



Proposed Acquisition By KCB Group Of Trust Merchant Bank SA

On 2nd August 2022, KCB Group announced the proposed acquisition of an 85.00% shareholding in the Trust Merchant Bank SA of DR Congo, with an option for a full takeover in two years. Subject to regulatory and shareholders' approval, the completion of the transaction will see KCB acquire control of TMB and open doors for an entry into the much-coveted DRC market. Assuming a similar timeline to the Equity Group's acquisition of BCDC Bank in 2020, we expect the transaction to be completed in Q1'23.

KCB is expected to pay a cash consideration which we estimate will be **KES 15.73Bn – KES 18.51Bn**. The transaction is priced at a P/Bv of **1.49x** which is 44.66% above the average transaction multiple of **1.03x** for regional takeover deals involving Kenyan banks since 2020. However, given the potential in the Congolese market and the growth figures we have seen within TMB, we expect the purchase to be a worthwhile venture in the future.

Table 1 : Regional Transactions Involving Kenyan Banks Since 2020

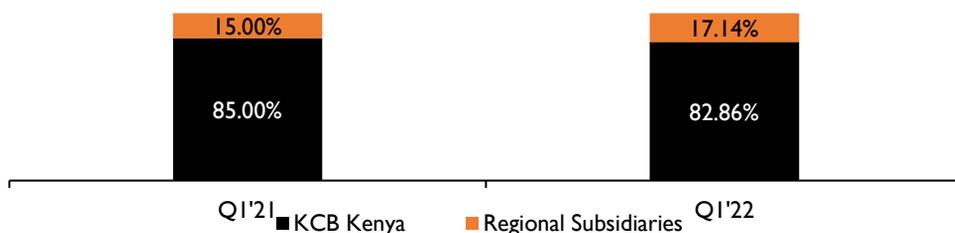
Acquirer	Target	P/Bv Multiple	Transaction Date
1. Access Bank (Nigeria)	Transnational Bank (Kenya)	0.74x	Feb-2020
2. I & M Holdings (Kenya)	Oriental Bank (Uganda)	1.09x	July-2020
3. Equity Group (Kenya)	BCDC (DRC)	1.20x	Aug-2020
4. KCB Group (Kenya)	BPR (Rwanda)	1.10x**	May -2021
Average P/Bv Multiple		1.03x	

** - An estimated figure as it was not disclosed

Source: Company filings, AIB-AXYS Estimates

KCB Roaring In The Region: The TMB acquisition follows the completion of the takeover of BPR Rwanda in Q1'22 which was merged with KCB Rwanda to create a larger entity. As per the Q1'22 Earnings, regional subsidiaries contributed 17.2% (KES 2.40Bn of KES 14.00 Bn total PBT) higher than the 15.00% recorded in Q1'21.

Graph 1 : Subsidiary Contribution to PBT- Q1'22 vs Q1'21



Source: Company filings, AIB-AXYS Estimates

04th August 2022

Current price: KES 40.75

Target price: KES 52.45

Upside: 28.71%

52 Week High: KES 49.90

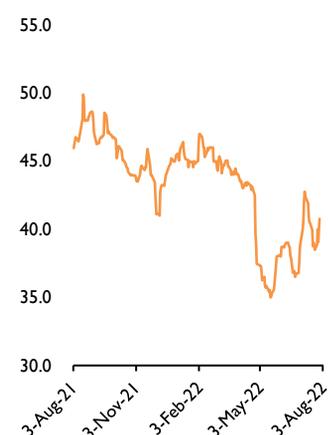
52 Week Low: KES 35.00

YTD Performance: -10.34%

EPS (FY21): KES 10.64

DPS (FY21): KES 3.00

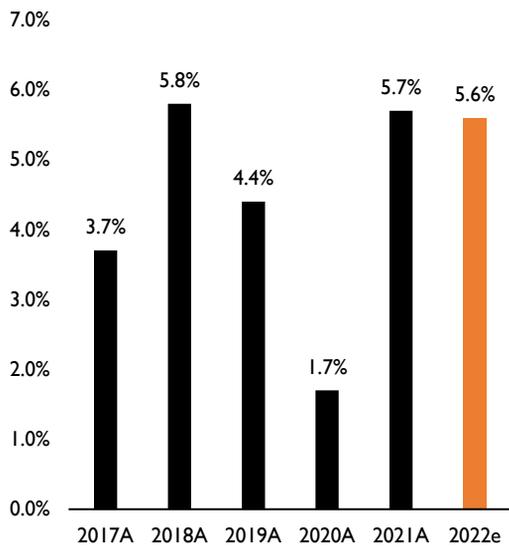
KCB Group 1-Year Share Price Movement



Analyst

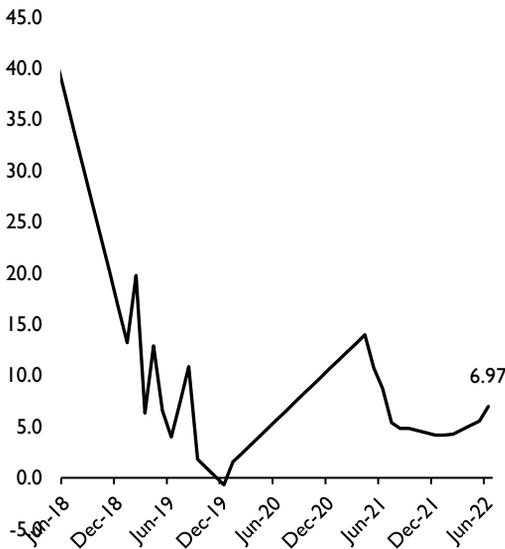
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Graph 2 : Real GDP Growth (Actual and Estimated)



Source: Banque Centrale du Congo (BCC)

Graph 3 : y/y Inflation for the Last 4 Years



Source: Banque Centrale du Congo (BCC)

➤ **DRC Economy:** The country was recently admitted into the East African Community as the bloc's 7th partner state. DRC is endowed with abundant natural resources and minerals; cobalt, copper, massive hydropower potential, significant arable land; and boasts the region's largest population, est. 93.00Mn people, made up mostly of the youth. Key highlights on the economy include:

- **Recovering Economy** - DRC's economy is recovering from years of political instability and conflict, especially in the mineral-rich eastern provinces. The economy expanded by 5.70% in 2021, on the back of the strength in the mining sector and recovery in non-mining sectors. However, the country has been experiencing pockets of conflict in some regions of the country with need for UN peacekeepers. Given TMB's focus on major urban centres coupled with Equity BCDC's success, we do not see the conflicted zones as a threat to operations.
- **Struggling currency** - The Congolese Franc, CDF, has experienced minimal currency devaluation of 0.42% in 2022 to trade at 1,996.22 against the USD, mainly supported by commodities inflows. The economy is highly dollarized with most deposits being held in dollar amounts as commerce remains distrustful of the local currency.
- **Mining Sector Driving Economic Growth** – The mining sector has remained as the key growth driver with copper and cobalt production rising by 12.00% and 7.60% respectively in 2021. Non-mining sectors (specifically agriculture and services) grew by 3.90% in 2021 despite economic restrictions due to the pandemic. The Current Account Deficit narrowed to 1.00% of GDP in 2021 (from 2.20% in 2020) on rising mining export volumes and improved terms of trade.

DRC Banking Sector: The banking sector is comprised of the central bank; Banque Centrale du Congo (BCC) and fifteen - commercial banks - with eleven of these majorly controlled by foreigners. On a bank per customer basis a single bank serves 6.20mn people compared to Kenya's 1.39Mn people per bank. Seventeen - Savings and Credit Cooperatives (SACCOs), Seven - deposit taking Microfinance Institutions (MFIs), financial transfer services, and one development bank, Societe Financiere de Developement (SOFIDE). We see the financial market as largely underdeveloped as it lacks a capital market and has a low banking penetration (17.00% vs Kenya's 88.00%) translating to increased lending opportunities for KCB.

Table 2 : TMB vs KCB Key Ratios Comparison With FY'20 as the Base Case

Ratio (FY'20)	TMB	KCB
NFI/Operating Income	83.61%	29.64%
YIEA	9.10%	10.45%
Cost of Funds	2.46%	2.73%
Cost to Income	76.28%	44.97%
ROaE	0.90%	14.11%
ROA	0.08%	2.04%
Loan/Deposit	32.08%	77.59%

Source: Company filings, AIB-AXYS

Trust Merchant Bank was established in 2004 and has grown to be the largest bank in DRC in terms of Branch network (110 Branches) and with the largest client base. Locally, the bank is viewed as a pioneer in financial inclusion as it was the first bank to offer Mobile banking through their platform *Pepele*, while also holding a bancassurance arm. Unlike the competitors who are based in the capital Kinshasa, the bank is headquartered in Lubumbashi, which is the capital of Copper mining and thus offers exposure to the rich minerals sector. On completion of the deal KCB will take over close to USD 1.50 Bn (**KES 138.77Bn**) in asset size and based on our estimates on the deal timeline and our KCB asset size growth we foresee KCB hitting an asset size of **KES 1.54Tn** in Q1'23. We see TMB remaining in an investment phase in the near term and should contribute significantly to KCB's bottom line by FY'25.

Based on the recent published results, FY'20, we made some key observations;

- **TMB should focus on improving efficiency:** Cost to income ratio has largely remained above the 70.00% levels, since 2016, which we view as a sign of low efficiency. We attribute this to a faster growth in operating expenses from the large branch network compared to the Net Operating Income. We recommend a focus on digital banking which will reduce Opex driving down the COI ratio to a preferable mid 40's. With 98.00% of transaction volumes in KCB been non-branch, we see TMB working towards achieving a similar feat given an already existing *Pepele* Mobile platform which has 1700 agents.
- **Impressive Balance Sheet Growth:** Deposits (+36.28% CAGR) have been growing faster than loans (+23.71% CAGR) in the five years to 2020. As such, the loan to deposit ratio has remained below the high of 47.25% recorded in 2016 and has been declining to close at 32.08% in 2020. As seen in the high NFI contribution to revenue as compared to KCB, the DRC banking sector is highly reliant on transactional charges as the absence of CRBs poses a risk pricing challenge when lending. Therefore, KCB should seek ways to accommodate an increase in lending bearing in mind the already huge NPLs in their books. With Lubumbashi being a minerals and trading hub, we recommend a focus on the mining, trade finance and asset lease financing sectors.

Impact on KCB's Share Price: We expect the news of the regional expansion to excite investors and is likely to continue to a share price rally. The counter closed 3rd August at KES 40.75 which was 1.75% higher than the previous trading session. On the downside the commitment to conclude the transaction by Q3'22 could see investors miss out on an interim dividend given that it is a cash transaction. Additionally, the need for further capital support to TMB could affect dividend payment ratio which we see as likely to remain below 30.00% level until FY'25. However, we maintain our dividend estimate of KES 3.00 at the close of FY'22. Additionally, we also maintain our BUY recommendation as the counter is still trading below our target price of KES 52.45 representing a 28.71% upside.

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