

# DYER & BLAIR INVESTMENT BANK

## EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

14<sup>TH</sup> NOVEMBER 2018



DYER & BLAIR  
INVESTMENT BANK

WE KNOW. YOU KNOW.

### KCB GROUP: 3Q18 EARNINGS UPDATE

Dear All,

KCB Group released its 3Q18 results recording a 19.7% y-o-y growth in profit after tax (PAT) to KES 18.0 BN. EPS for the period stood at KES 7.85. Trailing EPS stands at KES 7.72 (up 9.8% q-o-q). Annualized ROA and ROE multiples rose 39 bps and 333 bps y-o-y to 3.5% and 22.8% respectively.

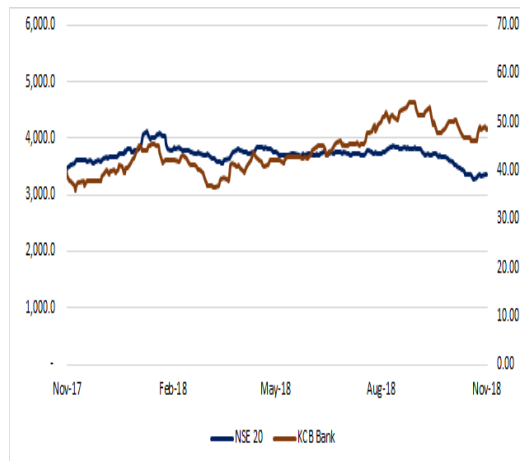
Below please find key highlights:

**Net interest income rose 1.8% y-o-y to KES 36.3 BN (down 4.4% q-o-q)** on the back of a 5.1% y-o-y rise in interest income to KES 49.2 BN (up 2.4% q-o-q) and a 16.0% y-o-y rise in interest expense to KES 12.9 BN. Annualized yield on interest earning assets declined 10 bps y-o-y to 11.8% whereas annualized cost of funds rose 24 bps y-o-y to 3.0%. Consequently, annualized net interest margin declined 34 bps y-o-y to 8.8%.

**Interest income from loans and advances rose 5.2% y-o-y to KES 39.0 BN.** As a result, annualized yield on average loans rose 78 bps y-o-y to 12.2% (same as at 1H18). Interest income from government securities rose 4.9% y-o-y to KES 9.7 BN, annualized yield on average government securities position came in at 11.6%. Interest expense on customer deposits grew 13.9% y-o-y to KES 11.3 BN. As a result, annualized cost of deposits rose 11 bps y-o-y to 2.9%. We associate the increase in cost of deposits to a 300 bps y-o-y increase in the proportion of term deposits to 26.0% and a 500 bps y-o-y decrease in the proportion of demand deposits to 61.0%.

**Non-funded income rose 2.6% y-o-y to KES 17.9 BN (+8.8% q-o-q).** This followed a 2.0% y-o-y decline in fees and commission income to KES 11.0 BN, comprising a 7.9% y-o-y decline in fees from loans and advances to KES 4.4 BN and a 2.4% y-o-y increase in other fees and commissions to KES 6.6 BN. Forex income rose 1.5% y-o-y to KES 3.9 BN whereas other operating income rose 24.1% y-o-y to KES 3.3 BN. Funded income reliance declined 18 bps y-o-y to 66.9%.

### KCB GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE	ABSOLUTE	EXCESS
RETURN	RETURN	RETURN
3 month (%)	(21.9)	(6.8)
6 month (%)	(23.1)	(4.1)
12 month (%)	(3.2)	20.7

### KEY METRICS

Current Price (KES)	38.25
52 week Range (KES)	35.75-54.00
YTD Return (%)	(10.5)
Issued Shares (MN)	3066.1
Market Cap (USD MN)	1,142.4

Recommendation	BUY
Target Price	57.83
Trailing EPS (KES)	7.72
NAV (KES)	34.40
P/E (x)	5.0
P/B (x)	1.1
Div Yld (%)	-

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#### LOAN BOOK COMPOSITION

Sector	Composition
Mining	0.3%
Energy & Water	3.8%
Agric.	2.8%
Tourism	3.2%
Financials	5.3%
Transport	4.7%
Construction	8.6%
Trade	8.2%
Manufacturing	10.6%
Real estate	17.1%
Personal	35.5%

Source: Company

*Customer deposits mix remained fairly unchanged at 51.0%-46.0% for corporate and retail segments with other deposits accounting for 3.0%.*

**Operating expenses (less loan loss provisions) declined 2.8% y-o-y to KES 26.8 BN.** This followed a 7.4% y-o-y decline in staff costs to KES 12.8 BN and a 1.5% y-o-y rise in other operating expenses to KES 10.6 BN. Cost efficiency gains especially around staff costs follow FY17's one off staff restructuring cost of about KES 2.0 BN that affected about 316 staff (249 in KCB Kenya). Cost to income ratio declined 245 bps y-o-y to 49.5%.

**Loans and advances rose 3.8% y-o-y to KES 435.3 BN** (up 3.3% q-o-q). Customer deposits on the other hand rose 6.2% y-o-y to KES 526.8 BN (up 0.4% q-o-q) whereas borrowed funds rose 43.7% y-o-y to KES 20.7 BN following a USD 100.0 MN line of credit that the group obtained from the African Development Bank in 1Q18 for on-lending to corporate businesses and SMEs. The loan to deposit ratio declined 190 bps y-o-y to 82.6% while the loans to deposits and borrowed funds ratio declined 264 bps y-o-y to 79.5%.

**87% of transactions were non branch** comprising of 42.0% via mobile channels, 33.0% via agency, internet and POS, and 12.0% via ATMs. Overall, revenue from non-branch channels rose 11.6% to KES 2.3 BN.

**KCB Bank Kenya's core capital ratio (core capital: total risk-weighted assets) rose 120 bps y-o-y to 15.0% (+20 bps q-o-q).** The total capital to risk weighted assets ratio declined 20 bps y-o-y to 16.5% (+10 bps q-o-q). IFRS 9-provisions adjusted core and total capital ratios stood at 16.4% and 17.9% respectively indicating that so far the IFRS 9 related impact on capital is about 140 bps. Liquidity ratio rose 120 bps y-o-y to 30.4%.

**Gross NPLs remained flat at KES 34.8 BN (+0.1% y-o-y, down 7.6% q-o-q).** Total NPL (gross NPL less interest in suspense) declined 1.5% y-o-y to KES 30.5 BN. The NPL ratio declined 25 bps y-o-y to 7.4% (down 80 bps q-o-q). The NPL coverage ratio (loan loss provision/ total NPL) declined 918 bps y-o-y to 54.9%.

**Notably, Loan loss provision expense declined 42.6% y-o-y to KES 1.8 BN** placing annualized cost of risk at 0.6%. We attribute this to the FY18's day one impact of IFRS 9 adoption and expect that cost of risk will revert back to 1.2%-1.4% as from FY19. That said KCB's pre-provisions operating profit rose 7.3% y-o-y to KES 27.4 BN indicating that varied factors explain its earnings growth namely income growth, drop in operating expenses and a lower cost of risk.

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### 3Q18 RESULTS CONFERENCE CALL

- **DATE:** MON 19<sup>TH</sup> NOV 2018
- **TIMES:** 16:00 Nairobi | 15:00 Johannesburg | 13:00 London | 08:00 New York

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**Across sectors and on a q-o-q basis**, check-off loans related NPLs declined 80 bps y-o-y to 2.4%, mortgage related NPLs declined 30 bps to 7.5%, corporate related NPLs declined 200 bps y-o-y to 9.6% and MSME related NPLs also declined 90 bps y-o-y to 14.3%.

**FY18 outlook:** Given the uncertainty on the regulatory environment, management has maintained its outlook from the beginning of the year namely: a return on equity of 21.1%, a cost to income ratio of 46.0% excluding one-off restructuring costs, an NPL ratio of 7.0%, a non funded income reliance ratio of 30.9%, a cost of risk of 1.3%, a deposit growth of 11.0% and a loan book growth of 8.0%. Cost of funds are aimed at 3.3% whereas net interest margin is targeted at 8.7%.

**Going forward:** We are positive on KCB given; improving capital adequacy ratios, improving asset quality, and improving cost efficiencies. The medium term regional outlook remains positive buoyed by positive political narratives from Kenya's "handshakes", South Sudan's new peace agreement, and the fact that the next election cycle in the region is now more than three years away. Risks to outlook include delay of payments by government related entities and an evolving regulatory environment especially the uncertainty on whether the interest rate caps will be repealed or not.

**On a trailing basis**, KCB is trading at a P/E multiple of 5.0x below the sector median of 6.2x and a P/B multiple of 1.1x above the sector median of 0.86x. Its ROA and ROE multiples stand at 3.5% and 22.8% against sector medians of 2.3% and 17.1% respectively. We maintain our **BUY** recommendation.

## PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	3Q18	3Q17	y-y% ch	3q18	2q18	3q17	y-y% ch	q-q% ch
Interest income	49,170	46,764	5.1	16,951	16,551	16,401	3.4	2.4
Interest expense	12,865	11,091	16.0	4,791	3,832	3,877	23.6	25.0
Net interest income	36,305	35,673	1.8	12,159	12,719	12,524	(2.9)	(4.4)
Other operating income	3,252	2,621	24.1	1,371	994	987	38.9	38.0
Fees and commission income	11,005	11,232	(2.0)	4,230	3,153	4,022	5.2	34.1
Net income from forex dealings	3,685	3,632	1.5	861	1,791	987	(12.8)	(51.9)
Total non-interest income	17,942	17,484	2.6	6,462	5,939	5,996	7.8	8.8
Total income	54,247	53,157	2.0	18,621	18,658	18,520	0.5	(0.2)
Less operating expenses	26,839	27,603	(2.8)	9,137	8,819	9,730	(6.1)	3.6
Operating profit	27,407	25,554	7.3	9,484	9,838	8,790	7.9	(3.6)
Bad debt charge	(1,799)	(3,137)	(42.6)	(972)	(227)	(1,124)	(13.6)	327.4
Exceptional items	-	0	-	0	-	-	-	-
Profit before tax	25,608	22,418	14.2	8,513	9,611	7,665	11.1	(11.4)
Less tax	(7,564)	(7,341)	3.0	(2,580)	(2,683)	(2,850)	(9.5)	(3.9)
Profit after tax	18,044	15,076	19.7	5,933	6,928	4,815	23.2	(14.4)
Attributable Income	18,044	15,076	19.7	5,933	6,928	4,815	23.2	(14.4)
EPS (KES)	7.85	6.56	19.7	3.90	2.26	3.21	21.4	72.6

(Source: Company, DBIB Research)

## BALANCE SHEET SUMMARY (KES MN)

Year End: December	3Q18	1H18	3Q17	y-y % ch	q-q % ch
Total shareholder's equity	105,462	98,984	103,193	2.2	6.5
Minority interest	0	0	0	-	0.0
Total Equity	105,462	98,984	103,193	2.2	6.5
Deposits due to other banks	12,641	8,570	10,501	20.4	47.5
Customer deposits	526,844	524,939	496,305	6.2	0.4
Borrowed funds	20,725	20,699	14,424	43.7	0.1
Other liabilities	18,493	14,491	19,410	(4.7)	27.6
Total equity and liabilities	684,165	667,682	643,833	6.3	2.5
Central bank balances	39,712	37,346	42,524	(6.6)	6.3
Deposits due from banks	39,507	49,637	42,280	(6.6)	(20.4)
Investment securities	119,529	112,545	103,647	15.3	6.2
Held for dealing securities	0.0	0	0	-	-
Customer loans and advances	435,281	421,509	419,494	3.8	3.3
Other assets	36,746	33,231	23,202	58.4	10.6
Intangible assets	2,958	3,086	3,379	(12.4)	(4.1)
Fixed assets	10,431	10,329	9,307	12.1	1.0
Total assets	684,165	667,682	643,833	6.3	2.5

(Source: Company, DBIB Research)

## INVESTMENT RETURN

	3Q18	1H18	3Q17	y-y bps ch	q-q bps ch
ROA (%)*	3.5	3.6	3.1	39	(11)
ROIC (%)*	3.7	3.8	3.3	41	(7)
ROE (%)*	22.8	24.5	19.5	333	(166)

(Source: Company, DBIB Research)

\*Annualized

## CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	3Q18	1H18	3Q17	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	15.0	14.8	13.8	120	20
Min. Statutory Ratio (%)	10.5	10.5	10.5	0	0
Total capital/TRWA (%)	16.5	16.4	16.7	(20)	10
Min. Statutory Ratio (%)	14.5	14.5	14.5	0	0
Liquidity Ratio (%)	30.4	31.8	29.2	120	(140)
Min. Statutory Ratio (%)	20.0	20.0	20.0	0	0

NPL Ratio (%)	7.4	8.2	7.6	(25)	(80)
NPL Coverage Ratio (%)	54.9	58.6	64.0	(918)	(370)
Long Term Debt to Total Liabilities and Equity (%)	3.0	3.1	2.2	79	(7)
NTA/share (KES)	31.0	28.9	30.6	37	208
Book value/share (KES)	34.4	32.3	33.7	74	211
Payout ratio (%)	-	25.3	-	0	(2532)
Adj payout ratio (%)	-	25.3	-	0	(2532)

(Source: Company, DBIB Research)

\*\*Total Loan Portfolio net of Interbank Lending

## OPERATING PERFORMANCE

	3Q18	1H18	3Q17	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	11.8	12.1	11.9	(10)	(25)
Cost of funds (%)*	3.0	2.9	2.8	24	15
Net Interest Margin (%)*	8.8	9.2	9.1	(34)	(40)
Loan-to-Deposits ratio (%)	82.6	80.3	84.5	(190)	232
Loan-to-Dep. & Borrowed Funds ratio (%)	79.5	77.3	82.1	(264)	224
Funded Income Generating Potential (%)	81.1	80.0	81.3	(16)	111
Funded Income Reliance (%)	66.9	67.8	67.1	(18)	(85)
Cost to income ratio (%)	49.5	49.7	51.9	(245)	(21)
Pre-tax margin (%)	47.2	48.0	42.2	503	(78)
PAT margin (%)	33.3	34.0	28.4	490	(73)

(Source: Company, DBIB Research)

\*Annualized

## APPENDIX

### COMPANY INVESTMENT RATINGS

**Buy:** Share price may generate more than 15.0% upside over the next 12 months

**Overweight:** Share price may generate between 5.0% and 15.0% upside over the next 12 months

**Hold:** Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

**Underweight:** Share price may generate between 10.0% and 15.0% downside over the next 12 months

**Sell:** Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

**Not Rated:** Counter is not within regular research coverage

### SECTOR INVESTMENT RATINGS

**Overweight:** Industry performance better than that of the whole market

**Equal weight:** Industry performance about the same as that of the whole market

**Underweight:** Industry performance worse than that of the whole market

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