	12.9	0.5
Loan Loss Provision	3.0	1.7	0.5	68.1
Total Operating Expenses	14.5	7.3	6.2	14.4
Profit After Tax	7.1	3.8	4.1	10.0
Dividend (KES.)	2.60	-	-	
Ratios				
Cost to Income Ratio	56.9	57.4	51.2	6.2
Loan to Deposit Ratio	68.3	70.4	67.4	3.0
NFI/Total Income	21.3	21.6	24.5	2.9
Gross NPL to Gross Loans	7.0	7.7	7.9	0.2
Liquidity Ratio	53.5	51.1	54.3	3.2

Source: Company Filings

FY2019 Outlook

- We expect the loan book and holdings of Government securities to remain relatively flat FY2019 relative to HY2019.
- Bank expected to grow its service distribution network largely through strategic business partnerships and an agency network.
- NFI will remain a key contributor to total income growth with focus on foreign exchange trading.

5. Barclays Bank of Kenya Limited

Key Financial Performance highlights

- **Profitability** - PAT up 3.1% to KES.3.9Bn mainly driven by a 15.4% increase in interest income from Government securities to KES.4.1Bn and 12.6% growth in NFI to KES.5.3Bn.
- **Asset Growth** - Up 11.8% to KES.353.8Bn supported by 15.4% growth in holding of Government Securities to 81.2%
- **Loan Book Growth** – expanded by 6% to KES.186.7Bn, boosted by retail loans disbursed through the Timiza platform.
- Holdings of **Government securities** increased by 15.4% to KES.15.4Bn despite a decline in yields.
- **Customer deposits** – Up from KES.216.8Bn to KES. 229.67Bn.
- **Operating expenses -** Operating expenses decreased marginally to KES.10.0Bn, resulting in a decline in the cost to income ratio (CIR) to 51.5%.
- **Asset Quality** - 16% increase in NPLs to KES.12.7Bn during the period resulting in an NPL ratio of 6.8% (HY 2018 – 6.2%).
- **Dividend** - Interim dividend - KES.0.20 per share (HY2018 KES.0.20).

Financial Performance

Financial Summary	FY2018	HY2018	HY2019	% Change
Balance Sheet (KES.Bn)				
Loans & Advances	177.4	176.1	186.7	6.0
Government Securities	63.2	70.3	81.2	15.4
Total Assets	334.8	316.6	353.8	11.8
Customer Deposits	207.4	216.8	229.7	5.9
Shareholders' Funds	44.2	40.8	42.9	3.9
Total Liabilities	280.6	275.8	311.5	12.9
Income Statement (KES.Bn)				
Interest Income	29.1	14.1	15.2	7.4
Interest income from loans & advances	21.5	10.5	11.0	3.9
Interest income from Gov't Securities	7.4	3.5	4.1	15.4
Non-Funded Income	9.7	4.7	5.3	12.6
Total Income	31.7	15.7	16.3	4.2
Total Interest expense	7.1	3.2	4.2	30.8
Total NPLs	10.8	10.9	12.7	16.0
Loan Loss Provision	3.9	1.7	1.6	0.04
Total Operating Expenses	21.0	10.3	10.0	0.03
Profit After Tax	7.4	3.8	3.9	3.1
Ratios				
Cost to Income Ratio	51.4	55.3	51.5	3.8
Loan to Deposit Ratio	86.0	81	81.3	0.3
NFI/Total Income	30.6	29.9	32.4	2.5
NPL Ratio	6.1	6.2	6.8	0.6
Liquidity Ratio	35.4	38.3	38.7	0.4

Source: Company Filings

FY2019 Outlook

- We maintain a **HOLD** recommendation guided by our fair value estimate of **KES.12.24**, an upside of 11.7% from the current price of KES.10.95.
- The bank operates on a P/E of 8.0x and P/B of 1.4x, both of which are above the industry average of 6.1x and 1.0x respectively.
- The retail banking business will be a key focus with products such as Timiza the bank's mobile phone based lending platform) and other digital products expected to drive business growth.
- We however expect stiff competition from other digital platforms that offer lower lending rates such as KCB M-Pesa to result in slower growth.
- We expect growth in interest income from government securities and loans to continue FY2019 as the bank increases their private sector lending as well as Government securities.
- Increase in operating expenses expected until 2021 as a result of a rise in branding and other expenses associated with the separation from Barclays PLC.

6. Stanbic Bank Ltd

- **Profitability** - PAT up 13.9% to KES.4.1Bn driven by a 19.6% growth in Net interest income to KES.6.7Bn.
- **Asset Growth - 12.4% growth in total assets supported by** 18.6% and 2.8% growth in loan book and holdings of **Government securities** to KES.161.9Bn and KES.94.1Bn respectively.
- **Customer deposits** during the period grew by 20.5% to stand at KES.201.6Bn.
- **Non-funded Income (NFI)** - Up 8.9% to KES.6.1Bn due to increase in net fees and commissions. Fees and commissions increased due to investment banking deals.
- **Total operating expenses** – Rose by 5.3% to KES.6.0Bn with loan loss provisions recording the biggest increase over the period (300%) to KES.1.2Bn.
- **Dividend** - The board of directors have declared a dividend of KES.1.25 a decline from HY2018 interim dividend of KES.2.25.

Financial Summary	**FY2018**	**HY2018**	**HY2019**	**% Change**
Balance Sheet				
Loans & Advances	174.9	136.5	161.9	18.6
Government Securities	72.3	91.5	94.1	2.8
Total Assets	290.6	278.8	313.3	12.4
Customer Deposits	219.5	167.3	201.6	20.5
Shareholders' Funds	44.6	42.2	46.8	10.9
Total Liabilities	245.9	236.6	266.5	12.6
Income Statement				
Net Interest Income	12.1	5.6	6.7	19.6
Non-Funded Income	9.9	5.6	6.1	8.9
Total Income	22.1	11.2	12.8	14.3
Gross NPLS	11.3	10.5	16.7	59.0
Loan Loss Provision	2.1	0.3	1.2	300.0
Total Operating Expenses	11.1	5.7	6.0	5.3
Profit Before Tax	8.9	5.2	5.6	7.7
Profit After Tax	6.3	3.6	4.1	13.9
Ratios (%)				
Cost to Income Ratio	50.2	51.3	47.1	4.2
Loan to Deposit Ratio	79.7	82.8	80.3	2.5
NFI/Total Income	44.8	48.6	47.7	0.9
NPL Ratio	10.0	6.1	8.7	2.6
Government Securities/Total Assets	24.9	32.8	30.0	2.8

Source: Company Filings

FY2019 Outlook

- We downgrade our recommendation to **BUY** on a fair value estimate of KES.108 an upside of 13.7% from the current price of KES.95.
- The share trades at a discount to market with a PE of 6.0x and PB 0.8x against the industry average of 6.1x and 1.0x respectively.
- PAT projected at KES.8.4Bn driven by both interest income and NFI growth.
- The bank is currently pursuing a voluntary retrenchment programme.

- We expect the NPL Ratio to reduce based on Government payments to its suppliers which will boost loan payments by borrowers.
- The lender reduced the interim dividend by KES.1.0 to be paid on 27th September, 2019.

7. Standard Chartered Bank Ltd

- **Profitability** - PAT up 4.4% supported by a 6.2% decline in total operating expenses to KES.7.6Bn.
- **Asset Growth** - Total assets grew by Supported by 7.5% growth in loan book.
- **Government Securities** - We observe a significant decline in appetite for Government securities which recorded a 15.4% decrease to KES.103.1Bn.
- **Customer deposits** -1% decline to KES.228.5Bn from KES.230.8Bn.
- **Interest income** – Interest income from loans and advances remained unchanged during the period under review at KES.6.7Bn while interest income from Government securities recorded a 14.1% to KES.5.5Bn.
- **NFI** - Down 2.1% to KES.4.7Bn largely on account of a 14.3% decline in income from other fees and commissions.
- **Total operating expenses** - Declined 6.2% to KES.7.6Bn mainly attributable to a 69.2% decline in loan loss provisioning to KES.0.4Bn.
- **Asset Quality** - Total NPLs rose 7.7% to KES.12.6Bn contributing to an NPL ratio of 10.5% (HY2018 -10.5%).
- **Dividend** - Interim Dividend of KES.5.0 to be paid on 30th October (HY 2018 - KES.5.0).

Financial Summary	FY2018	HY2018	HY2018	% Change
Balance Sheet				
Loans & Advances	118.7	111.7	120.1	7.5
Government Securities	99.1	121.9	103.1	15.4
Total Assets	285.4	296.0	294.5	0.5
Customer Deposits	224.3	230.8	228.5	1.0
Shareholders' Funds	46.6	44.6	46.9	5.2
Total Liabilities	238.8	251.3	247.7	1.4
Income Statement				
Interest Income	26.9	13.7	12.7	7.3
Interest income from loans & advances	13.1	6.7	6.7	0.0
Interest income from Gov't Securities	12.5	6.4	5.5	14.1
Non-Funded Income	9.2	4.8	4.7	2.1
Total Income	28.6	14.7	14.6	0.7
Total Interest expense	7.5	3.9	2.9	25.6
Total NPLs	13.9	11.7	12.6	7.7
Loan Loss Provision	1.9	1.3	0.4	69.2
Total Operating Expenses	16.8	8.1	7.6	6.2
Profit After Tax	8.1	4.5	4.7	4.4
Ratios (%)				
Cost to Income Ratio	58.7	55.1	50.0	5.1
Loan to Deposit Ratio	52.9	48.4	52.6	4.2
NFI/Total Income	32.2	32.7	32.2	0.5
NPL Ratio	11.7	10.5	10.5	0.0
Liquidity Ratio	66.6	71.3	67.3	4.0

Source: Company Filings

FY2019 Outlook

- We maintain a **HOLD** on the bank with a fair value estimate of KES.193.0 a downside of 1.4% from the current price of KES.195.75.
- FY PAT forecasted at KES.8.6Bn (FY2018 KES.8.1Bn) supported by NFI forecasted at KES.9.7Bn (FY.2017 KES.8.8Bn).
- We expect flat growth for the bank FY2019 on account of slow growth in interest income and NFI.
- Growth in the medium term should improve through the lender's focus on transforming its digital network and launch of its mobile lending platform. This will increase fees and commissions and loans disbursed in the medium term.

8. Commercial Bank of Africa

Key Financial Performance Highlights

- **Profitability** - PAT up 2.9% to KES.2.4Bn mainly attributable to 1.9% (KES.9.8Bn) increase in interest income and 1.2% (KES.4.8Bn) and 11.8% (KES.5.9Bn) decline in interest expense and total operating expenses respectively.
- **Total Assets** - Expanded 9.8% to KES.262Bn due to 81.0% growth in deposits and balances due from banking institutions abroad (KES.20.2Bn) and 5.7% increase in loan book to KES.120.3Bn.
- **Interest income** - Increased marginally by 1.9% to KES.9.8Bn driven by 4.5% (KES.5.9Bn) growth in interest income which offset a 1.9% decline in interest income from Government securities to KES.3.6Bn.
- **NFI** - Down 2.2% to KES.5.2Bn owing to 30.2% decline in fees and commission from loans and advances to KES.2.1Bn. NFI to total income also declined to 51.0% HY2019 from 52.5% same period in 2018.
- **Operating Expenses** - Decreased 11.8% to KES.5.9Bn due to 82.3% (KES.0.3Bn) decline in loan loss provision which offset an 8.4% increase in staff costs to KES.2.1Bn.
- **Asset Quality**: Deteriorated as Gross NPLs rose 6.8% to KES.12.2Bn. NPL ratio went up to 9.2% from 9.1% HY2018.

Financial Performance

Financial Summary	FY2018	HY2018	HY2019	% Change
Balance Sheet (KES.Bn)				
Loans & Advances	121.5	113.8	120.3	5.7
Government Securities	60.2	73.2	75.9	3.8
Total Assets	245.1	238.7	262.0	9.8
Customer Deposits	196.5	187.7	205.7	9.6
Shareholders' Funds	30.6	29.5	31.8	7.8
Total Liabilities	214.5	209.1	230.2	10.1
Income Statement (KES.Bn)				
Interest Income	19.4	9.6	9.8	1.9
Interest income from loans & advances	11.6	5.7	5.9	4.5
Interest income from Gov't Securities	7.4	3.7	3.6	1.9
Non-Interest Income	11.5	5.3	5.2	2.2
Total Income	21.2	10.1	10.2	1.2
Total Interest Expense	9.7	4.9	4.8	1.2
Total NPLs	12.0	11.4	12.2	6.8
Loan Loss Provision	3.7	1.6	0.3	82.3
Total Operating Expenses	14.8	6.7	5.9	11.8
Profit After Tax	5.0	2.3	2.4	2.9
Ratios				
Cost to Income Ratio	52.1	51.0	55.6	4.6
Loan to Deposit Ratio	61.8	60.6	58.5	2.1
NFI/Total Income	54.2	52.5	51.0	1.5
NPL Ratio	8.0	9.1	9.2	0.1
Liquidity Ratio	47.5	48.5	55.7	7.2

Source: Company Filings

- We do not expect the proposed NIC/CBA merger which is expected in Q3-2019 to have a major impact on the CBA's performance FY2019.
- However, the merger will have a positive impact on the company's long term prospects by providing an opportunity for the new entity to grow by tapping into both retail and corporate banking.
- We expect the bank's increased investment in digital banking and strategic partnerships (M-Shwari and Fuliza) to boost revenue growth and reduce operational costs.
- The bank has a diversified revenue streams resulting in NFI to total income ratio of 51.0% which is among the highest in the industry.

9. NIC Bank Ltd

Key Financial Performance Highlights

- **Profitability** - 4.2% decline in PAT to KES.1.9Bn mainly attributable to an 18.0% increase in operating expenses to KES.5.2Bn.
- **Total assets** - Up 6.6% to KES.214.1Bn driven by 8.1% and 3.1% growth in holdings of Government securities and loans and advances respectively to KES.60.3Bn and KES.118.5Bn.
- **Interest income** – Up marginally (0.9%) to KES.9.7Bn driven by a 3.8% (KES.3.4Bn) growth in income from Government Securities which offset a 0.7% decline in interest income from loans and advances to KES.6.2Bn.
- **Interest expense** - Down 7.0% to KES.4.1Bn owing to 8.7% decline in interest expense on customer deposits to KES.3.4Bn.
- **NFI** - Up 23.9% to KES.2.7Bn mainly driven by 29.3% (KES.0.8Bn) growth in fees and commissions on loans and advances and 67.8% (KES.0.6Bn) increase in other income.
- **Operating Expenses** - Up 18.0% to KES.5.2Bn attributable to 29.6% increase in loan loss provisions to KES.1.4Bn, 19.5% increase in other operating expenses to KES.1.3Bn and 9.1% rise in staff costs to KES.1.9Bn.
- **Cost to income ratio (CIR)** - Increased to 46.3% from 45.6% HY2018 owing to 18.0% increase in operating expenses.
- **Asset Quality** - Deteriorated as Gross NPLs went up 12.3% to KES.18.1Bn. The NPL ratio increased to 13.3% compared to 12.3% HY2018 above the industry average (12.7%).
- **Dividend** - The bank announced an interim dividend of KES.0.25 per share.

Financial Performance

Financial Summary	FY2018	HY2018	HY2019	% Change
Balance Sheet (KES.Bn)				
Loans & Advances	118.1	114.9	118.5	3.1
Government Securities	58.0	55.7	60.3	8.1
Total Assets	208.5	200.9	214.1	6.6
Customer Deposits	144.5	147.1	152.3	3.5
Shareholders' Funds	35.8	32.2	37.7	17.1
Total Liabilities	172.7	168.7	176.4	4.6
Income Statement (KES.Bn)				
Interest Income	19.3	9.6	9.7	0.9
Interest income from loans & advances	12.3	6.2	6.2	0.7
Interest income from Gov't Securities	6.8	3.3	3.4	3.8
Non-Interest Income	4.6	2.1	2.7	23.9
Total Income	15.2	7.3	8.2	12.5
Total Interest Expense	8.7	4.4	4.1	7.0
Total NPLs	16.8	16.2	18.1	12.3
Loan Loss Provision	2.4	1.1	1.4	29.6
Total Operating Expenses	9.4	4.4	5.2	18.0
Profit After Tax	4.2	1.99	1.90	4.2
Ratios				
Cost to Income Ratio	46.3	45.6	46.3	0.7
Loan to Deposit Ratio	81.7	78.2	77.8	0.4
NFI/Total Income	30.5	28.8	32.9	4.1
NPL Ratio	13.4	12.3	13.3	1.0
Liquidity Ratio	48.7	48.8	50.9	2.2

Source: Company Filings

FY2019 Outlook

- We recommend a **HOLD** on **NIC Group Plc** based on a fair value estimate of **KES.30.88** an 8.5% upside from the current market price of KES.28.45 (as at 30th August, 2019).
- The bank trades on a forward P/E of 4.7x and a P/B of 0.6x against sector average P/E of 6.1x and P/B of 1.0x.
- NIC's drop in profitability comes as its plans to merge with CBA Group takes shape. We expect the costs to increase in the short term due to merger-related costs.
- In the medium to long term the merger is expected to derive operational efficiency as the merged entity will have a bigger capital base and will benefit from the bank's respective strengths which include digitization (CBA) and asset financing (NIC).
- The bank has one of the highest NPL ratios in the banking industry. In the second half of 2019, focus will also be directed to improving asset quality.
- We expect the bank to drive proactive NPL management and monitoring of credit performance to enhance asset quality.

HY2019 Bank Financial Performance Summary

Bank	KCB	Equity	Co-op	DTB	Barclays	Stanbic	Stanchart	CBA	NIC
Balance Sheet									
Loans & Advances	478.7	320.9	257.6	190.8	186.7	161.9	120.1	120.3	118.5
Government Securities	132.9	179.6	97.0	120.7	81.2	94.1	103.1	75.9	60.3
Total Assets	746.5	638.7	429.2	375.9	353.8	313.3	294.5	262.0	214.1
Customer Deposits	563.2	458.6	325.1	283.1	229.7	201.6	228.5	205.7	152.3
Shareholders' Funds	117.5	102.7	71.0	56.9	42.9	46.8	46.9	31.8	37.7
Total Liabilities	629.0	536.0	357.2	313.4	311.5	266.5	247.7	230.2	176.4
Income Statement									
Interest Income	33.6	27.7	20.4	16.3	15.2	N/A	12.7	9.8	9.7
Interest income from loans & advances	26.8	18.6	14.7	9.9	11.0	N/A	6.7	5.9	6.2
Interest income from Gov't Securities	6.6	8.5	5.5	6.3	4.1	N/A	5.5	3.6	3.4
Non-Funded Income	13.2	16.5	8.8	3.0	5.3	6.1	4.7	5.2	2.7
Total Income	38.6	37.6	23.0	12.2	16.3	12.8	14.6	10.2	8.2
Total NPLs	34.6	25.7	30.6	12.9	12.7	N/A	12.6	12.2	18.1
Loan Loss Provision	3.0	0.9	1.2	0.5	1.6	1.2	0.4	0.3	1.4
Total Operating Expenses	20.6	20.6	12.6	6.2	10.0	6.0	7.6	5.9	5.2
Profit After Tax	12.7	11.9	7.5	4.1	3.9	4.1	4.7	2.4	1.9
Ratios									
Cost to Income Ratio	45.7	52.9	49.6	51.2	61.6	47.1	50.0	55.6	46.3
Loan to Deposit Ratio	89.2	70.0	79.0	67.4	81.3	80.3	52.6	58.5	77.8
NFI/Total Income	34.1	43.9	38.0	24.5	32.4	47.7	32.2	51.0	32.9
NPL Ratio	7.8	8.6	10.9	7.9	6.8	8.7	10.5	9.2	13.3
Liquidity Ratio	34.9	56.5	45.0	54.3	38.7	N/A	67.3	55.7	50.9
Valuation Ratios									
Share Price	40.40	9.65	11.40	113.25	10.95	95.0	195.75	-	28.45
P/E Ratio	5.2	7.3	5.2	4.7	8.0	6.0	8.5	-	4.7
P/B Ratio (X)	1.1	1.6	1.0	0.6	1.4	0.8	1.4	-	0.6
Dividend Yield (%)	8.7	5.0	8.8	2.3	1.3	6.1	9.7	-	4.4
ROA (%)	3.5	3.6	3.6	1.9	2.3	2.3	2.8	2.04	2.0
ROE (%)	21.9	21.1	21.5	12.0	16.8	14.3	17.5	16.3	12.1

*N/A– Not Available

Source: Company Filings

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Sterling Capital Limited recommendation guide is based on the difference between the current share price (CSP), and the fair value (FV) of the share as valued by Sterling Capital research. Recommendation categories are defined as follow:

Buy: FV between 13% and above CSP
Hold: FV between -12% and 12% around CSP
Sell: FV more than 12% below CSP

NB: The recommendation guide may change depending on the risk free rate.