

DYER & BLAIR INVESTMENT BANK

EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

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DYER & BLAIR
INVESTMENT BANK

WE KNOW. YOU KNOW.

KCB GROUP HOLDINGS: FY19 EARNINGS UPDATE

Dear All,

KCB GROUP released its FY19 results recording a 4.9% y-o-y increase in profit after tax (PAT) to KES 25.2 BN partly on account of post-NBK's acquisition impact on cost of risk. Pre-provisions operating earnings rose 24.4% y-o-y to KES 45.8 BN but bad debt provisions surged 201.9% y-o-y to KES 8.9 BN to see the annualized cost of risk at 1.8%. Trailing EPS stands at KES 8.11.

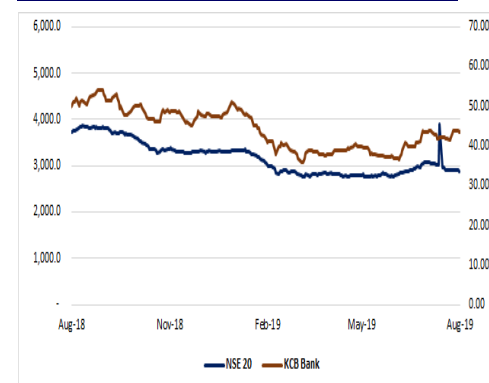
Below please find key highlights:

Net interest income rose 15.0% y-o-y to KES 56.1 BN on the back of a 12.2% y-o-y rise in interest income to KES 74.4 BN and a 4.4% y-o-y rise in interest expense to KES 18.2 BN. Annualized yield on interest earning assets declined 96 bps y-o-y to 10.6% whereas annualized cost of funds declined 54 bps y-o-y to 2.6%. Consequently, net interest margin declined 41 bps y-o-y to 8.0%.

Interest income from loans and advances rose 12.0% y-o-y to KES 59.0 BN placing the annualized yield on average loans at 11.9%, down 9 bps y-o-y reflecting the impact of Central Bank Policy rate cuts given that a sizable portion of loan book growth follows the consolidation of NBK. Interest income from government securities rose 8.3% y-o-y to KES 14.1 BN placing the annualized yield on average government securities at 9.7%, down 156 bps courtesy of FY19's government securities rally. Interest expense from customer deposits rose 5.2% y-o-y to KES 16.3 BN placing the annualized cost of average customer deposits at 2.7%, down 32 bps y-o-y following the consolidation of NBK.

Non-funded income rose 22.6% y-o-y to KES 28.2 BN. This followed a 39.4% y-o-y rise in total fees and commissions to KES 19.9 BN. Forex income rose 2.8% y-o-y to KES 4.5 BN. Other operating income declined 12.3% y-o-y to KES 3.8 BN. Fees and commissions on loans and advances rose 23.4% y-o-y to KES 9.2 BN whereas other fees and commissions rose 57.0% y-o-y to KES 10.7 BN. Funded income reliance ratio declined 142 bps y-o-y to 66.6%.

KCB GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE	ABSOLUTE	EXCESS
RETURN	RETURN	RETURN
3 months (%)	(6.9)	3.6
6 months (%)	26.4	31.1
12 months (%)	10.8	30.7

KEY METRICS

Current Price (KES)	45.85
Target Price (KES)	UNDER REVIEW
52 week Range (KES)	36.30-55.00
YTD Return (%)	(9.9)
Issued Shares (Mn)	3,209
Market Cap (USD Mn)	1,524

Recommendation	BUY
Trailing EPS (KES)	8.11
NAV (KES)	40.43
P/E (x)	5.7
P/B (x)	1.1
Div. Yield (%)	7.6

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Operating expenses (less loan loss provisions) rose 10.0% y-o-y to KES 38.5 BN mainly on the back of a 14.4% y-o-y rise in staff costs to KES 19.5 BN and a 7.3% y-o-y rise in other operating expenses to KES 14.2 BN. Cost to income ratio declined 306 bps y-o-y to 45.7%.

Customer loans and advances grew 17.4% y-o-y to KES 535.4 BN (+10.1% q-o-q) whereas investment securities rose 41.0% y-o-y to KES 169.2 BN. On the funding side, customer deposits rose 27.7% y-o-y to KES 686.6 BN whereas borrowed funds declined 4.3% y-o-y to KES 21.5 BN. Loan to deposit ratio declined 685 bps y-o-y to 78.0% whereas loans to deposits and borrowed funds ratio declined 581 bps y-o-y to 75.6%.

KCB Kenya's core capital ratio (Core capital/TRWA) declined 80 bps y-o-y to 15.6% above the statutory minimum of 10.5% while Total capital/TRWA declined 30 bps y-o-y to 17.1% above the statutory minimum of 14.5%.

	KCB Kenya		Group	
	Without IFRS 9	With IFRS 9	Without IFRS 9	With IFRS 9
Core capital ratio	16.2	15.6	17.6	17.2
Total capital ratio	18.1	17.1	19.5	19.0

Source: Company,

** Without IFRS 9 shows the capital ratio that include the expected credit loss provisions added back to capital in line with the CBK guidance note issued in April 2018 on implementation of IFRS 9.*

Gross non-performing loans rose 93.9% y-o-y to KES 63.4 BN. Interest in suspense rose 118.1% y-o-y to KES 9.0 BN. As a result, total NPLs (Gross NPLs less interest in suspense) rose 90.4% y-o-y to KES 54.4 BN. The NPL ratio rose 390 bps y-o-y to 10.6% while the NPL coverage (Loan loss provision/ Total NPL) ratio rose 245 bps y-o-y to 52.8%. Central Bank of Kenya's coverage ratio rose 30 bps y-o-y to 81.4% whereas IFRS coverage ratio rose 350 bps y-o-y to 72.1%

In line with our outlook, we expect volatility through out 2020 as the global economy and financial markets remain highly susceptible to unforeseen and in some cases isolated events

Our immediate view: Firstly, we think that continued spread of COVID-19, now a pandemic as per WHO, will exacerbate foreign investor concerns given the group's leverage and exposure to highly susceptible sectors such as manufacturing, aviation and tourism. Secondly, despite the repeal of interest rate caps last year, we think that lack of sector wide clarity on loan pricing moving forward and the apparent ineffectiveness of monetary policy rate cuts, render aggressive loan book forecasts tenuous. On the monetary policy front, we continue to argue that a reduction of the cash reserve ratio can lead to lower risk free yields and hence spur private sector credit growth more-so given the rising risk of domestication of budgeted external borrowing. On the fiscal side, given our view that proposed fiscal consolidation is unlikely to materialize, we are cautiously optimistic that on-going efforts to refinance outstanding debt through concessional loans will be fruitful. All that said, according to media reports, the government is in the process of structuring **a roads bond whose proceeds will partly be used to settle outstanding bills to public contractors**. We can't overstate how positive this will be for KCB if it materializes. While we maintain our BUY recommendation at current levels, we have placed our fair value on the group **under review** ahead of management's conference call next week (**March 18th 2020**).

Guidance on 2020 outlook: Management expects a loan book and deposit book growth of 14.0% respectively. They expect the NPL ratio to close at 8.0% with a cost of risk of 1.8%. They also expect non-funded income to rise 25.0% with a target NFI ratio of 36.2%. They see a yield on assets of 11.1%, a cost of funds of 2.8% and thus a NIM of 7.8%.

On a trailing basis: KCB is trading at a P/E ratio of 5.7x, against an industry median of 6.0x and a P/B of 1.1x above the industry median of 0.9x. ROE stands at 19.4% against a sector median of 15.8% whereas its ROA stands at 2.8% above a sector median of 2.4%. We maintain our **BUY** recommendation.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	FY19	FY18	y-y % ch	4q19	3q19	4q18	y-y % ch	q-q % ch
Interest income	74,351	66,281	12.2	22,903	17,845	17,110	33.9	28.3
Interest expense	18,220	17,450	4.4	5,451	4,567	4,585	18.9	19.4
Net interest income	56,131	48,831	15.0	17,451	13,278	12,526	39.3	31.4
Other operating income	3,825	4,361	(12.3)	459	1,155	1,109	(58.6)	(60.2)
Fees and commission income	19,850	14,239	39.4	5,712	5,235	3,234	76.7	9.1
Net income from forex dealings	4,497	4,374	2.8	1,025	1,412	690	48.6	(27.4)
Total non-interest income	28,172	22,974	22.6	7,197	7,803	5,032	43.0	(7.8)
Total income	84,303	71,804	17.4	24,648	21,081	17,557	40.4	16.9
Less operating expenses	38,516	35,001	10.0	11,878	9,029	8,162	45.5	31.6
Operating profit	45,786	36,803	24.4	12,770	12,052	9,396	35.9	6.0
Bad debt charge	(8,889)	(2,944)	201.9	(3,046)	(2,812)	(1,145)	166.1	8.3
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	36,897	33,859	9.0	9,724	9,240	8,251	17.9	5.2
Less tax	(11,732)	(9,864)	18.9	(3,722)	(2,800)	(2,300)	61.8	32.9
Profit after tax	25,165	23,995	4.9	6,002	6,440	5,951	0.9	(6.8)
Attributable Income	25,165	23,995	4.9	6,002	6,440	5,951	0.9	(6.8)
EPS (KES)	8.11	7.83	3.6	-0.22	0.03	-0.02	-	-
DPS (KES)	3.50	3.50	0.0	3.50	-1.00	3.50	-	-

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	FY19	9M19	FY18	y-y % ch	q-q % ch
Total shareholder's equity	129,741	121,232	113,661	14.1	7.0
Minority interest	-	-	-	-	0.0
Total Equity	129,741	121,232	113,661	14.1	7.0
Deposits due to other banks	20,371	13,506	20,105	1.3	50.8
Customer deposits	686,583	586,715	537,460	27.7	17.0
Borrowed funds	21,485	22,131	22,447	(4.3)	(2.9)
Other liabilities	40,392	20,750	20,640	95.7	94.7
Total equity and liabilities	898,572	764,335	714,313	25.8	17.6
Central bank balances	60,761	54,335	50,101	21.3	11.8
Deposits due from banks	47,647	42,530	32,017	48.8	12.0
Investment securities	169,243	128,459	120,070	41.0	31.7
Held for dealing securities	-	-	-	-	-
Customer loans and advances	535,370	486,423	455,880	17.4	10.1
Other assets	59,050	35,719	42,234	39.8	65.3
Intangible assets	6,337	4,892	3,003	111.0	29.6
Fixed assets	20,163	11,977	11,008	83.2	68.3
Total assets	898,572	764,335	714,313	25.8	17.6

(Source: Company, DBIB Research)

INVESTMENT RETURN

	FY19	9M19*	FY18	y-y bps ch	q-q bps ch
ROA (%)	2.8	3.3	3.4	(56)	(54)
ROIC (%)	3.0	3.5	3.6	(56)	(50)
ROE (%)	19.4	21.1	21.1	(171)	(168)

(Source: Company, DBIB Research)

*Annualized

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	FY19	9M19	FY18	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	15.6	16.5	16.4	(80)	(90)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	17.5	17.8	17.8	(30)	(30)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	30.8	32.7	29.4	140	(190)
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Core capital/TRWA (%)	15.6	16.5	16.4	(80)	(90)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	17.5	17.8	17.8	(30)	(30)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	30.8	32.7	29.4	140	(190)
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	14.4	15.9	15.9	(147)	(142)
Equity-to-Loans Ratio (%)	24.2	24.9	24.9	(70)	(69)
NPL Ratio (%)**	10.6	8.0	6.7	390	254
NPL Coverage Ratio (%)**	52.8	51.0	50.3	245	182
Long Term Debt to Total Liabilities and Equity (%)	2.4	2.9	3.1	(75)	(50)
NTA/share (KES)	34.1	35.6	33.5	67	(149)
Book value/share (KES)	40.4	39.5	37.1	336	89
Payout ratio (%)	43.2	-	44.7	(154)	-
Adj payout ratio (%)	44.6	-	44.7	(9)	-

(Source: Company, DBIB Research)

**Total Loan Portfolio net of Interbank Lending

OPERATING PERFORMANCE

	FY19	9M19*	FY18	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)	10.6	11.2	11.5	(96)	(60)
Cost of funds (%)	2.6	2.7	3.1	(54)	(13)
Net Interest Margin (%)	8.0	8.5	8.4	(41)	(47)
Loan-to-Deposits ratio (%)	78.0	82.9	84.8	(685)	(493)
Loan-to-Dep. & Borrowed Funds ratio (%)	75.6	79.9	81.4	(581)	(428)
Funded Income Generating Potential (%)	78.4	80.4	80.6	(222)	(203)
Funded Income Reliance (%)	66.6	64.8	68.0	(142)	174
Cost to income ratio (%)	45.7	44.7	48.7	(306)	103
Pre-tax margin (%)	43.8	45.6	47.2	(339)	(178)
PAT margin (%)	29.9	32.1	33.4	(357)	(227)

(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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