



KCB GROUP HOLDINGS: 1H20 EARNINGS UPDATE

Dear All,

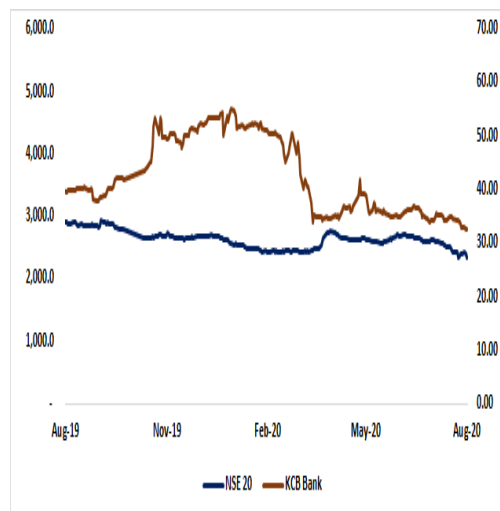
KCB GROUP released its 1H20 results recording a 40.4% y-o-y drop in profit after tax (PAT) to KES 7.6 BN. Trailing EPS stands at KES 6.23. The drop in profit followed an increase in bad debt impairment of 263.8% y-o-y to KES 11.0 BN due to the impact of the COVID-19 crisis and the consolidation of NBK. A 23.2% quarter on quarter decline in non funded income due to concessions on fees (fees on re-structured loans and transactions below KES 1,000) also impacted the performance.

Below please find key highlights:

Net interest income rose 22.3% y-o-y to KES 31.1 BN (+6.4% q-o-q) on the back of a 23.2% y-o-y rise in interest income to KES 41.4 BN and a 25.7% y-o-y increase in interest expense to KES 10.3 BN. We highlight that this double digit growth is primarily due to the consolidation of NBK in FY19. On a quarterly basis, KCB's net interest income rose 6.4% on the back of a 4.8% rise in interest income and a 0.1% rise in interest expense. The annualized yield on interest earning assets as at 1H20 declined 18 bps y-o-y to 10.8% whereas the annualized cost of funds declined 13 bps y-o-y to 2.6%. Consequently, net interest margin declined 5 bps y-o-y to 8.2%.

Non-funded income rose 6.0% y-o-y to KES 13.9 BN. This followed an 18.0% y-o-y rise in forex income to KES 2.4 BN and a 5.6% y-o-y rise in total fees and commissions to KES 9.4 BN. Other income declined 3.4% y-o-y to KES 2.1 BN. Notably, non funded income declined 23.2% q-o-q to KES 6.1 BN due to a 26.0% q-o-q decline in total fees and commissions and a 35.6% q-o-q decline in net forex income following the implementation of concessions on various fees under COVID-19 related customer relief. That said, fees on loans declined 7.9% y-o-y to KES 4.3 BN whereas other fees and commissions rose 5.5% y-o-y to KES 4.5 BN, suggesting that reduced lending and concessions on restructured loans might have contributed more to the decline in fees.

KCB GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months (%)	(9.3)	1.8
6 months (%)	(35.5)	(4.0)
12 months (%)	(17.9)	13.2

KEY METRICS

Current Price (KES)	32.55
52 week Range (KES)	32.55-55.00
YTD Return (%)	(39.7)
Issued Shares (Mn)	3,213.5
Market Cap (USD Mn)	965.6

Recommendation	BUY
Trailing EPS (KES)	6.23
NAV (KES)	41.1
P/E (x)	5.2
P/B (x)	0.8
Div. Yield (%)	-

Research Analyst

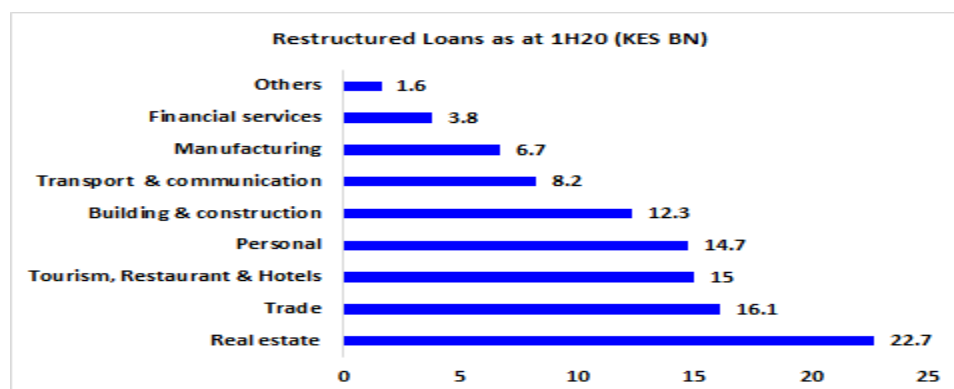
Edwin Chui

echui@dyerandblair.com

+254 0709930129

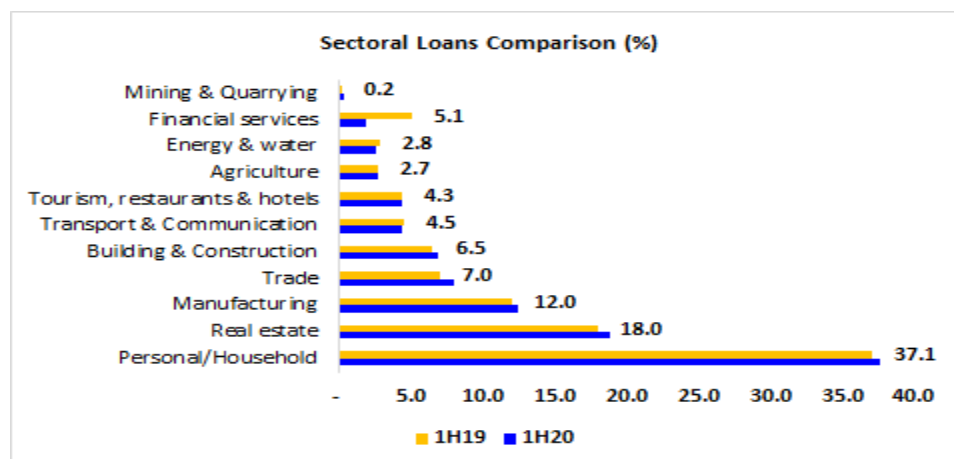
Operating expenses (less loan loss provisions) rose 20.3% y-o-y to KES 21.2 BN mainly on the back of a 27.4% y-o-y rise in other operating expenses to KES 8.2 BN and a 12.3% y-o-y rise in staff costs to KES 10.1 BN. However, as these include the consolidation of NBK, we observe that on a quarterly basis, operating expenses declined 9.7% to KES 10.1 BN in 2Q20. Cost to income ratio as at 1H20, rose 138 bps y-o-y to 47.0%.

Loan loss provision expense rose 263.8% y-o-y to KES 11.0 BN placing annualized cost of risk on average loans at a record 4.2%. For the period under review, KCB restructured facilities worth KES 101.0 BN to cushion customers against the effects of the crisis.



Source: Company

Customer loans and advances grew 17.0% y-o-y to KES 559.9 BN primarily due to consolidation of NBK. On a quarterly basis, loans and advances grew 1.1%. Similarly investment securities rose 54.5% y-o-y to KES 208.5 BN (2.9% q-o-q).



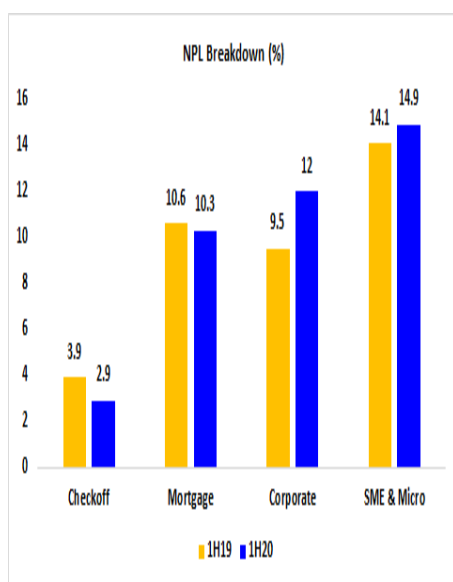
Source: Company

Customer deposits grew 34.6% y-o-y to KES 758.2 again on the back of consolidation of NBK. On a quarterly basis, customer deposits rose 2.4%. Loan to deposit ratio declined 1,116 bps y-o-y to 73.8% whereas loans to deposits and borrowed funds ratio declined 993 bps y-o-y to 71.8%.

KCB Group's core capital ratio (Core capital/TRWA) declined 10 bps y-o-y to 17.9% above the statutory minimum of 10.5% while Total capital/TRWA ratio rose 10 bps y-o-y to 19.5% above the statutory minimum of 14.5%.

KCB Kenya's core capital ratio (Core capital/TRWA) remained flat y-o-y at 16.1% (rose 90 bps q-o-q) above the statutory minimum of 10.5% while Total capital/TRWA ratio declined 10 bps y-o-y to 17.4% above the statutory minimum of 14.5%.

NBK's core capital ratio (Core capital/TRWA) rose 730 bps y-o-y to 8.8% below the statutory minimum of 10.5% while Total capital/TRWA ratio rose 760 bps y-o-y to 10.5% below the statutory minimum of 14.5%. The group plans to inject additional capital before the end of this year to ensure compliance and support the turnaround strategies that are expected to drive performance.



Source: Company

Gross non-performing loans rose 114.5% y-o-y to KES 83.9 BN (+26.7% q-o-q). Interest in suspense also rose 156.8% y-o-y to KES 11.6 BN (+20.7% q-o-q). As a result, total NPLs (Gross NPLs less interest in suspense) rose 108.9% y-o-y to KES 72.2 BN (+27.7% q-o-q).

The NPL ratio rose 548 bps y-o-y to 13.0% (+235 bps q-o-q). NPL coverage (Loan loss provision/ total NPL) ratio rose 347 bps y-o-y to 50.0% (declined 472 bps q-o-q). Central Bank of Kenya's coverage ratio rose 480 bps to 65.6% whereas IFRS coverage ratio declined 230 bps y-o-y to 61.7%.

On a trailing basis, KCB is trading at a P/E ratio of 5.2x, in line with the industry median of 5.2x and a P/B of 0.8x above the industry median of 0.7x. ROE stands at 11.5% against a sector median of 15.4% whereas its ROA stands at 1.6% against a sector median of 2.0%. As the first bank to announce its 1H20 earnings, we anticipate that the median multiples will change as other banks follow. We maintain our **BUY recommendation.**

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	1H20	1H19	y-y % ch	2q20	1q20	2q19	y-y % ch	q-q % ch
Interest income	41,382	33,603	23.2	21,175	20,207	16,826	25.9	4.8
Interest expense	10,313	8,201	25.7	5,160	5,153	4,132	24.9	0.1
Net interest income	31,070	25,402	22.3	16,016	15,054	12,694	26.2	6.4
Other operating income	2,136	2,210	(3.4)	1,119	1,016	1,179	(5.1)	10.2
Fees and commission income	9,397	8,902	5.6	3,995	5,402	4,860	(17.8)	(26.0)
Net income from forex dealings	2,431	2,060	18.0	952	1,479	1,083	(12.1)	(35.6)
Total non-interest income	13,964	13,172	6.0	6,067	7,897	7,122	(14.8)	(23.2)
Total income	45,033	38,574	16.7	22,082	22,951	19,816	11.4	(3.8)
Less operating expenses	21,181	17,610	20.3	10,050	11,131	8,511	18.1	(9.7)
Operating profit	23,852	20,964	13.8	12,032	11,820	11,305	6.4	1.8
Bad debt charge	(11,027)	(3,031)	263.8	(8,129)	(2,898)	(1,868)	335.2	180.5
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	12,825	17,933	(28.5)	3,903	8,922	9,437	(58.6)	(56.3)
Less tax	(5,247)	(5,210)	0.7	(2,587)	(2,660)	(2,488)	4.0	(2.7)
Profit after tax	7,578	12,723	(40.4)	1,316	6,262	6,949	(81.1)	(79.0)
Attributable Income	7,578	12,723	(40.4)	1,316	6,262	6,949	(81.1)	(79.0)
EPS (KES)	4.72	8.30	(43.1)	(3.1)	7.79	0.77	(498.7)	(139.4)
DPS (KES)	-	1.00	-	-	-	1.00	-	-

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	1H20	1Q20	1H19	y-y % ch	q-q % ch
Total shareholder's equity	132,139	135,546	117,524	12.4	(2.5)
Minority interest	-	-	-	-	-
Total Equity	132,139	135,546	117,524	12.4	(2.5)
Deposits due to other banks	13,362	13,280	18,839	(29.1)	0.6
Customer deposits	758,241	740,444	563,236	34.6	2.4
Borrowed funds	21,377	21,970	22,419	(4.6)	(2.7)
Other liabilities	27,953	35,828	24,502	14.1	(22.0)
Total equity and liabilities	953,072	947,068	746,519	27.7	0.6
Central bank balances	60,786	55,903	66,046	(8.0)	8.7
Deposits due from banks	53,328	50,073	16,965	214.3	6.5
Investment securities	208,523	202,643	135,007	54.5	2.9
Held for dealing securities	-	1,018.11	-	-	-
Customer loans and advances	559,884	553,861	478,731	17.0	1.1
Other assets	42,999	56,585	33,696	27.6	(24.0)
Intangible assets	7,313	6,302	2,524	189.8	16.0
Fixed assets	20,239	20,684	13,552	49.3	(2.2)
Total assets	953,072	947,068	746,519	27.7	0.6

(Source: Company, DBIB Research)

INVESTMENT RETURN

	1H20	1H19	1Q20	y-y bps ch	q-q bps ch
ROA (%)*	1.6	3.4	2.6	(182)	(105)
ROIC (%)*	1.7	3.6	2.8	(196)	(113)
ROE (%)*	11.5	21.7	18.5	(1018)	(701)

(Source: Company, DBIB Research)

*Annualized

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	1H20	1H19	1Q20	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	17.9	18.0	17.1	(10)	80
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	19.5	19.4	19.0	10	50
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	40.0	34.9	40.1	510	(10)
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	13.9	15.7	14.3	(188)	(45)
Equity-to-Loans Ratio (%)	23.6	24.5	24.5	(95)	(87)
NPL Ratio (%)**	13.0	7.6	10.7	548	235
NPL Coverage Ratio (%)**	50.0	46.5	54.7	347	(472)
Long Term Debt to Total Liabilities and Equity (%)	2.2	3.0	2.3	(76)	(8)
NTA/share (KES)	34.9	33.9	35.8	96	(92)
Book value/share (KES)	41.2	38.3	42.2	285	(106)
Payout ratio (%)	-	12.0	-	(1205)	-
Adj payout ratio (%)	-	24.1	-	(2410)	-

(Source: Company, DBIB Research)

**Total Loan Portfolio net of Interbank Lending

OPERATING PERFORMANCE

	1H20	1H19	1Q20	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	10.8	11.0	10.7	(18)	10
Cost of funds (%)*	2.6	2.7	2.6	(13)	(3)
Net Interest Margin (%)*	8.2	8.3	8.1	(5)	13
Loan-to-Deposits ratio (%)	73.8	85.0	74.8	(1,116)	(96)
Loan-to-Dep. & Borrowed Funds ratio (%)	71.8	81.7	72.6	(993)	(83)
Funded Income Generating Potential (%)	80.6	82.2	80.0	(159)	64
Funded Income Reliance (%)	69.0	65.9	65.6	314	340
Cost to income ratio (%)	47.0	45.7	48.5	138	(146)
Pre-tax margin (%)	28.5	46.5	38.9	(1,801)	(1,040)
PAT margin (%)	16.8	33.0	27.3	(1,616)	(1,046)

(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

DISCLAIMER

While every care has been taken in preparing this report and it has been prepared from sources believed to be reliable, no representation, warranty, or undertaking (express or implied) is given and no responsibility is accepted by Dyer and Blair Investment Bank Limited, its related companies, subsidiaries, affiliates, its employees and agents, as to the accuracy and completeness of the information contained herein or in respect of any reliance on or use thereof. This report is solely intended for distribution to clients of Dyer and Blair Investment Bank Limited. Any information may be changed after distribution at any time without any notice.