

NIC Bank - FY16 Earnings Update 'In Line With Expectations'

NIC posted a 3.6% y/y decline in FY16 pre-tax earnings to KES 6.2B, on the back of higher loan loss provision expense (+126.9% y/y). The bank kept dividend unchanged y/y by declaring a final dividend of KES 1.00 (interim KES 0.25).

Interest income rises as loan book growth falters: Interest income rose 11.8% y/y (-11.8% q/q) to KES 19.0B, even as net loans declined by a marginal 1.3% y/y (+3.6% q/q) to KES 114.5B. Interest income from loans and advances grew 8.5% y/y to KES 15.2B, while interest income from government securities was up 37.2% y/y to KES 3.7B on account of a 9.5% y/y (-11.9% q/q) increase in stock of total securities to KES 30.5B.

Interest expenses dip as customer deposits remain flat y/y: Interest expenses declined 5.8% y/y (-1.7% q/q) to KES 6.9B as the bank's total deposits posted a marginal decline of 0.5% y/y (+3.2% q/q) to KES 111.8B. Listed lenders have attempted to reduce the level of interest-bearing deposits on their books in a bid to reduce interest expenses after the amendment to the banking sector act implemented in September 2016 mandated a minimum savings rate of 70.0% of the CBR on all qualifying deposits.

Non-funded income flat y/y on FX income decline: NIC posted a 22.8% y/y (-16.6% q/q) decline in FX income to KES 1.1B. The year 2016 saw relative stability in the Kenyan Shilling, consequently resulting in reduced currency trading activities. However, gross fees and income posted a healthy growth of 9.0% y/y (-8.8% q/q) to KES 2.0B, while other non-funded income rose 19.5% y/y (+107.5% q/q) to KES 904.1M. Consequently, total non-funded income remained largely flat y/y (+3.2% q/q) at KES 4.0B. Non-funded income accounted for 24.8% of total earnings in FY16, down from 29.3% in FY15.

Loan book quality improves as provisions increase: The lender's NPL ratio improved 70bps y/y to 11.4%, as gross non-performing loans declined 5.3% y/y (-4.7% q/q). Loan loss provision expense booked in FY16 jumped 126.9% y/y to KES 3.7B resulting in an 80.9% y/y increase in total loan provisions to KES 5.0B. Consequently, the lender's total NPL coverage ratio jumped to 39.0%, from 21.0% in FY15. The decline in NPLs suggests an improvement in the quality of the bank's loan book and as such, we expect loan loss provision expense to normalize over the medium term.

Bloomberg Ticker:	NICB.KN
Reuters Ticker:	NIC.NR

Share Statistics

Current Price (KES)	24.50
P/E (x)	3.6
P/B (x)	0.5
Dividend Yield	5.1%
Issued Shares (M)	639.9
Market Cap (USD M)	150.8
Year End	31-Dec

Price Trend



Source: Bloomberg, ApexAfrica Research

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Operating costs increase amid improved efficiency: The lender's operating expenses increased 9.6% y/y (+6.4% q/q) to KES 6.3B on the back of higher staff costs (+14.4% y/y). Nonetheless, the lender's efficiency improved, highlighted by a 290bps y/y decline in the bank's cost to income ratio to 38.7%. Going forward we expect increased cost efficiency to bolster the bottom line as margins are squeezed due to the cap on lending rates.

Marked q/q increase in cost of funds signals NIM compression: The bank's loan book was down a marginal 1.3% y/y (+3.6% q/q) to KES 114.5B, while customer deposits were largely flat during the year at KES 111.8B. As a result, the lender's loan to deposit ratio declined 80bps y/y to 102.4%. The elevated loans-to-deposit ratio implies limited headroom for growth and may necessitate the uptake of debt to boost the bank's capital base. Borrowings rose 30.0% y/y (+35.3% y/y) to KES 19.9B.

NIC's cost of funds declined 20bps y/y to 5.1%, but was up 60bps q/q. The amendment in the banking sector act mandates a minimum savings rate on qualifying deposits and this is expected to increase interest expense on customer deposits in the medium term. NIC has been active in the asset finance segment and is now looking to source cheaper deposits by targeting the SME and transactional banking space and this may ease pressure on the bank's cost of funds over the medium term.

Higher loan loss provision expense dents bottom line: Pretax profit declined 3.6% y/y as higher loan loss provision expense (+126.9% y/y) negated the effects of a 24.9% y/y increase in net interest income. A higher tax charge (+35.1% y/y) to KES 3.2B, saw NIC register a 3.4% y/y decline in net profit. The decline in bottom line resulted in a 270bps y/y decline in the bank's Return on Equity (ROE) to 14.3%, while return on assets was down 10bps y/y to 2.6%.

The bank's core capital (+380bps y/y) and total capital (+240bps y/y) ratios posted healthy gains to 18.7% and 23.0% respectively. Liquidity improved 950bps y/y to 38.7%. The lender kept dividend unchanged y/y at KES 1.25 by announcing a final dividend of KES 1.00.

Looking ahead: The lender's results were largely in line with expectations. Going forward we anticipate some NIM compression as a consequence of the cap on lending rates. In our view the lender may struggle to attract cheap deposits in the medium term and this may result in a marked increase in the bank's cost of funds which may further pile pressure on margins.

We anticipate increased cost efficiency to drive the bottom line in the future, supported by the bank's continued attempt to drive traffic towards its cheaper digital platform. Non-funded income is also expected to play a pivotal role in the bank's earnings mix as interest margins come under pressure.

In our view, non-performing loans, a slow down in business activity in Kenya ahead of the General Elections and the cap on lending rates are key challenges facing the lender in the medium term.

Share price update: NIC Bank's current share price of KES 24.50, sees the lender trade at historically low valuation metrics of 3.6 times FY16 earnings and 0.5 times FY16 book value, with a trailing dividend yield of 5.1%. We do not see a significant reaction on the bank's share price given that the bank's numbers were largely in line with market expectations.

Financials

	FY15	1Q16	2Q16	3Q16	4Q16	FY16	% chg y/y	% chg q/q
	KES '000	KES '000	KES '000	KES '000	KES '000	KES '000		
Income Statement								
Interest Income	17,014,132	5,007,257	4,848,725	4,870,074	4,294,619	19,020,675	11.8%	-11.8%
Interest Expense	7,271,599	2,052,454	1,728,414	1,548,694	1,522,516	6,852,078	-5.8%	-1.7%
Net Interest Income	9,742,533	2,954,803	3,120,311	3,321,380	2,772,103	12,168,597	24.9%	-16.5%
Foreign Exchange Income	1,431,231	305,109	272,245	287,859	239,934	1,105,147	-22.8%	-16.6%
Gross Fees and Commission	1,844,429	505,612	520,675	514,721	469,343	2,010,351	9.0%	-8.8%
Other Income	756,500	326,758	226,687	114,003	236,613	904,061	19.5%	107.5%
Non Interest Income	4,032,160	1,137,479	1,019,607	916,583	945,890	4,019,559	-0.3%	3.2%
Total Operating Income	13,774,693	4,092,282	4,139,918	4,237,963	3,717,993	16,188,156	17.5%	-12.3%
Total Operating Expenses	7,377,418	2,693,014	2,320,504	2,717,384	2,290,305	10,021,207	35.8%	-15.7%
Loan Loss Provision Expense	1,652,475	1,315,115	794,553	1,085,928	553,934	3,749,530	126.9%	-49.0%
Operating Profit	6,397,275	1,399,268	1,819,414	1,520,579	1,427,688	6,166,949	-3.6%	-6.1%
Profit Before Tax	6,397,275	1,399,268	1,819,414	1,520,579	1,427,688	6,166,949	-3.6%	-6.1%
Current Tax	2,388,860	408,479	505,101	461,775	1,850,980	3,226,335	35.1%	
Profit After Tax	4,485,125	990,789	1,314,313	1,058,804	966,490	4,330,396	-3.4%	
EPS (KES)	7.00	1.55	2.05	1.66	1.51	6.77	-3.3%	
Balance Sheet								
Total Shareholders' Equity	26,346,142	27,115,560	28,289,935	29,551,617	30,345,364	30,345,364	15.2%	2.7%
Deposits due to Banks & Financial Institutions	9,064,552	5,756,289	5,877,891	4,656,169	2,775,926	2,775,926	-	-40.4%
Borrowed Funds	15,356,190	15,232,609	20,412,988	14,755,486	19,965,484	19,965,484	30.0%	35.3%
Customer Deposits	112,364,637	110,331,939	112,000,727	108,358,276	111,824,685	111,824,685	-0.5%	3.2%
Total Liabilities	139,442,126	133,785,620	140,768,400	135,717,861	139,113,621	139,113,621	-0.2%	2.5%
Total Equity and Liabilities	165,788,268	160,901,181	169,058,335	165,269,478	169,458,985	169,458,985	2.2%	2.5%
Cash and CBK Balances	8,940,056	10,400,155	8,117,105	8,435,060	7,263,501	7,263,501	-18.8%	-13.9%
Balances due from Banks & Financial Institutions	6,675,640	5,981,317	13,237,433	4,812,264	9,682,208	9,682,208	45.0%	101.2%
Government and Other Securities	27,832,978	25,571,332	29,063,685	34,589,735	30,470,895	30,470,895	9.5%	-11.9%
Net Loans and Advances	116,009,302	111,987,605	112,150,830	110,470,843	114,466,274	114,466,274	-1.3%	3.6%
Fixed Assets	1,063,760	1,007,252	1,067,345	1,080,168	1,043,497	1,043,497	-1.9%	-3.4%
Total Assets	165,788,268	160,901,181	169,058,335	165,269,478	169,458,985	169,458,985	2.2%	2.5%
Key Ratios								
Gross NPL (KES M)	14,351,893	13,391,635	12,565,456	14,251,802	13,587,912	13,587,912	-5.3%	-4.7%
Interest In Suspense (KES M)	1,123,359	1,461,626	553,456	676,464	704,080	704,080	-37.3%	4.1%
Total NPL (KES M)	13,228,534	11,930,009	12,012,000	13,575,338	12,883,832	12,883,832	-2.6%	-5.1%
Loan Loss Provision (KES M)	2,776,627	3,732,017	3,952,895	4,978,105	5,022,089	5,022,089	80.9%	0.9%
Net NPL	10,451,907	8,197,992	8,059,105	8,597,233	7,861,743	7,861,743	-24.8%	-8.6%
NPL Ratio	12.1%	11.6%	10.8%	12.3%	11.4%	11.4%		
Cost of Risk	1.4%	4.7%	2.8%	3.9%	1.9%	3.3%		
Loan to Deposits	103.2%	101.5%	100.1%	101.9%	102.4%	102.4%		
Yield on Interest Earning Assets	11.3%	14.0%	12.6%	13.0%	11.1%	12.3%		
Cost of Funds	5.3%	6.3%	5.0%	4.8%	4.5%	5.1%		
NIM	6.0%	7.7%	7.6%	8.1%	6.6%	7.2%		
Non Funded/Total Income	29.3%	27.8%	24.6%	21.6%	25.4%	24.8%		
Cost to Income Ratio	41.6%	33.7%	36.9%	38.5%	46.7%	38.7%		
ROE	17.0%	14.6%	18.6%	14.3%	12.7%	14.3%		
ROA	2.7%	2.5%	3.1%	2.6%	2.3%	2.6%		
Core Capital/TRWA	14.9%	15.2%	16.7%	17.2%	18.7%	18.7%		
Total Capital/TRWA	20.6%	21.4%	22.8%	23.0%	23.0%	23.0%		
Liquidity Ratio	29.2%	31.6%	38.6%	34.0%	38.7%	38.7%		
P/E (x)						3.6		
P/B (x)						0.5		
Dividend Yield						5.1%		

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.

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