

CREDIT RATING ANNOUNCEMENT

GCR affirms Bank of Africa Kenya Limited's rating of A-(KE); Outlook Negative.

Johannesburg, 11 Sep 2015 -- Global Credit Ratings has affirmed the national scale ratings assigned to Bank of Africa Kenya Limited of A-(KE) and A1-(KE) in the long term and short term respectively; with the outlook accorded as Negative. The rating(s) are valid until September 2016.

SUMMARY RATING RATIONALE

Global Credit Ratings ("GCR") has accorded the above credit rating(s) to Bank of Africa Kenya Limited ("BOA Kenya" and/or "the bank") based on the following key criteria:

The ratings of Bank of Africa Kenya Limited's ("BOA Kenya" and/or "the bank") are supported by its established domestic and regional footprint, demonstrated shareholder support and adequate capital position. The negative outlook reflects a diminished relative market position and weakened financial profile in terms of profitability and asset quality (most notably the fast pace at which loans transition through the arrears buckets).

Underlining their continued commitment to the bank, shareholders injected KES1.7bn in 1H F15 (following a KES1.7bn injection in F14), which resulted in a 290 basis point increase in the bank's Tier I capital adequacy ratio to 13.8% between F13 and 1H F15 (against a new statutory minimum requirement of 10.5%). In addition, a subordinated loan of KES1.3bn obtained from its parent helped improve the bank's total capital adequacy ratio to 18.1% at 1H F15 (FYE13: 12.7%). However, capitalisation could come under pressure if the bank is unable to curtail the rise in non-performing loans ("NPLs").

The bank reported significantly higher NPLs (KES2.4bn) at FYE14, a 79.6% increase over FYE13. This was due to the systemic lag effects of a high interest rate regime in 2012/2013 and subdued economic activities in F14, and according to the Central Bank of Kenya ("CBK"), suboptimal underwriting standards and weak credit monitoring. While the increase in NPLs was counterbalanced by improved capitalisation, GCR expects BOA Kenya's credit profile to remain vulnerable to loan deterioration, given the higher interest rate environment, and the rise in past due but not impaired loans by 2.7x to KES2.3bn at FYE14 (27.8% of capital). Further concern is raised by the bank's low provisioning levels, with the sum of individually assessed provisions and collateral value not fully covering NPLs at FYE14 and 1H F15.

BOA Kenya reported muted operating income growth, and a substantial (80.9%) decline in net income to KES144.1m in F14. This resulted from compressed interest margins, a spike in impairment costs and an increase in operating expenditure (owing largely to the opening of six new branches and marketing costs). Looking forward, the bank's 1H F15 results point to another lacklustre earnings performance at full year.

The predominance of customer deposits in BOA Kenya's funding profile (typical of the Kenyan banking sector), inevitably results in asset and liability mismatches. However, liquidity concerns are considered minimal due to the bank's maintenance of its liquidity ratio above the prudential minimum of 20% together, with strong shareholder support.

BOA Kenya's limited scale, high reliance on shareholder support, diminished market position relative to rated peers and weakened financial profile make an upgrade unlikely at this stage. An upward movement in the bank's ratings could arise from substantial and sustainable improvements in asset quality and profitability, as well as significantly enhanced market share. The rating could come under pressure if there is a further weakening in profitability and asset quality, and/or any diminution/withdrawal of parental support.

NATIONAL SCALE RATINGS HISTORY

Initial rating (Jun/2010)

Long term: A-(KE); Short term: A1-(KE)

Outlook: Positive

Last rating (Aug/2014)

Long term: A-(KE); Short term: A1-(KE)

Outlook: Stable

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APPLICABLE METHODOLOGIES AND RELATED RESEARCH

Global Criteria for Rating Banks and Other Financial Institutions, updated March 2015
Kenyan Bank Statistical Bulletin (June 2015)
BOA Kenya rating reports (2010-14)

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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.

Bank of Africa Kenya Limited participated in the rating process via 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 Bank of Africa Kenya Limited with no contestation of the rating/s.

Information received from Bank of Africa Kenya Limited and other reliable third parties to accord the credit rating(s) included;

- Audited financial results as at 31 December 2014 (and four years of comparative numbers)
- Unaudited interim results at 30 June 2015
- 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, Bank of Africa Kenya 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

Arrears	An overdue debt, liability or obligation. An account is said to be 'in arrears' if one or more payments have been missed in transactions where regular payments are contractually required.
Arrears Bucket	A non-performance classification, classified according to the number of days in arrears, i.e. 30, 60, 90 days.
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.
Audit Report	An audit report is a written opinion of an auditor (attesting to the financial statements' fairness and compliance with generally accepted accounting principles).
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.
Basis Point	A basis point is 1/100th of a percentage point.
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.
Collateral	Asset provided to a creditor as security for a loan.
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.
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 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.
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.
National Scale Rating	The national scale 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.

Non-Performing Loan	When a borrower is overdue, typically 90+ days in arrears or as defined by the lender, or in the transaction documents.
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.
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.
Provision	The amount set aside or deducted from operating income to cover expected or identified loan losses.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
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.

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