

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 GROUP: FY18 EARNINGS UPDATE

Dear All,

Barclays Bank Kenya (BBK) released its FY18 results, posting a 7.1% y-o-y increase in profit after tax (PAT) to KES 7.4 BN. Profit before tax gained 2.7% y-o-y to KES 10.6 BN. EPS for the period stands at KES 1.37. ROA declined 27 bps y-o-y to 2.3% whereas ROE rose 107 bps y-o-y to 16.8%. The Directors recommend a final dividend of KES 0.90 bringing the total dividend to KES 1.10, up 10.0% y-o-y.

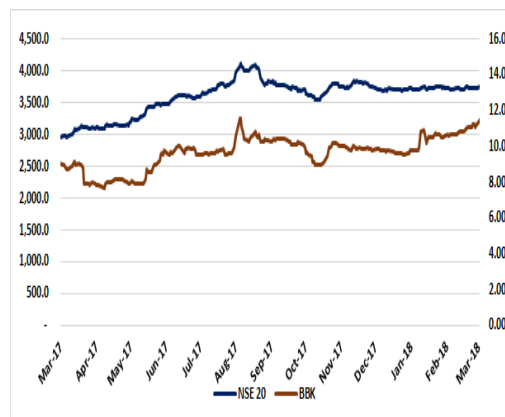
Below please find key highlights:

Net interest income grew 0.9% y-o-y to KES 22.0 BN. This was on the back of a 7.0% y-o-y growth in interest income to KES 29.1 BN and a 31.6% y-o-y increase in interest expense to KES 7.1 BN. Yield on interest earning assets declined 36 bps y-o-y to 11.3% whereas cost of funds rose 16 bps y-o-y to 2.6%. As a result, net interest margin declined 52 bps y-o-y to 8.7%.

Interest income from loans and advances rose 1.3% y-o-y to KES 21.5 BN placing the yield on average loans at 12.5%, down 17 bps y-o-y. Interest income from government securities increased 27.8% y-o-y to KES 7.4 BN. The yield on average government securities rose 140 bps y-o-y to 12.1%. Management attributed the decline in interest income to the 100 bps reduction of the Central Bank Policy rate in FY18 through its impact on the lending caps.

Non-funded income rose 14.7% y-o-y to KES 9.7 BN on the back of a 6.7% y-o-y rise in fees and commissions to KES 5.6 BN and a 14.5% y-o-y rise in net income from forex dealings to KES 3.3 BN. Under fees and commissions, fees on loans and advances rose 65.5% y-o-y to KES 1.1 BN mainly on the back of the Timiza product (mobile lending product) through which the bank has disbursed KES 10.0 BN since its launch in 1Q18. Other fees and commissions declined 1.4% y-o-y to KES 4.6 BN.

BARCLAYS KENYA: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE	ABSOLUTE	EXCESS
RETURN	RETURN	RETURN
3 months	7.9	4.5
6 months	7.4	12.4
12 months	4.5	26.1

KEY METRICS

Current Price (KES)	11.60
52 week Range (KES)	10.00-13.40
YTD Return (%)	5.94
Issued Shares (Mn)	5,431.5
Market Cap (USD Mn)	632.3

Recommendation	Buy
Trailing EPS (KES)	1.37
NAV (KES)	8.14
P/E (x)	8.5
P/B (x)	1.4
Div Yld. (%)	9.5

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Timiza platform onboard about 3.0 million customers in its first year has disbursed about KES 10.0 BN to date.

Business Mix as at FY12

1. Corporate Banking
2. Retail Banking
3. Business Banking
4. Markets

Business Mix as at FY18

1. Corporate Banking
2. Trade Finance
3. Banc-assurance
4. Retail Banking
5. Investment Banking
6. Equities Brokerage
7. SME Banking
8. Timiza
9. Business Banking
10. Fixed Income Trading
11. Wealth Management
12. Markets

Operating expenses less loan loss provisions rose 2.4% y-o-y to KES 17.2 BN mainly on the back of a 24.0% y-o-y increase in other operating expenses to KES 4.9 BN. Staff costs declined 3.4% y-o-y to KES 9.8 BN whereas rental charge declined 14.0% y-o-y to KES 1.2 BN. Cost to income ratio declined 126 bps y-o-y to 54.2%.

Contrary to other players in the sector, loan loss provision expensed rose 24.3% y-o-y to KES 3.9 BN placing the cost of risk at 2.2% attributable to the adoption of IFRS 9 and non-performance from a number of corporate accounts.

Customer loans and advances rose 5.3% y-o-y to KES 177.4 BN while customer deposits increased 11.5% y-o-y to KES 207.4 BN. As a result, the loans to deposits ratio declined 504 bps y-o-y to 85.5%. Available for sale (AFS) government securities rose 8.1% y-o-y to KES 63.3 BN while held for dealing securities grew two fold to KES 29.7 BN.

Gross NPLs rose 10.3% y-o-y to KES 13.9 BN attributable to the adoption of IFRS 9 and non performance by a few corporate entities. Interest in suspense declined 5.2% y-o-y to KES 3.1 BN resulting in a 15.7% y-o-y increase in total NPL to KES 10.8 BN. Loan loss provision rose 17.5% y-o-y to KES 6.5% leading to a 13.0% y-o-y increase in the net NPLs to KES 4.3 BN. The NPL ratio (gross NPL/ gross loans) rose 30 bps y-o-y to 7.3% whereas NPL coverage (loan loss provision/ total NPL) recorded a 93 bps y-o-y increase to 60.5%.

Core capital ratio (Core capital/TRWA) declined 150 bps y-o-y to 14.4% above the statutory minimum of 10.5%, while Total capital/TRWA declined 160 bps y-o-y to 16.7% above the statutory minimum of 14.5%. Liquidity ratio rose 230 bps y-o-y to 35.7%, above the statutory minimum of 20.0%.

In the first year under the new strategy, Barclays achieved the highest ROE since 2016, the lowest cost to income ratio since 2016, the fastest loans and advances growth post interest rate cap, fastest growth of operating profit in 8 years, fastest growth in customer liabilities since 2008 and fastest revenue growth since 2016. In order to sustain this momentum, management has among other things set up a Chief Customer Office and a Chief Data Office to transform customer experience and re-engineer data analytics and big data.

Barclays Kenya's separation program: Management is aiming to transition 50.0% of services that rely on Barclays PLC in 2019 with the final phase of the re-branding expected to happen by June 2020. The Absa group will cover the cost of transition by foregoing an equivalent amount of dividend.

Management's case for a better valuation moving forward:

- Growing income and balance sheet.
- Stable dividend cover and capacity for future increases,
- Potential EPS improvement, on a normalized basis, through the rebranding period
- Potential statutory EPS improvement post the rebranding period and
- Sequential and potential improvement in Total Returns during and post the rebranding period.

In our view: The briefing presentation and the discussions afterward, highlighted a strong focus on the stock price that is not typical of management. From detailing how the Barclays share price outperformed its competition in FY18 to enumerating a case for better valuation going forward, management showed a strong determination to drive up the share price over time. As we have written before, the performance of Barclays share price in recent years has failed to match our views on the sustainability and predictability of the group's earnings in part because of relatively lower visibility especially among local fund managers. Further, as management highlighted, the group's contrary position on FY18's loan loss impairment, may create room for a better fundamental story in FY19 as other banks revert to their typical cost of risk numbers to the extent that unless the rebranding and transition goes so wrong, we think that Barclays share price could break KES 13.00 per share and above in the next 2-3 years.

On a trailing basis: Barclays Bank of Kenya is trading at a P/E and a P/B ratio of 8.5x and 1.4x against an industry median of 6.5x and 1.0x respectively. Its ROE and ROA multiples stand at 16.8% and 2.3% against sector median multiples of 15.7% and 2.2% respectively. We maintain our **BUY** recommendation.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	9M18	9M17	y-y% ch	3Q18	2Q18	3Q17	y-y% ch	q-q% ch
Interest income	21,674	20,130	7.7	7,535	7,216	6,993	7.7	4.4
Interest expense	5,178	3,981	30.1	2,006	1,712	1,388	44.5	17.1
Net interest income	16,496	16,149	2.1	5,529	5,504	5,605	(1.4)	0.5
Other operating income	605	282	114.9	315	160	81	290.5	96.5
Fees and commission income	4,231	4,011	5.5	1,466	1,404	1,298	12.9	4.4
Net income from forex dealings	2,523	2,162	16.7	881	882	682	29.2	(0.1)
Total non-interest income	7,359	6,455	14.0	2,662	2,447	2,060	29.2	8.8
Total income	23,854	22,604	5.5	8,191	7,951	7,665	6.9	3.0
Less operating expenses	13,304	12,562	5.9	4,644	4,236	4,129	12.5	9.6
Operating profit	10,550	10,042	5.1	3,547	3,715	3,536	0.3	(4.5)
Bad debt charge	(2,829)	(2,333)	21.3	(1,112)	(1,141)	(979)	13.6	(2.6)
Exceptional items	-	-	0.0	-	-	-	0.0	0.0
Profit before income tax	7,721	7,709	0.2	2,435	2,573	2,557	(4.8)	(5.4)
Less tax	(2,286)	(2,380)	(3.9)	(762)	(694)	(770)	(1.1)	9.9
Profit after tax	5,435	5,329	2.0	1,673	1,880	1,786	(6.3)	(11.0)
Attributable Income	5,435	5,329	2.0	1,673	1,880	1,786	(6.3)	(11.0)
EPS (KES)	1.00	0.98	1.99	0.31	0.35	0.33	(6.3)	(11.0)

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	FY18	3Q18	FY17	y-y% ch	q-q% ch
Total shareholder's equity	44,207	42,684	44,099	0.2	3.6
Minority interest	-	-	-	0.0	0.0
Total Equity	44,207	42,684	44,099	0.2	3.6
Deposits due to other banks	5,308	2,347	3,059	73.5	126.2
Customer deposits	207,408	220,245	185,977	11.5	(5.8)
Balances due to group	57,034	43,664	28,831	97.8	30.6
Other liabilities	10,883	13,287	9,210	18.2	(18.1)
Total equity and liabilities	324,840	322,226	271,177	19.8	0.8
Central bank balances	23,531	21,196	16,354	43.9	11.0
Deposits due from banks	15,698	5,960	5,283	197.2	163.4
AFS securities	63,230	74,595	58,476	8.1	(15.2)
Held for dealing securities	29,708	28,261	9,608	209.2	5.1
Customer loans and advances	177,354	178,434	168,397	5.3	(0.6)
Other assets	12,103	10,520	9,159	32.1	15.0
Intangible assets	878	859	1,156	(24.0)	2.2
Fixed assets	2,337	2,400	2,744	(14.8)	(2.6)
Total assets	324,840	322,226	271,177	19.8	0.8

(Source: Company, DBIB Research)

INVESTMENT RETURN

	FY18	FY17	3Q18*	y-y bps ch	q-q bps ch
ROA (%)	2.3	2.6	2.2	(27)	3
ROIC (%)	2.4	2.6	2.3	(28)	2
ROE (%)	16.8	15.7	17.0	107	(20)

(Source: Company, DBIB Research)

*Annualized

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	FY18	FY17	3Q18	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	14.4	15.9	14.8	(150)	(40.)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	16.4	18.0	16.7	(160)	(30)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	35.7	33.4	39.9	230	(420)
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	13.6	16.3	13.2	(265)	36
Equity-to-Loans Ratio (%)	24.9	26.2	23.9	(126)	100
NPL Ratio (%)	7.3	7.0	7.6	30	(29)
NPL Coverage Ratio (%)	60.5	59.5	62.6	93	(214)
Long Term Debt to Total Liabilities and Equity (%)	17.6	10.6	13.6	693	401
NTA/share (KES)	8.0	7.9	7.7	7	28
Book value/share (KES)	8.1	8.1	7.9	2	28
Payout ratio (%)	80.6	78.4	109.9	215	NA

(Source: Company, DBIB Research)

**Total Loan Portfolio net of Interbank Lending

OPERATING PERFORMANCE

	FY18	FY17	3Q18	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)	11.3	11.7	11.2	(36)	18
Cost of funds (%)	2.6	2.5	2.6	16	3
Net Interest Margin (%)	8.7	9.2	8.6	(52)	15
Loan-to-Deposits ratio (%)	85.5	90.5	81.0	(504)	449
Loan-to-Dep.& Borrowed Funds ratio (%)	65.7	77.3	67.0	(1155)	(127)
Funded Income Generating Potential (%)	78.9	85.6	80.4	(672)	(148)
Funded Income Reliance (%)	69.4	72.1	69.2	(266)	24
Cost to income ratio (%)	54.2	55.5	55.8	(126)	(157)
Pre-tax margin (%)	33.6	34.2	32.4	(65)	122
PAT margin (%)	23.4	22.9	22.8	51	61

(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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