Barclays bank released a set of **mixed results** for the full year 2016. The results were characterized by better than expected balance sheet growth and lower than expected earnings growth. Profit after tax declined 12% to Kes 7.4 billion on the back of increased provisioning, and low growth in non-funded income.

Loan book grew **16% to Kes 169 Bn** compared to our 10% growth estimate (AIB Capital Kenya Banking Sector Update Feb 2017). This was largely driven by a 33% increase in the corporate book. The business banking book which comprises of mainly credit to the SME segment grew 19% while the consumer book grew by a modest 4%. The bank has been able to diversify away from its consumer book currently contributing 50% of loan book down from 55% in 2015 and 58% in 2014.

Out of the Kes 24 Bn in new loans issued in 2016, Kes 7Bn was lent out in quarter 1, Kes 1bn in Quarter 2, Kes 6 bn in Quarter 3 and Kes 10 bn in quarter 4. The **impressive quarter 4 performance** came as a surprise to us, given the persistent slowdown in private sector credit growth throughout quarter 4. Management attributed this to demand from the consumer book which increased significantly in quarter 4 following the interest rate cap. Existing consumers, whose debt coverage ratio improved following the decline in interest, saw their appetite for credit increase, thereby allowing them to top up their existing loans. Management has however indicated that this development is not expected to persist beyond the 2 quarter of 2017.

Deposits grew 8% to Kes 178 Bn lagging our 10% growth estimate. Management indicates that as at close of the year, 68% of its deposits was non-interest bearing. Consequently cost of funds declined to 2.6% from 2.7% in the previous year. This was a deliberate strategy by management to move away from expensive term deposits in favor of transactional current account deposits in a bid to counter the effects of the interest rate cap on margins.

Net interest income grew 9% to Kes 22 Bn driven by the strong loan book growth. Yield on loans averaged 12.7% down from 13.6%. Yield on government securities improved marginally to 10.0% from 9.3% in 2015. Non-interest income improved by 3% to Kes 9.3 Bn. The **slower than expected growth** was attributed to a change in accounting practice, that saw fees on loans being accounted as interest income and card related expenses now accounted for under fees expenses instead of operating expenses.

RATING: BUY

Bloomberg ticker	**BCBL KN**
Last close KES)	8.30
Target price (KES)	12.88
Upside potential	55%
Market cap	46.17
Dividend Yield	12%
52-week range	7.05 - 13.30

Key Highlights

Loan Book grew by 16% to KES 169 bn

Deposits grew by 8% to KES 178 bn

Net profit down 12% to KES 7.4 bn

Net Interest Income up 9% to KES 22 bn

Non Funded Income up 3% to KES 9.3 bn

NPL provisions up 129% to KES 3.9 bn

CTI up from 52.9% to 53.3%

ROE down from 21.0% to 17.5%

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CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 4

An **interesting** development in the Banks income statement was the 129% jump in provisions to Kes 3.9 bn. Management attributed this to 1.) 16% increase in the loan book, 2.) Challenges in the business environment and 3.) A deliberate adoption of prudent impairment practice. Despite the negative effects this had on earnings, we view this as a positive development for the bank. First we believe that the bank may be **preparing itself for the adoption** of the new IFRS 9 accounting standard that will be adopted from Jan 2018. This may help them adopt the standard without **adverse volatility** in earnings. Secondly, there coverage ratio improved from 52% in 2015 to 59% in 2016. This improves the ability of the bank to absorb potential loan losses in the future. Lastly, the high uptick in impairment is unlikely to recur in 2017 and this may have helped in **smoothening future earnings growth curve**.

Outlook: Management has indicated that it will not be deviating from its current strategy despite the changes in operating environment. They guided that they will continue to **diversify away** from their retail book by beefing up their corporate business and business banking (SME's). Management is also seeking to diversify away from interest income through bank assurance, brokerage and transactional banking. Automation is also a key **priority** for the bank. In a bid to further manage its costs and improve customer experience, the bank is looking to invest in automation and alternative channels.

We remain **bullish** on the banks earnings growth for the next 5 years. We project an average earnings growth of 14% between 2017 and 2020. We further expect loan book growth to remain ahead of industry average as the bank continues to implement its new strategy. We expect ROE to average at 19% over the same period. We however believe that the bank will have to increase their retention ratio going forward, so as to retain more capital for this aggressive growth. Barclays is currently trading at **1.06x PB** against a **5 year average of 2.37x** and **industry average of 0.83x**. It's trading at a **Dividend yield of 12%.** **Click on this link to view our detailed valuation of Barclays Kenya.**

Management Comments

On the balance sheet;

- ✓ Quarter 4 was best performing quarter for the loan book
- ✓ Post rate cap, Personal lending segment is the biggest winner. The low pricing led to increased demand from borrowers in the segment.
- ✓ Borrowers in the Corporate segment are being charged higher rates after the rate cap.
- ✓ Foreign book's loan to deposit is above 100%. BBK has an open credit line with PLC that substitutes deposits in their foreign currency lending.
- ✓ Retail and SME are their biggest source of deposits

On Cost of risk;

- ✓ Retail is the biggest source of NPLS
- ✓ Statutory reserve ratio currently below zero signifying the conservative approach the bank has taken in its provisioning.
- ✓ Future provisioning will go up in line with loan book growth and performance of the business environment. It is unlikely that the huge uptick will recur.
- ✓ BBK currently doing simulations & parallel reporting to try and understand the effects of IFRS 9

On interest rates;

- ✓ BBK expects interest rates to remain under pressure. They do not expect any monetary policy easing in 2017 as expected earlier.
- ✓ Consumer prices on the rise. Oil prices to remain elevated. And negative effects of the drought. These will make easing highly unlikely.

On Barclays PLC divesture in Barclays Africa;

- ✓ Barclays PLC is looking to sell down its stock in Barclays Africa to a level where they will not be required to consolidate. Barclays BBK is selling DOWN not OUT. It is expected to sell down from current 50% to 20%

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