Barclays Bank of Kenya - FY16 Earnings Update
‘A New Normal’

Barclays Bank of Kenya (BBK) kicked off the full-year corporate earnings season, with an 11.9% y/y decline in FY16 PAT to KES 7.4B. This was attributable to an 18.7% y/y surge in interest expenses that curtailed net interest income performance (+9.0% y/y). The bottom line also took a hit from a 122.4% y/y surge in impairment charges as NPLs continued to rise (+300bps y/y to 6.6%).The bank kept dividend unchanged from FY15 by announcing a final dividend of KES 0.80 (Interim KES 0.20)

Larger loan book drives growth in top line: The lender registered an 11.2% y/y growth in interest income, on the back of a 9.4% y/y jump in interest income from loans and advances. Interest income from government securities was up 8.6% y/y to KES 5.6B. The growth in interest income was largely attributed to a 15.9% y/y growth in net loans and advances to KES 168.5B. BBK’s yield on loans tumbled 90 bps y/y to 12.7% in FY16, down from 13.6% in FY15 as the cap on lending rates took effect in 4Q16.

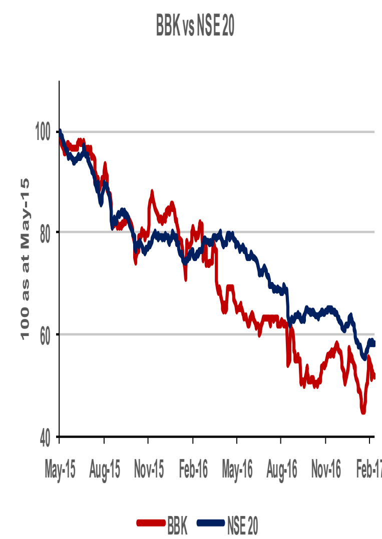
Interest expense surges on the back of a growing deposit base: Interest expense rose 18.7% y/y to KES 5.8B, outpacing the 11.2% y/y growth in interest income. BBK’s customer deposits closed the year up 7.9% y/y to KES 178.2B, with the growth driven by the bank’s business (+16.0% y/y), corporate (+11.0% y/y) and retail (+4.0% y/y) segments. The growth in interest expense was partly a consequence of the recently amended banking sector bill which mandates a minimum savings rate of 7.0% on qualifying deposits. However, as at FY16, 68.0% of BBK’s deposits were non-interest bearing, up from 45.0% in FY15. Going forward, we expect the bank’s access to cheap deposits to be restricted, even as a bulk of its deposit book remains transactional in nature. BBK’s strong presence in the corporate banking space is characterized historically by above average interest expenses due to high bargaining power of large depositors.

Non-funded income rises as fixed income trading turns profitable: The lender posted a 3.3% y/y rise in non-funded income to KES 9.3B after the bank’s fixed income trading segment ended the period in the green. BBK booked an income of KES 885M from its fixed income trading operations (FY15: loss of KES 453M), partly off-setting the 21.3% y/y decline in risk and service fees. Additionally, bancassurance posted a strong growth of 127.2% y/y to KES 493M. Nonetheless. The bank’s non-funded to total income ratio dipped 120 bps y/y in FY16 to 29.5%.

Bloomberg Ticker:	**BCBL.KN**
Reuters Ticker:	**BBK.NR**

Share Statistics	
Current Price (KES)	8.30
P/E (x)	6.1
P/B (x)	1.1
Issued Shares (M)	5,431.5
Market Cap (USD M)	430.9
Year End	31-Dec

Price Trend



Source: Bloomberg, ApexAfrica Research

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Operating expenses under control: Growth in total operating expenses clocked in at 8.0% y/y to KES 16.9B, largely alongside expectations. Nonetheless, the bank remains highly efficient as characterized by the 2.8% CAGR of operating expenses between FY13 and FY16, well below inflation. BBK has invested heavily in considerably cheaper alternative channels to boosts efficiency and reduce its overall cost base. The banks cost to income ratio increased 40bps y/y to 53.4% in FY16.

Investment in alternative channels to boost efficiency: The lender has focused heavily on driving efficiency by enhancing and implementing alternative banking channels which direct traffic away from the more expensive brick & mortar branches. In FY16, 43% of all transactions occurred at the branch level, down significantly from 59% in FY15. Furthermore, transactions occurring through the bank's digital platform grew 500 bps y/y to 14% in FY16.

Top-ups boost loan book: BBK registered a 15.9% y/y growth in loans and advances to KES 168.5B. This was attributed to top-ups of existing facilities in the wake of the lending rate cap which increased appetites of existing borrowers by lowering debt service ratios. Loan book growth was driven primarily by the corporate (+33.0% y/y), business (+19% y/y) and retail (+4.0% y/y) banking segments. While the growth in BBK's loan book is encouraging, and will bode well for the bottom line, we are mindful that growth from top-ups will likely level off in 2H17. Additionally, the uptake of private sector credit will likely slow down during 2H17 as the country heads into an election period.

Spiking NPLs signal choppy waters: Gross non-performing loans surged 115.0% y/y to KES 11.5B, taking the bank's gross NPL ratio to 6.6% in FY16, up from 3.6% in FY15. According to the BBK, the industry's gross NPL ratio stands at 9.2%. The higher NPLs prompted a 122.4% y/y increase in loan loss provision expense to KES 3.9B.

The bank attributes the sudden increase in NPLs to a more prudent impairment approach, based on stringent risk models. While the increase in under-performing assets is alarming, we note that BBK has maintained one of the lowest NPL ratios in the industry and the increase could be partially described as mean reverting. Furthermore, the bank's NPL coverage ratio stood at a comfortable 79.0% as at FY16. Consequently, we do not see significant risk of stress on the bank's balance sheet as a result of non-performing loans.

Looking ahead: BBK's FY16 results were broadly in line with our expectations, even as uncertainty prevailed over the bank's performance in 4Q16 due to the implementation of the rate cap. While challenges in Kenya's banking sector continue to exert pressure on lenders' stock prices we remain positive about the bank's long-term growth outlook. BBK has a formidable presence in the corporate, multinational and retail segments and dominance over this niche has been profitable for the lender, even as competition intensifies. Additionally, BBK has one of the lowest NPL ratio in the sector. The banking industry has recently faced pressure from non-performing loans which have forced lenders to rationalize lending to troubled industries resulting in the curtailing of loan book growth. BBK's NPL ratio of 6.5% underscores the quality of the lender's loan book while ensuring the bank ample headroom for growth.

Share Price Update: BBK currently trades at KES 8.30; down 8.8%, YTD. The decline this year has been largely in line with peers in the sector, undermining BBK's appeal as a defensive stock. Nonetheless, the lender's current dividend yield of 12.0% ranks it as among the top dividend payers in the sector and will result in increased accumulation by income-oriented investors. The stock trades close to its 52-week low of KES 7.15, providing an ideal entry for a long term value/ dividend oriented investor. BBK currently trades at 6.1 times FY16 earnings and 1.1 times FY16 book value.

Financials

Income Statement	FY15 KES '000	1Q16 KES '000	2Q16 KES '000	3Q16 KES '000	4Q16 KES '000	FY16 KES '000	% chg y/y	% chg q/q
Interest Income	25,285,748	6,742,231	7,161,226	7,202,037	7,015,695	28,121,189	11.2%	-2.6%
Interest Expense	4,875,227	1,323,021	1,483,315	1,442,639	1,537,983	5,786,958	18.7%	6.6%
Net Interest Income	**20,410,521**	**5,419,210**	**5,677,911**	**5,759,398**	**5,477,712**	**22,334,231**	**9.4%**	**-4.9%**
Foreign Exchange Income	2,033,747	676,605	671,990	603,232	668,510	2,620,337	28.8%	10.8%
Gross Fees and Commission	6,650,033	1,652,485	1,698,245	1,518,814	900,947	5,770,491	-13.2%	-40.7%
Other Income	367,459	241,173	197,399	321,395	199,086	959,053	161.0%	-38.1%
Non Interest Income	9,051,239	2,570,263	2,567,634	2,443,441	1,768,543	9,349,881	3.3%	-27.6%
Total Operating Income	**29,461,760**	**7,989,473**	**8,245,545**	**8,202,839**	**7,246,255**	**31,684,112**	**7.5%**	**-11.7%**
Total Operating Expenses	17,388,180	4,946,831	5,465,063	5,311,718	5,108,093	20,831,705	19.8%	-3.8%
Loan Loss Provision Expense	**1,765,778**	**797,890**	**1,211,553**	**1,126,692**	**791,002**	**3,927,137**	**122.4%**	**-29.8%**
Operating Profit	**12,073,580**	**3,042,642**	**2,780,482**	**2,891,121**	**2,138,162**	**10,852,407**	**-10.1%**	**-26.0%**
Profit Before Tax	**12,073,580**	**3,042,642**	**2,780,482**	**2,891,121**	**2,138,162**	**10,852,407**	**-10.1%**	**-26.0%**
Current Tax	3,612,757	933,130	1,020,780	1,042,090	796,394	3,792,394	5.0%	-23.6%
Profit After Tax	8,400,582	2,181,684	1,905,005	1,973,088	1,339,619	7,399,396	-11.9%	-32.1%
EPS (KES)	**1.55**	**0.40**	**0.35**	**0.37**	**0.24**	**1.36**	**-12.3%**	**-35.1%**
Balance Sheet								
Total Shareholders' Equity	39,716,371	42,315,483	39,103,237	41,465,431	42,388,242	42,388,242	6.7%	2.2%
Deposits due to Banks & Financial Institutions	187,385	192,447	163,145	5,062,916	3,263,679	3,263,679	-	-35.5%
Balances due to banking institutions in the group	27,816,476	19,531,238	23,201,805	25,872,156	24,895,103	24,895,103	-10.5%	-3.8%
Customer Deposits	**165,082,830**	**168,932,598**	**182,875,680**	**180,862,520**	**178,179,795**	**178,179,795**	**7.9%**	**-1.5%**
Total Liabilities	**201,160,649**	**199,318,684**	**217,038,988**	**222,537,700**	**217,303,770**	**217,303,770**	**8.0%**	**-2.4%**
Total Equity and Liabilities	**240,877,020**	**241,634,167**	**256,142,225**	**264,003,131**	**259,692,012**	**259,692,012**	**7.8%**	**-1.6%**
Cash and CBK Balances	18,180,495	16,420,866	23,099,412	17,802,195	13,378,044	13,378,044	-26.4%	-24.9%
Balances due from Banks & Financial Institutions	252,867	381,931	2,005,909	311,718	218,530	218,530	-13.6%	-29.9%
Government and Other Securities	48,051,245	51,679,547	54,908,955	66,683,092	56,044,294	56,044,294	16.6%	-16.0%
Net Loans and Ldvances	**145,378,553**	**152,442,482**	**153,304,212**	**158,843,058**	**168,509,529**	**168,509,529**	**15.9%**	**6.1%**
Fixed Assets	3,324,019	3,421,874	3,351,384	3,269,495	3,080,831	3,080,831	-7.3%	-5.8%
Total Assets	**240,877,020**	**241,634,467**	**256,142,225**	**264,003,131**	**259,692,012**	**259,692,012**	**7.8%**	**-1.6%**
Key Ratios								
Gross NPL (KES M)	5,336,166	7,891,337	8,764,640	10,412,797	11,472,301	11,472,301	115.0%	10.2%
Interest In Suspense (KES M)	1,454,488	1,494,942	2,211,200	2,634,290	2,689,552	2,689,552	84.9%	2.1%
Total NPL (KES M)	3,881,678	6,396,395	6,553,440	7,778,507	8,782,749	8,782,749	126.3%	12.9%
Loan Loss Provision (KES M)	2,012,924	3,504,980	3,849,515	4,578,571	5,149,446	5,149,446	155.8%	12.5%
Net NPL	1,868,754	2,891,415	2,703,925	3,199,936	3,633,303	3,633,303	94.4%	13.5%
NPL Ratio	3.6%	5.1%	5.6%	6.4%	6.6%	6.6%		
Cost of Risk	1.2%	2.1%	3.2%	2.8%	1.9%	2.3%		
Loan to Deposits	88.1%	90.2%	83.8%	87.8%	94.6%	94.6%		
Yield on Interest Earning Assets	13.1%	13.2%	13.6%	12.8%	12.5%	12.5%		
Cost of Funds	2.5%	2.8%	2.9%	2.7%	3.0%	2.8%		
NIM	10.5%	10.4%	10.7%	10.0%	9.5%	9.7%		
Non Funded/Total Income	30.7%	32.2%	31.1%	29.8%	24.4%	29.5%		
Cost to Income Ratio	53.0%	51.9%	51.6%	51.0%	59.6%	53.4%		
ROE	21.2%	20.6%	19.5%	19.0%	12.6%	17.5%		
ROA	3.5%	3.6%	3.0%	0.7%	0.5%	2.8%		
Core Capital/TRWA	15.7%	16.0%	15.8%	16.5%	15.7%	15.7%		
Total Capital/TRWA	18.4%	18.2%	18.0%	19.1%	17.9%	17.9%		
Liquidity Ratio	34.1%	33.2%	36.6%	34.5%	28.3%	28.3%		
P/E (x)						**6.1**		
P/B (x)						**1.1**		
Dividend Yield						**12.0%**		

Source: Company Filings, ApexAfrica Research

Appendix

Investment ratings

- **Buy:** A total return is anticipated in excess of the market's long-term historic annual rate (approximately 10%). Total return expectations should be higher for stocks that possess greater risk.

- **Hold:** Hold the shares with neither a materially positive total return nor a materially negative total return anticipated.

- **Sell:** Stock should be sold as materially negative total return is anticipated.

Disclaimer

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