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Victoria Commercial Bank Limited

Kenya Bank Analysis **August 2015**

Rating class	Rating scale	Rating	Rating outlook	Expiry date
Long-term Short-term	National National	$BBB_{(KE)}$ $A2_{(KE)}$	Stable	August 2016

Financial data:

(USDm)

	31/12/13	31/12/14
KES/USD (avg.)	86.12	90.47
KES/USD (close)	86.40	89.05
Total assets†	175.6	213.4
Tier I capital‡	26.6	29.4
Tier II capital‡	0.8	1.6
Net advances	96.8	123.3
Liquid assets	50.8	59.3
Operating income	11.2	11.7
Profit after tax	5.0	5.1
Market cap.		n.a
Market share*		0.5%

† Including off-balance sheet items.
‡ Refers to the calculation of regulatory capital as per banking regulations.
* Based on Central Bank of Kenya calculation of total banking industry assets at 31 December 2014.

Rating history:

Initial Ratings (October 2012)
Long-term rating: $BBB_{(KE)}$
Short-term rating: $A3_{(KE)}$
Ratings outlook: Positive

Last Ratings (August 2014)
Long-term: $BBB_{(KE)}$
Short-term: $A2_{(KE)}$
Ratings outlook: Stable

Related methodologies/research:

Global Criteria for Rating Banks and Other Financial Institutions, updated March 2015
Kenyan Bank Statistical Bulletin (June 2015)
VCB rating reports (2012-14)

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Summary rating rationale

- The ratings of Victoria Commercial Bank Limited ("VCB" or "the bank") reflect its successful relationship-based niche private banking model and broadly stable credit profile, underpinned by excellent asset quality, comfortable capitalisation and sound profitability. The bank's ratings are however, constrained by its relatively small size, which implies low systemic importance relative to the larger local banks.
- VCB maintained healthy capitalisation ratios, with reported core and total capital adequacy ratios of 18.2% and 19.2% respectively at FYE14 (FYE13: 19.8% and 20.4%). This has been supported by the bank's high profit retention over the years, and most recently, a rights issue of KES18m in F14. However, additional capital might be desirable in the future if the growth in risk weighted assets continues to outpace capital generation (as seen in the previous two years), or if minimum capital proposals (requiring banks to hold at least KES5bn in core capital by December 2018) come into effect.
- The bank has maintained an excellent credit history, with no loans classified as non-performing for over a decade. The bank's outstanding asset quality is partly a function of the niche market in which it operates, but most importantly reflects its stringent credit origination standards and proactive post disbursement monitoring. Given VCB's client selectivity, credit concentrations within its lending portfolio are high. However, GCR takes comfort from the bank's disciplined underwriting approach.
- VCB recorded a moderate increase in its net income of 7.7% in F14 (F13: 23.2%; F12: 52.2%). Consequently, profitability in terms of return on average assets has declined over the last couple of years to 3.0% and 3.6% in F14 and F13 respectively (F12: 3.7%), as net interest margins narrowed as a result of competitive pressures. Nonetheless, profitability and efficiency metrics remain healthy.
- Despite the large maturity mismatch between interest-earning assets and liabilities, liquidity risk is mitigated to a large extent by maintaining a reasonable discretional buffer of highly tradable marketable securities (mainly government securities) and other liquid assets. In this regard, VCB maintains its liquidity ratio above the required statutory liquidity ratio of 20%.

Factors that could trigger a rating action may include

Positive changes: GCR considers the broader context of market position as one of its key rating factors. Market position is based on the bank's market share and core competences; advantages and vulnerabilities arising from its market position are examined, with emphasis on diversification, strategy, management and systems. As such, VCB's ratings could be positively impacted by substantial gains in market share, while maintaining stable profitability, asset quality and capitalisation. Furthermore, the bank's ratings would benefit from increased diversification of both earnings and funding.

Negative changes: Downward pressure on VCB's ratings could stem from a deterioration in macroeconomic conditions, which could adversely affect its asset quality, capital base and earnings power and/or negative changes in the bank's financial profile.

Corporate profile

Business summary[1]

VCB commenced operations in 1987 as a private finance company specialising in leasing finance, mainly targeting the small and medium sized enterprises ("SME") sector in Kisumu, Kenya. In April 1996, VCB converted to a commercial bank, before changing from a private company to an unlisted public company in May 2011, to pave the way for rights issues and private placements. The bank offers relationship-based niche private banking services, focusing on corporate and high net worth clients.

Ownership structure

Table 1 provides a breakdown of the bank's main shareholders as at 31 December 2014.

Table 1: Shareholding composition	Country of residence	%
Kanji Damji Pattni	Kenya	13.3
Kingsway Investments Ltd	Kenya	9.2
Orchid Holdings Ltd	Kenya	8.6
Rochester Holdings Limited	Kenya	7.4
Rajan Jani & Yadav Rajan Jani	Kenya	5.0
Asif E A Sheikh	Kenya	4.8
Premchand Hemraj Gudka & Avani Jayeshkumar Devraj -Joint Executors Of Estate of late H Gudka	Kenya	4.5
Premchand H Gudka	Kenya	4.5
Godfrey C.Omondi	Kenya	4.1
Occidental Insurance Company Limited	Kenya	3.4
Others (< 3% individual shareholdings)	Kenya	35.2
Total		**100.0**

Source: VCB.

Strategy and operations

VCB operates as a small niche private bank with three branches in Nairobi, following the opening of an additional branch in May 2014. Given the bank's limited focus on broad based retail banking, there are no plans for extensive branch expansion, although the bank aims to expand its reach into other high income locations around Nairobi to reflect its positioning in the market. Due to the limited branch network, the bank offers free courier services for banking instruments such as cheques and mails, for its clients.

Although mainly targeting high net worth individuals and mid-to-large size corporates, the bank also offers personal banking services to the employees of its corporate clients. The bank's success has been built on personal associations with clients and designing financial solutions to suit different client needs. The bank is in the process of rolling out credit cards (issued under the Mastercard brand). After introducing an e-banking platform in F14, the bank has introduced M-Pesa[2] mobile banking.

Governance structure[3]

Table 2 summarises the composition of the board of directors ("board") and adherence to selected aspects of good corporate governance. VCB is in compliance with the guidelines on corporate governance practices issued by the Central Bank of Kenya ("CBK").

Table 2: Corporate governance	
Description	**Findings**
Number of directors	7
Directors - *executives*	1 of 7
- *non-executives*	6 of 7
- *independent*	4 of 7
Separation of the chairman	Chairman is separate from the Managing Director.
Frequency of meetings	At least quarterly.
Board committees	Board Audit Risk and Compliance Committee, Board Credit Risk Committee and Board Nomination and Remuneration Committee. To Further, entrench good corporate governance practices, the board has established various management committees.
External auditor rotation policy	PricewaterhouseCoopers, 5 years.

Source: VCB.

Financial Reporting

VCB's financial statements are prepared in accordance with International Financial Reporting Standards, the Banking Act and the Kenyan Companies Act. The bank's external auditors, PricewaterhouseCoopers, issued an unqualified audit opinion on the F14 financial statements.

Operating environment

Economic overview[4]

Kenya's real gross domestic product ("GDP") growth remains robust, supported by strong credit growth and a dynamic investment environment. The economy expanded by 5.3% in 2014 (2013: 5.7%) reflecting strong activity in construction (on the back of rising private and public investments, eg, the Mombasa-Nairobi standard gauge railway project), manufacturing and retail trade, offsetting constrained growth in agriculture and tourism, due to poor rains and security concerns respectively.

Table 3: Macroeconomic Indicators (%)	**2012**	**2013**	**2014**	**2015f**
Real GDP growth	4.5	5.7	5.3	6.9
Inflation (annual avg. % change)	9.4	5.7	6.9	5.1
Government gross debt % GDP	40.8	42.2	48.6	50.1
Current account % GDP	(8.4)	(8.7)	(9.2)	(7.7)

f – forecast. Source: IMF Economic outlook, April 2015.

After exceeding the CBK's target range (5±2.5%) in July (7.7%) and August (8.4%) 2014, headline inflation continued to decline reaching 6.0% in

[1] Refer to GCR's previous rating reports for additional background information.

[2] M-Pesa is a mobile-phone based money transfer and micro-financing services through Safaricom in Kenya.

[3] Given the intricacies associated with good corporate governance, GCR recommends an independent assessment to test true compliance.

[4] CBK Weekly Report, 2 April 2015; International Monetary Fund ("IMF") Country Report, October 2014/February 2015; CBK Monthly Economic Review, December 2014.

December 2014, supported by lower international oil prices and increases in geothermal energy generation capacity. However, inflation rose to 7.0% in June 2015. Table 4 shows the trend for selected monetary and financial indicators over the review period.

Table 4: Inflation, interest rates and other financial indicators (in %)

	Dec-13	Jun-14	Dec-14	Jul-15
Inflation (YoY)	7.2	7.4	6.0	7.0*
CBR	8.5	8.5	8.5	11.5
KBRR	-	-	9.1	9.9
Interbank rate	9.0	6.6	6.9	8.0
Treasury bill rate (91-days)	9.5	9.8	8.6	8.2
Average lending rate	17.0	16.4	16.0	15.3**
Exchange rate (USD/KES)	86.3	87.6	90.4	100.4

* At June, 2015.
** At May, 2015.
Source: CBK Monthly Economic Review December 2014, CBK. Weekly Statistical Bulletin, 3 July 2015.

Bank lending rates have, on average, declined since the Kenya Banks Reference Rate ("KBRR") became effective in July 2014. The KBRR was introduced to facilitate a transparent credit pricing framework and enhance the transmission of monetary policy signals through commercial banks' lending rates. The KBRR is computed as an average of the policy rate/central bank rate ("CBR") and the weighted 2-month moving average of the 91-day Treasury bill rates. The CBR was raised by 150bps from 10.0% to 11.5% in July 2015, to contain inflationary pressures and stem further depreciation of the KES, signalling an increase in bank lending rates.

Real GDP growth is expected to accelerate to 6.9% in 2015 and average around 7% over the medium term, due to the scaling up of public investments in infrastructure (transport and power generation) and deeper regional integration. Downside risks include renewed security concerns, a sudden shift in global investors' risk tolerance or sentiment, and weak regional and global growth. A sharp deterioration in security conditions will adversely impact tourism receipts, investor confidence, country risk assessments, foreign direct investments and portfolio flows. Annual capital inflows have reached about 10% of GDP in recent years, making Kenya vulnerable to shifts in investor sentiment. Kenya's economy remains vulnerable to droughts, given the prevalence of rain-fed agriculture and high dependence on hydro-power generation. In the longer term, higher growth could be further supported by oil and gas exploitation, if the commercial viability of recent discoveries is confirmed.

Industry overview[5]

As at 31 December 2014, Kenya's banking sector ("the sector") comprised 43 commercial banks, one mortgage finance company, eight representative offices of foreign banks and nine microfinance banks.

The sector continued to grow in terms of inclusiveness, efficiency and stability against the backdrop of legal, regulatory and supervisory reforms and initiatives.

The sector recorded a 12.2% growth in pre-tax profits during the year, largely supported by the growth in the credit portfolio, investment in government securities, and commissions and earnings from foreign exchange trading. Both the total assets and total deposits held by commercial banks recorded growth rates of 18.4%. The increase in assets was largely driven by a higher demand for credit in 2014 as compared to 2013, while the rise in deposits resulted largely from increased deposit mobilisation by banks as they expanded their outreach and service networks to tap unserved segments of the market. However, asset quality registered a marginal decline with the gross non-performing loan ("NPL") ratio increasing from 5.2% at 31 December 2013 to 5.6% at 31 December 2014. The increase in NPLs was partly attributed to the lag effects of a high interest rate regime in 2012/2013, as well as adverse effects on tourism, agriculture, building and construction, real estate, mining and quarrying sectors, arising from factors such as insecurity due to the threat of terrorist activity, delayed onset of long rains, and uncertainty regarding reforms in the mining sector. Similarly, the sector's capital adequacy marginally decreased from 20.7% at 31 December 2013 to 19.7% at 31 December 2014. The decline was attributable to a higher increase in total risk weighted assets, (which grew by 31%) compared to the increase in total capital of 24.6%.

Table 5: Key industry indicators (%)	31 December 2013	31 December 2014
Capital adequacy		
Capital adequacy ratio	20.7	19.7
Tier I ratio	17.9	16.4
Asset quality		
Gross NPLs/Gross loans	5.2	5.6
Net NPLs/Gross loans	2.2	2.5
Profitability		
ROaA	4.7	3.4
ROaE	29.1	26.6
Liquidity		
Liquid assets/total deposits	38.6	37.8

Source: CBK Bank Supervision Annual Report 2014.

From a regulatory perspective, there has been a proposal by Kenya's Treasury Secretary, Henry Rotich, to raise the minimum capital level for commercial banks from KES1bn to KES5bn (with compliance by December 2018). The revised capital requirement is yet to be approved by Parliament.

The sector is projected to maintain an upward performance trend in 2015 as a result of the continued expansion of banks within and outside of Kenya. The CBK's efforts to strengthen legal and regulatory frameworks (through increased transparency in credit pricing, further entrenchment of the credit information sharing initiative and enhancement of agency banking)

[5] CBK Bank Supervision Annual Report 2014.

are expected to impact positively on the sector's competitive structure and asset quality. In addition, continued automation in the sector is expected to further enhance operational efficiencies and boost economies of scale.

Competitive position[6]

Key peer analysis indicators for F14 are provided in Table 6. Competition both in the corporate, as well as consumer segments is intensifying, as banks are progressively expanding their product offerings. VCB, however, has demonstrated its ability to weather these changes by leveraging on its relationship-based niche private bank model. In this respect, according to the weighted market share index ("WMSI")[7], the bank moved up 2 positions to 25th position at FYE14.

Table 6: Peer analysis (KESm)‡	ABC	K - REP	GTB	VCB
Market size index (%)	*0.6*	*0.5*	*1.1*	*0.5*
Total assets+	21 439	15 799	32 992	17 244
Market share (%)	*0.7*	*0.5*	*1.0*	*0.5*
Net loans	13 128	10 608	12 441	10 979
Market share (%)	*0.7*	*0.6*	*0.7*	*0.6*
Total deposits	16 050	12 065	17 734	12 289
Market share (%)	*0.7*	*0.5*	*0.8*	*0.5*
Shareholders' funds	2 623	2 432	7 165	2 876
Market share (%)	*0.5*	*0.5*	*1.4*	*0.6*
Selected ratios (%)				
Capital adequacy	17.2	20.6	25.9	19.2
Gross NPL ratio	6.5	6.9	3.7	0.0
Cost ratio	73.0	59.0	61.0	38.9
ROaE	9.8	21.1	7.4	17.2
ROaA	1.2	3.3	1.6	3.0

‡ Refers to Kenyan operations.
+ Excluding contingencies.
Source: CBK.

Financial profile

Likelihood of support

GCR feels that the relatively small size of VCB's deposit base places it at a lower systemic importance than the larger local banks. However, the bank has demonstrated ability to access shareholder funds, evidenced by successful capital raising initiatives.

Funding composition

Deposits continued to be the key source of funding for the bank in F14 (being mainly derived from corporates and high net worth individuals). Despite exhibiting a small branch network (and little focus on retail deposit mobilsation), VCB has managed to grow its deposit base through customised targeting of its existing client base. In this regard, the bank's customer deposit base grew by 35.9% in F14 (F13: 19.6%). Interbank borrowing, albeit increasing by 20.2% in F14, continued to account for a low proportion of funding (4.4%), while long-term offshore borrowings (earmarked for foreign currency lending) declined by 6.5%, due to repayments. Owing to its narrow target market for deposit generation (high net worth clients and corporates), and offshore credit lines, the bank has been incurring relatively high funding costs. To address this, the bank aims to mobilise retail deposits in the future.

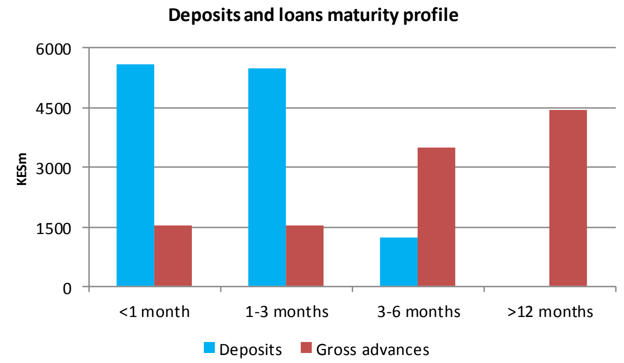
Table 7: Funding profile	F13		F14	
	KESm	%	KESm	%
Customer deposits	9 044	81.8	12 289	85.9
Corporates	*3 960*	*35.8*	*5 147*	*36.0*
Individuals	*5 084*	*46.0*	*7 142*	*49.9*
Interbank borrowings	530	4.8	637	4.4
Domestic banks	*186*	*1.7*	*100*	*0.7*
Foreign banks	*344*	*3.1*	*537*	*3.7*
Long-term borrowing+	1 483	13.4	1 387	9.7
Total	**11 057**	**100.0**	**14 313**	**100.0**

+ Comprises a 6 year USD15m line of credit from Symnex Limited and 10 year USD18m line of credit from Cistenique Investment Fund. Both facilities are at an interest rate of 6% per annum. Facilities availed to support lending in foreign currency.
Source: VCB.

Deposits remained fairly diversified, with the largest depositor and top 20 largest depositors accounting for 2.8% and 16.1% of total deposits at FYE14 (FYE13: 1.5% and 10.6%).

Liquidity risk

Local lending institutions are structurally exposed to liquidity risk due to the maturity mismatches between assets and liabilities, where the average duration of liabilities is shorter than that of assets. This is as a result of an underdeveloped bond market, volatile interest rates and low levels of financial intermediation. VCB's liquidity risk is further exacerbated by the wholesale nature of its deposits (rendering it susceptible to external shocks). Nonetheless, management indicated that over 90% of wholesale deposits are rolled-over year-on-year.



The deposits and loans maturity profile analysis reflects net maturity gaps in the short-term (less than 1 month and 1-3 months maturity buckets). To manage the resultant mismatches, VCB maintains a reasonable discretionary buffer of highly tradable marketable securities and other liquid assets, with a yearly average net liquid assets to customer deposits ratio of 29.8% at FYE14 (FYE13: 35.4%). Also, the bank maintains its liquidity ratio above the required statutory liquidity ratio of 20%.

[6] Banking sector comparatives based on Kenyan operations (excluding regional subsidiaries).

[7] The WMSI is a composite of the respective banks' market share of net assets, deposits, total shareholders' funds, number of loan accounts and number of deposits accounts.

Table 8: Net liquid assets to customer deposits (%)	F12	F13	F14
At close of the year	38.4	30.8	32.6
Average for the year	37.8	35.4	29.8
Maximum for the year	46.8	42.2	35.2
Minimum for the year	28.5	25.5	24.3

Source: VCB.

Capital structure

VCB enjoys a relatively strong capital position amongst the small peer group in the market. Supported by earnings retention and a rights issue of KES18m, the bank grew its regulatory capital base by 16.1% to KES2.8bn at FYE14. The bank has sustained healthy capitalisation ratios, recording core and total capital adequacy of 18.2% and 19.2% respectively at FYE14 (FYE13: 19.8% and 20.4%). However, additional capital might be desirable in the future if the growth in risk weighted assets continues to outpace capital generation, as seen in the previous two years or if minimum capital proposals (requiring banks to hold at least KES5bn in core capital) come into effect.

Table 9: Capitalisation	F13 KESm	F14 KESm	5M F15 KESm
Tier I capital	2 300	2 615	2 703
Tier II capital	73	141	141
Total regulatory capital	**2 373**	**2 756**	**2 844**
Total risk weighted assets ("RWA")	**11 641**	**14 376**	**16 397**
Adjusted credit risk weighted assets	*9 946*	*12 226*	*14 196*
Market risk weighted assets	*215*	*382*	*433*
Operational risk weighted assets	*1 480*	*1 768*	*1 768*
Tier I capital: RWA	**19.8**	**18.2**	**16.5**
Statutory requirement @ 10.5%			
Regulatory capital: RWA			
Statutory requirement @ 14.5%	**20.4**	**19.2**	**17.3**

Source: VCB.

Operational profile

Risk management

VCB has a strong risk management framework, which is based on risk principles approved by the board, and underpinned by numerous reporting lines. The existing framework embodies all aspects of credit, operational, market and liquidity risk among other risks. In addition, the framework includes setting key controls standards, compliance monitoring and continuous education of staff on all risks faced. Accounting for 85.0% of RWA at FYE14 (FYE13: 85.4%), credit risk is the main risk to VCB, while operational and market risk rank second and third respectively.

Credit Risk

Asset composition

In line with prior years, balance sheet growth was supported by increased funding. Despite a moderate increase in the allocation of funding to risky assets, the bank's asset mix remained fairly unchanged year-on-year. In a bid to earn passive off-balance sheet income, VCB grew its contingencies by 15.2% in F14, with the majority of the facilities being self-liquidating and posing limited credit risk. Going forward, VCB intends to increase its portfolio of contingent products, which will be limited to 25% of total balance sheet assets.

Table 10: Asset composition	F13 KESm	F13 %	F14 KESm	F14 %
Cash and liquid assets	4 387	28.9	5 278	27.8
Cash	*42*	*0.3*	*48*	*0.3*
Balances with CBK	*427*	*2.8*	*1036*	*5.4*
CBK - REPO	*-*	*-*	*`450*	*2.4*
*Marketable securities**	*2 006*	*13.2*	*2 704*	*14.2*
Balances with banks	*1 912*	*12.6*	*1 040*	*5.5*
Customer loans	8 363	55.1	10 979	57.8
Investment in associate	558	3.7	597	3.1
Fixed assets	137	0.9	185	1.0
Other assets	199	1.3	205	1.1
Contingencies	1 526	10.1	1 758	9.2
Acceptances and LCs	*796*	*5.3*	*933*	*4.9*
Guarantees	*730*	*4.8*	*825*	*4.3*
Total	**15 170**	**100.0**	**19 002**	**100.0**

*Marketable securities mainly comprise Government securities
Source: VCB.

Loan portfolio

Despite decelerating somewhat, gross loans and advances recorded growth of 31.3% in F14 (F13: 58.2%). The bank's selectivity criteria and the high value of transactions associated with lending to its niche corporate clientele has resulted in some credit concentrations within the loan portfolio, with the top 20 exposures accounting for 68.3% of total loans and advances at FYE14 (FYE13: 69.8%). The largest borrower amounted to 5.8% (FYE13: 6.0%) of the loan book and 23.3% (FYE13: 19.9%) of capital at FYE14. Nonetheless, comfort is derived from the bank's robust credit risk management practices and it is noted that the single largest exposure to capital was within the CBK prudential guideline, which limit exposures to a single borrower/group to 25% of capital.

Table 11: Gross loans and advances	F13 KESm	F13 %	F14 KESm	F14 %
By sector				
Agriculture	476	5.7	432	3.9
Construction	663	7.9	339	3.1
Individuals	513	6.1	461	4.2
Manufacturing	2 763	33.0	3 253	29.5
IT and Telecommunication	160	1.9	87	0.8
Wholesale and retail trade	1 746	20.8	2 693	24.5
Other	2 058	24.6	3 739	34.0
Total	**8 379**	**100.0**	**11 004**	**100.0**
By borrower				
Corporates	7 866	93.9	10 543	95.8
Large corporates	*916*	*10.9*	*1 481*	*13.5*
SMEs	*6 950*	*83.0*	*9 062*	*82.3*
Individuals	513	6.1	461	4.2
Overdrafts	*1*	*<0.1*	*10*	*0.1*
Mortgages	*134*	*1.6*	*145*	*1.3*
Term loans	*378*	*4.5*	*306*	*2.8*
Total	**8 379**	**100.0**	**11 004**	**100.0**

Source: VCB.

The bank has sectoral limits in place, guided by the performance of each sector, as well as associated risks. VCB's portfolio mix continues to reflect high exposures to the manufacturing, wholesale trade and real estate sectors, given that it strategically targets mid to large corporates.

Asset quality
VCB's selective picking of clients at the pre-loan application process stage (in its niche market) and strong risk management capabilities at the post loan disbursement stage has enabled high asset quality to be maintained. In this respect, the bank has not registered any non-performing loans for at least the past decade. Furthermore, it is positively noted that the bank avoids any exposure to unsecured lending.

Table 12: Asset quality	F13 KESm	F14 KESm	1Q F15 KESm
Gross advances	**8 379**	**11 004**	**11 382**
Neither past due nor impaired	*8 379*	*11 004*	*11 382*
Past due but not impaired	-	-	-
Impaired	-	-	-
Less : Provisions	**(15)**	**(25)**	**(25)**
Individually assessed	-	-	-
Collectively assessed	*(15)*	*(25)*	*(25)*
Net Loans and advances	**8 364**	**10 979**	**11,357**
Loan write-offs	1	1	-
Loan recoveries	3	3	-
Gross NPL ratio (%)	-	-	-
Total provisions/Gross loans (%)	0.2	0.2	0.2

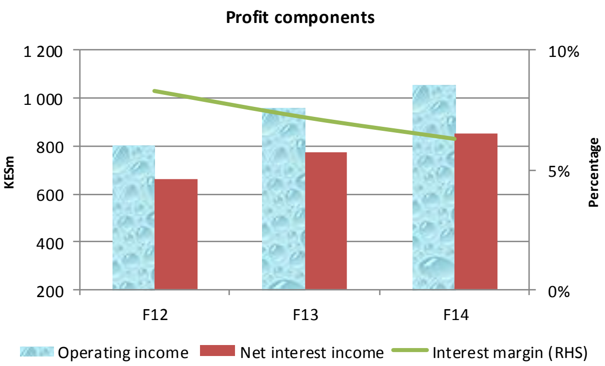
Source: VCB.

GCR believes that any asset quality pressures emanating from rising interest rates are mitigated by the bank's disciplined underwriting approach.

Financial performance

A five year financial profile is included at the back of this report, supplemented by the commentary below.

VCB recorded a moderate improvement in its net income of 7.7% in F14 (F13: 23.2%). Profitability, measured in terms of return on average equity and assets declined somewhat to 17.2% and 3.0% respectively in F14 (F13: 18.9% and 3.6%), largely due to compressed net interest margins from competitive pressures. Nonetheless, profitability and efficiency ratios remain healthy.



Net interest income: Net interest income increased by a lower 10.5% in F14 (F13: 16.9% and F12: 40.1%), supported by 31.3% growth in gross advances, but constrained by higher funding costs attributable to the long-term offshore borrowings and domestic competitive pressures. The bank remains highly dependent on interest income, with net interest income accounting for 80.6% of operating income in F14 (F13: 80.3%).

Non-interest income: Non-funded income grew by a reduced 8.1% in F14 (F13: 29.4%). Fee and commission income derived mainly from customer account related charges and off-balance sheet income, and has been the main contributor to non-interest income accounting for 60.9% of non-funded income in F14 (F13: 63%).

Operating expenses: With a cost ratio of 38.9% in F14 (F13: 38.2%), VCB's operations have remained fairly cost effective compared to peers, despite increased staff costs and the acquisition of an additional branch.

Future prospects

The bank's unaudited results for 5M F14 and 5M F15 are shown in Table 13.

Table 13: Actual interim results (KESm)	Actual 5M F14	Actual 5M F15	Growth (%)
Income statement			
Interest income	712	838	17.7
Interest expense	(372)	(471)	26.6
Net interest income	**340**	**367**	**7.9**
Other income	69	77	11.6
Total operating income	**409**	**444**	**8.6**
Operating expenditure	(167)	(183)	9.6
Loan loss provision	(15)	(9)	(40.0)
Profit before tax	**227**	**252**	**11.0**
Balance sheet			
Cash and liquid assets	4 161	4 754	14.3
Net loans and advances	9 700	12 288	26.7
Customer deposits	10 594	14 007	32.2
Total capital and reserves	2 659	3 037	14.2
Total assets*	15 262	18 629	22.1

*Excluding contingencies.
Source: VCB.

Pre-tax earnings increased by 11% in 5M F15, compared to the corresponding prior year period. Notable growth was experienced across all balance sheet parameters at 5M FYE14, supported by increased customer deposits. Overall, year-to-date results point towards a positive full year F15 in terms of profitability, and growth in assets.

Given the prevailing contraction in net interest margins, going forward, the bank's profitability metrics could benefit from the addition of low cost retail deposits to its funding base, which will also drive growth of transaction related income.

Victoria Commercial Bank Limited

(Kenya Shillings in millions except as noted)

Year end: 31 December	2010	2011	2012	2013	2014
Income Statement Analysis					
Interest income	584.6	740.1	1 352.8	1 375.4	1 754.7
Interest expense	(213.9)	(269.2)	(693.0)	(604.3)	(902.9)
Net interest income	**370.7**	**470.9**	**659.8**	**771.1**	**851.8**
Fee and commission income	57.3	66.4	92.8	119.4	124.7
Trading income	21.6	34.9	16.5	24.3	23.4
Other income	66.3	7.2	37.1	45.8	56.8
Total operating income	**515.9**	**579.3**	**806.3**	**960.7**	**1 056.7**
Impairment charge	4.4	15.3	5.7	(7.5)	(10.2)
Operating expenditure	(209.4)	(265.0)	(321.1)	(366.8)	(410.9)
Net profit before tax	**310.9**	**329.7**	**490.9**	**586.4**	**635.7**
Tax	(96.2)	(99.4)	(140.4)	(154.5)	(170.5)
Net income	**214.8**	**230.3**	**350.5**	**431.9**	**465.2**
Balance Sheet Analysis					
Subscribed capital	399.1	399.1	953.6	953.6	971.6
Reserves (incl. net income for the year)	703.8	853.3	1 082.5	1 574.6	1 904.0
Total capital and reserves	**1 102.9**	**1 252.5**	**2 036.0**	**2 528.1**	**2 875.5**
Bank borrowings (incl. deposits, placements & REPOs)	129.4	453.0	342.1	530.0	636.6
Customer deposits	4 908.2	5 906.5	7 560.9	8 985.8	12 288.3
Other borrowings	-	-	312.8	1 482.7	1 387.4
Short-term funding (< 1 year)	**5 037.6**	**6 359.5**	**8 215.8**	**10 998.5**	**14 312.3**
Customer deposits	26.5	-	-	57.9	0.4
Other funding (> 1 year)	**26.5**	**-**	**-**	**57.9**	**0.4**
Payables/Deferred liabilities	48.3	33.2	71.0	59.8	55.9
Other liabilities	**48.3**	**33.2**	**71.0**	**59.8**	**55.9**
Total capital and liabilities	**6 215.4**	**7 645.2**	**10 322.8**	**13 644.2**	**17 244.1**
Cash in hand	24.2	32.7	38.0	42.0	47.9
Balances with central bank	628.5	242.8	447.6	427.1	1 485.5
Fixed assets	119.3	145.4	142.5	137.4	185.4
Receivables/Deferred assets	104.7	123.1	244.5	198.8	205.2
Non-earnings assets	**876.7**	**543.9**	**872.6**	**805.3**	**1 924.0**
Loans & advances (net of provisions)	3 484.9	4 110.4	5 291.2	8 363.5	10 979.2
Bank placements	420.9	1 072.9	1 011.7	1 912.2	1 040.5
Marketable/Trading securities	974.8	1 531.2	2 817.3	2 005.7	2 703.8
Total investments	140.7	81.4	-	-	-
Investments in subsidiaries/associates	317.3	305.4	330.0	557.6	596.6
Total earning assets	**5 338.7**	**7 101.3**	**9 450.2**	**12 838.9**	**15 320.1**
Total assets	**6 215.4**	**7 645.2**	**10 322.8**	**13 644.2**	**17 244.1**
Contingencies	**598.6**	**828.9**	**1 571.3**	**1 525.6**	**1 757.9**
Ratio Analysis (%)					
Capitalisation					
Internal capital generation	19.5	16.7	16.3	17.1	16.2
Total capital / Net advances + net equity invest. + guarantees	26.1	24.9	29.7	25.6	22.6
Total capital / Total assets	17.7	16.4	19.7	18.5	16.7
Liquidity					
Net advances / Customer deposits	70.6	69.6	70.0	92.5	89.3
Net advances / Customer deposits + other short-term funding	68.8	64.6	64.4	75.6	76.7
Net advances / Total funding (excl. equity portion)	68.8	64.6	64.4	75.6	76.7
Liquid & trading assets / Total assets	33.0	37.7	41.8	32.2	30.6
Liquid & trading assets / Total short-term funding	40.7	45.3	52.5	39.9	36.9
Liquid & trading assets / Total funding (excl. equity portion)	40.5	45.3	52.5	39.7	36.9
Asset quality					
Impaired loans / Gross advances	0.0	0.0	0.0	0.0	0.0
Total loan loss reserves / Gross advances	0.1	0.5	0.5	0.2	0.1
Bad debt charge (income statement) / Gross advances (avg.)	(0.1)	(0.4)	(0.1)	0.1	0.1
Bad debt charge (income statement) / Total operating income	(0.9)	(2.6)	(0.7)	0.8	1.0
Profitability					
Net interest margin	8.2	8.1	8.3	7.2	6.3
Interest income + com. fees / Earning assets + guarantees (a/avg.)	6.8	6.8	7.0	6.1	5.3
Non-interest income / Total operating income	28.1	18.7	18.2	19.7	19.4
Non-interest income / Total operating expenses (or burden ratio)	69.3	40.9	45.6	51.7	49.9
Cost ratio	40.6	45.7	39.8	38.2	38.9
ROaE	21.1	17.8	20.1	18.9	17.2
ROaA	3.8	3.0	3.7	3.6	3.0
Nominal growth indicators					
Total assets	21.2	23.0	35.0	32.2	26.4
Net advances	9.8	17.9	28.7	58.1	31.3
Shareholders funds	18.0	13.6	62.6	24.2	13.7
Total capital and reserves	18.0	13.6	62.6	24.2	13.7
Customer deposits	21.2	19.7	28.0	19.6	35.9
Net income	42.7	7.2	52.2	23.2	7.7

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GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S FINANCIAL INSTITUTIONS GLOSSARY

Annual Report	A status report on the current financial condition of a company. It usually includes the chairman's report, the auditor's report and detailed financial statements. It is issued once a year for shareholders to examine before the annual general meeting (AGM). In many markets, comprehensive Integrated Reports covering a wide spectrum of information have replaced traditional annual reports.
Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Asset Quality	Asset quality refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (i.e. being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Balance Sheet	Also known as a Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Bond	A long term debt instrument issued by either: a company, institution or the government to raise funds.
Bullish	Perception that demand or prices will rise. The opposite of bearish.
Capital	The sum of money that is invested to generate proceeds.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its current liabilities and also in relation to the risks associated with its assets. An appropriate level of capital adequacy ensures that the entity has sufficient capital to support its activities and that its net worth is sufficient to absorb adverse changes in the value of its assets without becoming insolvent.
Capital Base	The issued capital of a company, plus reserves and retained profits.
Cash	Funds that can be readily spent or used to meet current obligations.
Corporate Governance	Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed, and is used to ensure the effectiveness, accountability and transparency of an entity to its stakeholders.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Rating Agency	An entity that provides credit rating services.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and/or interest when due.
Creditworthiness	An assessment of a debtor's ability to meet debt obligations.
Customer Deposit	Cash received in exchange for a service, including safekeeping, savings, investment, etc. Customer deposits are a liability in a bank's books.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Default	Failure to meet the payment obligation of either interest or principal on a debt or bond. Technically, a borrower does not default, the initiative comes from the lender who declares that the borrower is in default.
Economic Indicators	Statistical data about a country's economy, such as unemployment figures, the Consumer Price Index (CPI), Gross Domestic Product (GDP), money supply and housing statistics. This data gives information about the future direction of output and demand in an economy.
Equity	Equity (or shareholders' funds) is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Exchange	A standardised marketplace in which different assets are traded.
Exchange Rate	The value of one country's currency expressed in terms of another.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding.
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Financial Statements	Presentation of financial data including balance sheets, income statements and statements of cash flow, or any supporting statement that is intended to communicate an entity's financial position at a point in time.
Fixed Assets	Assets of a company that will be used or held for longer than a year. They include tangible assets, such as land and equipment, stake in subsidiaries and other investments, as well as intangible assets such as goodwill, information technology or a company's logo and brand.
Forecast	A calculation or estimate of future financial events.
Guarantee	An undertaking in writing by one person (the guarantor) given to another, usually a bank (the creditor) to be answerable for the debt of a third person (the debtor) to the creditor, upon default of the debtor.

Income Statement	A summary of all the expenditure and income of a company over a set period.
Insolvent	When an entity's liabilities exceed its assets.
Intangible Assets	The non-physical assets of a company such as trademarks, patents, copyright, information systems and goodwill.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Lease	Conveyance of land, buildings, equipment or other assets from one person (lessor) to another (lessee) for a specific period of time for monetary or other consideration, usually in the form of rent.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Line of Credit	A pre-approved loan authorisation with a specific borrowing limit based on creditworthiness. A line of credit allows borrowers to obtain a number of loans without re-applying each time as long as the total of borrowed funds does not exceed the credit limit.
Liquid Assets	Assets, generally of a short term, that can be converted into cash.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Liquidity Risk	The risk that a company may not be able to meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets. Regarding securities, the risk that a financial instrument cannot be traded at its market price due to the size, structure or efficiency of the market.
Long term	Not current; ordinarily more than one year.
Margin	The rate taken by the lender over the cost of funds, which effectively represents the entity's profit and remuneration for taking the risk of the loan; also known as spread.
Market risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Monetary Policy	Measures taken by the central bank to influence the quantity of money or the rate of interest with a view to achieving stable prices, full employment and economic growth.
Net Interest Margin	Net interest margin is the net interest income divided by average interest earning assets.
Non-Performing Loan	When a borrower is overdue, typically 90+ days in arrears or as defined by the lender, or in the transaction documents.
NPL Ratio	The ratio of non-performing loans and advances to total gross loans and advances, expressed as a percentage.
Off Balance Sheet	Off balance sheet items are assets or liabilities that are not shown on a company's balance sheet. They are usually referred to in the notes to a company's accounts.
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. This includes legal risk, but excludes strategic risk and reputational risk.
Overdraft	When the amount of money withdrawn from a bank account is greater than the amount actually available in the account, the excess is known as an overdraft, and the account is said to be overdrawn.
Past Due	Any note or other time instrument of indebtedness that has not been paid on the due date.
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Private Placement	The sale of securities to a small number of institutional investors such as large banks, insurance companies and pension funds. Such issuances do not require a formal prospectus and are often not listed on an exchange.
Prospectus	A document produced by a company issuing new equity or debt, which provides detailed information about the offering and the company.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Rating Outlook	A Rating outlook indicates the potential direction of a rated entity's rating over the medium term, typically one to two years. An outlook may be defined as: 'Stable' (nothing to suggest that the rating will change), 'Positive' (the rating symbol may be raised), 'Negative' (the rating symbol may be lowered) or 'Evolving' (the rating symbol may be raised or lowered).
Regulatory Capital	The total of primary, secondary and tertiary capital.
REPO	In a REPO one party sells assets or securities to another and agrees to repurchase them later at a set price on a specified date.
Reputational Risk	The risk of impairment of an entity's image in the community or the long-term trust placed in it by its shareholders as a result of a variety of factors, such as performance, strategy execution, the

	ability to create shareholder value, or an activity, action or stance taken by the entity.
Rights Issue	One of the ways that a company can raise additional funds is to issue new shares. These must be first offered to current shareholders and a rights issue allows a shareholder to buy shares in proportion to the number already held.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Securities	Various instruments used in the capital market to raise funds.
Security	An asset deposited or pledged as a guarantee of the fulfilment of an undertaking or the repayment of a loan, to be forfeited in case of default.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short Term	Current; ordinarily less than one year.
Solvent	The state of a company where its assets exceed its liabilities and it is able to service its debt and meet its other obligations, especially in the long-term.
Strategic Risk	The risk of an adverse impact on capital and earnings due to business policy decisions (made or not made), changes in the economic environment, deficient or insufficient implementation of decisions, or failure to adapt to changes in the environment. Strategic risk is either the failure to do the right thing, doing the right thing poorly, or doing the wrong thing.
Treasury Bill	Short-term obligation backed by the government that bears no interest and is sold at a discount.
Write-off	The total reduction in the value of an asset.

SALIENT FEATURES OF ACCORDED RATINGS

GCR affirms that a.) no part of the rating was influenced by any other business activities of the credit rating agency; b.) the rating was based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

Victoria Commercial Bank Limited participated in the rating process via face-to-face management meetings and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The credit rating/s has been disclosed to Victoria Commercial Bank Limited with no contestation of the rating/s.

Information received from Victoria Commercial Bank Limited and other reliable third parties to accord the credit rating(s) included:

- Audited financial results as at 31 December 2014
- Unaudited interim results at 31 May 2015
- 4 years of comparative numbers
- Budgeted financial statements for 2015
- Latest internal and/or external audit report to management
- A breakdown of facilities available and related counterparties
- Corporate governance and enterprise risk framework

The ratings above were solicited by, or on behalf of, Victoria Commercial Bank Limited, and therefore, GCR has been compensated for the provision of the ratings.