KINGDOM SECURITIES

KCB Group Plc

Earnings Update – Q3-2022

KCB Group posted KES 43.03Bn in profits before tax (PBT), a 20.9% y-y growth from KES 35.81Bn. Profit after tax (PAT) was up 21.0% y-y to KES 30.73Bn from KES 25.17Bn in Q3-21. The performance was supported by a 30.2% y-y growth in non-funded income (NFI) and a 22.1% y-y drop in loan loss provisions. Regional subsidiary profit contribution doubled with PAT contribution of 30.7% from 15.1% in Q3-21.

The board of directors recommended a per share interim dividend of KES 1.00(Q3-21 – KES 1.00) with EPS growing by 27.4% from 9.92 to 12.64. The PE and PB stood at 3.0x and 0.6x respectively.

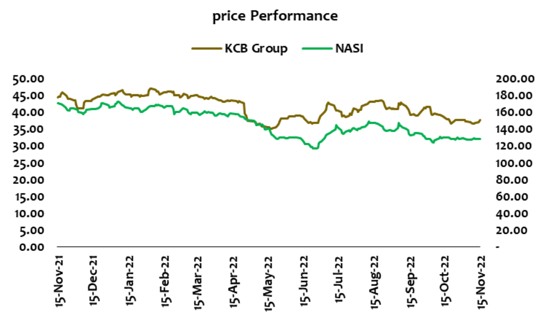
We retain a LONG-TERM BUY RECOMMENDATION on the share with a valuation of KES 50.86, an upside of 35.1% on KES 37.65 as of 15th November 2022 as the lender continue to show strong fundamentals and growth in all its key subsidiaries despite challenging macroeconomic environment. Counter trades 5.3% above 6-months average but 12.4% below 3-month value and 17.3% down on year to date.

- Net interest income (NII) was up 9.1% y-y to KES 61.59Bn from KES 56.44Bn in Q3-21 driven by a 13.6% y-y growth in interest income while suppressed by a 28.4% y-y growth in interest expense. In Q3-22, NII grew marginally by 0.7% q-q with interest income growing by 3.9% q-q. NII contribution to total income thinned to 66.8% from 70.6% in Q3-21.
- Interest income was up 13.6% to KES 83.54Bn from KES 73.53Bn in Q1-21 supported by a 28.2% and 10.2% y-y growth in income from government securities and advances respectively. The uptick in government securities income was a due to an improved sum of return from government security to 11.7% from 10.9% in Q1-21 and a 6.9% y-y in book growth. Loan book return was suppressed by low average yields of 10.0% (Q3-21 10.4%) despite loan book growth of 16.4% y-y. Asset yield was at 10.7% from 10.8% in Q3-21. Interest income improved by 3.9% q-q as income from loans and advances grew by 4.6% q-q with net loan book growing by KES 107.00Mn during the period. Interest from government securities was up 2.3% with the book growing by KES 17.44Bn.
- Interest expenses surged by 13.3% y-y to KES 21.95Bn from KES 17.09 Bn in Q3-21. The cost line was driven by a 21.7% y-y rise in expense on deposit with cost of deposit rising to 2.7% in Q3-22 from 2.4% Q3-21 and deposit book growing by 7.4% y-y. Cost of deposit from other banks increased by 53.8% y-y as deposit from banks growing by 23.2%. The high drive for deposit saw cost of funds surge to 3.0% from 2.6% in Q3-21.
- Non-Funded Income (NFI) was up 30.2% y-y to KES 30.55Bn from KES 23.47Bn. Net fees and commission were up 17.3% y-y while income from foreign exchange trading increased by 86.4% driven by a 147.9% y-y growth by the Kenyan subsidiary.

Bloomberg Ticker:	KNCB KN
Recommendation	Long Term Buy
Share Stats	
Implied Price	50.86
Current Price	37.65
Upside/Downside	35.1%
3-Month Avg	39.79
6-Month Avg	39.32
12-Month Avg	41.57
52 Week High-Low	47.00 - 35.00
Issued shares (Mn)	3,213.46
Free Float	70.3%
Market Cap (KES Bn)	120,986.87
Market Cap (USD Bn)	992.27
EPS Annualized	12.64
PE	3.0
BVPS	59.2
PB	0.6
DPS	3.00
Dividend Yield	8.0%
DPS Pay-out	23.7%
Total Implied Return	43.1%

Price Performance

Period	KCB Group	NASI
3-Months	-12.4%	-13.0%
6-Months	5.3%	-8.4%
Y-T-D	-17.3%	-23.5%
Y-Y	-15.1%	-25.1%



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NFI from digital channels was KES 6.34Bn with mobile banking NFI growing by 22.0% y-y ranking in 4.38Bn to represent Mobile NFI to Total Fees & Commission. NFI contribution increased to 33.2% from 29.4% in Q3-21. E-credit products expanded by 21.0% y-y to KES 138.8Bn.

Fuliza grew by 29.0% y-y to a total of KES 89.1Bn disbursed. Vooma Loans were up 34.0% y-y to KES 15.5Bn while KCB M-Pesa thinned by 2.0% y-y to KES 33.3Bn

Quarter on quarter, NFI was up 5.1% q-q presented by 8.9% q-q rise in foreign exchange trading income and 89.4% q-q on other income.

- Expenses were up by 10.8% y-y to KES 48.84Bn from KES 44.10Bn in Q3-21. The const was impacted by merged operation with BPR of Rwanda, increased operational activity and a 14.5% y-y rise in staff cost. Excluding provisions, expenses were up 11.3% y-y as the expenses were kept low on a 22.1% y-y decline in loan loss provisions. Cost to Income (CTI) was at 53.0% from 55.2% in Q3-21 while CTI excluding loan loss provision was at 45.1% from 43.5% over the period.

  During the quarter, expenses were up 3.5% with provisions up 31.5% while expenses excluding provisions were marginally down by 0.9%.

Balance Sheet

- Total assets expanded by 13.7% to KES 1,276.28Bn from KES 1,122.46Bn as an addition KES 153.82Bn was added in Q3-22.
- The growth was due to a 6.9% growth in investments in securities to KES 269.89Bn from KES 252.45Bn while Q3-22 added 17.44Bn. This saw proportion of Securities to total asset at 21.1% from 22.5%.
- Net loan book increased to KES 758.82Bn, a 13.7% y-y growth from KES651.82Bn. Q3-21 injected KES 107.00Bn additional net loans. The Kenyan unit saw a 13.6% growth in net loans with the subsidiaries growing by 26.5% on BPR acquisition to boost group contribution to 23.4% from 21.6% in q3-21. Ratio to total assets improved to 59.5%.
- Asset growth was supported by a 7.4% y-y increase in deposits to KES 922.30Bn from KES 859.10Bn as Kenyan subsidiary deposits was up by 8.0% y-y. Advances to deposit improved to near historical levels of 82.3%.
- Need to balance liquidity levels and share loan book growth, the lender took an additional KES 27.42Bn in net loans to KES 62.69Bn, a 77.7% y-y surge from KES 35.27Bn. Debt to equity remained flat at 21.6% compared to 21.5% in Q3-21.
- Shareholders funds were up 15.7% y-y to KES 190.22Bn from KES 164.38Bn. Retained earnings shrunk by 4.9% on interim dividend payment and reallocation to statutory loan reserves which increased by 92.9% q-q in Q3-22 due to growing loan books and tightening regulation retirements.

  The effects of shareholders funds were felt most on the Kenyan subsidiary where retained earnings dropped by 10.5% while statutory loan reserves surged by 123.8% in Q3-22 compared to Q2-22.

Key Ratios

- Cost of funds were up to 3.0% vs 2.6% in Q3-21 on increase in Interest on borrowed funds. This pushed the net interest margin down to 7.0% from 7.7%.
- Return on average equity (ROaE) was up to 23.3% from 22.0% in Q3-21 while return on average assets (ROaA) was 36.4% from 3.2% over the same period.
- Gross Non-performing loans (NPLs) surged by 52.1% while total net NPL were up 57.9% y-y leading to NPLs growing to 18.2%, a 450bps y-y worse compared to 13.7% in Q3-21. The index, however, improved by 330.0bps

compared to 21.4% seen in H1-22 the figure dipping by 13.9% and 14.6% q-q on the gross NPL and total NPL respectively due to a decline in the corporate and mortgage NPLs which had surged in H1-22.
Looking at subsidiaries, the Kenyan unit subsidiary worsened to 19.8%, high compared to 14.2% Kenyan banking NPLs.

- Cost of risk improved to 1.4% from 2.0% due to a 22.1% y-y drop in loan loss provisions.

Outlook

- Acquisition of the DRC-based lender Trust Merchant Bank SA (TMB) remains on track after the shareholders approved the proposed acquisition. This is set to grow the balance sheet to the largest regional bank listed on the NSE.
- Continued focus on digital capabilities will see growth in NFIs especially on e-credit platform.
- The bank continues to aim at 15%-17% range on NPLs, with figures showing they are on track especially on NBK and South Sudan subsidiaries through book clean up.
- The bank defied economic performance as the lender is set to grow faster than the IMF East African Community projected growth of 4.5%.
- We opine that it is the right time for the lender to review its dividend to KES 4.00 in line with the dividend policy of dividend payout of up to 50% of distributable profits payments.

Profit and Loss (KES Mn)	Q3-2021	Q3-2022	%Δ Y-Y	Q2-2022	Q3-2022	%Δ Q-Q
Interest income	73,531	83,541	13.6%	27,911	29,002	3.9%
Interest Expense	17,094	21,947	28.4%	7,060	7,999	13.3%
NII	56,437	61,594	9.1%	20,852	21,002	0.7%
NFI	23,469	30,551	30.2%	9,924	11,335	14.2%
Operating Income	79,906	92,145	15.3%	30,776	32,338	5.1%
Loan Loss Provisions	9,328	7,268	-22.1%	2,243	2,949	31.5%
Operating Expense	44,096	48,841	10.8%	16,629	17,212	3.5%
Opex exl Provisions	34,768	41,573	19.6%	14,386	14,263	-0.9%
PBT	35,810	43,304	20.9%	14,146	15,126	6.9%
PAT	25,173	30,459	21.0%	9,983	10,937	9.6%
EPS	9.92	12.64	27.4%			
DPS	1.00	1.00	0.0%			

Balance Sheet (KES Mn)	Q3-2021	Q3-2022	%Δ Y-Y
Investment securities	252,446	269,887	6.9%
Loans and Advances	651,816	758,816	16.4%
Total Assets	1,122,464	1,276,283	13.7%
Customer Deposits	859,103	922,304	7.4%
Borrowing	35,273	62,688	77.7%
Shareholders' Fund	164,383	190,218	15.7%

Non-Performing Loans	Q3-2021	Q3-2022	%Δ Y-Y
Gross NPL	98,142	149,294	52.1%
Total NPL	85,979	135,799	57.9%

Key Ratios	Q3-2021	Q3-2022
NII % Operating Income	70.6%	66.8%
NFI % Operating Income	29.4%	33.2%
Mobile NFI to Total Fees & Commission	28.6%	25.8%
CTI	55.2%	53.0%
CTI exl Provisions	43.5%	45.1%
ROaE	22.0%	23.3%
Yields on Loans	10.4%	10.0%
Yield of Government Securities	10.9%	11.7%
Cost of Deposits	2.4%	2.7%
Cost of Funds	2.6%	3.0%
Net Interest Margins	7.6%	7.0%
Cost f Risk	2.0%	1.4%
Gross NPL: Gross Loans	13.7%	18.2%
NPL Coverage	72.0%	61.4%
Advances to Deposit	75.9%	82.3%
Advances to Deposit and Borrowing	72.9%	77.0%
Investment in Securities to Assets	22.5%	21.1%
Net Loans to Assets	58.1%	59.5%
Debt to Equity	21.5%	21.6%

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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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