DYER & BLAIR INVESTMENT BANK
EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

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DYER & BLAIR
INVESTMENT BANK
WE KNOW. YOU KNOW.

BARCLAYS BANK OF KENYA: 1H18 EARNINGS UPDATE

Dear All,

BARCLAYS BANK OF KENYA (BBK) released its 1H18 results recording a 6.2% y-o-y increase in profit after tax (PAT) to KES 3.8 BN. EPS for the period stood at KES 0.69. Its Trailing EPS stands at KES 1.32. Annualized ROE rose 107 bps y-o-y to 18.4% whereas annualized ROA declined 27 bps y-o-y to 2.4%. As expected, directors maintained the interim dividend at KES 0.20 per share (Dividend yield of 1.6%).

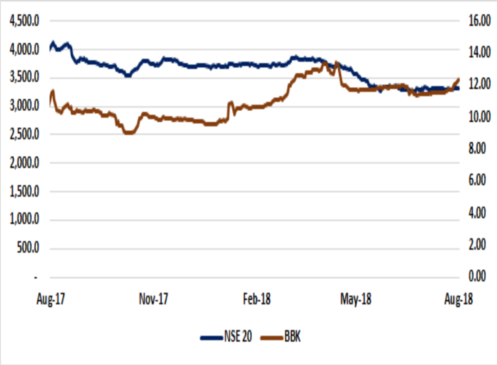
Below please find key highlights:

Net interest income rose 4.0% y-o-y to KES 10.9 BN. This was on the back of a 7.6% y-o-y rise in interest income to KES 14.1 BN and a 22.4% y-o-y increase in interest expense to KES 3.2 BN. Annualized yield on interest earning assets declined 76 bps y-o-y to 10.6% whereas annualized cost of funds declined 2 bps y-o-y to 2.4%. As a result, annualized net interest margin declined 74 bps y-o-y to 8.2%.

Interest income from loans and advances rose 0.6% y-o-y to KES 10.6 BN while interest from government securities rose 36.1% y-o-y to KES 3.5 BN. Interest expense from customer deposits rose 19.0% y-o-y to KES 2.8 BN whereas interest expense from deposits and placements from other banks rose 50.6% y-o-y to KES 0.4 BN.

Non-funded income rose 6.9% y-o-y to KES 4.7 BN. This was courtesy of a 1.9% y-o-y increase in fees and commissions to KES 2.8 BN and a 10.9% y-o-y increase in forex income to KES 1.6 BN. Fees and commissions on loans rose 47.1% y-o-y to KES 474.3 MN whereas other fees and commissions declined 4.2% y-o-y to 2.3 BN. As the bank continues to scale its alternative channels and other sources of non-funded income, we expect to see strong growth in the year.

BARCLAYS KENYA: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 month (%)	3.3	16.1
6 month (%)	16.0	26.5
12 month (%)	6.9	25.6

KEY METRICS	
Current Price (KES)	12.35
52 week Range (KES)	8.55-13.40
YTD Return (%)	28.7
Issued Shares (MN)	5,431.5
Market Cap (USD MN)	667.5

Recommendation	Hold
Trailing EPS (KES)	1.32
NAV (KES)	7.51
P/E (x)	9.4
P/B (x)	1.6
Div. Yld (%)	1.6

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Operating expenses less loan loss provisions rose 2.7% y-o-y to KES 8.7 BN. This was courtesy of a 15.1% y-o-y rise in other operating expenses to KES 2.3 BN and a marginal 0.4% y-o-y decline in staff costs to KES 5.1 BN. Rental charge declined 5.8% y-o-y to KES 596.9 MN underscoring the impact of the recent consolidation of branches. Cost to income ratio declined 116 bps y-o-y to 55.3%.

Impairment charge (loan loss provision expense) rose 26.9% y-o-y to KES 1.7 BN presenting quite a surprise given our assumption that the impairment charge would fall due to the impact of full adoption of IFRS 9 as at January 1st 2018 and the improved operating environment in 2018. We will engage the management team tomorrow (August 14th 2018) so as to understand the reason for this increase more so if it has to do with the recently launched mass market mobile lending product dubbed "Timiza".

Loans and advances rose 7.5% y-o-y to KES 176.1 BN (+6.4% q-o-q) indicating increased lending following the 1.9% y-o-y decline (1.7% q-o-q decline) that the bank recorded in 1Q18. Available for sale securities rose 33.6% y-o-y to KES 70.3 BN (+5.0% q-o-q). Held for dealing securities rose 376.9% y-o-y to KES 22.9 BN (+30.9% q-o-q).

Customer deposits rose 14.9% y-o-y to KES 216.8 BN (+12.2% q-o-q) whereas balances due to group rose 94.2% y-o-y to KES 41.9 BN. The loan to deposits ratio declined 559 bps y-o-y to 81.2% whereas loan to deposits and borrowed funds declined 978 bps y-o-y to 66.7%.

Adjusted capital ratios take into account the Central Bank of Kenya's 5 year waiver for banks to regularize their capital declines occasioned by the implementation of IFRS 9.

Gross NPLs rose 19.7% y-o-y to KES 14.4 BN (plus 13.7% q-o-q). Interest in suspense rose 6.0% y-o-y to KES 3.4 BN. Consequently total NPLs rose 24.7% y-o-y to KES 10.9 BN. Loan loss provision rose 27.9% y-o-y to KES 6.4 BN. As a result net-non performing loans rose 20.6% y-o-y to KES 4.6 BN. As we have commented above, the growth in impairment is curious given our assumption that Barclays did full IFRS 9 adoption and our observation that the operating environment has improved compared to last year. NPL ratio (gross NPL/ gross loans) rose 71 bps y-o-y to 7.5% whereas NPL coverage (loan loss provision/ total NPL) rose 144 bps y-o-y to 58.3%.

Core capital ratio (Core capital/TRWA) declined 100 bps y-o-y to 14.7% whereas Total capital/TRWA declined 110 bps y-o-y to 16.7%. Both ratios remain above the statutory minimums of 10.5% and 14.5% respectively. Adjusted core and total capital ratios stand at 15.0% (down 120 bps q-o-q) and 18.2% (down 130 bps q-o-q) respectively. Liquidity ratio rose 220 bps y-o-y to 38.3% (above the statutory minimum of 20.0%).

Barclays Bank of Kenya received shareholder approval to change the Group's name from Barclays Bank Limited to "Absa Group Limited" in line with "The Transitional Trade Mark License Agreement" entered into between Barclays Africa Group and Barclays PLC as part of the separation arrangement. They however have until 6th June 2020 to effect this change.

Going forward: Whereas it is demonstrably true that South African controlled entities in Kenya tend to underperform, we believe that on balance the flexibility gained from the separation will create new growth frontiers for the bank and enable it to realize a corporate governance dividend given the heightened regulation in the sector. On its part, management is continuing to focus on developing and scaling recently launched revenue streams inclusive of Banc-assurance, Brokerage, Asset Finance, and Mortgage Finance in an effort to diversify away from funded income. Lastly, as the main shareholder of Barclays Kenya remains the same, management does not expect their dividend payout policy to change.

On a trailing basis, Barclays Bank of Kenya is trading at a P/E ratio of 9.4x, relative to an industry median of 8.7x, a P/B of 1.6x relative to an industry median of 1.1x. Its ROE and ROA multiples stand at 18.4% and 2.4% against sector median multiples of 14.5% and 2.3% respectively. Given the improved financial performance, our outlook for the year and our belief that the separation will bode well for the bank's competitiveness against other local banks, we maintain our **Hold** recommendation.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	1H18	1H17	y-y% ch	2q18	1q18	2q17	y-y% ch	q-q% ch
Interest income	14,139	13,137	7.6	7,216	6,923	6,735	7.2	4.2
Interest expense	3,172	2,593	22.4	1,712	1,460	1,225	39.8	17.3
Net interest income	10,967	10,544	4.0	5,504	5,463	5,509	(0.1)	0.7
Other operating income	290	201	44.4	160	129	94	71.0	23.9
Fees and commission income	2,765	2,713	1.9	1,404	1,361	1,255	11.9	3.2
Net income from forex dealings	1,642	1,480	10.9	882	760	675	30.7	16.1
Total non-interest income	4,697	4,394	6.9	2,447	2,250	2,024	20.9	8.7
Total income	15,663	14,939	4.9	7,951	7,713	7,533	5.5	3.1
Less operating expenses	8,661	8,433	2.7	4,236	4,425	4,322	(2.0)	(4.3)
Operating profit	7,003	6,506	7.6	3,715	3,288	3,211	15.7	13.0
Bad debt charge	(1,717)	(1,353)	26.9	(1,141)	(575)	(579)	97.2	98.3
Profit before income tax	5,286	5,152	2.6	2,573	2,713	2,632	(2.2)	(5.1)
Less tax	(1,524)	(1,610)	(5.3)	(694)	(830)	(839)	(17.4)	(16.5)
Profit after tax	3,762	3,543	6.2	1,880	1,882	1,793	4.8	(0.1)
Attributable Income	3,762	3,543	6.2	1,880	1,882	1,793	4.8	(0.1)
EPS (KES)	0.69	0.65	6.2	0.35	0.35	0	4.8	(0.1)
DPS (KES)	0.20	0.20	-	0.20	-	0	0.0	-

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	1H18	1Q18	1H17	y-y% ch	q-q% ch
Total shareholder's equity	40,807	44,245	44,047	(7.4)	(7.8)
Minority interest	-	-	-	-	-
Total Equity	40,807	44,245	44,047	(7.4)	(7.8)
Deposits due to other banks	5,435	5,314	1,667	226.0	2.3
Customer deposits	216,809	193,286	181,536	19.4	12.2
Balances due to group	41,894	38,103	22,182	88.9	9.9
Other liabilities	11,684	9,743	11,356	2.9	19.9
Total equity and liabilities	316,629	290,692	260,789	21.4	8.9
Central bank balances	15,716	13,056	19,706	(20.2)	20.4
Deposits due from banks	19,212	12,012	6,616	190.4	59.9
AFS securities	70,343	67,004	44,020	59.8	5.0
Held for dealing securities	22,986	17,560	5,504	317.6	30.9
Customer loans and advances	176,115	165,541	168,702	4.4	6.4
Other assets	8,753	11,810	11,618	(24.7)	(25.9)
Intangible assets	955	1,054	1,459	(34.5)	(9.4)
Fixed assets	2,548	2,654	3,164	(19.5)	(4.0)
Total assets	316,629	290,692	260,789	21.4	8.9

(Source: Company, DBIB Research)

INVESTMENT RETURN

	1H18*	1Q18*	1H17*	y-y bps ch	q-q bps ch
ROA (%)	2.4	2.6	2.6	(27)	(21)
ROIC (%)	2.5	2.7	2.8	(31)	(21)
ROE (%)	18.4	17.0	17.4	107	142

(Source: Company, DBIB Research)

**Annualized*

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	14.7	15.1	15.7	(100)	(40)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	16.7	17.2	17.8	(110)	(50)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	38.3	36.2	36.1	220	210
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	12.9	15.2	15.2	(232)	(233)
Equity-to-Loans Ratio (%)	23.2	26.7	24.9	(173)	(356)
NPL Ratio (%)**	7.5	7.1	6.8	71	45
NPL Coverage Ratio (%)**	58.3	61.5	56.8	144	(325)
Long Term Debt to Total Liabilities and Equity (%)	13.2	13.1	8.0	519	12
NTA/share (KES)	7.3	8.0	7.3	8	(61)
Book value/share (KES)	7.5	8.1	7.5	0	(63)
Payout ratio (%)	28.9	0.0	30.7	(179)	N/A

(Source: Company, DBIB Research)
***Total Loan Portfolio net of Interbank Lending*

OPERATING PERFORMANCE

	1H18	1Q18	1H17	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	10.6	11.3	11.4	(76)	(68)
Cost of funds (%)*	2.4	1.9	2.4	(2)	55
Net Interest Margin (%)*	8.2	9.5	9.0	(74)	(123)
Loan-to-Deposits ratio (%)	81.2	85.6	86.8	(559)	(441)
Loan-to-Dep.& Borrowed Funds ratio (%)	66.7	69.9	76.5	(978)	(326)
Funded Income Generating Potential (%)	83.9	84.1	85.9	(198)	(22)
Funded Income Reliance (%)	70.0	70.8	70.6	(57)	(81)
Cost to income ratio (%)	55.3	57.4	56.5	(116)	(208)
Pre-tax margin (%)	33.7	35.2	34.5	(74)	(142)
PAT margin (%)	24.0	24.4	23.7	30	(39)

(Source: Company, DBIB Research)
**Annualized*

Appendix

Company Investment ratings

Buy: Share price may generate more than 15.0% upside over the next 12 months

Overweight: Share price may generate between 5.0% and 15.0% upside over the next 12 months

Hold: Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

Underweight: Share price may generate between 10.0% and 15.0% downside over the next 12 months

Sell: Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

Not Rated: Counter is not within regular research coverage

Sector Investment Ratings

Overweight： Industry performance better than that of the whole market

Equal weight： Industry performance about the same as that of the whole market

Underweight： Industry performance worse than that of the whole market

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