Victoria Commercial Bank Limited

Kenya Bank Analysis **July 2017**

Rating class	Rating scale	Rating	Rating outlook	Expiry date
Long-term	National	BBB$_{(KE)}$	Positive	July 2018
Short-term	National	A2$_{(KE)}$		

Financial data:

(USDm comparative)

	31/12/15	31/12/16
KES/USD (avg.)	98.24	101.52
KES/USD (close)	102.33	102.49
Total assets†	240.6	259.3
Tier 1 capital‡	32.7	47.3
Tier 2 capital‡	1.3	1.4
Net advances	128.3	149.2
Liquid assets	60.2	62.5
Operating income	15.2	13.9
Profit after tax	7.3	5.8
Market cap.		n.a
Market share*		0.7%

† Including off-balance sheet items.
‡ Refers to the calculation of regulatory capital as per banking regulations.
* Based on the Central Bank of Kenya calculation of total banking industry assets at 31 December 2016.

Rating history:

Initial rating (October 2012)
Long-term rating: BBB$_{(KE)}$
Short-term rating: A3$_{(KE)}$
Rating outlook: Positive

Last rating (July 2016)
Long-term: BBB$_{(KE)}$
Short-term: A2$_{(KE)}$
Rating outlook: Stable

Related methodologies/research:
Global Criteria for Rating Banks and Other Financial Institutions, updated March 2017
Kenyan Bank Statistical Bulletin (December 2016)
VCB rating reports (2012-16)

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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 resilience in a challenging operating environment, supported by satisfactory asset quality and capitalisation, and sound liquidity and profitability. The bank's ratings are, however, constrained by its relatively small size, which implies low systemic importance relative to the larger local banks.
- Due to VCB's highly selective client base; stringent pre-loan application processes; and strong risk management capabilities; the bank has consistently maintained strong asset quality, demonstrated by zero non performing loans ("NPLs") for at least the past decade. Past due but not impaired loans (early arrears, <90 days) represented a small portion (1.1%) of the total gross loans at FY16 (FY15: 1.3%).
- Following an oversubscribed rights issue in FY16, Tier 1 capital grew by 45% to KES4.8bn at FY16. Consequently, the bank's capitalisation ratios improved significantly, recording Tier 1 and total capital adequacy ratios of 24.7% and 25.5% respectively at FY16 (FY15: 18.6% and 19.3%).
- Total liability funding grew by 4.9% to KES17.2bn at FY16 (FY15: 14.6%). Customer deposits (the bank's main source of funding) grew by 11.9% in FY16 (against 6.7% YoY average customer deposit growth for the banking sector at end-December 2016) drawing from the bank's relationship based business model which has enabled it to attract deposits from its clients. This is despite weakening consumer confidence (following the placement in receivership of some mid/lower tier banks) and as the sector undergoes regulation-driven structural changes. Like many lending institutions, VCB is subject to short-term asset liability mismatches. Nonetheless, management indicated that over 90% of wholesale deposits are typically rolled over YoY and to manage the resultant mismatches, the bank maintains its liquidity ratio above both the regulatory and board approved minima. The ratio of liquid assets to short-term funding registered 38.2% at FY16, up from 37.5% at FY15.
- Net profit before tax ("NPBT") from recurring operations grew by 17.6% to KES796.4m at FY16 driven by an 8.9% and 20.9% growth in net interest, and fee and commission income respectively. The bank's ROaA and ROaE from recurring operations increased to 2.8% and 15.6% respectively at FY16 (FY15: 2.5% and 14.8%).

Factors that could trigger a rating action may include

Positive change: Maintenance of strong asset quality, sound liquidity and capitalisation, combined with improved funding diversification and tenor, could positively impact the ratings. Furthermore, the bank's ratings would benefit from substantial improvement in market position within the bank's niche base.

Negative change: Downward pressure on VCB's ratings could stem from 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 Nairobi and Kisumu, Kenya. In March 1996, the private finance company converted to a commercial bank, now known as VCB. To pave the way for rights issues and funding private placements, the bank changed its status from a private to an unlisted public company by way of a special resolution passed in March 2012. The bank offers relationship-based niche private banking services, focusing on corporate and high net worth clients.

Ownership structure

The bank is owned by a diverse group of shareholders none of them hold a controlling interest. Table 1 provides a breakdown of the bank's main shareholders as at 31 December 2016.

Table 1: Shareholding composition	Country of residence	%
Kanji Damji Pattni	Kenya	11.26
Orchid Holdings Ltd	Kenya	8.12
Kingsway Investments Ltd	Kenya	7.14
Rochester Holdings Limited	Kenya	6.03
Rajan Jani & Yadav Rajan Jani	Kenya	4.97
Premchand Hemraj Gudka & Avani Jayeshkumar Devraj -Joint Executors Of Estate of late H Gudka	Kenya	4.25
Premchand H Gudka	Kenya	4.24
Godfrey C.Omondi	Kenya	3.20
Nishe Investments Limited	Kenya	2.83
Minal Rajesh Chollera	Kenya	2.73
Occidental Insurance Company Limited	Kenya	2.62
Victoria SPL (ESOP)	Kenya	2.59
Others (< 2.59% individual shareholdings)	Kenya	40.02
Total		**100.0**

Source: VCB.

Strategy and operations

VCB operates as a small niche private bank with three branches in Nairobi. The bank's success has been built on personal associations with clients and designing financial solutions to suit different client needs.

Given the bank's limited focus on broad based retail banking, the bank does not have an extensive branch network. At 31 December 2016 the bank's branch network remained unchanged (three) from the prior year.. Due to the limited branch network, the bank offers free courier services for banking instruments such as cheques and mail, to its clients.

Although mainly targeting high net worth individuals and mid-to-large sized corporates, the bank is looking to grow its asset book to reach KES 53bn by 2021 with the aim of placing it in the tier 2 category of banks. The bank also expects net lending in excess of KES 30bn by 2021, targeting larger clients in the market. This will be achieved partly by moving into new sectors. The bank continues to place emphasis on technological innovation going forward.

Governance structure[2]

The board of directors ("board") fulfils its obligations through board committees, the composition of which is informed by the Central Bank of Kenya's ("CBK") Prudential Guidelines, and the Kenyan Banking Act ("the Banking Act"). The board-established committees include: Audit, Credit, Nomination and Remuneration, and Risk Management. To further entrench good corporate governance practices, the board has established various management committees, namely: Executive, Risk Management and Compliance, Assets and Liabilities, Credit Risk Management, and ICT Steering.

VCB is governed by a six member board, made up of one executive (the managing director) and five non-executive directors of which four are independent. VCB's board is headed by a non-executive director, ensuring the separation of the roles of the managing director and the board chairman. Loans granted to insiders/related parties are approved by the entire board and fully secured in line with CBK prudential guidelines and Banking Act provisions.

Financial Reporting

VCB's financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). The content also complies with the Banking Act and the Kenyan Companies Act. The bank's external auditor, PricewaterhouseCoopers, issued an unqualified audit opinion on the FY16 financial statements.

Operating environment[3]

Economic overview

Kenya reported an estimated 5.8% GDP growth in 2016, on the back of strong public fixed capital formation, services, agricultural productivity and resilient consumer demand, amongst others. Although growth fell behind the state's aspirational targets, the economy does reflect underlying momentum from public investment in fixed capital and renewed foreign investor interest. Several key infrastructure construction tenders have either been awarded, or have advanced materially in their planning. These projects aside, Kenya has decades of backlogged infrastructure capex to address, and these infrastructure deficiencies continue to bottleneck the development of private sector enterprises (in particular those dependent on

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

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

[3] Source: IMF World Economic Outlook (April 2017); CBK Monthly Economic Review (December 2016); Monetary Policy Statement (March 2017); CBK Monthly economic indicators, (February 2017); CBK quarterly economic review (October-December 2016).

logistics infrastructure and those in energy intensive sectors).

Inflation also moderated during 2016, with the CPI falling from 8% in December 2015 to a low of 5% in May 2016, thereafter, rising to a 6.5% average in 2H 2016, and 7% and 9% in January and February 2017 respectively. This could largely be attributable to a sharp spike in food and beverage inflation to 16.5%, with core foodstuffs such as maize and potato prices increasing by more than 20% due to drought conditions in much of the country/region. This follows already steep food price inflation since 2015 and implies that disposable income, particularly in the lower income brackets, is being eroded, which could have a knock-on effect to other retail categories and manufacturing.

Despite rising inflationary pressures, the CBK loosened monetary policy during 2016, with the Central Bank Lending Rate ("CBR") falling to 10.0% in September 2016, from 11.5% in January 2016. Over the same period, T-bill rates fell from 11.36% to a low of 7.76% (October 2016), before rising steadily to 8.62% in January 2017. In August 2016, the government of Kenya signed a bill to cap the interest rate that banks can charge customers at 4% above the CBR. This has effectively capped the maximum interest rate and has provided savings on several listed companies' existing loan agreements. However, with banks' margins expected to be squeezed by the recent developments, it remains unclear what impact this will have on banks' willingness to lend going forward. This regulatory change follows the collapse of three banks from August 2015 to March 2016.

Political uncertainties ahead of the national government elections in August 2017 also pose a risk to growth, as new government sponsored projects are likely to taper off and businesses may adopt a conservative stance in terms of stock levels and the granting of credit.

Industry overview

At 31 December 2016, the banking sector comprised 40 commercial banks (from 42 at 30 April 2016 as a result of Chase Bank and Imperial Bank being in receivership). In addition, there is one mortgage finance company, 13 microfinance banks, eight representative offices of foreign banks, 77 foreign exchange bureaus, 17 money remittance providers and three credit reference bureaus.

Banking sector regulations passed in 2016 included the cap on interest rates. Another change promulgated was the introduction of IFRS 9 (effective January 2018), which requires banks to increase loan loss provisioning. The new standard stipulates that banks should implement a forward looking approach to estimate credit losses (expected loss model), compared to the current standard that requires banks to provide for loans only after they have become non-performing (actual loss model).

The CBK announced its intention to finalise the processing of licence applications for two institutions (Dubai Islamic Bank, and Mayfair Bank) that had already been granted an 'approval in principle'. This is seen as a first step to lifting the moratorium on licensing of new commercial banks, which was put in place in November 2015.

Kenya Bankers Association launched its real-time interbank switch, PesaLink, and kicked off a phased rollout of the digital payments platform. PesaLink enables customers to make payments between banks in real time without the need for intermediaries, and customers using PesaLink can initiate transactions from diverse channels including mobile, banks' branches, ATMs, agency banking outlets and through the internet.

Deposit and net loan growth were 6.7% and 5.4%, respectively, below 6-year averages of 12.8% and 14.6%, respectively. NPL levels remain a concern within the banking sector with loan loss provisions growing at 67.3% and 77.7% for non-listed and listed banks, respectively. The level of provisioning is expected to increase as banks adopt IFRS 9.

Table 2: Financial soundness indicators	Dec-15	Dec-16†	% change
Total assets	3 492.6	3 762.5	7.8
Gross loans	2 165.3	2 340.0	8.1
Gross NPLS	147.3	212.9	44.5
Net loans	2 091.4	2 127.1	5.4
Total deposits	2 485.9	2 653.1	6.7
Pre-tax profit	134.0	150.3	11.9
Shareholder funds	540.6	606.7	5.6
Selected indicators (%):			
Capital adequacy ratio	19.0	18.7	(1.6)
Tier 1 capital adequacy ratio	16.0	15.8	(3.1)
Gross NPLs/Gross loans	6.8	9.1	33.7
Liquidity ratio	38.1	41.8	9.7

† Excludes data for banks under receivership.
Source: CBK Monthly economic indicators, February 2017, CBK quarterly economic review October-December 2016.

Private sector credit growth declined to 4.3% in December 2016 from a high of 21.0% in August 2015. The decline is attributed to structural reforms in the banking sector and strict adherence to prudential guidelines in terms of loan book quality, prudent reporting and provisioning sufficiently. This prompted banks to prefer lending to the government rather than the private sector, due to its lower risk profile.

Customer deposits were the main source of bank funding, accounting for 70.5% of the banking sector total liabilities and shareholders' funds at 31 December 2016.

At 4.4%, core earnings growth was faster in 2016 than in 2015 (2.8% growth). This indicates that on average, banks' earnings were not significantly affected by the interest rate cap in 2016, with the full effects of the cap expected to show in 2017 performances. However, given rising operating costs in the sector, and expected margin reductions owing to the enactment of the Banking (Amendment) Act 2016, some banks resorted to reducing staff and closing branches, with close to 840 bank employees affected in 2016, and 21 branches closed.

Competitive position[4]

The Kenyan banking sector is highly fragmented and competitive, with Tier 1 banks (top 8 banks) accounting for 64.9% of total industry assets, and the rest split among 31other players at FY16[5]. Key peer analysis indicators for FY16 are provided in Table 3.

By its weighted market share index ("WMSI"), VCB ranked 22nd with a market share of 0.7% at 31 December 2016 (FY15: 0.6%) and 3rd out of 21 Tier 3 banks at 31 December 2016.

Table 3: Peer analysis (KESm)‡	ABC	GCB	GTB	VCB
Market shares (%)				
WMSI[6]	0.6	0.5	0.9	0.7
Total assets	0.6	0.4	0.8	0.6
Loans and advances	0.7	0.4	0.6	0.7
Customer deposits	0.6	0.5	0.6	0.6
Selected ratios (%)				
Capital adequacy	16.0	25.7	27.1	25.5
Gross NPL ratio	13.8	2.1	5.5	-
Coverage ratio	10.3	47.9	35.3	n.a
Advance to deposits ratio	88.5	71.0	77.9	97.4
Cost ratio	78.6	45.8	66.8	42.9
ROE	5.4	16.2	5.5	15.6
ROA	0.7	3.1	1.5	2.8

‡ Refers to Kenyan operations.
Source: CBK.

Financial profile

Likelihood of support

Although the Kenyan government has demonstrated its position as interventionist, this must be viewed as a systemic protection mechanism only (there is no history of providing bailouts to distressed financial institutions). Furthermore, 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, VCB's shareholders have continuously demonstrated support for the bank, underwriting all capital raising initiatives, evidencing the likelihood of support in case of need. Furthermore, VCB last cash call was oversubscribed yet the offer period was only 2 weeks.

Funding composition

A breakdown of the bank's funding profile is shown in Table 4. Total liability funding grew by 4.9% to KES17.2bn at FY16 (FY15: 14.6%). Customer deposits grew by 11.9% in FY16 against 6.7% YoY average customer deposit growth for the banking sector at end-December 2016. The bank is predominantly funded by customer deposits which comprised a higher 91.2% of liability funding at FY16 (FY15: 85.5%) drawing from its relationship based business model which has enabled it to attract deposits from its clients. This is despite weakening consumer confidence (following the placement in receivership of some mid/lower tier banks) and as the sector undergoes regulation-driven structural changes.

Table 4: Liability funding profile	FY15		FY16	
	KESm	%	KESm	%
Customer deposits	14 024	85.5	15 696	91.2
Corporates	*5 804*	*35.4*	*6 560*	*38.1*
Individuals	*8 220*	*50.1*	*9 136*	*53.1*
Interbank borrowings	1 077	6.6	-	-
Domestic banks	*666*	*4.1*	-	-
Foreign banks	*411*	*2.5*	-	-
Long-term borrowings+	1 305	7.9	1 520	8.8
Total	**16 406**	**100.0**	**17 216**	**100.00**

+ In FY16, the bank acquired a 5 year USD4m term loan, attracting interest of 5.25% p.a and is repayable on 30 June 2021. The remaining balance 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.

Funding has also been augmented by medium/long term borrowings from development finance institutions ("DFIs") and foreign banks, which have served to diversify and lengthen the funding base. In continued efforts to secure additional long-term funding, the bank acquired a 5 year USD 4m term loan in 2016, availed to support lending in foreign currency. Furthermore, provisional negotiations are underway with some DFIs for additional funding sources and are expected to be concluded in 2017. During FY16, the bank repaid its long-term offshore interbank borrowings (earmarked for foreign currency lending) as well as domestic interbank borrowings.

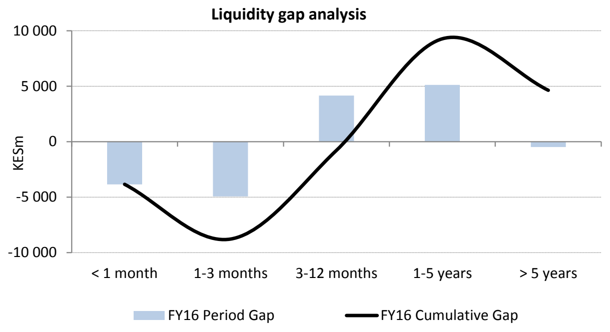
Owing to its narrow target market for deposit generation (high net worth clients and corporates), and high proportion of term deposits, the bank has been incurring relatively high funding costs. To address this, ongoing efforts are in place to mobilise retail deposits in the future. In terms of size, the top 20 depositors constituted 17.3% of customer deposits at FY16, while the top exposure accounted for 3.0% of the customer deposit book.

Liquidity risk

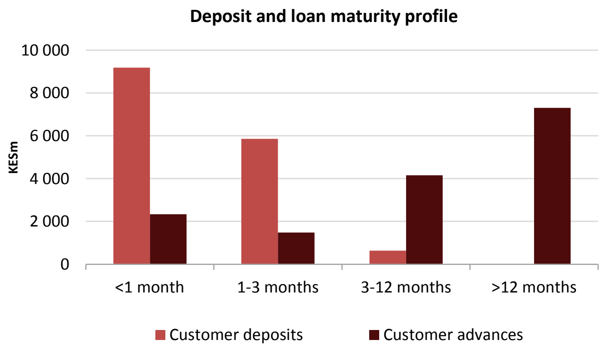
Like many lending institutions, VCB is subject to short-term asset liability mismatches. In this regard, the bank largely displays negative liquidity gaps in the

4 Banking sector comparatives based on Kenyan operations (excluding regional subsidiaries).
5 Excluding Fidelity Commercial Bank.
6 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.

3 month cumulative maturity bucket equivalent to 1.8x of regulatory capital at FY16.



The bank's deposit and loan maturity profile analysis reflects net maturity gaps in the short-term (less than 1 month and 1-3 months) maturity buckets. VCB's liquidity risk is further exacerbated by the wholesale nature of its deposits (rendering it susceptible to external shocks).



To mitigate the liquidity risk above, management indicated that over 90% of wholesale deposits are typically rolled-over YoY and to manage the resultant mismatches, the bank retains sufficient liquidity buffers, maintaining its average liquidity ratio well above the minimum statutory requirement of 20%.

Table 5: Net liquid assets to customer deposits (%)	FY14	FY15	FY16
At close of the year	32.6	27.1	31.4
Average for the year	29.8	29.5	33.0
Maximum for the year	35.2	33.5	38.6
Minimum for the year	24.3	23.7	25.8

Source: VCB.

Capital structure

VCB's capital and total risk weighted assets ("RWAs") exposures are shown in Table 6. Following an oversubscribed rights issue in FY16, Tier 1 capital grew by 45% to KES 4.8bn at FY16. Consequently, the bank's capitalisation ratios improved significantly, recording Tier 1 and total capital adequacy ratios of 24.7% and 25.5% respectively at FY16 (FY15: 18.6% and 19.3%). Going forward, management indicated that the bank's capital expansion will mainly be addressed through organic growth and earnings retention.

Table 6: Capitalisation	FY15 KESm	FY16 KESm	1Q FY17 KESm
Tier 1 capital	3 343	4 849	4 988
Ordinary share capital	*608*	*829*	*838*
Share premium	*420*	*1 272*	*1 321*
Retained earnings	*2 314*	*2 748*	*2 829*
Other reserves	*(1)*	*-*	*-*
Tier 2 capital	132	139	139
Total regulatory capital	**3 475**	**4 988**	**5 127**
RWA	**18 004**	**19 599**	**20 081**
Tier 1 capital: RWA	**18.6**	**24.7**	**24.8**
Statutory requirement @ 10.5%			
Regulatory capital: RWA	**19.3**	**25.5**	**25.5**
Statutory requirement @ 14.5%			

Source: VCB.

Operational profile

Credit Risk

Asset composition

VCB's asset composition is shown in Table 7. Total assets grew by 11.9% in FY16 (FY15: 16.1%), driven by net advances (the main sourced of credit risk) which contributed a higher 68.3% to total assets at FY16 (FY15: 65.5%). The YoY average asset growth for the banking sector was 7.8% at end-December 2016.

Table 7: Asset composition	FY15 KESm	FY15 %	FY16 KESm	FY16 %
Cash and liquid assets	6 160	30.8	6 410	28.6
Cash	*82*	*0.4*	*68*	*0.3*
Balances with CBK	*1 238*	*6.2*	*1 272*	*5.7*
*Marketable securities**	*3 348*	*16.7*	*3 358*	*15.0*
Balances with banks	*1 492*	*7.5*	*1 712*	*7.6*
Customer loans	13 124	65.5	15 293	68.3
Investment in associates	253	1.3	284	1.3
Fixed assets #	235	1.2	192	0.9
Other assets	248	1.2	225	1.0
Total	**20 020**	**100.0**	**22 404**	**100.0**

*Mainly comprise Government securities.
At FY15, fixed assets consisted of property and equipment held for sale worth KES40m.
Source: VCB.

The bank's off-balance sheet exposure in the form of guarantees, letters of credit ("LCs") and committed facilities, decreased by 9.4% in FY16 to KES 4.1bn, representing a lower 15.7% of total on- and off-balance sheet assets at FY16 (FY15: 18.7%). GCR notes that these exposures are mainly extended to strong and reputable clients. The majority of the guarantees and LCs are self-liquidating or cash covered. Management indicated that the bank intends to maintain its portfolio of contingent assets below 25% of total balance sheet assets.

Table 8: Contingencies	FY15 KESm	FY15 %	FY16 KESm	FY16 %
Acceptances and LCs	1 869	40.6	1 566	37.5
Guarantees	963	20.9	641	15.4
Other commitments	1 771	38.5	1 964	47.1
Total	**4 603**	**100.0**	**4 171**	**100.0**

Source: VCB.

Loan portfolio

Gross advances grew by a lower 16.6% in FY16 compared to 19.7% in FY15 due to a deliberate slowdown in credit origination. The bank maintained a focus on the quality of current risk assets, and very selective lending criteria in response to a challenging operating environment characterised by higher risk of credit default. The implementation of the interest rate caps may further mute loan growth. On-balance sheet lending is mainly through term loans (56.4%) and overdraft facilities (33.4%) to large corporates and SMEs.

Table 9: Gross loans and advances	FY15 KESm	FY15 %	FY16 KESm	FY16 %
By sector				
Agriculture	556	4.2	743	4.8
Construction	574	4.4	1 484	9.7
Individuals	660	5.0	1 258	8.2
Manufacturing	3 955	30.0	4 289	27.9
IT and telecommunication	84	0.6	50	0.3
Wholesale and retail trade	2 995	22.8	4 043	26.3
Related parties	152	1.2	239	1.6
Other	4 193	31.8	3 244	21.1
Total	**13 169**	**100.0**	**15 350**	**100.0**
By borrower				
Corporates	12 509	95.0	14 092	91.8
Large corporates	*2 075*	*15.8*	*2 159*	*14.1*
SMEs	*10 434*	*79.2*	*11 933*	*77.7*
Individuals	660	5.0	1 258	8.2
Overdrafts	*49*	*0.4*	*116*	*0.8*
Mortgages	*207*	*1.6*	*259*	*1.7*
Term loans	*404*	*3.0*	*883*	*5.8*
Total	**13 169**	**100.0**	**15 350**	**100.0**

Source: VCB.

Lending is predominantly to a niche corporate clientele which has resulted in some credit concentrations within the loan portfolio, with the top 20 exposures accounting for 53.1% of total loans and advances at FY16 (FY15: 68.0%). The largest borrower amounted to 4.0% (FY15: 5.4%) of the credit book and 16% (FY15: 20.5%) of total regulatory capital at FY16. By economic sector, the bank's loan portfolio is fairly diversified albeit reflecting high exposures to the manufacturing (27.9%), and wholesale and retail trade (26.3%) sectors, given that it strategically targets mid-to large size corporates.

Asset quality

Due to VCB's highly selective client base; stringent pre-loan application processes; and strong risk management capabilities, the bank has consistently maintained strong asset quality demonstrated by zero NPLs for at least the past decade. Past due but not impaired loans (early arears, <90 days) represented an insignificant 1.1% of the total gross loans at FY16 (FY15: 1.3%). Furthermore, it is positively noted that the bank avoids any exposure to unsecured lending.

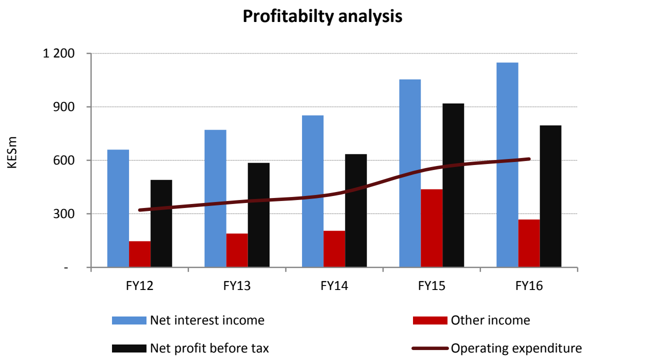
Table 10: Asset quality	FY15 KESm	FY16 KESm	1Q FY17 KESm
Gross advances	**13 169**	**15 350**	**15 515**
Neither past due nor impaired	*12 999*	*15 187*	*15 325*
Past due but not impaired	*170*	*163*	*190*
Impaired	-	-	-
Less: Provisions	**(45)**	**(57)**	**(62)**
Individually assessed	-	-	-
Collectively assessed	*(45)*	*(57)*	*(62)*
Net loans and advances	**13 124**	**15 293**	**15 453**
Loan write-offs	26	32	-
Loan recoveries	-	-	-
Gross NPL ratio (%)	-	-	-
Total provisions/Gross loans (%)	0.3	0.4	0.4

Source: VCB.

Financial performance and prospects

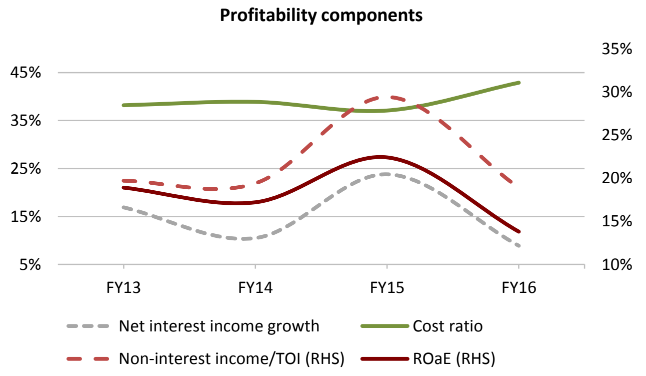
A five year financial synopsis, which forms the basis of the financial performance analysis, is shown on page 8 of this report, supplemented by the commentary below.

NPBT declined by 13.3% to KES796.4m at FY16 despite an 8.9% and 20.9% growth in net interest, and fee and commission income, respectively. The decline was mainly driven by the normalising of other income after a once off gain from the sale of an associate in FY15. NPBT from recurring operations grew by 17.6% in FY16 and the bank's ROaA and ROaE from recurring operations increased to 2.8% and 15.6% respectively at FY16 (FY15: 2.5% and 14.8%).



Interest income grew by 3% in FY16 supported by loan growth and government securities uptake. In the same period, interest expenses declined by 1.7% (FY15: 46.8% growth) due to concentrated efforts in growing low cost current and savings accounts as opposed to expensive term deposits, reducing funding costs. However, interest spreads have been compressing in the last six months of 2016 following the implementation of the Banking (Amendment) Act limiting lending rates to 4% above CBR and minimum deposit rates at 70% of CBR. Excluding a once-off gain from sale of an associate in FY15, non-interest income (mainly from fees and commissions) grew by 36.7% in FY16 contributing 18.9% to total operating income ("TOI") (FY15: 15.7%).

Overall, total operating income amounted to KES1.4bn, representing a 4.7% decline (FY15: 41.3% growth) from FY15, while operating expenses, driven by staff costs, also grew by 9.8% (FY15: 34.7%) to KES607.6m. Consequently, the cost/income ratio increased to 42.9% in FY16 (FY15: 37.1%).



Unaudited results for the three months ending 31 March 2017, compared to the same period in FY16, are shown in Table 11.

Pre-tax earnings increased 32.8% in 1Q FY17, compared to the corresponding prior year period. Despite the interest rate caps on lending, interest income grew by 21.7% in 1Q FY17 supported by loan growth.

Table 11: Actual interim results (KESm)	Actual 1Q FY16	Actual 1Q FY17	Growth (%)
Income statement			
Interest income	626	590	(5.8)
Interest expense	(368)	(276)	(25.0)
Net interest income	**258**	**314**	**21.7**
Other income	53	72	35.8
Total operating income	**311**	**386**	**24.1**
Operating expenditure	(137)	(150)	9.5
Loan loss provision	(<0.1)	(5)	4900.0
Profit before tax	**174**	**231**	**32.8**
Balance sheet			
Cash and liquid assets	5 851	5 676	(3.0)
Net loans and advances	13 732	15 454	12.5
Customer deposits	15 646	15 909	1.7
Total capital and reserves	3 652	5 287	44.8
Total assets*	21 159	22 873	8.1

*Excluding contingencies.
Source: VCB.

Looking ahead, VCB's is well positioned to maintain a profitable and conservative business profile. The bank has demonstrated its ability to adapt to the increasingly competitive environment by leveraging on its relationship-based niche private bank model. It is anticipated that VCB will continue to benefit from its reputable customer service, and is well positioned to maintain a profitable and conservative business profile. Potential challenges could emanate from investor aversion in the wake of the upcoming elections.

Victoria Commercial Bank Limited

(Kenya Shillings in millions except as noted)

Year end: 31 December	2012	2013	2014	2015	2016
Income Statement Analysis					
Interest income	1 352.8	1 375.4	1 754.7	2 379.9	2 450.8
Interest expense	(693.0)	(604.3)	(902.9)	(1 325.4)	(1 302.9)
Net interest income	**659.8**	**771.1**	**851.8**	**1 054.5**	**1 147.9**
Fee and commission income	92.8	119.4	124.7	163.2	197.1
Trading income	16.5	24.3	23.4	27.7	26.2
Other income	37.1	45.8	56.8	246.0	44.7
Total operating income	**806.3**	**960.7**	**1 056.7**	**1 491.4**	**1 416.0**
Impairment charge	(5.7)	(7.5)	(11.0)	(20.0)	(12.0)
Operating expenditure	(321.1)	(366.8)	(410.9)	(553.5)	(607.6)
Net profit before tax	**479.5**	**586.4**	**634.9**	**917.9**	**796.4**
Tax	(140.4)	(154.5)	(170.5)	(205.3)	(204.0)
Net profit after tax	**339.1**	**431.9**	**464.3**	**712.6**	**592.4**
Balance Sheet Analysis					
Subscribed capital	953.6	953.6	971.6	1 027.9	2 100.9
Reserves (incl. net income for the year)	1 082.5	1 574.6	1 904.0	2 483.6	2 959.1
Total capital and reserves	**2 036.0**	**2 528.1**	**2 875.5**	**3 511.5**	**5 060.0**
Bank borrowings (incl. deposits, placements and REPOs)	342.1	530.0	636.6	1 076.9	-
Customer deposits	7 560.9	8 985.8	12 288.3	14 022.8	15 695.9
Other borrowings	312.8	1 482.7	1 387.4	1 305.4	1 098.9
Short-term funding (< 1 year)	**8 215.8**	**10 998.5**	**14 312.3**	**16 405.1**	**16 794.8**
Customer deposits	-	57.9	0.4	1.6	-
Other borrowings	-	-	-	-	421.0
Long-term funding (> 1 year)	**-**	**57.9**	**0.4**	**1.6**	**421.0**
Payables/Deferred liabilities	71.0	59.8	55.9	101.8	127.6
Other liabilities	**71.0**	**59.8**	**55.9**	**101.8**	**127.6**
Total capital and liabilities	**10 322.8**	**13 644.2**	**17 244.1**	**20 020.1**	**22 403.5**
Cash in hand	38.0	42.0	47.9	82.1	67.6
Balances with central bank	447.6	427.1	1 485.5	1 237.5	1 271.6
Fixed assets	142.5	137.4	185.4	235.5	192.4
Receivables/Deferred assets	244.5	198.8	205.2	247.9	224.8
Non-earnings assets	**872.6**	**805.3**	**1 924.0**	**1 803.0**	**1 756.4**
Loans and advances (net of provisions)	5 291.2	8 363.5	10 979.2	13 124.4	15 292.8
Bank placements	1 011.7	1 912.2	1 040.5	1 491.7	1 712.0
Marketable/Trading securities	2 817.3	2 005.7	2 703.8	3 347.9	3 358.2
Investments in subsidiaries/associates	330.0	557.6	596.6	253.1	284.0
Total earning assets	**9 450.2**	**12 838.9**	**15 320.1**	**18 217.1**	**20 647.1**
Total assets	**10 322.8**	**13 644.2**	**17 244.1**	**20 020.1**	**22 403.5**
Contingencies	**2 629.1**	**3 127.8**	**3 074.7**	**4 603.3**	**4 171.4**
Ratio Analysis (%)					
Capitalisation					
Internal capital generation	15.7	17.1	16.1	20.3	14.5
Total capital / Net advances + net equity invest. + guarantees	29.7	25.6	22.6	22.0	28.9
Total capital / Total assets	19.7	18.5	16.7	17.5	22.6
Liquidity					
Net advances / Customer deposits	70.0	92.5	89.3	93.6	97.4
Net advances / Customer deposits + other short-term funding	64.4	75.6	76.7	80.0	91.1
Net advances / Total funding (excl. equity portion)	64.4	75.6	76.7	80.0	88.8
Liquid and trading assets / Total assets	41.8	32.2	30.6	30.8	28.6
Liquid and trading assets / Total short-term funding	52.5	39.9	36.9	37.5	38.2
Liquid and trading assets / Total funding (excl. equity portion)	52.5	39.7	36.9	37.5	37.2
Asset quality					
Impaired loans / Gross advances	0.0	0.0	0.0	0.0	0.0
Total loan loss reserves / Gross advances	0.5	0.4	0.2	0.3	0.4
Bad debt charge (income statement) / Gross advances (avg.)	0.1	0.1	0.1	0.2	0.1
Bad debt charge (income statement) / Total operating income	0.7	0.8	1.0	1.3	0.8
Profitability					
Net interest margin	8.3	7.2	6.3	6.4	6.0
Interest income + com. fees / Earning assets + guarantees (a/avg.)	7.0	6.1	5.3	5.3	5.0
Non-interest income / Total operating income	18.2	19.7	19.4	29.3	18.9
Non-interest income / Total operating expenses (or burden ratio)	45.6	51.7	49.9	78.9	44.1
Cost ratio	39.8	38.2	38.9	37.1	42.9
ROaE	19.4	18.9	17.2	22.3	15.6
ROaA	3.6	3.6	3.0	3.8	2.8
Nominal growth indicators					
Total assets	35.0	32.2	26.4	16.1	11.9
Net advances	28.7	58.1	31.3	19.5	16.5
Shareholders funds	62.6	24.2	13.7	22.1	44.1
Total capital and reserves	62.6	24.2	13.7	22.1	44.1
Customer deposits	28.0	19.6	35.9	14.1	11.9
Net income	47.3	27.3	36.9	65.0	27.6

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

Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
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 (ie, 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.
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.
Cash	Funds that can be readily spent or used to meet current obligations.
Contingent Assets	Assets not recorded in an entity's financial reports, but which may be realised.
Corporate Governance	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.
Cost Ratio	The ratio of operating expenses to operating income. Used to measures a bank's efficiency.
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.
Customer Deposit	Cash received in exchange for a service, including safekeeping, savings, investment, etc. Customer deposits are a liability in a bank's books.
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.
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.
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.
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.
International Financial Reporting Standards	IFRS is designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
International Scale Rating LC	International local currency (International LC) ratings measure the likelihood of repayment in the currency of the jurisdiction in which the issuer is domiciled. Therefore, the rating does not take into account the possibility that it will not be able to convert local currency into foreign currency or make transfers between sovereign jurisdictions.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
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.

Long-Term Rating	Reflects an issuer's ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation's current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
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.
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.
Moratorium	A period of time in which an activity is suspended until such time as a change in circumstances permits its removal. For example, a borrower can declare a moratorium on the repayments of the principal, and sometimes the interest, on a loan.
Net Profit	Trading/operating profits after deducting the expenses detailed in the profit and loss account (including taxes).
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.
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.
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.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
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.
Retained Earnings	Earnings not paid out as dividends by a company. Retained earnings are typically reinvested back into the business and are an important component of shareholders' equity.
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.
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.
Short-Term Rating	An opinion of an issuer's ability to meet all financial obligations over the upcoming 12 month period, including interest payments and debt redemptions.
Term Deposit	A savings account held for a fixed term. Also called a time deposit. Generally, there are penalties for early withdrawal.
Tier 1 Capital	Primary capital consists of issued ordinary share capital, hybrid debt capital, perpetual preference share capital, retained earnings and reserves. This amount is then reduced by the portion of capital that is allocated to trading activities and other regulatory deductions.
Tier 2 Capital	Secondary capital is mainly made up of subordinated debt, portfolio impairment and 50% of any revaluation reserves and other specified regulatory deductions.

For a detailed glossary of terms please click here

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 ratings have been disclosed to Victoria Commercial Bank Limited with no contestation of the ratings.

Information received from Victoria Commercial Bank Limited and other reliable third parties to accord the credit ratings included:

- Audited financial results as at 31 December 2016 (and four years comparative numbers)
- Unaudited interim results at 31 March 2017
- Budgeted financial statements for 2017
- 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.