Stanbic Holdings announced a decline in Profit after tax of 10% to KES 4.4 billion on the back of a faster growth in expenses than in income. Operating expenses grew by 23% to KES 10.7 bn while total income grew by 5% to KES 18.5 bn. This resulted in an increase in the cost to income ratio from 51% to 58%. The massive increase in operating expenses was attributed to negative effects of hyperinflation in South Sudan. Management indicates that without these effects, the growth in total expenses would have been just 10% giving a cost to income ratio of 52% which would have resulted in an increase in the bottom line.

Net interest income increased by 17% to KES 10.8 bn on the back of a 10% growth in the loan book to KES 115.6 bn and improved margins for the first three quarters of 2016, mainly in the personal and business segment. The growth in the total loan book was mainly driven by a 14% growth of the corporate book and supplemented by a 6% increase in loans in the Personal and Business segment. Stanbic Holding's loan book is largely corporate, which accounts for 55% of total loans (2015: 53%).

Non funded income increased only slightly, by 0.2% to KES 7.7 bn. Despite increased transaction volumes through the bank's digital channels, growth in net fees and commissions was hampered by decrease in brokerage commission as a result of a decline in activity at the Nairobi Securities exchange. SBG Securities, the group's investment brokerage arm, reported a 44% decline in revenues to KES 224 mn and a loss of KES 7 mn, which was also impacted by the absence of a one off gain of KES 99m on the sale of NSE shares in 2015. Trading income for the group however increased slightly, mainly due to foreign exchange gains as a result of devaluation of the South Sudanese Pound, and income from the group's Bancassurance business increased by 100%.

Customer deposits grew by 12% to KES 119.3 bn, mainly driven by growth of deposits in the corporate segment. Deposits in the corporate segment grew by 18% while deposits in the personal and business banking segment grew by 6%. This led to an increase in the proportion of corporate deposits to total deposits from 49% to 52%. In terms of deposit type, there was significant increase in the proportion of savings accounts to total deposits from 11% to 20%. Current accounts still remain the largest, at 59% (2015: 58%).

The growth in deposits was lower than our estimate, which means the bank did not benefit as much as we had expected from the flight to safety of depositors that was seen after the collapse of Chase Bank in 2015.

RATING: BUY

Bloomberg ticker	**CFCB KN**
Last close (KES)	67.00
Target price (KES)	84.19
Upside potential	25.66%
Market cap (KES bn)	26.09
Dividend Yield	7.84%
52-week range	63.00 – 98.00

Key Highlights

Loan Book grew by 10% to KES 115.6 bn

Deposits grew by 12% to KES 119.3 bn

Net profit down 10% to KES 4.4 bn

NII up 17% to KES 10.8 bn

NFI unchanged at KES 7.7 bn

NPL provisions up 93% to KES 1.8 bn

CTI up from 51.2% to 57.9%

Tangible ROE down from 17% to 15%

Analysts

Dominic Ruriga
rurigad@aibcapital.com

Abdulrahman Hussein
husseina@aibcapital.com

Dealing

Bernard Kung'u
kungub@aibcapital.com

Ben Gichuru
gichurub@aibcapital.com

Mary Byera
byeram@aibcapital.com

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The bank's bottom line was also impacted by a 93% increase in impairment charges to KES 1.7 bn. This was higher than our projected 1.3 bn, and was mainly attributed to adoption of prudent provisions for South Sudan assets, downgrade of some corporate clients and growth in loan book. Stanbic's coverage ratio however declined from 26.2% to 24.5% following an increase in NPLs by KES 1.6 bn, to an estimated 5% NPL ratio.

The group's ROE (net of goodwill) declined from 17% to 15%, in line with our projections. Dividend per share declined from KES 6.15 in 2015 to KES 5.25.

Outlook: Going forward, we do not expect the bank's earnings to be significantly impacted by the interest rate cap relative to its peers. Their net interest margins have historically been low at averages of between 5-6% and the group has maintained focus to diversify their revenue streams away from interest income through bancassurance, brokerage and transactional banking. Despite a decrease in the proportion of non-interest income to total income ratio from 46% to 41%, Stanbic still boasts of having the highest ratio among the listed banks. We expect an average ROE (net of goodwill) of 17% over the next 5 years.

Management has indicated that they do not expect the bank to be significantly impacted by IFRS 9 due to adoption of conservative guidelines. Considering that the bank has one of the lowest coverage ratio among listed banks, we maintain our expectation that the bank's provisions will increase with the adoption of IFRS 9 to improve the ratio towards peer average of 49.6%.

Stanbic is currently trading at a 0.86x tangible PB (excluding goodwill) against an industry average of 0.88x. We maintain a BUY recommendation based on our target price of KES 84.19, which gives an upside potential of 25.66%.

Click on this link to view our detailed valuation of Stanbic Holdings.

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