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CREDIT RATING ANNOUNCEMENT

GCR upgrades Victoria Commercial Bank Limited's rating to BBB+$_{(KE)}$; Outlook Stable.

Johannesburg, 30 July 2018 -- Global Credit Ratings ("GCR") has upgraded Victoria Commercial Bank Limited's long-term national scale ratings to BBB+$_{(KE)}$ and maintained the short-term national scale ratings of A2$_{(KE)}$; with the outlook accorded as Stable. The ratings are valid until 31 July 2019.

SUMMARY RATINGS RATIONALE

Global Credit Ratings has accorded the above credit ratings to Victoria Commercial Bank ("VCB", "the bank") based on the following key factors:

Victoria Commercial Bank Limited has strong asset quality, adequate capitalisation, good earnings as well as stable funding and liquidity. The bank's ratings are, however, constrained by its lack of diversity and low number of clients, which implies lower systemic importance relative to the larger local banks.

VCB has a highly selective client base; stringent pre-loan application processes; and strong risk management capabilities; which enable it to achieve strong asset quality. The bank's gross non-performing loan ("NPL") ratio of 0.1% at FY17 reverted back to 0% at 1H18 is expected to remain at the ten-year average of 0%. VCB is expected to maintain a lower risk profile relative to its peers.

The bank's capitalization is considered adequate with a Tier 1 capital adequacy ratio of 22.1% (24.7%) against a regulatory minimum of 10.5% and a total risk weighted capital adequacy ratio of 22.7% (25.5%). GCR expects the bank's Tier 1 capital ratio to remain adequate ranging from 19.0% to 22% over the next 12 months mainly being addressed through organic growth and earnings retention. The bank's earnings performance remained solid with Net profit before tax increasing by 6.6% to KES849.2m at FY17 buoyed by a 37.7% increase in fee and commission income while net operating income also increased by 16%. However, operating expenditure increased 24.8% resulting in a cost ratio of 46.2% (FY16: 42.9%) which compares favourably to peers. ROaA slightly declined to 2.6% (FY16: 2.8%) while ROaE reduced slightly to 11.6% (FY16: 13.8 %). Earnings growth is expected to continue albeit at a lower rate as economic conditions improve and the bank reduces its cost of funding by growing retail deposits.

The bank's funding base is stable as it is predominantly funded by deposits comprising 71% of total funds with shareholder funding contributing 22%, and DFIs and others 7%. Customer deposits comprised a higher 92.1% of liability funding at FY17 (FY16: 91.2%) drawing from its relationship-based business model, branch expansion and rise in deposit base. Customer deposits grew by 19% in FY17 against 6.5% YoY average customer deposit growth for the banking sector at end-December 2017. The growth is expected to continue as the bank continues to expand its branch network, this growth rate is expected to be maintained in the next 12 months. The bank, has been incurring relatively high funding costs owing to its narrow target market for deposit generation and lack of transactional deposits. The bank manages mismatches, by maintaining its liquidity ratio above both the regulatory and board approved minima. The ratio of liquid assets to short-term funding registered 37.5% at FY17 (FY16: 38.2%).

With its relatively lower number of clients and lack of diversity, GCR considers that the scale of the bank exposes it to greater operational risk compared to its peers with larger market share.

The bank's rating could be positively impacted if the bank continues to outperform the market in terms of asset quality, capitalisation with improved funding and liquidity metrics. The ratings could be negatively affected by a deterioration in asset quality, earnings, capitalisation, liquidity as well as change in business strategy.

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NATIONAL SCALE RATINGS HISTORY

Initial rating (October 2012)
Long-term: BBB(KE); Short-term: A3(KE)
Outlook: Positive

Last rating (July 2017)
Long-term: BBB(KE); Short-term: A2(KE)
Outlook: Positive

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APPLICABLE METHODOLOGIES AND RELATED RESEARCH

Global Criteria for Rating Banks and Other Financial Institutions (March 2017)
Kenya Bank Statistical Bulletin (December 2017)
VCB rating reports (2012-17)

RATING LIMITATIONS AND DISCLAIMERS

SALIENT FEATURES OF ACCORDED RATINGS

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

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 2017 (and four years comparative numbers)
- Unaudited interim results at 31 March 2018
- Budgeted financial statements for 2018
- Latest internal and/or external audit report to management
- 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.

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

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.
Budget	Financial plan that serves as an estimate of future cost, revenues or both.
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.
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.
Credit Rating Agency	An entity that provides credit rating services.
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.
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.
Impairment	Reduction in the value of an asset because the asset is no longer expected to generate the same benefits, as determined by the company through periodic assessments.
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.
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.

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National Scale Rating	Provides a relative measure of creditworthiness for rated entities only within the country concerned. Under this rating scale, a 'AAA' long term national scale rating will typically be assigned to the lowest relative risk within that country, which in most cases will be the sovereign state.
Net Profit	Trading/operating profits after deducting the expenses detailed in the profit and loss account (including taxes).
Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
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.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
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.
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.
Stock Exchange	A market with a trading-floor or a screen-based system where members buy and sell securities.

For a glossary of terms please click here