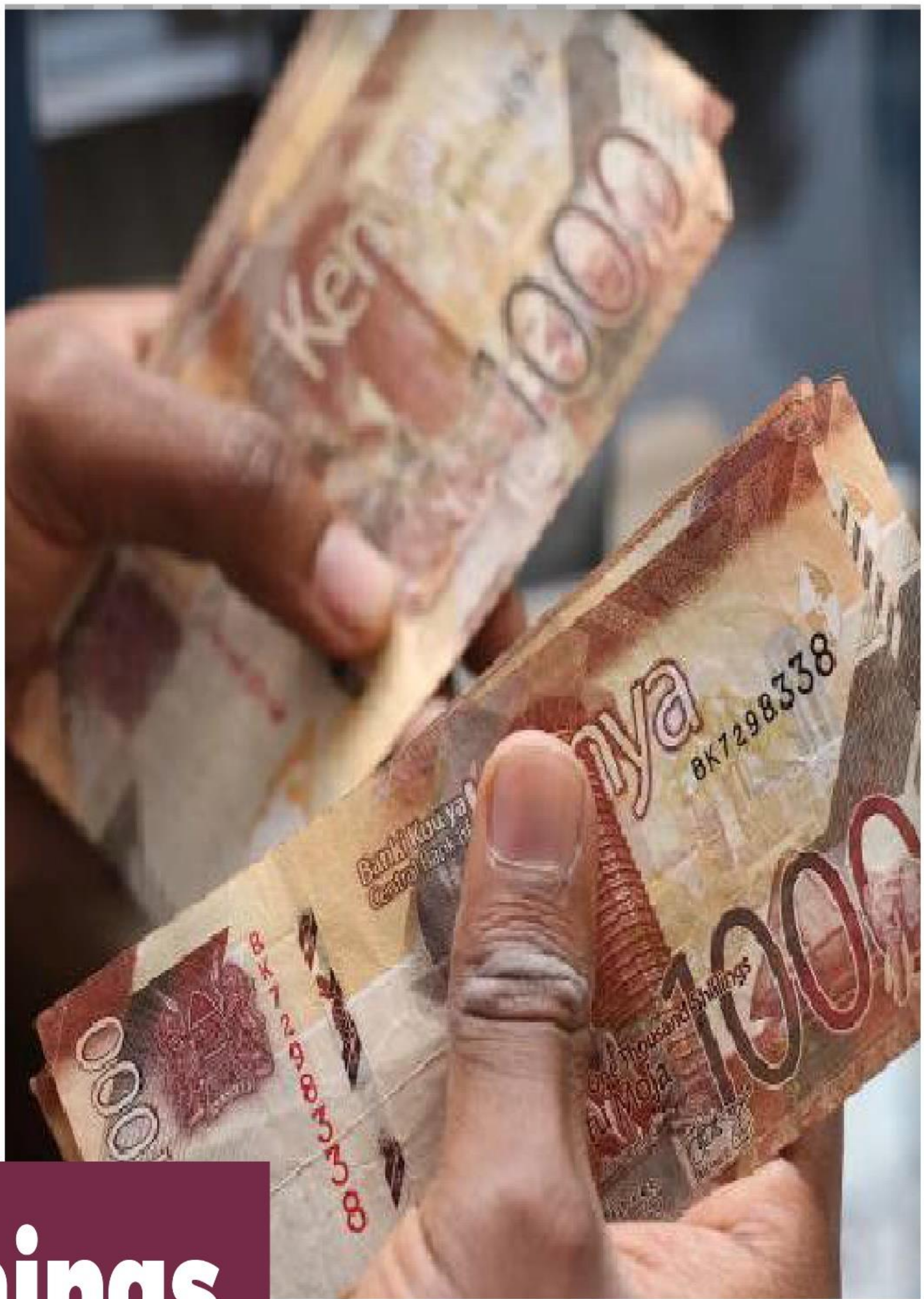
www.aib-axysafrica.com



Earnings Note

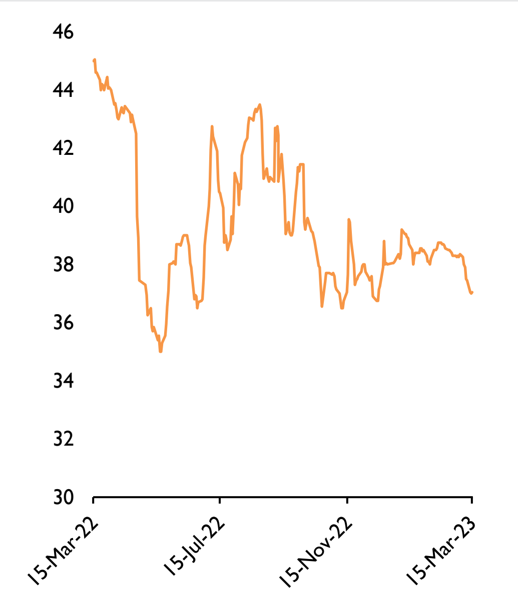
research@aib-axysafrica.com

Company details

Bloomberg Ticker	KNCB:KN
NSE Code:	KCB
Issued Shares (Bn)	3.21
52-week high:	45.05
52-week Low	34.35

As at 16th March 2023

Price chart – Last 12 Months



AIB-AXYS Research, NSE

Historical Price Performance

	1m	3m	6m	12m
Absolute	**-4.26%**	**-0.27%**	**-8.18%**	**-17.67%**

AIB-AXYS Research, NSE

Analysts

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March 17th 2023

KCB Group FY'22 Earnings Note

Recomm: **BUY**	**Current Price**: KES 34.35	**Target Price**: KES 48.53

Summary

- **KCB Group released their FY'22 earnings results posting a 19.78% & 19.13% climb in EPS & PAT respectively** to KES 12.71/share and KES 40.61Bn respectively driven by a 11.53% increase in net interest income and a 39.79% growth in non-interest income. Trailing ROaE & ROaA improved to 25.54% & 3.53% respectively in FY'22. NIMs remained adequate at 7.46% while the profit margin edged down 2bps y/y to 31.44%. In line with our expectation, the board of directors recommended a final dividend of KES 1.00 taking the total dividend paid out in FY'22 to KES 2.00 representing a 33.33% decline from KES 3.00 paid out in FY'21.

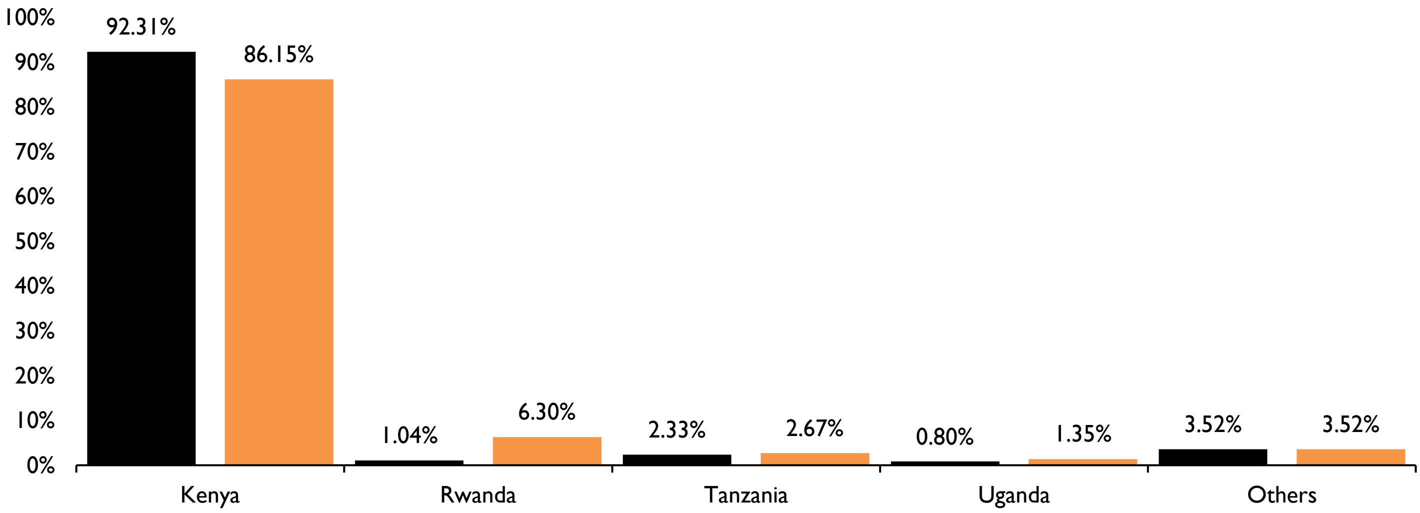
- **Loan book grew 27.80% y/y to KES 863.27Bn slower than the 35.63% y/y growth in the customer deposits to KES 1.14Tn** leading to a 466bps decline in the loan deposit ratio to 76.03% from 80.69% recorded in FY'21. We observed a 23.00% growth in value of mobile loans disbursed driven by Fuliza and KCB Mobi loan to close FY'22 at 193.10Bn. It was also noted that the average ticket size for Fuliza & KCB Mobi Loan edged up in FY'22 by 29.00% & 36.00% respectively while that of KCB MPESA declined by 5.00%. There was a 30.00% uptick in value of transactions conducted through digital channels driven by mobile and internet banking which supported growth of the loan book. The Corporate:Retail customer deposits mix stood at 48:52 with 71.00% of the deposits denominated in local currency and 29.00% in Foreign Currency. The Deposits growth was largely driven by growth of existing businesses and recent acquisition of Trust Merchant Bank of DRC. Allocation to government securities grew 265bps y/y to 278.02Bn in FY'22 driven by hunt for higher yields.

Key Highlights

- **Net Interest income lags Non-funded Income:** Net Interest Income grew 11.53% y/y to 86.65Bn slower than a 39.79% y/y increase in Non-Funded income to 43.25Bn mainly driven by a 20.63% y/y jump in income from loan fees and commissions. Furthermore, the impact of the prevailing dollar shortage and Kenya shilling depreciation challenges were seen in the Forex trading income growth of 69.24% to 11.08Bn from 6.55Bn in FY'21, as the bid/ask spreads have widened to between 5-8.00% of the CBK indicative rate. The lender's balance between higher asset yields and sourcing for cheaper deposits led to a 99bp decline in the Net Interest Margin (NIM) to 7.46% while the Yield on assets fell 97ps y/y to 10.14% FY'22. Cost of funds increased 5bps to 2.86% y/y attributable to the the acquisition of TMB.
- **Digital channels growth not enough to improve efficiency:** The Cost to Income ratio less impairment grew 167bps on a year-on-year basis to 45.70% mainly attributed to slower operating income growth (+19.58% y/y) compared to a 22.38% y/y increase in staff costs to 30.26Bn. Contrary to FY'21 industry trend, Loan loss provisions grew 168pbs y/y to KES 13.21Bn indicating increased lending risk.
- **Asset Quality Concerns persist:** Gross NPLs edged up 31.22% y/y to KES 161.20Bn, leading to the NPL ratio increasing 42bps y/y to 17.01% higher than the latest industry average of 13.30%. Meanwhile, the NPL Coverage worsened to 52.39% from 52.93% in FY'21 driven by Gross NPL growing faster than provisioning. KCB's huge NPL figure remains a concern for investors where we believe management's guidance of a single digit NPL in the next FY not realistic even with the approval of risk-based pricing. Given the current tough operating environment and inadequate results from the current efforts to reduce NPLs we expect KCB to struggle in bringing the NPL figure down,

Subsidiary Performance – The regional subsidiaries consolidation continued to payoff with the regional businesses' (Outside Kenya) contribution to profit before tax increased to 13.85% in FY'22 from 7.69% in FY'21.

Subsidiary Contribution to Profit Before Tax (PBT)



I. **Tanzania -** We observed strong growth in the Tanzanian business where PBT grew 46.59% to KES 1.57Bn from KES 1.07Bn in FY'21. The Tanzanian business also recorded a key milestone of achieving Tier I status after increasing assets to more than Tsh 1.00Tn.

II. **Rwanda** – The Rwandan business PBT grew 6.77x to KES 3.70Bn from KES 476.00Mn in FY'21. We expect an even better performance from the Rwandan unit following continued consolidation of BPR following the earlier acquisition. The change in leadership and expansion of Rwanda as a key EAC market will also be key drivers of growth. However, we expect strong competition from Equity and Bank of Kigali especially on the government business front.

III. **DRC** – Following the completion of the 85.00% stake purchase in TMB, we expect the next phase to include TMB's integration to KCB's core banking system as well as other system and functions realignment. We view TMB as being in the investment phase and will contribute to an increase in the Operating expenses in the near term. However, TMB's main value propositions include: 1) Trade finance opportunities in the mineral rich eastern region 2) Access to Non-funded income which is a trend in DRC's banking sector (Revenue mix favors NFI more than NII) 3) DRC's market is highly dollarized giving KCB access to dollar supply within the Group operations.

IV. **Investment Services Unit (Kenya) -** The group announced restructuring of the investment services unit with the set up an asset management unit as well as growing of KCB Investment Banking services. We expect these to be key NFI contributors down the road.

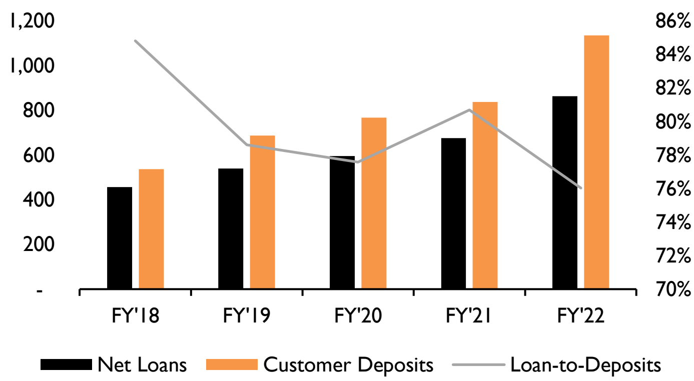
V. **National Bank (NBK)** – We observed a 29.41% decline in the PAT to KES 719.19Mn driven by Non-interest Income (+25.41%) despite an increase in impairment provisioning (+98.02%). The loan book expanded 6.17% to KES 71.Bn with customer deposits remaining flat at KES Bn. Notably, Gross NPLs declined % to KES Bn. We continue to see positive growth signals from NBK despite remaining undercapitalized following a faster growth in risk weighted assets compared to the increase in the core capital. The Group announced the need to recapitalize NBK which we estimate will be circa KES 936.02Mn. Additionally, the Group is in the process of transitioning and merging NBK and KCB's core banking systems which is expected to reduce operating expenses, in the long run.

Outlook – The positive results are attributable to higher lending income and reduced provisioning supported by digital channels through transactions and digital loans. We take note of the continued strong growth in the balance sheet on the back of the integration and consolidation of the recently acquired regional subsidiaries. We are concerned with the historically above-industry average NPL ratio. Future growth in bank's earnings will be driven by digital channels, loan book growth and regional subsidiaries consolidation.

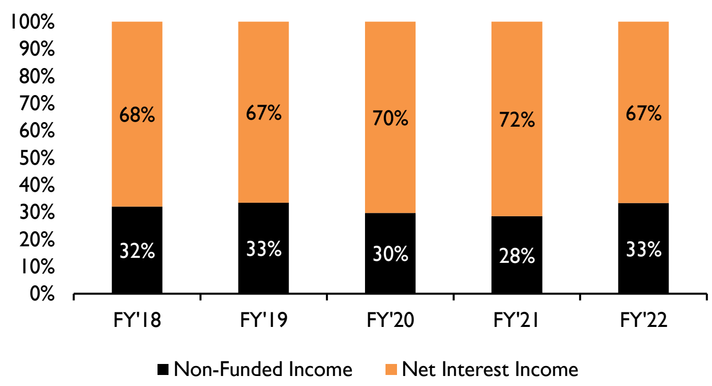
Valuation – The counter is currently trading at a P/B multiple of 0.59x compared to a sector average of 0.77x. The counter closed its trading at KES 34.35, a YTD loss of 9.84%. However, we maintain our **BUY** recommendation on the counter as we believe the current price provides an attractive entry point for long-term investors coupled with the 5.19% dividend yield.

KCB Group FY'22 Earnings Charts

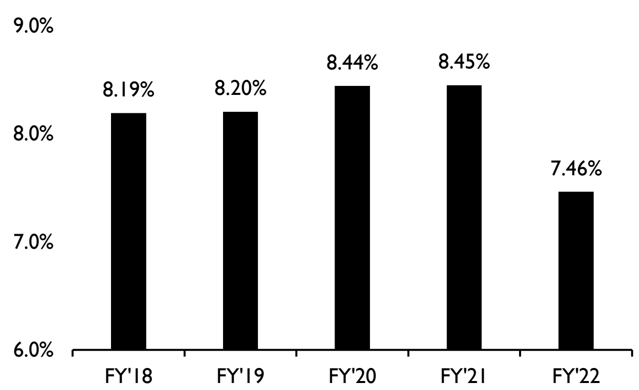
Graph 1: Customer Deposits continue to drive Balance sheet growth



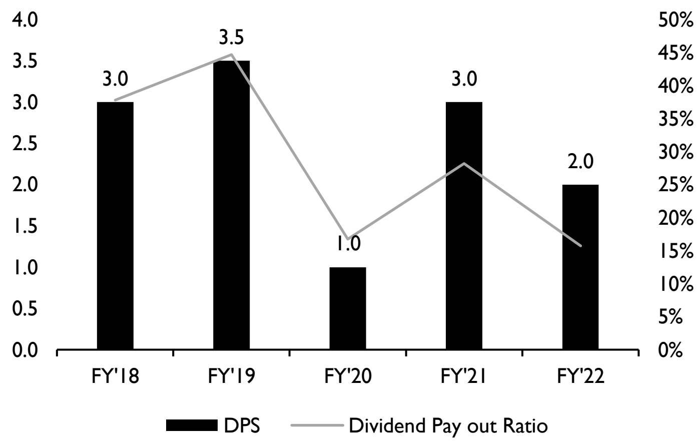
Graph 2: Revenue mix continues to favour Net Interest Income



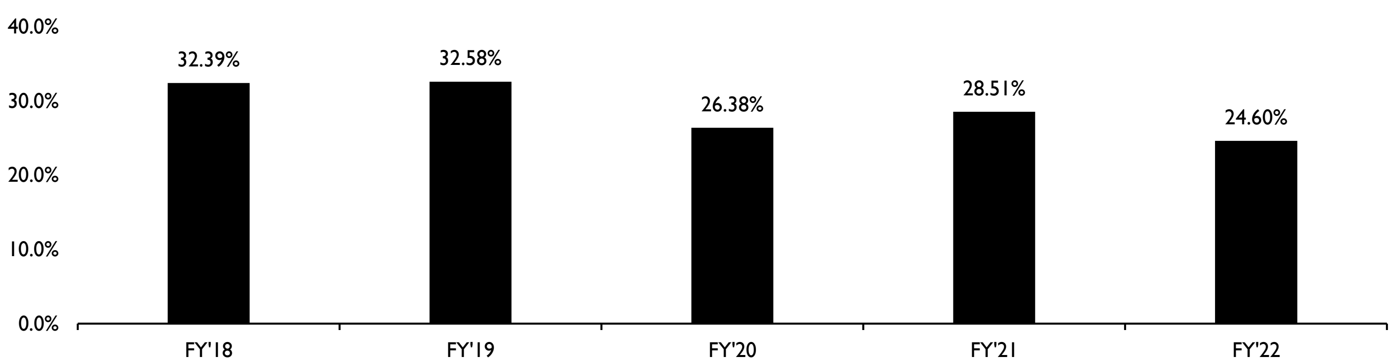
Graph 3: We observed a slight decline in Net Interest Margins



Graph 4: Dividend Payout Ratio declined moderately



Graph 5: Forex Income as a % of Net Income slows down



Source: NSE, CBK, Company Fillings, AIB-AXYS Analyst Estimates

Financial Statement Summary

1. Statement of Profit and Loss

Income Statement	FY20	FY'21	Q1'22	Q2'22	Q3'22	FY'22	y/y % Change	FY'22e	Variance
Net Interest Income	67,937.58	77,694.02	19,739.82	40,591.53	61,593.99	86,653.31	11.53%	80,204.45	8.04%
Net non-Interest Income	28,450.60	30,940.59	9,291.57	19,215.62	30,550.66	43,251.52	39.79%	36,475.14	18.58%
Total Operating income	**96,388.18**	**108,634.61**	**29,031.39**	**59,807.15**	**92,144.65**	**129,904.82**	**19.58%**	**116,679.58**	**11.33%**
Provision for Impairment	(27,508.44)	(12,988.10)	(2,075.38)	(4,318.68)	(7,267.76)	(13,206.88)	1.68%	(11,212.23)	17.79%
Total Operating expenses	(70,669.30)	(60,820.30)	(60,820.30)	(60,820.30)	(60,820.30)	(72,573.47)	19.32%	(64,331.09)	12.81%
Profit before tax	**25,718.88**	**47,814.30**	**(31,788.91)**	**(1,013.16)**	**31,324.35**	**57,331.35**	**19.90%**	**52,348.49**	**9.52%**
Profit after tax	**19,603.65**	**34,091.63**	**(36,032.10)**	**(9,669.77)**	**18,479.38**	**40,613.52**	**19.13%**	**37,631.15**	**7.93%**
Core EPS	6.10	10.61	-11.19	-2.97	12.64	12.71	19.78%	11.74	8.29%
DPS	1.00	3.00	-	-	1.00	2.00	-33.33%	3.50	-42.86%

2. Statement of Financial Position

	FY20	FY'21	Q1'22	Q2'22	Q3'22	FY'22	y/y % Change	FY'22e	Variance
Government Securities	208,764.86	270,835.05	274,442.88	277,843.95	269,887.44	278,020.34	2.65%	314,363.32	-11.6%
Loans and Advances	595,254.30	675,480.44	704,366.08	730,335.49	758,815.99	863,268.08	27.80%	776,704.11	11.1%
Total Assets	**987,810.25**	**1,139,672.57**	**1,116,908.41**	**1,210,107.54**	**1,276,282.69**	**1,554,029.97**	**36.36%**	**1,311,842.21**	18.5%
Customer Deposits	767,224.47	837,141.38	845,817.47	908,573.11	922,303.72	1,135,417.38	35.63%	955,286.86	18.9%
Total Liabilities	845,385.97	966,164.96	966,164.96	966,164.96	966,164.96	1,347,753.71	39.50%	1,113,869.12	21.0%
Shareholder's Funds	**147,508.22**	**171,713.20**	**181,833.39**	**179,113.25**	**187,771.58**	**200,200.42**	**16.59%**	**198,178.67**	1.0%

3. Key Metrics

	FY'20	FY'21	Q1'22	Q2'22	Q3'22	FY'22
Growth Metrices (y/y)						
Loan book Growth	10.28%	13.48%	17.96%	20.33%	16.42%	27.80%
Customer Deposits Growth	11.75%	9.11%	12.86%	7.36%	7.36%	35.63%
PAT Growth	-23.70%	77.54%	-665.13%	-163.20%	-26.59%	19.13%
Spreads Analysis						
Yield on Assets	11.09%	11.11%	10.01%	9.96%	9.61%	10.14%
Cost of Funds	2.73%	2.81%	2.64%	2.69%	2.69%	2.86%
Net Interest Margin	8.44%	8.45%	7.56%	7.43%	7.07%	7.46%
ROaE	14.11%	21.76%	-14.05%	5.62%	7.19%	25.54%
ROaA	2.04%	3.21%	-2.21%	0.84%	1.05%	3.53%
Profit Margin	20.00%	31.46%	-123.88%	-15.96%	20.20%	31.44%
Operating Efficiency						
Cost of Income Less LLP	44.97%	44.03%	202.35%	94.47%	58.12%	45.70%
Cost of Assets	4.58%	4.50%	5.61%	5.06%	4.47%	4.41%
Loan to Deposit	77.59%	80.69%	83.28%	80.38%	82.27%	76.03%
Asset Quality						
NPL	14.80%	16.59%	16.93%	21.42%	17.82%	17.01%
NPL Coverage	59.78%	52.93%	52.65%	45.82%	52.83%	52.39%
Cost of Risk	4.62%	1.92%	0.29%	0.59%	0.96%	1.53%
Capital Adequacy						
Core Capital/TRWA	18.20%	18.00%	19.20%	17.70%	14.50%	13.90%
Total Capital /TRWA	21.60%	21.70%	22.80%	21.60%	18.10%	17.10%
Liquidity	36.10%	39.10%	36.90%	39.00%	38.50%	40.90%

Source: Company Fillings, AIB-AXYS Estimates

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