KINGDOM SECURITIES

# KCB Group Plc

# Earnings Update – H1-2022

## KCB Group Limited – Regional Expansion Through Acquisition

**KCB Group posted KES 28.18Bn in profit before tax (PBT), a 28.6% y-y growth from KES 21.92Bn in H1-21. Profit after tax (PAT) was up 28.4% y-y to KES 19.65Bn from KES 15.30Bn. The performance was supported by a 29.9% growth in non-financing income and a 34.4% dip in loan loss provisions. On quarterly basis, PBT saw a flat growth of 0.8% q-q to KES 14.15Bn in Q2-22 from KES 14.03Bn in Q1-22.**

**The Group continues with regional expansion with the recent proposed acquisition of 85% shares of Trust Merchant Bank SA (TMB) of DRC.**

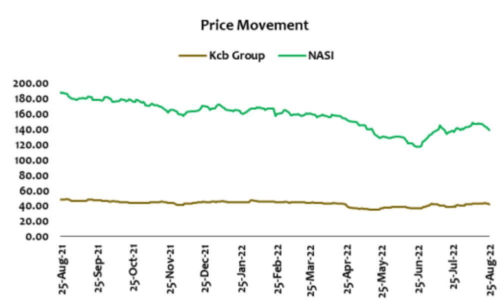
**The annualized EPS stood at 12.15, a PE of 3.5x and PB of 0.8x compared to sector PE of 4.7x. The lender did not offer the traditional interim dividend.**

**We retain a LONG-TERM BUY recommendation with a valuation of KES 50.86, an upside of 21.7% to Thursday August 25, 2022, price of KES 41.80. Value is suppressed by government payment of amounts due on pending bills especially on infrastructure bills affecting NPLs and the ongoing acquisition of TRM of DRC.**

- The Group's net interest income increased by 11.5% y-y to KES 40.59Bn from KES 36.42Bn driven by a 15.7% y-y growth in net interest income while limited by expensive deposit that pushed interest expenses up by 30.3% y-y. The NII were up 5.6% q-q. NII contribution to total income eased to 67.9% from 71.1% in H1-21.
- Interest income was up 15.7% y-y to KES 54.54Bn from KES 47.12Bn in H1-21. The growth was supported by a 31.5% increase in return on government securities while interest income from loans and advances managed a 11.3% y-y growth. Returns on government security was buoyed a 30.4% y-y expansion of the investment book despite yields remaining near flat at 11.4% from 11.5% in H1-21. Interest income from loans benefited from a 20.3% expansion on the loan book while yields on loans were down 50bps to 10.0% from 10.5% in H1-21. Quarterly saw interest income grow by 4.8% q-q with interest income from government securities return growing by 7.2% q-q while interest income from loans and advances grew by 4.1% y-y.
- Market liquidity challenges saw the lender shift deposit mix leading to interest expense growing by 30.3% y-y to KES 13.94Bn from KES 10.70Bn. The mix pushed interest expense on customer deposit 26.0% y-y higher as demand deposits thinned forcing to switch to term and call deposits. forcing cost of deposit to 3.0% from 2.6% in H1-21 while the deposits grew by 15.6% y-y. In Q2-22, the quarter saw interest expense up 2.5% q-q higher as interest expense on deposit up by 1.3% q-q.
- Non-funded income (NFI) was up 29.9% y-y to KES 19.22Bn from KES 14.79Bn. The income line was supported by a 33.0% y-y rise in lending fees income, 18.0% improvement in services fees on growing trade finance business while income from foreign exchange trading was up 81.5% y-y benefiting from regional business and a weakening shilling. Second quarter saw NFI grow by 6.8% q-q heavily supported by an 83.6% q-q growth in foreign exchange trading income. NFI contribution to total income was at 32.1%, better than 28.9% in H1-21.

| Bloomberg Ticker: | KNCB KN |
|---|---|
| Recommendation | Long Term Buy |
| **Share Stats** | |
| Implied Price | 50.86 |
| Current Price | 41.80 |
| Upside/Downside | 21.7% |
| 3-Month Avg | 39.79 |
| 6-Month Avg | 40.70 |
| 12-Month Avg | 43.06 |
| 52 Week High-Low | 48.65 - 35.00 |
| Issued shares (Mn) | 3,213.46 |
| Free Float | 70.3% |
| Market Cap (KES Bn) | 134,322.75 |
| Market Cap (USD Bn) | 1,120.69 |
| EPS Annualized | 12.15 |
| PE | 3.4 |
| BVPS | 56.6 |
| PB | 0.7 |
| DPS | 3.00 |
| Dividend Yield | 7.2% |
| DPS Payout | 24.7% |

| Price Movement | | |
|---|---|---|
| Period | KCB Group | NASI |
| 25-Aug-22 | 41.80 | 138.79 |
| W-W | -3.6% | -5.3% |
| M-M | 7.6% | 0.5% |
| Y-T-D | -8.2% | -16.9% |
| Y-Y | -13.4% | -25.9% |





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- Operating expenses increased by 8.0% to KES 31.63Bn from KES 29.29Bn benefiting from a 34.4% y-y drop in loan loss provisions as the lender continue to ride on the hardline provision done in 2020 and 2021 due to the expected pandemic interruption on business. Cost to income declined to 52.9% from 57.2% in H1-21.
- The benefits on 2020 provisions seems to be weaning as Q2 provisions were up 8.1% q-q in line with the 25.97Bn additional loans issued during the period.
- Staff cost on consolidation of the Rwandan subsidiary, BPR, pushed operating expense excluding provision up by 20.3% y-y to KES 27.31Bn from KES 22.71Bn. This was further worsened by a 32.9% y-y rise in other operating expenses utilized the set-up and rebranding of the subsidiary. This pushed CTI excluding provisions up to 45.7% from 44.3%. Staff cost increased by 9.7% q-q in Q2-22 while other operating expenses surged by 21.3% q-q.

### Balance Sheet

- The Group's total asset increased by KES 187.95Bn, a 18.4% y-y growth to KES 1,210.11Bn from KES 1,022.15Bn. The growth was due to a KES 137Bn in organic growth and a consolidation benefit of KES 51.0Bn on acquisition BPR of Rwanda.
- Customer deposits grew by 122.54Bn to KES 908.57Bn, a 15.6% y-y jump from KES 786.04Bn.
- Investment in securities increased by 30.4% y-y to KES 277.84Bn from KES 213.04Bn in H1-21. Proportion of the investment in securities to total assets was at 23.0% from 20.8% same period 2021.
- Net loan book expanded by 20.3% y-y, an addition of KES 123.37Bn to KES 730.34Bn from KES 606.97Bn. The growth partially benefited from the consolidation of BPR. Advances to loan ratio dipped to 80.4% from 85.3% in H1-22 while loan to total assets were 100bps up to 60.4% from 59.4%.
- To manage liquidity, the lender borrowed a net of KES 5.20Bn pushing borrowing up 14.8% y-y from KES 35.04Bn to KES 40.24.
- Shareholders' fund was up 18.9% y-y to KES 181.75Bn from KES 152.90Bn as retained earnings grew by 13.5%. This aided debt to equity marginally down to 22.1% from 22.9%.

### Key Ratios

- Key ratios saw deposit mix push cost of funds up to 3.0% from 2.6% in H1-21 lowering net interest margins by 90bps to 7.0% from 7.9% over the period.
- During the period, return on average equities (ROaE) were up to 23.0% from 20.7% while return on average total (ROaA) 3.3% from 3.1%.
- Cost of risk (CoR) eased to 1.2% from 2.2% on lower provisions with the lender benefiting from the aggressive provisions done in 2020 and 2021.
- Total non-performing loans (NPLs) surged to by 81.2% to KES 159.03Bn from KES 83.58Bn. This pushed NPL ratio a high of 21.5% from 14.3% seen in H1-21.
- The Kenyan subsidiary saw NPLs surge from 11.8% in H1-21 to 22.8%, 680bps higher compared to the Kenyan industry NPL rate of 14.7% as at end of June 2022.
- NPL coverage declined to 54.6% from 70.1% as the lender remains comfortable on the security held against the lending.

### Outlook

- The Group is set to enter the DRC market with the acquire 85% of the shares of Trust Merchant Bank SA (TMB). This will give it an upper hand in the regional business as currently it sits as the second largest lender in Rwanda.
- There remains a need to manage the NPLs despite the target of 15%-17% range. This will continue to prove a challenge as the key sectors affecting the NPLs are yet to fully recovers while large government infrastructure payments are still pending. Even with the cut on NPL, we expect the lender to remain above the Kenyan industry NPLs by close of 2022.
- We expect heavy write off on accounts that have full provisions especially under the NBK subsidiary whose NPL stands at 33.9% (37.3% in H1-21). This is seen as the fastest and easiest way to cut on the NPL rate.
- Regardless of the lender failing to issue an interim dividend, we opine that the Board will recommend an interim dividend in Q3-22 in line with 2022 recommendation. The Group will still maintain a KES 3.00 total dividend by end of the year.

| Profit and Loss (KES Mn) | H1-2021 | H1-2022 | %Δ Y-Y | Q1-2022 | Q1-2022 | %Δ Q-Q |
|---|---|---|---|---|---|---|
| Interest income | 47,118 | 54,539 | 15.7% | 26,628 | 27,911 | 4.8% |
| Interest Expense | 10,702 | 13,947 | 30.3% | 6,888 | 7,060 | 2.5% |
| NII | 36,416 | 40,592 | 11.5% | 19,740 | 20,852 | 5.6% |
| NFI | 14,794 | 19,216 | 29.9% | 9,292 | 9,924 | 6.8% |
| Operating Income | 51,210 | 59,807 | 16.8% | 29,031 | 30,776 | 6.0% |
| Loan Loss Provisions | 6,583 | 4,319 | -34.4% | 2,075 | 2,243 | 8.1% |
| Operating Expense | 29,294 | 31,629 | 8.0% | 14,999 | 16,629 | 10.9% |
| Opex exl Provisions | 22,711 | 27,310 | 20.3% | 12,924 | 14,386 | 11.3% |
| PBT | 21,916 | 28,178 | 28.6% | 14,032 | 14,146 | 0.8% |
| PAT | 15,304 | 19,647 | 28.4% | 9,789 | 9,858 | 0.7% |
| **EPS** | **8.53** | **12.15** | 16.3% | **12.18** | **12.15** | -0.2% |

| Balance Sheet (KES Mn) | H1-2021 | H1-2022 | %Δ Y-Y |
|---|---|---|---|
| Investment securities | 213,040 | 277,844 | 30.4% |
| Loans and Advances | 606,967 | 730,335 | 20.3% |
| Total Assets | 1,022,153 | 1,210,108 | 18.4% |
| Customer Deposits | 786,035 | 908,573 | 15.6% |
| Borrowing | 35,042 | 40,244 | 14.8% |
| Shareholders' Fund | 152,920 | 181,750 | 18.9% |

| Non-Performing Loans | H1-2021 | H1-2022 | %Δ Y-Y |
|---|---|---|---|
| Gross NPL | 95,733 | 173,428 | 81.2% |
| Total NPL | 83,584 | 159,032 | 90.3% |

| Key Ratios | H1-2021 | H1-2022 |
|---|---|---|
| NII % Operating Income | 71.1% | 67.9% |
| NFI % Operating Income | 28.9% | 32.1% |
| CTI | 57.2% | 52.9% |
| CTI exl Provisions | 44.3% | 45.7% |
| ROaE | 20.7% | 23.0% |
| Yields on Loans | 10.5% | 10.0% |
| Yield of Government Securities | 11.5% | 11.4% |
| Cost of Deposits | 2.4% | 2.6% |
| Cost of Funds | 2.6% | 3.0% |
| Net Interest Margins | 7.9% | 7.0% |
| Cost f Risk | 2.2% | 1.2% |
| Gross NPL: Gross Loans | 14.3% | 21.5% |
| NPL Coverage | 70.1% | 54.6% |
| Advances to Deposit | 85.3% | 80.4% |
| Advances to Deposit and Borrowing | 73.9% | 77.0% |
| Investment in Securities to Assets | 20.8% | 23.0% |
| Net Loans to Assets | 59.4% | 60.4% |
| Debt to Equity | 22.9% | 22.1% |

## Research Analyst Certification:

The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that all of the views expressed herein accurately reflect their personal views. Each research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the view(s) expressed by that research analyst in this research report.

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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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