Standard Chartered Bank – 1H2013 Results Note

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We are **NEUTRAL** on Standard Chartered Bank

Current market price (10.09.13)	296.00
Trailing BVPS (2012)	106.36
Trailing P/B	2.77
3 Year Historical P/B	2.66
Forecasted BVPS	127.21
Target Price	338.62
Upside potential	14.4%

Investment Summary

We are **NEUTRAL** on Standard Chartered Bank.

In our view, the bank still has some ground to cover in terms of deployment of loans and advances as evidenced by the drop in the interest income on the same.

Key Results Highlights

- **Interest income growth on the back of government securities**: Interest income from government securities increased by KES 799 million to KES 2.8 billion (1H2013) from KES 2.0 billion (1H2012).
- **Lower interest rate environment dents interest income on loans and advances**: Interest income on loans and advances dropped by 3.4% to KES 7.5 billion (1H2013) from KES 7.8 billion (1H2012)
- **Other fees and commissions supports other operating income growth**: Other fees and commissions recorded a 14.4% growth to KES 1.6 billion (1H2013) from KES 1.4 billion (1H2012) due to a higher number of large volume transactions during the period.
- A 14.4% increase in operating expenses to KES 4.7 billion (1H2013) from KES 4.1 billion (1H2012) was due to significant increases recorded in staff costs............

Year to 31 Dec	2012A	2013F
Net Income (KES 000)	8,069,533	8,702,712
EPS	27.33	27.61
BVPS	106.36	127.21
P/E x	10.79	10.68
P/B x	2.77	2.32
ROE	26.2%	22.1%
ROA	4.1%	3.8%
C/I Ratio	40.8%	42.9%

Standard Chartered Bank 1H2013 Earnings Update

Income statement (KES '000)	1H2012	1H2013	% Change
Interest income	9,929,299	10,420,669	4.9%
Interest expense	2,603,406	2,402,068	-7.7%
Net Interest Income	**7,325,893**	**8,018,601**	**9.5%**
Net Interest Margin	5.1%	4.3%	
Other operating income	3,668,960	3,811,324	3.9%
Total Income	**10,994,853**	**11,829,925**	**7.6%**
Operating expenses	4,139,279	4,735,271	14.4%
Loan loss provision	355,124	555,641	56.5%
Profit before tax (PBT)	**6,500,450**	**6,539,013**	**0.6%**
Total comprehensive income for the year	**6,397,131**	**5,765,703**	**-9.9%**
Cost of customer deposits	**1.3%**	**1.2%**	
Cost of bank deposits	**14.7%**	**12.5%**	
Cost/Income Ratio	**37.6%**	**40.0%**	
EPS	**15.28**	**14.61**	

Bank Balance Sheet (KES '000)	FY2012	1H2013	% Change
ASSETS			
Kenya Government Securities (Available for sale)	42,406,412	63,405,313	49.5%
Deposits and balances due from banking institutions in the group	10,158,076	8,072,929	-20.5%
Loans and advances to customers (net)	112,694,523	118,369,916	5.0%
Total Assets	**195,352,756**	**213,755,222**	**9.4%**
LIABILITIES			
Customer deposits	140,524,846	147,403,828	4.9%
Deposits due to banking institutions in the group	13,751,932	17,984,609	30.8%
Total Liabilities	**164,599,942**	**181,420,543**	**10.2%**
Shareholders' Funds	**30,752,814**	**32,334,679**	**5.1%**
Loan/deposit ratio	**80.2%**	**80.3%**	
Liquidity ratio	**38.0%**	**42.0%**	
Core capital/Total risk weighted assets	**13.1%**	**17.3%**	
Total capital/Total risk weighted assets	**14.8%**	**14.8%**	

Source: Company Release

Standard Chartered Bank's 1H2013 pretax profit recorded a marginal increase of KES 39 million (0.6% gain) to KES 6.5 billion compared to 1H2012.

Revenue Overview

Interest income from government securities increased by KES 799 million

Interest income growth on the back of government securities: Total interest income jumped 4.9% to KES 10.4 billion in 1H2013 propelled by a 40.8% increase in interest income from government securities. Interest income from government securities increased by KES 799 million to KES 2.8 billion (1H2013) from KES 2.0 billion (1H2012). However, the yield on government securities dropped by 120 bps to 4.2% (1H2013) from 5.4% (1H2012) due to strong growth (86.8% increase) in Kenya government securities available for sale.

Lower interest rate environment dents interest income on loans and advances: Interest income on loans and advances dropped by 3.4% to KES 7.5 billion

3.4% decline on interest income on loans and advances

(1H2013) from KES 7.8 billion (1H2012) mainly due to the relatively lower interest rate environment experienced in 1H2013 as compared to 1H2012. Data from the Central Bank of Kenya indicates that average lending rates In 1H2013 stood at 17.7% as compared to 20.1% in 1H2012. As a result, the yield on loans dropped by 110 bps to 6.4% (1H2013) from 7.5% (1H2012).

Interest income on deposits and placements with banking institutions increased by 30.0% to KES 77 million while other interest income dropped by 45.3% to KES 71 million. The yield on placements with other banks increased to 4.0% in 1H2013 from 3.0% in 1H2012.

Interest expenses reduce in line with Central Bank Rate reduction: Total interest expenses dropped by 7.7% to KES 2.4 billion (1H2013) from KES 2.6 billion (1H2012) on account of a significant drop in the cost of customer deposits and cost of bank deposits.

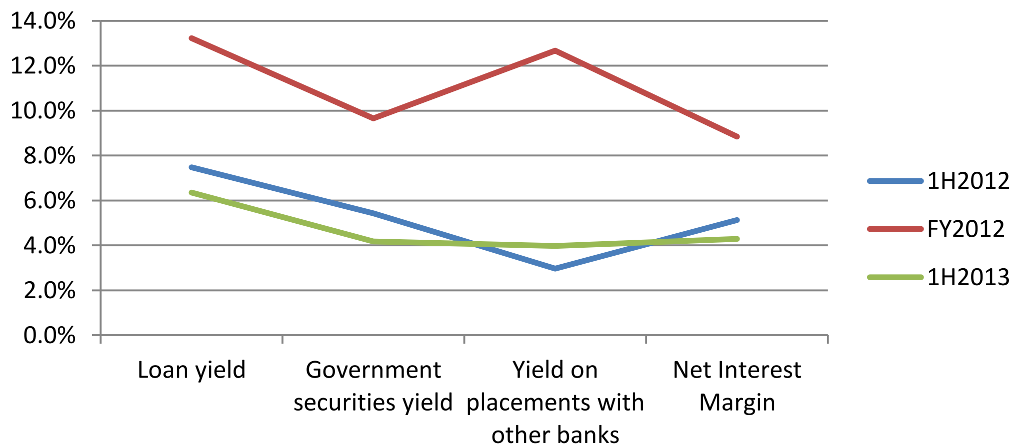
Interest expense on customer deposits dropped by KES 57 million

Interest expense on customer deposits dropped by KES 57 million (3.1% y-o-y drop) to KES 1.8 billion in 1H2013. This is in line with the drop in the Central Bank Rate that fell from a high of 18.0% at the end of 1H2012 to 8.5% in 1H2013. Cost of customer deposits consequently dropped by 10 bps to 1.2% (1H2013).

An 18.5% y-o-y drop in interest expenses on deposits and placements to KES 628 million (1H2013) led the drop in overall interest expenses. The cost of bank deposits dipped by 220 bps to 12.5%. Other interest expenses registered a marginal 6.5% decline to KES 21 million (1H2013) from KES 23 million (1H2012).

Fall in net interest margin due to increase in underlying interest earning assets

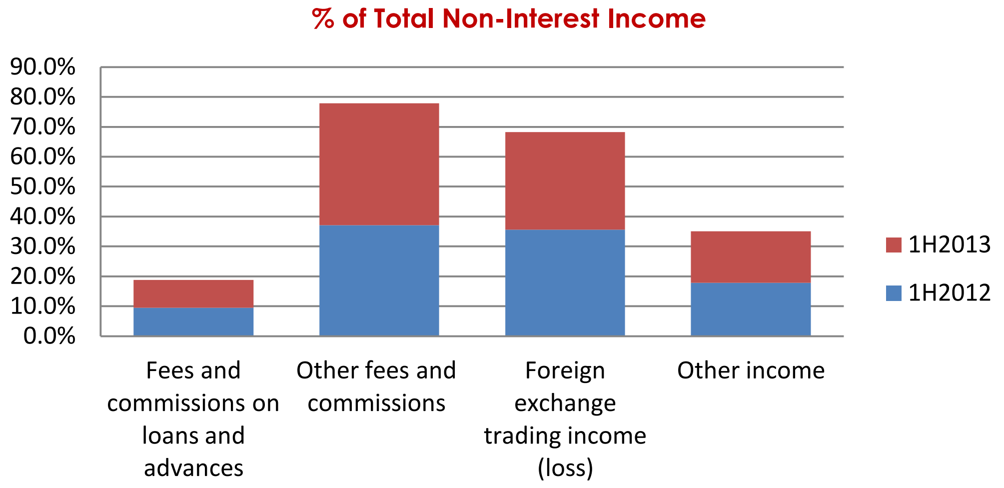
Depressed Net Interest Margin: The net interest margin fell by 80 bps to 4.3% (1H2013) from 5.1% (1H2012) despite a 9.5% growth in net interest income. This was due to the strong growth in lower yielding assets (86.8% y-o-y growth in Kenya Government Securities relative to a 13.7% growth in high yielding assets (loans and advances to customers).



Higher number of large volume transactions lifts other fees and commissions

Other fees and commissions boosts other operating income: Total non-interest income recorded a 3.9% y-o-y growth to KES 3.8 billion. Fees and commissions on loans and advances edged up 2.9% to KES 356 million. Other fees and commissions recorded a 14.4% growth to KES 1.6 billion (1H2013) from KES 1.4 billion (1H2012) due to a higher number of large volume transactions during the period.

Foreign exchange trading income fell by 4.9% to KES 1.2 billion (1H2013) from KES 1.3 billion (1H2012) while other income remained unchanged at KES 655 million.



OpEx analysis

Staff costs pushed up operational expenses

A 14.4% increase in operating expenses to KES 4.7 billion (1H2013) from KES 4.1 billion (1H2012) was due to significant increases recorded in staff costs, other operating expenses and rental charges. Staff costs increased by KES 281 million (12.5% y-o-y increase) to KES 2.5 billion while other operating expenses increased by 17.6% y-o-y to KES 1.4 billion. Rental charges increased by 36.1% to KES 233 million.

Amortisation charges edged up 8.2% to KES 218 million. The bank has been investing in technology recently launching its first digital branch in Kenya. This is a bold move by the bank that will see it contain its staff costs and increase profitability going forward.

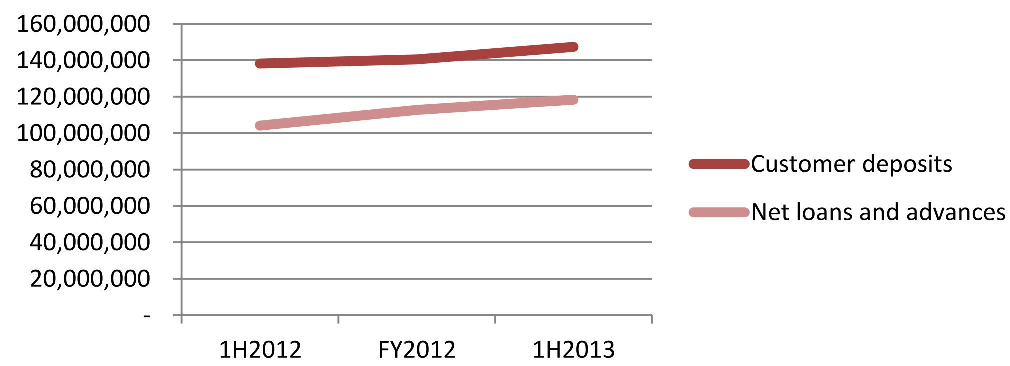
Asset Quality Analysis

Increase in loan loss provisions

Gross non-performing loans and advances increased by 88.9% to KES 3.8 billion (1H2013) from KES 2.0 billion (1H2012). Loan loss provisions increased in line with the rise in non-performing loans edging up 56.5% to KES 556 million.

Net non-perfoming loans/net loan book rose 100 bps to 2.0%. In our view, this raises concerns about the quality of the loan book considering that funds allocated during the period had a strong bias towards government securities.

Balance Sheet



KES 6.9 billion in deposits amassed during the first half of the year

During 1H2013, Standard Chartered Bank managed to lend out KES 5.7 billion (5.0% half-on-half increase) in loans and advances to customers. During the same period, the bank amassed KES 6.9 billion in additional deposits (4.9% half-on-half increase) bringing the total customer deposits to KES 147.4 billion.

Increased investment in government securities was principally driven by significant growth in customer deposits and growth in capital supported by the rights issue and retained earnings.

Outlook

Need for aggressive lending

In our view, the bank still has some ground to cover in terms of deployment of loans and advances as evidenced by the drop in the interest income on the same.

Interest income from government securities is bound to increase given the prevailing high yield environment and the sheer volume of government securities.

Cost containment a plus

We are encouraged by the bank's efficiency, evidenced by the lower C/I ratio as compared to the industry levels. Going forward, we expect modest growth in deployment of loans and advances as the bank aims to mitigate against further deterioration of asset quality.

Recommendation

We maintain our **NEUTRAL** recommendation on Standard Chartered.

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Our target price of KES 338.62 gives a 14.4% upside potential based on the current market price (KES 296.00). We have used the forecasted BVPS and a 3 year historical average P/B to arrive at the target price.