

DYER & BLAIR INVESTMENT BANK

EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

21ST MAY 2020



DYER & BLAIR
INVESTMENT BANK

WE KNOW. YOU KNOW.

KCB GROUP HOLDINGS: 1Q20 EARNINGS UPDATE

Dear All,

KCB GROUP released its 1Q20 results recording an 8.5% y-o-y increase in profit after tax (PAT) to KES 6.3 BN. On a like for like basis (KCB's 1Q19 + NBK's 1Q19), profit rose 7.2% y-o-y. For our variance analysis and for the sake of discussion, we use the numbers on a like for like basis. As expected, cost of risk drove performance with bad debt charges up 90.6% y-o-y to KES 2.9 BN (annualized cost of risk of 2.1%) eating into operating profit before provisions which was up 16.8% y-o-y to KES 11.8 BN.

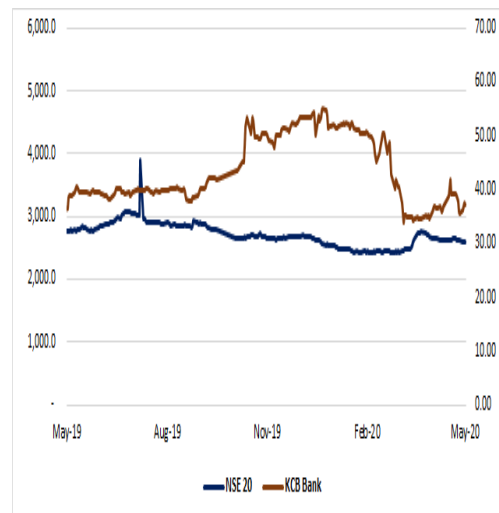
Below please find key highlights:

Net interest income rose 4.4% y-o-y to KES 15.1 BN on the back of a 5.6% y-o-y rise in interest income to KES 20.2 BN and a 9.4% y-o-y rise in interest expense to KES 5.1 BN. Annualized yield on interest earning assets declined 54 bps y-o-y to 10.7% whereas annualized cost of funds declined 15 bps y-o-y to 2.6%. Consequently, net interest margin declined 39 bps y-o-y to 8.1%.

Interest income from loans and advances rose 0.7% y-o-y to KES 14.7 BN placing the annualized yield on average loans at 11.5%, down 61 bps y-o-y, reflecting the impact of Central Bank Policy rate cuts and slowed lending courtesy of the COVID-19 crisis. Interest income from government securities rose 19.6% y-o-y to KES 5.3 BN placing the annualized yield on average government securities at 12.6%. Interest expense from customer deposits rose 11.9% y-o-y to KES 4.7 BN placing the annualized cost of average customer deposits at 2.9%.

Non-funded income rose 20.9% y-o-y to KES 7.9 BN. This followed a 24.7% y-o-y rise in total fees and commissions to KES 5.4 BN. Forex income rose 31.8% y-o-y to KES 1.5 BN. Other operating income declined 5.9% y-o-y to KES 1.0 BN. Fees and commissions on loans and advances rose 23.7% y-o-y to KES 2.7 BN whereas other fees and commissions rose 25.7% y-o-y to KES 2.7 BN. Funded income reliance ratio declined 323 bps y-o-y to 65.6%.

KCB GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months (%)	(26.6)	(6.3)
6 months (%)	(24.5)	(1.2)
12 months (%)	1.5	25.3

KEY METRICS

Current Price (KES)	37.05
Target Price (KES)	UNDER REVIEW
52 week Range (KES)	33.90-55.00
YTD Return (%)	(31.4)
Issued Shares (Mn)	3,209
Market Cap (USD Mn)	1,113.2

Recommendation	BUY
Trailing EPS (KES)	8.37
NAV (KES)	42.24
P/E (x)	4.4
P/B (x)	0.9
Div. Yield (%)	-

Research Analyst

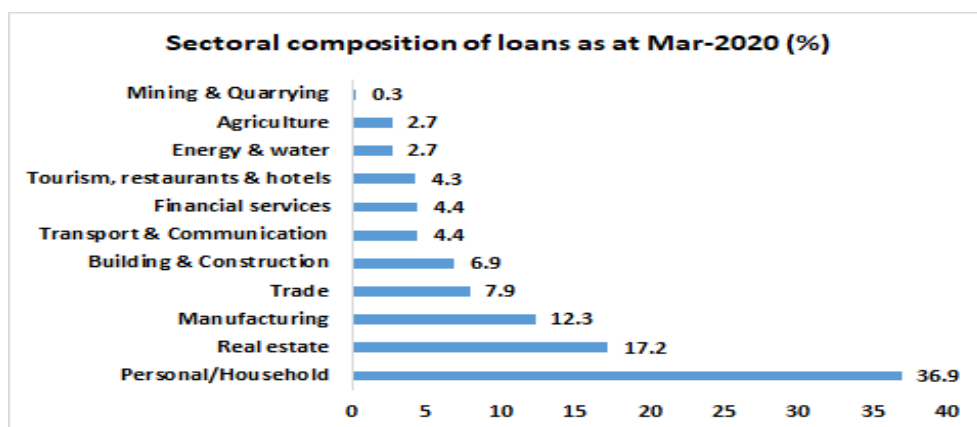
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Operating expenses (less loan loss provisions) rose 2.7% y-o-y to KES 11.1 BN mainly on the back of a 3.6% y-o-y rise in staff costs to KES 5.8 BN and a 0.1% y-o-y drop in other operating expenses to KES 3.8 BN. Cost to income ratio declined 323 bps y-o-y to 48.5%.

Customer loans and advances grew 8.6% y-o-y to KES 553.9 BN (+3.5% q-o-q) whereas investment securities rose 17.6% y-o-y to KES 202.6 BN. On the funding side, customer deposits rose 15.4% y-o-y to KES 740.4 BN whereas borrowed funds rose 2.3% y-o-y to KES 21.9 BN. Loan to deposit ratio declined 470 bps y-o-y to 74.8% whereas loans to deposits and borrowed funds ratio declined 428 bps y-o-y to 72.6%.



Source: Company

KCB Kenya's core capital ratio (Core capital/TRWA) declined 120 bps y-o-y to 15.2% above the statutory minimum of 10.5% while Total capital/TRWA declined 50 bps y-o-y to 17.2% above the statutory minimum of 14.5%. Liquidity ratio rose 310 bps y-o-y to 35.4%.

	KCB Kenya		Group	
	Without IFRS 9	With IFRS 9	Without IFRS 9	With IFRS 9
Core capital ratio	15.7	15.2	17.5	17.1
Total capital ratio	17.6	17.2	19.4	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

National Bank of Kenya's core capital ratio (Core capital/TRWA) rose 730 bps y-o-y to 9.7% below the statutory minimum of 10.5% while its Total capital/TRWA rose 770 bps y-o-y to 11.5%, below the statutory minimum of 14.5%. Its liquidity ratio rose 530 bps y-o-y to 45.7%, above the statutory minimum of 20.0%.

NATIONAL BANK OF KENYA		
	Without IFRS 9	With IFRS 9
Core capital ratio	9.8	9.7
Total capital ratio	11.6	11.5

Source: Company,

Gross non-performing loans declined 5.8% y-o-y to KES 66.2 BN. Interest in suspense rose 5.2% y-o-y to KES 9.6 BN. As a result, total NPLs (Gross NPLs less interest in suspense) declined 7.5% y-o-y to KES 56.6 BN. The NPL ratio declined 143 bps y-o-y to 10.7% while the NPL coverage (Loan loss provision/ Total NPL) ratio rose 623 bps y-o-y to 54.7%. Central Bank of Kenya's coverage ratio rose 1,070 bps y-o-y to 74.6% whereas IFRS coverage ratio rose 450 bps y-o-y to 65.3%.

Restructured Loans: Management earlier on announced that they had restructured KES 80.0 BN of loans, representing about 14.4% of its loans as at 1Q20 and about 45.0% of the total KES 176.0 BN worth of loans that have been restructured by the 7 largest banks. With most of the restructuring taking the form of a three month moratorium on interest and principal, we are concerned about the lack of clarity on when the COVID-19 crisis will be contained as well as its second order effects. These concerns are exacerbated by KCB's loan book structure that is about 66.4% exposed to personal/household loans, real estate and manufacturing, key sectors that will carry the brunt of the crisis.

On a trailing basis: KCB is trading at a P/E ratio of 4.4x, against an industry median of 4.9x and a P/B of 0.9x above the industry median of 0.8x. ROE stands at 18.5% against a sector median of 16.7% whereas its ROA stands at 2.6% above a sector median of 2.4%. We maintain our **BUY** recommendation.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	1Q20	1Q19	1Q19**	4Q19	y-y % ch	y-y % ch**	q-q % ch	FY19
Interest income	20,207	16,777	19,134	22,903	20.4	5.6	(11.8)	74,351
Interest expense	5,153	4,069	4,709	5,451	26.6	9.4	(5.5)	18,220
Net interest income	15,054	12,708	14,424	17,451	18.5	4.4	(13.7)	56,131
Other operating income	1,016	1,031	1,079	459	(1.4)	(5.9)	121.2	3,825
Fees and commission income	5,402	4,042	4,332	5,712	33.6	24.7	(5.4)	19,850
Net income from forex dealings	1,479	977	1,122	1,025	51.4	31.8	44.3	4,497
Total non-interest income	7,897	6,050	6,534	7,197	30.5	20.9	9.7	28,172
Total income	22,951	18,758	20,958	24,648	22.4	9.5	(6.9)	84,303
Less operating expenses	11,131	9,099	10,842	11,878	22.3	2.7	(6.3)	38,516
Operating profit	11,820	9,659	10,117	12,770	22.4	16.8	(7.4)	45,786
Bad debt charge	(2,898)	(1,163)	(1,520)	(3,046)	149.1	90.6	(4.9)	(8,889)
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	8,922	8,496	8,596	9,724	5.0	3.8	(8.2)	36,897
Less tax	(2,660)	(2,723)	(2,756)	(3,722)	(2.3)	(3.5)	(28.5)	(11,732)
Profit after tax	6,262	5,774	5,840	6,002	8.5	7.2	4.3	25,165
Attributable Income	6,262	5,774	5,840	6,002	8.5	7.2	4.3	25,165
EPS (KES)	7.79	7.53	7.62	-0.22	3.5	2.2	-	8.11
DPS (KES)	-	-	-	-	-	-	-	3.50

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	1Q20	FY19	1Q19	1Q19**	y-y % ch	y-y % ch**	q-q % ch
Total shareholder's equity	135,546	129,741	119,463	126,612	13.5	7.1	4.5
Minority interest	-	-	-	-	-	-	-
Total Equity	135,546	129,741	119,463	126,612	13.5	7.1	4.5
Deposits due to other banks	13,280	20,371	9,516	15,027	39.5	(11.6)	(34.8)
Customer deposits	740,444	686,583	552,205	641,725	34.1	15.4	7.8
Borrowed funds	21,970	21,485	21,466	21,466	2.3	2.3	2.3
Other liabilities	35,828	40,392	23,013	25,899	55.7	38.3	(11.3)
Total equity and liabilities	947,068	898,572	725,663	830,729	30.5	14.0	5.4
Central bank balances	55,903	60,761	56,332	61,080	(0.8)	(8.5)	(8.0)
Deposits due from banks	50,073	47,647	19,368	21,013	158.5	138.3	5.1
Investment securities	202,643	169,243	133,307	172,325	52.0	17.6	19.7
Held for dealing securities	1,018	-	-	-	-	-	-
Customer loans and advances	553,861	535,370	464,263	510,188	19.3	8.6	3.5
Other assets	56,585	59,050	38,657	46,534	46.4	21.6	(4.2)
Intangible assets	6,302	6,337	3,848	5,169	63.8	21.9	(0.6)
Fixed assets	20,684	20,163	9,888	14,420	109.2	43.4	2.6
Total assets	947,068	898,572	725,663	830,729	30.5	14.0	5.4

(Source: Company, DBIB Research)

INVESTMENT RETURN

	1Q20	1Q19	1Q19**	FY19	y-y bps ch	y-y bps ch**	q-q bps ch
ROA (%)	2.6	3.2	2.8	2.8	(54)	(17)	(16)
ROIC (%)	2.8	3.3	3.0	3.0	(54)	(17)	(21)
ROE (%)	18.5	19.3	18.5	19.4	(85)	3	(92)

(Source: Company, DBIB Research)

*Annualized

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

KCB KENYA	1Q20	1Q19	FY19	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	15.2	16.4	15.6	(120)	(40)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	17.2	17.7	17.5	(50)	(30)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	35.4	32.3	30.8	310	460
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
NATIONAL BANK OF KENYA					
Core capital/TRWA (%)	9.7	2.4	9.8	730	(10)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	11.5	3.8	11.5	770	0
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	45.7	40.4	46.1	530	(40)
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-

KCB GROUP

	1Q20	1Q19	1Q19**	FY19	y-y bps ch	y-y bps ch**	q-q bps ch
Leverage Ratio (%)	14.3	16.5	15.2	14.4	(215)	(93)	(13)
Equity-to-Loans Ratio (%)	24.5	25.7	24.8	24.2	(126)	(34)	24
NPL Ratio (%)***	10.7	7.7	12.1	10.6	296	(143)	9
NPL Coverage Ratio (%)***	54.7	44.4	48.5	52.8	1029	623	192
L/Term Debt to Total Liabilities and Equity (%)	2.3	3.0	2.6	2.4	(64)	(26)	(7)
NTA/share (KES)	37.5	35.7	36.6	34.1	172	87	332
Book value/share (KES)	44.2	39.0	41.3	40.4	525	291	378

(Source: Company, DBIB Research)

***Total Loan Portfolio net of Interbank Lending, ** like for like numbers

OPERATING PERFORMANCE

	1Q20	1Q19	1Q19**	FY19	y-y bps ch	y-y bps ch**	q-q bps ch
Yield on interest earning assets (%)*	10.7	11.2	11.2	10.6	(56)	(54)	12
Cost of funds (%)*	2.6	2.7	2.7	2.6	(15)	(15)	1
Net Interest Margin (%)*	8.1	8.5	8.5	8.0	(41)	(39)	11
Loan-to-Deposits ratio (%)	74.8	84.1	79.5	78.0	(927)	(470)	(317)
Loan-to-Dep.& Borrowed Funds ratio (%)	72.6	80.9	76.9	75.6	(828)	(428)	(296)
Funded Income Generating Potential (%)	80.0	82.3	82.2	78.4	(236)	(217)	157
Funded Income Reliance (%)	65.6	67.7	68.8	66.6	(216)	(323)	(99)
Cost to income ratio (%)	48.5	48.5	51.7	45.7	(1)	(323)	281
Pre-tax margin (%)	38.9	45.3	41.0	43.8	(642)	(214)	(489)
PAT margin (%)	27.3	30.8	27.9	29.9	(350)	(58)	(257)

(Source: Company, DBIB Research)

* Annualized, **like for like numbers,

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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