Company Research Report
18 March 2019
Armstrong Kamphoni
Kamphonia@cedarcapital.mw
+265 1 832 307

CEDAR CAPITAL

Equity research | Company Earnings Update

- **Standard Bank Malawi's FY18 earnings decline of 13% year-on-year to MKW10.6 billion significantly underperformed our forecast of a 2% year-on-year decline.** Consequently, the EPS of MKW45.22 was 11% lower than our forecast of MKW50.89. This poor showing came on the back of a 16% shrinkage in balance sheet assets and lower yields on both advances and investment securities.

- **Changed asset mix.** A 56% decline in traditionally the strongest income earning asset; "placement with other banks" to MKW76.4 billion, now comprising 24% from 46% of the interest earning asset book, marked a significant change in the asset mix. The extra liquidity was channelled into loans and treasury securities.

- **Improving asset quality;** a 7% decline in NPLs to MKW12.9 billion saw the NPLs ratio improve 323bps points to 11.4%. A 20% expansion in the loan book to MKW113 billion did help by enlarging the denominator.

- **Strong growth in non-funded income of 22%** year-on-year to MKW21.2 billion was counteracted by a 13% decline in net interest income, following the change in the asset book mix and lower yields on advances.

- **Deteriorating cost to income ratio;** although expenses growth was kept to a below inflation level of 5.2%, the cost to income ratio deteriorated to 69%, the worst level in the last 5 years due to lower income.

- **Recommendation maintained**; We are currently reviewing our rating. In the meantime, we maintain our **REDUCE** recommendation**.** At the current share price of K670, SBM is trading at a **P/E of 12.6x** and **P/B of 1.73x**. We find these levels demanding as the price is not reflecting the softening of the bank's key metrics.

Key Forecast	Dec 17A	Dec 18A	Dec 19E	Dec 20E
PAT	12 162	10 582	11 557	13 275
EPS	51,83	45,09	49,25	56,57
EPS Growth (%)	(37,39)	(12,99)	9,21	14,87
P/E (x)	11,77	12,60	11,58	10,08
NAV per share	307,80	329,15	332,76	362,81
P/NAV(x)	1,98	1,73	1,71	1,58
DPS (MKW)	10,65	24,29	26,53	14,14
Dividend yield (%)	1,75	3,63	3,96	2,11

Recommendation: **REDUCE** Maintained

Price target: Under review

Share data

RIC	SBC.MV
Sub industry	Banks
Price (18 Mar 2019)	MKW570
Market cap (MKW b)	133.7
Market cap (USD m)	183.5
Free float (%)	11.44
Trailing EPS (MKW)	45.22
NAV per share (MKW)	329.15
P/E (x)	12.60
P/B (x)	1.73

Margins (%)	31-Dec-17	31-Dec-18
Interest Margin	11,95	10,05
Interest Spread	11,68	9,82
Cost of Funding	1,45	1,46
Lending Rates	25,00	23,00
Leverage & NPLs	31-Dec-17	31-Dec-18
Impairments/Average Advances (%)	6,61	4,35
NPLS	**13 821,00**	**12 889,00**
NPLS/Advances (%)	14,67	11,44
Cost per loan Asset	0,36	0,31
Profitability	31-Dec-17	31-Dec-18
Return on Equity (%)	18,01	14,16
Return on Assets (%)	3,31	2,71
Loans/Deposits Ratio (%)	36,31	49,12
Debt/Equity Ratio (%)	0,19	0,57
Cost to Income Ratio (%)	65,78	69,13

Source – Bank, Cedar Capital Research

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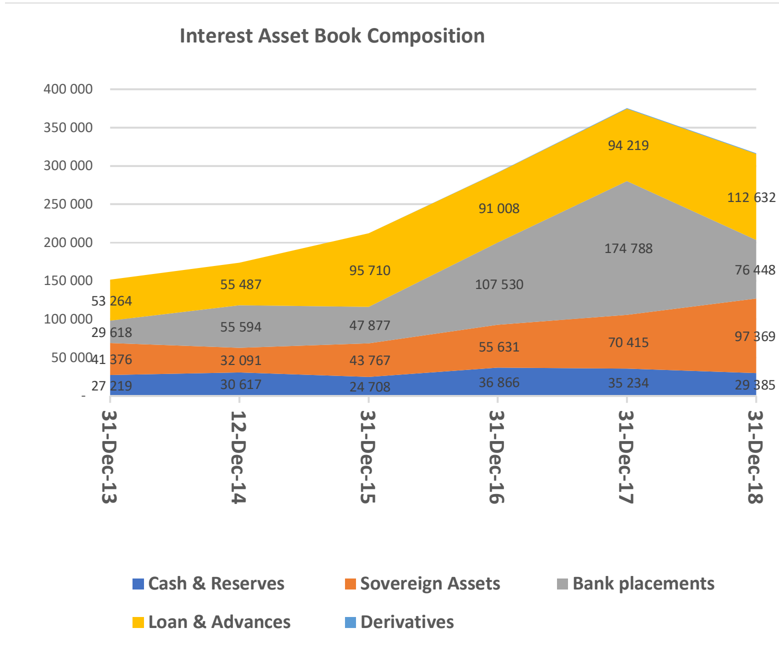
Interest income declined 11% year-on-year to MKW39 billion with the lacklustre performance attributed to;

(a) A 190bps decline in the yield on the interest earning book from 11.95%pa to 10.05%pa driven by softer lending rates which closed the year at 23%pa against 25%pa at the end of FY17.

(b) The yield on treasury bills has also trended downwards, opening the year at 15%pa and progressively declining during the year to close at 11.42%pa, a drop of 358bps.

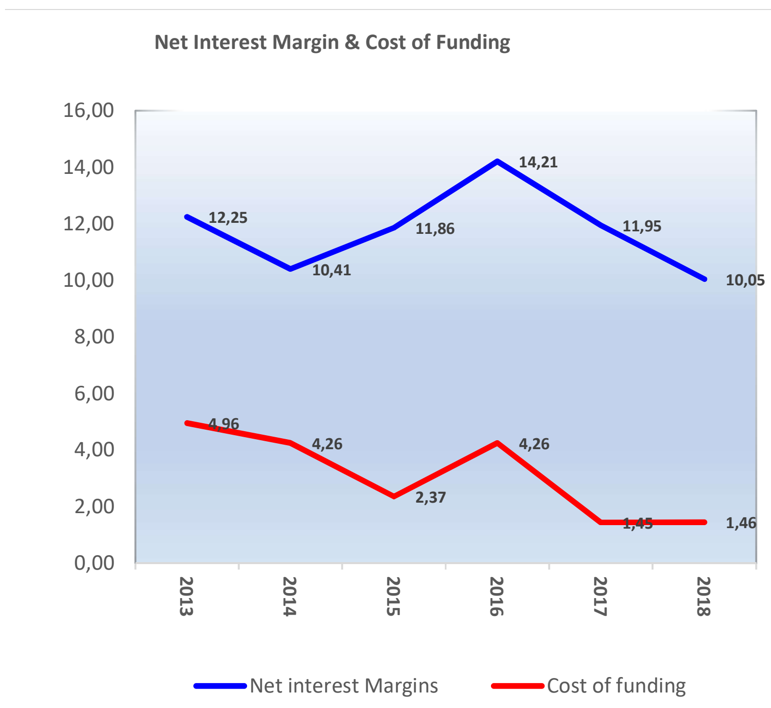
(c) A change in the mix of the interest earning asset book as 'placements with other banks' more than halved to MKW76 billion, with the liquidity deployed in credit which grew 20% to MKW112.6 billion and treasury bills which rose 38% to MKW97.4 billion.



Source: Cedar Capital Research

Interest expense rose 8% to MKW4.3 billion, at a time when the customer deposit base shrunk 12% to MKW229.3 billion, through an outflow of MKW30 billion of customer deposits. This happened at a time, when the cost of fixed deposits was increasing from 3%pa to 4.5%pa. Reliance on bank funding was also restrained, falling 43% to MKW34.6 billion. As the bank let go of expensive deposits, its cost of funding remained static at 1.46%pa.

Net interest income declined 13% to MKW34.7 billion; a consequence of compressing jaws as net interest income fell, while funding costs were up a percentage point, resulting in the net interest margin deteriorating 190bps points to 10.05%pa.



Source: Cedar Capital Research

The provision charge for loan losses was down 21% to MKW4.9 billion, on the back of improving credit quality and reducing NPLs in the agriculture book. Total NPLs in the book were down 7% to MKW12.9 billion, which saw the credit loss ratio improving 323bps to 11.4%pa.

Non-funded income (NFI) was up 22% to MKW21.2 billion, driven by a 29% rise in commission & fee income to MKW12.1 billion, on the back of increased transactions on the platform. Income from the bank's forte of trading was up 14% to MKW9.1 billion,

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Total banking income at MKW59 billion was flat as a result of the decline in loan loss provision debit and a push in NFI, cancelling out the fall of net interest income.

On the other hand, operating expenses advanced 5.2% to MKW35.3 billion, significantly below inflation and highlighting the success of the bank's cost containment measures. However, because of the lack of growth in revenues, the cost to income ratio deteriorated from 65% to 69%.

Profit after tax declined 13% to MKW10.6 billion, which following the 37% drop in profits in FY17, makes it the second consecutive period of profit declines. Profit levels are now below FY13 levels.

Gross loans grew 20% to MKW112.6 billion, possibly flagging the change in strategy away from bank placements. The composition of the loan book, although still favouring agriculture, the biggest growth in FY18 was advances to the wholesale/retail sector and what can be described as fresh exposure to transport and communication sectors. The loan to deposit ratio closed FY18 at 49%, up from 36% previously due to the shrinkage in deposits and the expansion in the loan book.

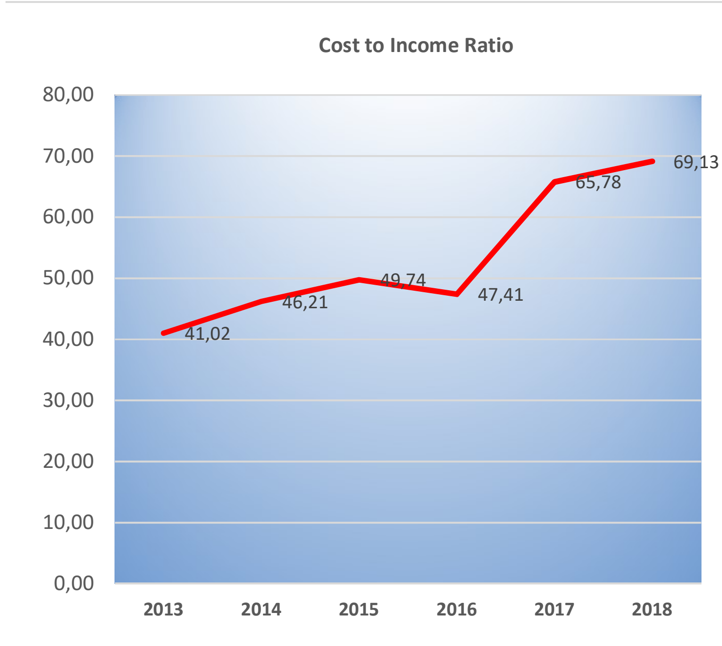
Total balance sheet assets shrunk 16% to MKW357.2 billion, due to the contraction in 'bank placements' and no movement in 'intangibles' and PPE.

Shareholders' Funds grew 7% to MKW77.2 billion, attributed to the MKW10.6 billion profits in FY18.

Increased dividend pay-out; the board is recommending a dividend of MK24.29 per share, which is a pay-out ratio of 53%, a marked rise of 128% on FY17 dividend suggesting that the board and management see limited growth prospects in the short to medium term.

In the outlook, the macroeconomic conditions are expected to remain stable, and economic growth will reflect the state of the summer agriculture season. Little exchange rate volatility is anticipated. Yields on treasury paper have continued to soften while lending rates are expected to be stable but leaning towards further softening.

The presidential election scheduled for 21 May 2019 is likely to result in increased government borrowings and possibly affect liquidity conditions in the banking sector.



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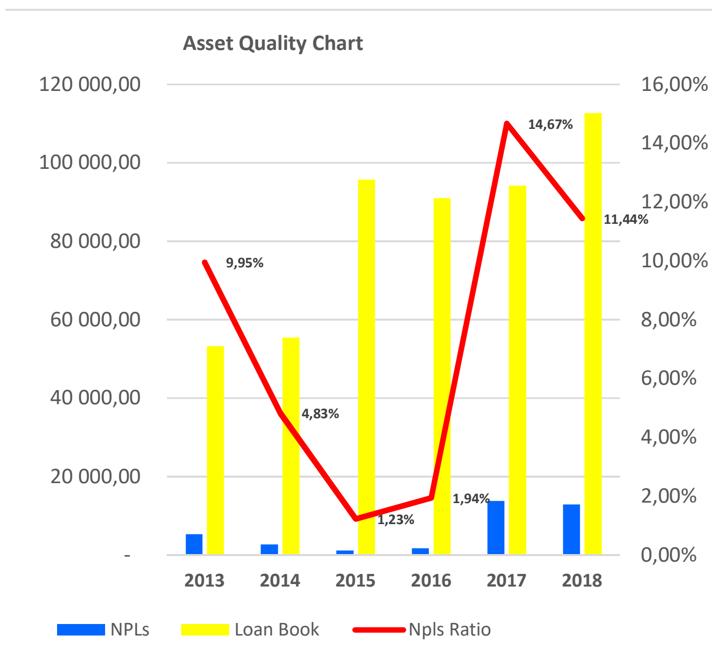

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Our view. We expect the performance of the bank to remain under pressure. The monetary policy committee meeting of January 2019 reduced interest rates through a cocktail of interventions comprising reduction of the policy rate by 150bps to 14.5%; reduction of LRR on local deposits by 250bps to 5% and a reduction of the Lombard rate margin from 200bps on policy rate to 40bps. Following these interventions, the RBM gave a guideline to the banks to adopt the Lombard rate of 14.9% as their base lending rate. Thus, we do not see an immediate improvement in margins.

The share price of SBM has been sticky largely due to illiquidity and at K570 per share it is trading at a **P/E of 12.6x** and **P/B of 1.73x**. We find these levels demanding as the price is not reflecting the softening of the bank's key metrics. **REDUCE.**

SUMMARY STATEMENT OF PROFIT OR LOSS

	31-Dec-17	31-Dec-18	Year -on- Year (%)
Interest Income	**43 787**	**38 998**	(10,94)
Interest Expense	**(3 938)**	**(4 258)**	8,13
Net Interest Income	**39 849**	**34 740**	(12,82)
Provision for Loan Losses	(6 224)	(4 902)	(21,24)
Total Interest Based Income	**33 625**	**29 838**	(11,26)
Commissions	9 371	12 105	29,18
Forex Income	8 034	9 141	13,78
Total Non-Funded Income	**17 405**	**21 246**	22,07
Total Banking Income	**51 030**	**51 084**	0,11
Total Expenditure	***(33 569)***	***(35 312)***	5,19
Profit/Losses Before Taxes	**17 461**	**15 772**	(9,67)
Taxation	(5 299)	(5 190)	(2,06)
Minority Interests	-	-	
Net Profit/loss	**12 162**	**10 582**	(12,99)

STATEMENT OF FINANCIAL POSITION

	31-Dec-17	31-Dec-18	Year -on- Year (%)
Cash & short-term funds	35 234	29 385	(16,60)
Gvt Securities	70 415	97 369	38,28
Placements with other banks	174 788	76 448	(56,26)
Loan & Advances	94 219	112 632	19,54
Derivative Assets	541	369	(31,79)
Total Interest Earning (Operating) Assets	**375 197**	**316 203**	(15,72)
Intangible Assets	20 942	19 487	
Tax	3 362	-	
Other Assets	9 429	5 623	
PPE	15 208	15 845	4,19
Total Non-Operating (Fixed Assets)	**48 941**	**40 955**	(16,32)
Total Assets	**424 138**	**357 158**	(15,79)

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Customer Deposits	259 488	229 284	(11,64)
Bank Deposits	60 659	34 579	(42,99)
Derivative Liabilities	188	160	
Trading Liabilities	135	444	
Total Interest-Bearing Liabilities	**320 470**	**264 467**	(17,48)
Provisions	23 192	3 761	
Other Liabilities	2 856	8 267	
Tax Liabilities	5 388	3 423	
Total Non-Interest-Bearing Liabilities	**31 436**	**15 451**	(50,85)
Tier I Capital	234	234	
Share Premium	8 492	8 492	
Reserves	10 738	7 382	
Retained Earnings	52 768	61 132	
Shareholders' Equity	**72 232**	**77 240**	6,93
Total Equity and Liabilities	**424 138**	**357 158**	(15,79)

Cedar Capital Limited
4th Floor, Livingstone Towers
Sir Glyn Jones Road
P O Box 3340
Blantyre, Malawi
+265 1 831 995
Feedback: nzimar@cedarcapital.mw