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Securities

Standard Chartered Bank Botswana Ltd

Full Year Results to 31 December 2015

High cost of funds weighs down margins...

Equity Research

Botswana

15 July 2016

Financials

Recommendation			HOLD
Current Price (BWP)			8.10
Upside/(Downside)			-16.30%
Highest Price - last 12 months			12.71
Lowest Price - last 12 months			8.10
PER (x)			50.99
PBV (x)			2.32
Div. yield (%)			6.47%
Earnings Yield (%)			1.96%
Income Statement (BWP'm)	**FY 15**	**FY 14**	**%ch**
Net interest income	471.27	595.35	-20.84%
Non-interest income	408.73	478.08	-14.51%
Operating income	879.99	1,073.43	-18.02%
Impairments	105.35	1.44	7200.62%
Operating expenses	705.99	665.50	6.09%
Profit before tax	68.65	406.49	-83.11%
Attributable earnings	47.39	319.18	-85.15%
EPS (thebe)*	15.88	106.98	-85.16%
DPS (thebe)*	56.69	71.42	-20.62%
NAV/share (thebe)	349.01	402.08	-13.20%
Balance sheet			
Cash on hand	1,139.25	1,005.15	13.34%
Bank of Botswana Certificates	2,308.81	884.62	160.99%
PP&E	33.68	39.92	-15.62%
Loans and Advances	9,414.85	10,654.44	-11.63%
Other assets	233.40	216.14	7.99%
Total Assets	13,130.00	12,800.27	2.58%
Total Assets			
Deposits	11,150.52	11,033.14	1.06%
Subordinated debt	686.26	297.26	130.86%
Other Liabilities	251.94	270.27	-6.78%
Shareholders funds	1,041.28	1,199.60	-13.20%
Liabilities & Equity	13,130.00	12,800.27	2.58%
Ratios			
Net interest margin*	4.70%	6.58%	
Cost-income*	80.23%	62.00%	
non interest- total income *	46.45%	44.54%	
Loan-deposit ratio	73.00%	81.00%	
Cost of risk	1.05%	0.02%	
RoaE*	4.23%	28.30%	
RoaA*	0.37%	2.80%	
CAR	19.80%	16.10%	

Standard Chartered Bank Botswana (SCBB) registered a 1.81% marginal increase in interest income to BWP 856.9m vs. BWP 841.6m at FY 14, despite a tough operating environment against the backdrop of interest rates hitting all-time lows. The bank's loan book recorded an 11.63% y-o-y decrease, while interest expenses grew by 56.59% to BWP 385.6m (FY 14: BWP 246.3m) - we presume because of competitive pricing for deposits as suggested by the 90bps rise in average cost of funding to 3.4%. On the other hand, average asset yields contracted by 90bps to 7.4%, ultimately resulting in narrower spreads, and net interest revenue thus decreased by 20.84% to BWP 471.3m. Consequently, NIMs narrowed by 170 bps to 4.10%.

Net fee income shrunk by 14.51% to BWP 408.7m vs. BWP 478.1m at FY 14, brought about by a 24.46% decline in trading income to BWP 156.5m mainly due to lower foreign currency income which management attributed to heightened competition and price sensitivity of customers. The bank registered a 5.89% decline in fee and commission income to BWP 280.4m primarily due to a 26.45% y-o-y decrease in insurance brokerage income to BWP 56.4m; while the commission expense rose by a moderate 4.09%. The aforementioned thus led to an 18.02% decrease in operating income.

Operating expenses increased by 6.09% to BWP 706.0m, which was above the average inflation rate of 3.04%, mainly on the back of a 15.02% y-o-y increase in administration expenses to BWP 425.7m (FY 14: BWP 370.1m) underpinned by a 27.63% rise in group recharges – i.e. management fees related to group and business support functions.

Conversely, staff expenses decreased by 11.70% to BWP 220.0m, which management partly attributed to internal restructuring that took place the prior year and resulted in a drop in expenditure generated from employee benefits such as salaries and wages (-8.48%) and pension fund costs (-16.28%). Given the decline in total income, the CIR rose by 18.23pp to 80.23%.

Impairment charges surged to BWP 105.3m (FY 14: BWP 1.4m) largely attributable to a single client on the corporate side (whose full exposure, according to management, was approximately BWP 70.0m). This heavily weighed down PBT, which declined by 83.11% to BWP 68.7m vs. BWP 406.5m at FY 14.

The effective tax rate increased to 30.97% vs. 21.48% at FY 14 driven by prior year adjustments on deferred tax and as a result, PAT shrunk by 85.15% notably to BWP 47.4m. Subsequently, RoAE dropped to 4.23% from 28.30% at the previous year. Despite this performance, the bank still declared a healthy dividend yielding 5.68% (FY 14: 4.63%) at the current share price, paying out 56.69 thebe per share (FY 14: 71.42 thebe per share) – 3.6x the EPS of 15.88 thebe, suggesting management views the FY 15 performance as a once off.

Net customer loans and advances decreased by 11.57% to BWP 7.2bn vs. BWP 8.1bn at FY 14, below the bank's listed peer average increase of 12.32%. SCBB's NPL ratio increased to 2.02% (FY 14: 0.74%) mainly on the back of the aforementioned corporate client, and was thus not reflective of overall book quality. Without that once off provision, management indicated the NPL ratio would have been 1.02%.

Despite the rise, the NPL ratio was still below the prudential maximum guideline of 2.50% and the industry aggregate of 3.3% (as at 31 December 2015). BoBC holdings increased significantly by 160.99% to BWP 2.3bn despite their yields averaging historical lows of 1.80% and 1.58%, for the 14day and 91day BoBC's, respectively, by year end. We assume that the surge in BoBC holdings was reflective of excess system liquidity, a general feature in the market triggered by the central bank's 5pp cut in the primary reserve requirement from 10% to 5% - which consequently saw BWP 2.3bn released into the market.

On the liabilities side, the Corporate & Institutional Banking division accounted for 54.06% of non-bank deposits and registered 10.91% y-o-y growth to BWP 5.3bn. Wholesale deposits constituted 54% of total deposits – consistent with the broader industry funding structure (71.3% of the sector's deposits during FY 15 were wholesale in nature). The Commercial Banking division recorded a 41.91% y-o-y decrease in customer deposits to BWP 1.3bn, and this translated into a 1.75% decrease in SCBB's customer deposits to BWP 9.9bn vs. BWP 10.0bn at FY 14. The bank's balance sheet remained highly liquid as reflected by a liquid asset ratio of 30.92% (FY 14: 17.13%), well above the prudential minimum of 10.0%. SCBB registered an LDR of 73.0% - 7 pp below the preferred ceiling of 80%, and an improvement from 81% at FY 14. Loans to deposits and borrowings was 68.12%.

SCBB raised long term subordinated debt of BWP 389.0m, which underpinned the 130.86% rise in senior debt to BWP 686.3m from BWP 297.3m at FY 14. The increase in Tier II capital underpinned the 8.35% increase in supplementary capital to BWP 1.5bn, which assisted by a 12.20% decrease in risk weighted assets, strengthened the bank's CAR to 19.8% (FY 14: 16.1%), 4.8pp above the 15.0% statutory minimum.

Outlook: SCBB's FY 15 results were below our expectations, courtesy of the BWP 105.3m impairment charge. The bank's LDR of 73%, indicates room for further risk asset growth going forward, backed by its high liquidity and well capitalised balance sheet, thus creating room to increase its current loan market share of 15%.

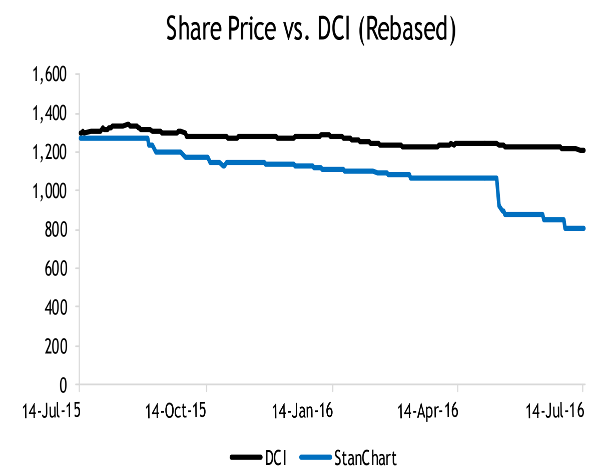
The launch of products in FY 15 such as the prepaid electricity & real time *DSTV* payments on SCBB's mobile banking platform should improve customer convenience and thus increase transactional activity which would in turn boost NIR. Other efforts launched during the financial year included 100% mortgage financing.

Other innovation efforts included the launch of an offshore fixed income proposition. This product is the first in the market to make such investment instruments available to retail customers through a local distribution channel, and should further boost NIR. SCBB's global presence should aid its penetration of offshore solution markets.

The Commercial Banking segment is to launch both short and long term 'bancassurance' solutions in 2016, and provide enhanced cash management solutions through its digital platform *Straight2Bank*.

With the economy looking to strengthen in 2016, and the lifting of the historical moratorium on bank charges, we are of view that the banking operating environment is set to improve. Whilst the overall market average was 2.13% at FY 15, SCBB maintained tight risk management, registering a cost of risk of 1.05% - well below the peer average, despite its large impairment charge. SCBB's RoAE was 4.23%, well below our listed peer average of 19.35%. However, SCBB maintained an average RoAE of 32.71% for the 4 years prior to FY 15, 45 bps above the listed peer average of 32.26%. We thus expect SCBB's returns to revert back towards that four year mean going forward, or at the very least to match its peers.

The bank trades at PER and PBV multiple of 50.99x (PER is 15.82x when adjusted for the "exceptional" provision) and 2.51x, respectively. This is against its listed peer averages of 12.81x and 2.48x, respectively. Using relative valuations, we derive a fair value of **BWP 7.33** suggesting a 9.51% downside on the current price of BWP 8.10. We therefore recommend a **HOLD** call on the counter.



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