www.aib-axysafrica.com

Earnings Note

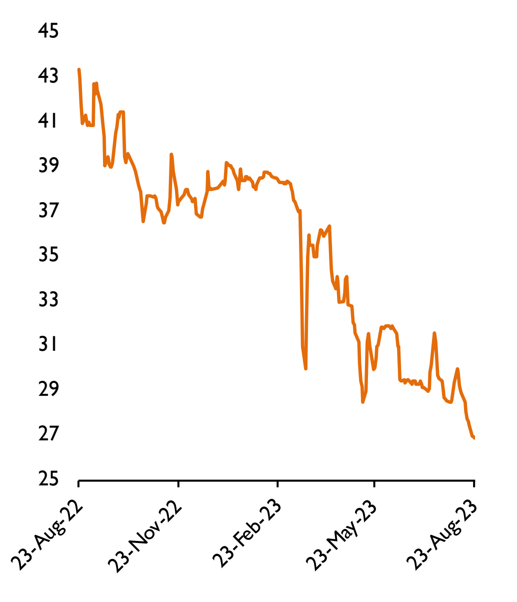
research@aib-axysafrica.com

Company details

Bloomberg Ticker	KNCB:KN
NSE Code:	KCB
Issued Shares (Bn)	3.21
52-week high:	43.35
52-week Low	26.90

As at 23rd August 2023

Price chart – Last 12 Months



AIB-AXYS Research, NSE

Historical Price Performance

	1m	3m	6m	12m
Absolute	**-8.66%**	**-10.18%**	**-29.95%**	**-37.95%**

AIB-AXYS Research, NSE

Analysts

Solomon Kariuki

ks@aib-axysafrica.com

Stacy Makau

smakau@aib-axysafrica.com

August 24th 2023

KCB Group HY'23 Earnings Note

Recomm: **BUY**	**Current Price**: KES 26.90	**Target Price**: KES 38.60

Stock Update

Result Update

Summary

- **KCB Group released their HY'23 earnings results posting a 20.11% y/y and 20.08% y/y decrease in PAT and EPS respectively** to KES 15.60Bn and KES 9.71 per share respectively driven by a 60.02% y/y increase in operating expenses compared to the 22.17% y/y growth in operating income. Top-line growth was driven by a 12.11% y/y increase in net interest income and a 43.43% y/y climb in non-interest income. Adjusted for a legal award relating to NBK, the group PAT would have remained flat on a year-on-year basis. Trailing ROaE and ROaA declined to 19.08% and 2.42% respectively in HY'23. NIMs remained adequate at 6.74% while the profit margin edged down to 21.98%.
- **Customer deposits grew 61.93% y/y to KES 1.47Tn faster than the 32.10% y/y growth in the loan book to KES 964.81Bn** leading to a 14.81% decline in the loan deposit ratio to 65.58% from 80.38% recorded in HY'22. Loan book growth was driven by increased lending to businesses and households. We observed a 91.00% y/y growth in the value of mobile loans disbursed driven by Fuliza, KCB Mobi loan and the introduction of lending for small businesses to close HY'23 at KES 154.30Bn. There was a 41.00% increase in the value of transactions conducted through digital channels driven by mobile and internet banking, which supported loan book growth. The loan book constitutes of 72.00% in local currency and 28.00% in foreign currency. The corporate to Retail customer deposits mix stood at 49:51 with 68.00% of the deposits denominated in local currency and 32.00% in foreign currency. Customer deposits growth was mainly driven by consolidation of TMB Bank of DRC and growth of existing businesses. Allocation to government securities grew 30.44% y/y to KES 362.42Bn in HY'23 driven by the hunt for higher yields.

Key Highlights

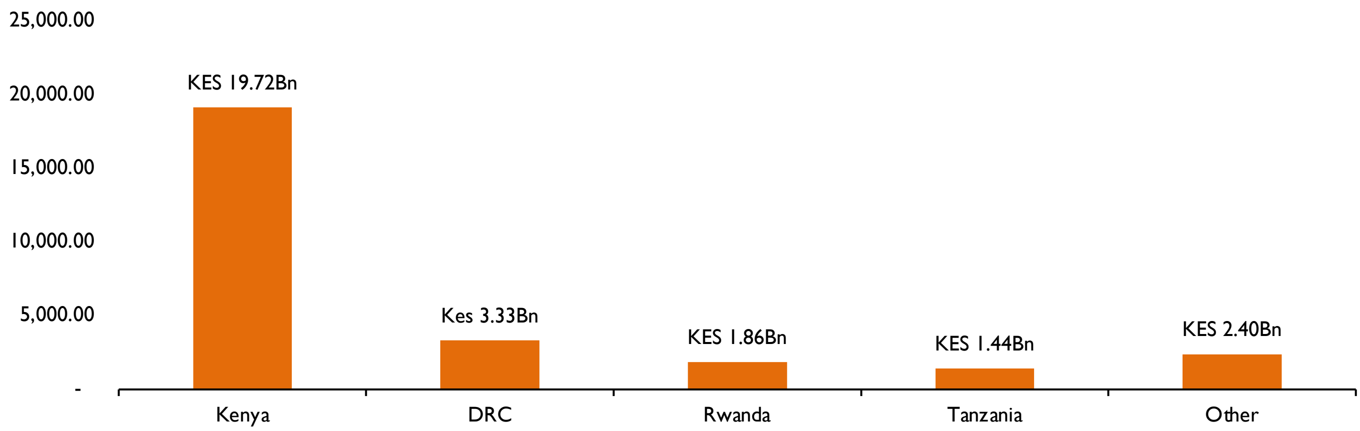
- **Net Interest Income lags Non-funded Income:** Net interest Income grew 12.11% y/y to KES 45.51Bn slower than the 43.43 y/y growth in non-funded income to KES 27.56Bn. The jump in NFI was attributable by increased trade financing lending (driven by G2G oil deal) to KES 392.00Bn and the effect of consolidation of TMB. Forex trading income grew 19.78% y/y to KES 5.91Bn highlighting the arbitrage opportunities in the market brought about by the dollar shortage. Net interest income growth was driven by a 28.61% y/y increase in interest income from higher interest from loans and government securities but weighed down by a faster increase in interest expense by 76.63% y/y, mainly from the Kenyan subsidiary. Consequently, the NII:NFI revenue mixed shifted to 62:38 in favor of non-funded income from 68:32 in HY'22. The lenders balance between higher asset yields and sourcing for cheaper deposits in a high interest environment led to a 174bps y/y decline in Net Interest Margin (NIM) to 6.74% from 8.48% in HY'22. Yield on assets declined 1.54bps y/y to 9.81%. Cost of funds marginally increased by 21bps y/y to 3.25% highlighting the effects of the rising interest environment.
- **Asset Quality Concerns Persist:** Gross NPLs edged up 4.94% y/y to KES 182.00Bn while the NPL ratio declined by 421bps y/y to 17.20%, higher than the latest industry average of 14.50%. Meanwhile, the NPL coverage improved by 530bps y/y to 51.12% driven by a faster growth in provisioning, mainly in the Kenyan subsidiary. Foreign currency loans contributed KES 8.00Bn while TMB added an additional KES 9.00Bn. KCB's huge NPL figure remains a concern for investors, and we expect continued pressure on asset quality given the tough operating environment and continued depreciation of the local currency. Notably, we observed recovery efforts bearing fruit with KES 32.00Bn being recovered.

Other Performance Metrices

Digital Channels Growth Not Enough to Improve Efficiency- The Cost to Income ratio less impairment grew 965bps y/y to 55.32% from 45.66% in HY'22 mainly attributed to the 60.02% y/y growth in operating expenses compared to the slower growth in operating income by 22.17% y/y. The significant growth in operating expenses was attributable to consolidation of TMB, restructuring of business and provision for NBK's legal award. The cost of assets less impairment increased by 18bps y/y to 2.63%. In line with the industry trend, loan loss provisioning increased 135.98% y/y to KES 10.19Bn of which the Kenyan subsidiary contributed 77.95% being KES 7.94Bn (+141.64% y/y) indicating increased lending risk in the Kenyan business.

Subsidiary Performance – The regional subsidiaries consolidation continued to payoff with the regional businesses' (outside Kenya) contribution to profit before tax increasing by 166.00% y/y to 38.10% in HY'23.

Graph 1: Subsidiary Contribution to Profit Before Tax (PBT)



I. **TMB Bank of DRC** – Following the completion of the 85.00% stake purchase in TMB, the subsidiary has been consolidated to the groups core banking system. The consolidation of TMB subsequently led to an increase in the groups operating expenses. We observed the consolidation of TMB business proving to be a profitable with the subsidiary contributing 22.00% of the 54.08% y/y increase in total assets to KES 1.86Tn and 10.00% of the 32.10% y/y growth of the loan book. Additionally, TMB contributed 16.20% of the 61.93% y/y growth of customer deposits. We expect continued strong performance from TMB with the main value propositions including: 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 3) DRC's market is highly dollarized giving KCB access to dollar supply within the Group operations.

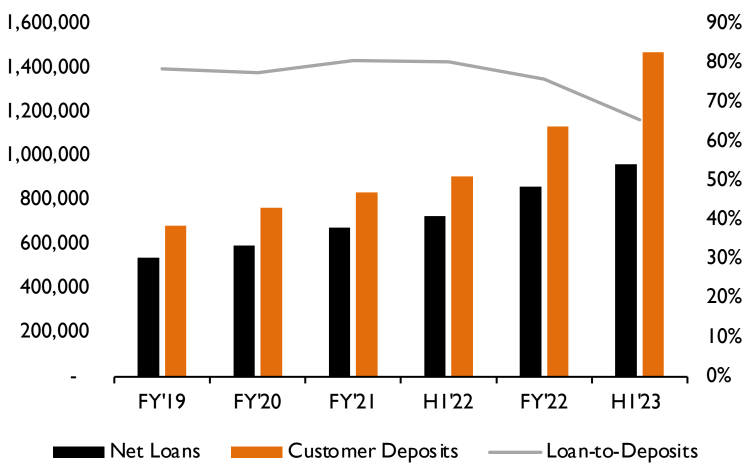
II. **National Bank of Kenya (NBK)** – We observed a 680.81% y/y decline in PAT to a loss of KES 3.84Bn driven by a decline in operating income by 5.55% y/y to KES5.44Bn and a 93.45% y/y increase in operating expenses to KES 9.28Bn. The increase in operating expenses included provisioning for a court ruling that went against the bank. The loan book expanded by 11.96% y/y to KES 77.21Bn faster than the customer deposit growth of 4.80% y/y to KES 117.85Bn. Notably, Gross NPLs declined 16.64% y/y to KES 23.45Bn with impairment provisioning increasing 73.35% to KES 0.98Bn. NBK remained undercapitalized following an increase in risk weighted assets compared to a decrease in core capital. The Group announced the need to recapitalize NBK and is in the process of transitioning and merging NBK's and KCB's core banking systems which is expected to reduce operating expenses in the long run.

Outlook – We foresee Non-Funded Income growth to be driven by TMB business, growth in trade financing and supported by growth in digital channels. Notably, the onboarding into the Pan African Payment Platform System (PAPS) is likely to drive trade Finance lending. Going forward, continued strong growth in the balance sheet will be on the back of integration and consolidation of the recently acquired regional subsidiaries. We foresee the banks lending will continue to be supported by implementation of risk-based pricing models and financing to key economic sectors such as trade and manufacturing. Furthermore, we anticipate the lender's diversification into asset management and the growth of KCB Investment Banking Services will be key contributors to income growth. However, we remain concerned with the weak Kenyan Subsidiary and NBK performance. We are concerned with the historically above average NPL ratio and thin capital buffers which may lead a balance between NPL monitoring and additional capital injection.

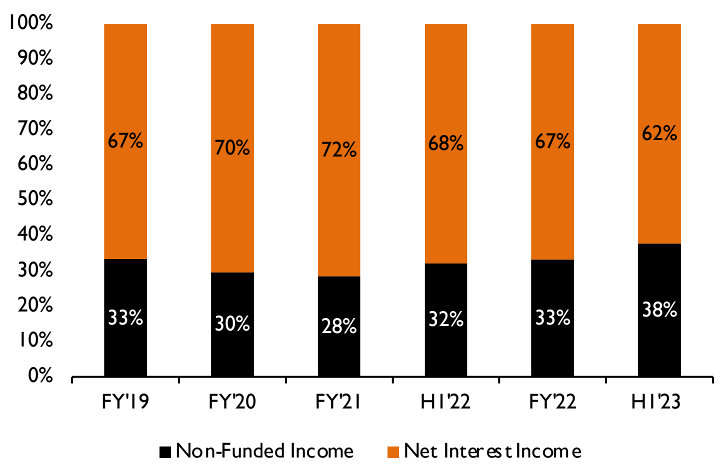
Valuation – The counter is currently trading at a P/B multiple of 0.41x and a P/E ratio of 2.77x. The counter closed yesterdays trading at KES 26.90, a 52-week low and a YTD loss of 29.40%. We maintain our **BUY** recommendation on the counter as we believe the current price provides an attractive entry point for long term investors with a target price of KES 38.60 representing an upside potential of 43.49%.

KCB Group HY'23 Earnings Charts

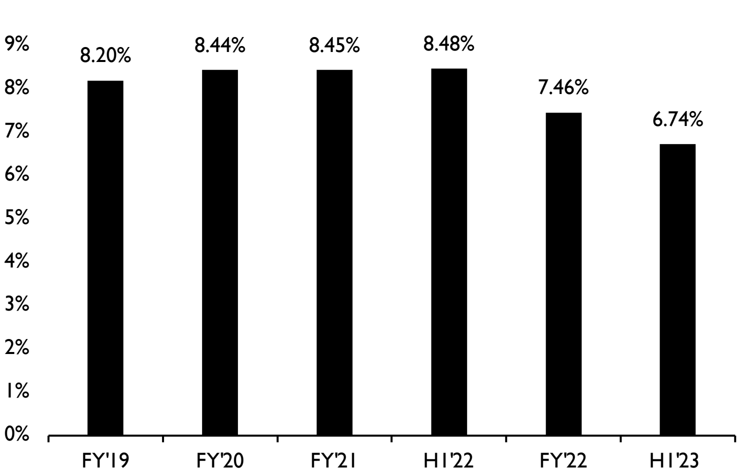
Graph 2: Customer Deposits continue to drive Balance sheet growth



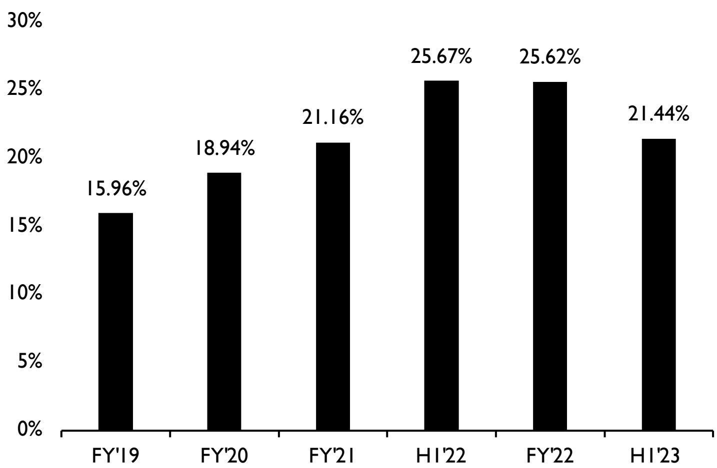
Graph 3: Revenue mix continues to favour Net Interest Income



Graph 4 We observed a slight decline in Net Interest Margins



Graph 5: Forex Income as a % of Non-Funded Income slows down



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

Financial Statement Summary

1. Statement of Profit and Loss

Income Statement	FY'19	FY'20	FY'21	H1'22	FY'22	H1'23	y/y % Change
Net Interest Income	56,131.00	67,535.86	77,694.02	40,591.53	86,653.31	45,508.33	12.11%
Net non-Interest Income	28,171.54	28,450.60	30,940.59	19,215.62	43,251.52	27,560.02	43.43%
Total Operating income	84,302.54	95,986.46	108,634.61	59,807.15	129,904.82	73,068.35	22.17%
Provision for Impairment	(8,888.94)	(27,508.44)	(12,988.10)	(4,318.68)	(13,206.88)	(10,191.36)	135.98%
Total Operating expenses	(47,405.18)	(70,669.30)	(60,820.30)	(31,628.75)	(72,573.47)	(50,610.97)	60.02%
Profit before tax	**36,897.36**	**25,317.16**	**47,814.30**	**28,178.40**	**57,331.35**	**22,457.38**	-20.30%
Profit after tax	**25,165.17**	**19,201.92**	**34,091.63**	**19,521.78**	**40,613.52**	**15,595.58**	-20.11%
Core EPS Annualized	7.83	5.98	10.63	12.23	12.71	9.99	-18.27%

2. Statement of Financial Position

	FY'19	FY'20	FY'21	H1'22	FY'22	H1'23	y/y % Change
Government Securities	128,459.45	208,764.86	270,835.05	277,843.95	278,020.34	362,422.83	30.44%
Loans and Advances	539,747.26	595,254.30	675,480.44	730,335.49	863,268.08	964,808.68	32.10%
Total Assets	**898,572.21**	**987,810.25**	**1,139,672.57**	**1,210,107.54**	**1,554,029.97**	**1,864,591.05**	54.08%
Customer Deposits	686,583.18	767,224.47	837,141.38	908,573.11	1,135,417.38	1,471,246.36	61.93%
Total Liabilities	768,831.11	845,385.97	966,164.96	1,028,357.80	1,347,753.71	1,646,593.61	60.12%
Shareholder's Funds	**129,741.11**	**142,424.28**	**171,713.20**	**179,113.25**	**200,200.42**	**211,232.04**	17.93%

3. Key Metrics

	FY'19	FY'20	FY'21	H1'22	FY'22	H1'23
Growth Metrices (y/y)						
Loan book Growth	18.40%	10.28%	13.48%	20.33%	27.80%	32.10%
Customer Deposits Growth	27.75%	11.75%	9.11%	15.59%	35.63%	61.93%
PAT Growth	4.88%	-23.70%	77.54%	27.59%	19.13%	-20.11%
Spreads Analysis						
Yield on Assets	10.87%	11.09%	11.11%	11.35%	10.14%	9.81%
Cost of Funds	2.78%	2.73%	2.81%	3.04%	2.86%	3.25%
Net Interest Margin	8.20%	8.44%	8.45%	8.48%	7.46%	6.74%
ROaE	20.68%	14.11%	21.76%	23.20%	21.96%	19.08%
ROaA	3.12%	2.04%	3.21%	3.45%	3.03%	2.42%
Profit Margin	29.85%	20.00%	31.46%	32.85%	31.44%	21.98%
Operating Effiency						
Cost of Income Less LLP	45.69%	44.97%	44.03%	45.66%	45.70%	55.32%
Cost of Assets	4.78%	4.58%	4.50%	2.45%	4.41%	2.63%
Loan to Deposit	78.61%	77.59%	80.69%	80.38%	76.03%	65.58%
Asset Quality						
NPL	10.98%	14.80%	16.59%	21.42%	17.01%	17.20%
NPL Coverage	59.47%	59.78%	52.93%	45.82%	52.39%	51.12%
Cost of Risk	10.54%	28.66%	11.96%	7.22%	10.17%	13.95%
Capital Adequency						
Core Capital/TRWA	17.20%	17.90%	18.00%	17.70%	13.90%	15.00%
Total Capital /TRWA	19.00%	19.50%	21.70%	21.60%	17.10%	18.40%
Liquidity	0.00%	0.00%	39.10%	39.00%	40.90%	52.10%

Source: Company Fillings, AIB-AXYS Estimates

Research Desk

Solomon Kariuki
Research Analyst

Stacy Makau
Research Analyst

Email: research@aibaxysafrica.com

Equities Dealing

Nina Goswami

Bernard Kung'u

Bernard Gichuru

Brian Tanui

Samuel Githinji

Sheema Shah

Samuel Wachira

Benson Ngugi

Email: trading@aib-axysafrica.com

Bonds Dealing

Crispus Otieno

Titus Marenye

Aundrina Musyoka

Kenneth Minjire

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