KINGDOM SECURITIES

KCB Group Plc – Earnings Update H1-2020

We Continue with a long-term hold recommendation on KCB Group despite the lender reporting a 28.5% decline in Profit Before Tax (PBT) to KES 12.82Bn from KES 17.93Bn in H1-19. Profit After Tax (PAT) dipped to KES 7.58Bn, a 40.4% dip from KES 12.72Bn. The group maintained its top line performance with bottom line heavily affected by 263.8% increase in loan loss provisions caused by the KES 101Bn loan restructure. Earnings Per Share (EPS) shrunk by 43.1%. The management did not recommend and interim dividend.

Profit and Loss: Net Interest income (NII) increased by 23.2% to KES 31.07Bn in H1-2020 from KES 25.40Bn in H1-19. Interest income was up 23.2% y-y to KES 41.38Bn from KES 33.60Bn in H1-19.

- Conservative strategy of shifting investment to government securities saw returns from the holdings grow by 65.0% despite downward shift in yields. Interest expenses increased by 25.7% driven by 28.7% increase in cost of customer deposit.
- Non-funded income (NFI) saw a 6% growth to KES 13.96Bn from KES 13.17Bn. slow growth in loan book constrained growth of fees from loans to 5.6% while fees and other commissions were up by 5.5%. contribution of NFI to total income shrunk to 31.0% from 34.1%.
- Total expenses increased by 56.0% driven by a 263.8% increase in loan loss provisions due to potential losses arising from the pandemic. Expenses excluding provisions increased by 20.3% heavily affected by a 12.3% increase in staff and 27.4% in other operating expenses. Kenyan subsidiary operating expenses were up 42.9% while expenses excluding provisions declined by 15.5% boosted by an 113.1% dip in staff costs.
- Cost to Income (CTI) were up 71.5% from 53.5% while CTI excluding provisions were up to 47.0% from 45.7% in H1-19. Kenyan entity CTI were up to 68.4% from 50.6% while CTI excluding provisions eased by 39.7% from 42.7%.

Balance Sheet: The Group balance sheet performance is seen to improve on year on year basis while has lagged when viewed quarter on quarter.

- Deposits grew by 34.6% y-y and 2.4% Q-Q. the group took a conservative stand growing the loan book by 17.0% y-y. viewed Q-Q, the Group loan book grew by 1.1%.
- Deposit we heavily deployed in government securities which grew by 52.6% y-y and 2.2% Q-Q. on overall, total assets increased by 27.7% y-y while marginally by 0.6% Q-Q.
- Advance to Deposit (AD) ratio inched downward to 80.7% from 84.6% in H1-19. Local subsidiary AD ratio was at 85.4% from 91.1%.
- Introduction of NBK to the stable saw the group loan book grow by 17.0% y-y but less impressive level of 1.1% Q-Q. The bank restructured a total of KES 101.0Bn with 73% corporate, mortgage 20% and 7% of retail loans.

Recommendation:	LONG TERM HOLD
Bloomberg Ticker:	KNCB KN
Share Stats	
Current Price	32.55
12 Month Average	42.52
52 Week High	55.00
52 Week Low	32.55
Issued shares (Mn)	3,209.04
Free Float	70.30%
Market Cap (KES Bn)	104.45
Market Cap (USD Bn)	0.96
EPS	4.72
P/E	6.9
PB	0.8

P&L KES Mn	H1-2019	H1-2020
Interest Income	33,603	41,382
Interest Expense	8,201	10,313
Net Interest Margin	25,402	31,070
Non-Funded Income	13,172	13,964
Total Income	38,574	45,033
Loan Loss Provisions	3,031	11,027
Operating Expenses	20,641	32,208
PBT	17,933	12,825
PAT	12,723	7,578
EPS	8.30	4.72

Balance Sheet KES Mn	H1-2019	H1-2020
Investment Securities	135,007	208,523
Net Loans and Advances	478,731	559,884
Total Assets	746,519	953,072
Customer Deposits	563,236	758,241
Shareholders' Fund	117,524	132,139

Regulatory Ratios	H1-2019	H1-2020
Core Capital/Total deposits Liabilities	20.1%	17.5%
Core Capital / TWAR	18.0%	17.9%
Total Capital/TWAR	19.4%	19.5%
Adjusted Core Capital/Total Deposit Liabilities	20.8%	17.8%
Adjusted Core Capital/TWAR	18.6%	18.3%
Adjusted Total Capital/TWAR	20.1%	19.8%
Liquidity Ratio	34.9%	40.0%

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- Restructured loans pushed gross non-performing loans (GNPL) up by 114.5% y-y and 26.7% Q-Q. Loan loss provision were up 263.8% y-y and 280.5% Q-Q.
- Strategic shift saw liquidity levels improve while total risk weighted assets (TWAR) declined by 0.5% Q-Q leading to a decline in regulatory ratios.
- Kenyan subsidiary loan loss provisions shot up by 282.5% y-y and by 311.1% Q-Q on loan restructuring. The restructuring focused on capitalization of arrears, a 1-3-month principle and interest moratorium, revision of tenor to a longer tenor. Majority of the loans retained their interest levels.

Key ratios: Group Return on Average Equity (ROaE) plunged to 11.6% from 23.5% in H1-2019. Cost of funds remained stable at 2.8% while net interest margins (NIMs) eased to 7.8% from 8.3% seen over the same period. Cost of risk jumped to 4.0% from 1.3% on driven by the unknown business environment.

Subsidiaries: Introduction of NBK reported a PBT of 186.63Mn, a 62.2% increase from KES 15.09Mn reports in H1-19. A payment of KES 567.93Mn in deferred taxes left the subsidiary with a loss of KES 381.30Mn, down from a profit of KES 107.77Mn. the subsidiary has led to increased subsidiary contribution to 11.4% from 6.3% on PBT, total income at 20.2% from 11.8% in H1-19.

Outlook:

- The management projects a continued constrain on the business and economy in the remaining part of the year as the COVID-19 pandemic evolves.
- Being the largest bank in loan book value, we anticipate the bank to continue being hit by on loan restructuring leading to higher gross non-performing loans and loan loss provisions.
- With the credit risk posed by the current business and economic environment, we will continue to see the bank shift to assets to investment securities while growing the loan book at c.2% Q-Q.

P&L % Growth	H1-2019	H1-2020
Interest Income	4.3%	23.2%
Interest Expense	1.6%	25.7%
NII	5.2%	22.3%
NFI	14.7%	6.0%
Total Income	8.3%	16.7%
Total Expense	11.4%	56.0%
Total Expense Excluding Provisions	1.3%	20.3%
PBT	4.9%	-28.5%
PAT	5.0%	-40.4%
EPS	5.1%	-43.1%

Balance Sheet % Growth	H1-2019	H1-2020
Investment Securities	20.0%	54.5%
Loan and Advances	13.6%	17.0%
Asset	11.8%	27.7%
Deposit	7.3%	34.6%
Shareholders' Fund	18.7%	12.4%

Key Ratio	H1-2019	H1-2020
NFI Contribution to Income	34.1%	31.0%
AD Ratio	89.2%	80.7%
Govt Securities as % of Assets	18.1%	21.9%
Loan as % of Assets	64.1%	58.7%
ROaE	23.5%	11.6%
Gross NPL to Gross Loans	7.8%	13.7%
NPL Coverage	60.8%	61.7%
Cost of Funds	2.8%	2.7%
Net Interest Margin	8.3%	7.8%
Cost of Risk	1.3%	4.0%
Debt to Equity	19.1%	16.2%

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Recommendation Guide:

Analysts' stock ratings are defined as follows:

- **Buy** – A buy rating reflects 1) An analyst has a bullish conviction on a stock 2) A 30% or greater expected return.
- **Accumulate** – An accumulate rating reflects 1) An analyst has a lesser bullish conviction on a stock 2) Expected return falls between 10% and 30%.
- **Hold** – A hold rating reflects 1) An analyst has a neutral conviction (lack of bullish or bearish conviction) on a stock 2) Expected return falls within the range of 5% to 10%.
- **Speculative Buy** – A speculative buy rating reflects 1) An analyst has a bullish conviction accompanied by a substantially higher than normal risk 2) Expected return falls above 10%.
- **Sell** – A sell rating reflects 1) An analyst has a bearish conviction on a stock 2) Expected return falls below 5%.

*Expected Return (ER) represents the sum total of both capital appreciation and the dividend yield.

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