DYER & BLAIR INVESTMENT BANK

EARNINGS UPDATE

Founder Member of the Nairobi Securities Exchange

25TH AUGUST 2022

DYER & BLAIR
INVESTMENT BANK
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KCB GROUP: 1H22 EARNINGS UPDATE

Dear All,

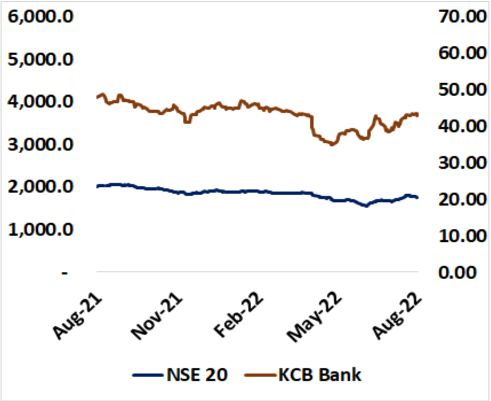
KCB Group released its 1H22 results reporting a 28.4% y-o-y improvement in after tax profits to KES 19.6 BN. The improvement in the financial performance was powered by a 29.9% y-o-y rise in non-funded income to KES 19.2 BN, an 11.5% y-o-y upswing in net interest income to KES 40.6 BN and a 34.4% y-o-y decline in loan loss provisions to KES 4.3 BN. EPS for the period went up by 27.6% y-o-y to KES 12.15.

Below please find key highlights:

Net interest income inched higher by 11.5% y-o-y to KES 40.6 BN, led by a 15.7% y-o-y growth in total interest income to KES 54.5 BN against a 30.3% y-o-y climb in total interest expenses to KES 13.9 BN. The annualized yield on interest earning assets eased by 37 bps y-o-y to settle at 10.6% in contrast with the annualized cost of funds which increased by 35 bps y-o-y to 2.9%. The group's management attributed the higher cost of funds to the continuing impact of an elevated interest rate environment both globally and domestically. The out-turn was a 72 bps y-o-y decline in the group's net interest margin (NIM) to 7.6%.

Interest income arising from loans and advances improved by 11.3% y-o-y to KES 38.4 BN bolstered by a 20.3% y-o-y growth in the net loan book to KES 730.3 BN but curtailed by a 56 bps y-o-y decline in the annualized yield on loans to 10.9%. The yield on loans was weighed down by suspended interest following the deterioration in the group's asset quality (despite the robust loan book growth). **Income arising from investments in government securities heaved up by 31.5% y-o-y to KES 15.9 BN** fueled by a 33.8% y-o-y rise in the group's holding of government and investment securities to KES 285.0 BN as the annualized yield on government securities experienced a downtick of 8 bps y-o-y to 11.3%.

KCB GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE RETURN	ABSOLUTE RETURN	EXCESS RETURN
3 months (%)	17.5	12.6
6 months (%)	(6.6)	1.4
12 months (%)	(10.8)	2.6

KEY METRICS	
Current Price (KES)	42.95
52 week Range (KES)	35.00-48.65
YTD Return (%)	(5.5)
Issued Shares (Mn)	3,213.5
Market Cap (USD Mn)	1,152.0
Trailing EPS (KES)	13.3
NAV (KES)	55.7
P/E (x)	3.2
P/B (x)	0.8
Div. Yield (%)	-

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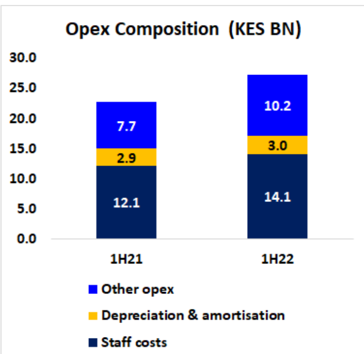
Interest expenses linked to customer deposits climbed by 26.0% y-o-y to KES 11.5 BN in line with a 15.6% y-o-y growth in customer deposits to KES 908.6 BN and a 29 bps y-o-y rise in the annualized cost of customer deposits to 2.6%.

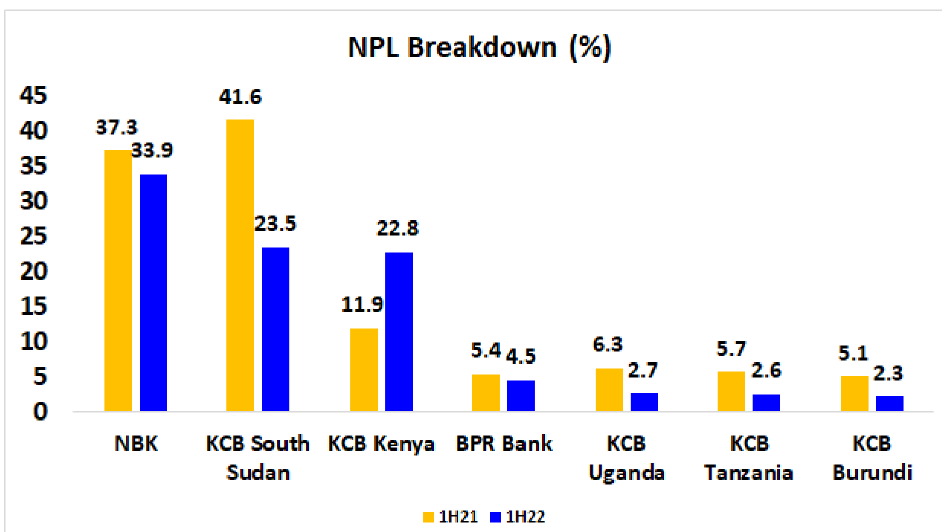
Non-funded income trended higher, rising by 29.9% y-o-y to KES 19.2 BN lifting the contribution of non-funded income to total operating income by 324 bps y-o-y to 32.1% (1H21: 28.9%). The growth witnessed in non-funded income was largely driven by an 81.5% y-o-y jump in forex trading income to KES 4.9 BN, a 32.9% y-o-y rise in fees and commissions on loans and advances to KES 5.3 BN and a 17.8% y-o-y growth in other fees and commissions to KES 6.1 BN.



Source: Company

The group's operating expenses (minus provisions) climbed by 20.3% y-o-y to KES 27.3 BN mainly on the back of a 32.7% y-o-y increase in other expenses to KES 9.5 BN and a 16.2% y-o-y growth in staff costs to KES 14.1 BN. As a result of the faster rise in operating expenses (minus provisions) in comparison to total operating income (+16.8% y-o-y to KES 59.8 BN), the group's cost-to-income ratio rose by 131 bps y-o-y to 45.7% (1H21: 44.3%).

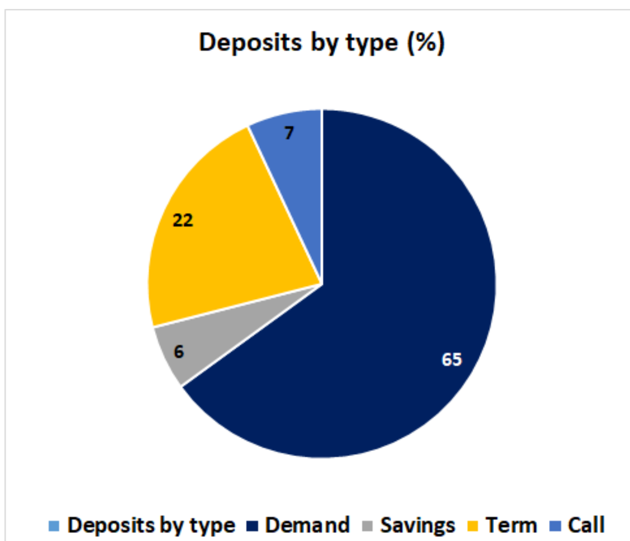
The group's gross non-performing loans soared by 81.2% y-o-y to KES 173.4 BN while interest in suspense grew by 18.5% y-o-y to KES 14.4 BN, as a result, total NPLs (gross NPLs less interest in suspense) inched higher by 90.3% y-o-y to KES 159.0 BN. **Consequently, the group's NPL ratio (as per the group's computation) soared to 21.5% (1H21: 14.3%) towering the Kenyan banking industry average NPL ratio of 14.7%.**



Source: Company

Despite the jump in gross non-performing loans, loan loss provisions eased by 34.4% y-o-y to KES 4.3 BN placing the annualized cost of risk at 1.2%, 100 bps lower y-o-y. The group attributed the lower provisioning in the face of deteriorating asset quality to robust collateral levels associated with the bad loans. **Asset quality challenges were mainly experienced in the Kenya business and were centered on the manufacturing, building & construction and hospitality sectors**. Furthermore, the corporate loan book was strained by the impact of delayed recovery from the pandemic, elevated inflationary pressures, overdue bill payments and geopolitical disruptions affecting the cash flows of clients. The group's NPL coverage ratio, (as per the group's computation) contracted to 54.6% in 1H22 from 70.1% in 1H21.

Net loans and advances to customers rose by 20.3% y-o-y to KES 730.3 BN (+3.7% q-o-q) driven by improved lending in personal, trade, transport and communication sectors. Government and investment securities also edged up further, increasing by 33.8% y-o-y to KES 285.0 BN (+1.1% q-o-q). On the funding side, **customer deposits increased by 15.6% y-o-y to KES 908.6 BN (+7.4% q-o-q)** principally backed by growth in demand deposits. In terms of proportions, however, the percentage of demand deposits declined to 65.0% from 67.0% in 1H21. Borrowed funds went up by 14.8% y-o-y to KES 40.2 BN (+6.3% q-o-q). The loan-to-deposit ratio went up by 316 bps y-o-y to 80.4% in concert with the loan-to-deposit and borrowed funds ratio which climbed by 305 bps y-o-y to 77.0%.



Source: Company

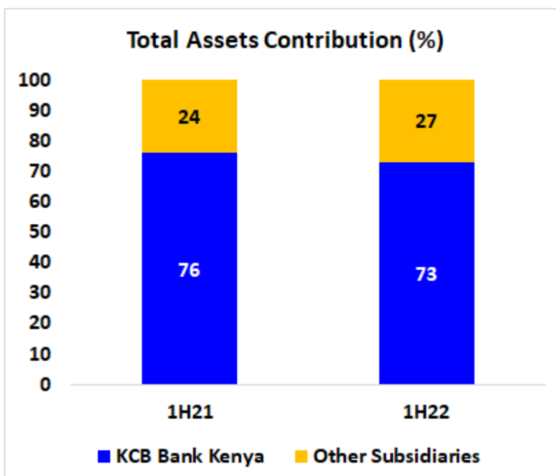
The group's asset base grew by KES 188.0 BN or 18.4% y-o-y to KES 1.2 TN (+3.7% q-o-q). Out of the KES 188.0 BN, KES 51.0 BN arose from the consolidation of BPR, while the remaining KES 137.0 BN originated from organic growth.

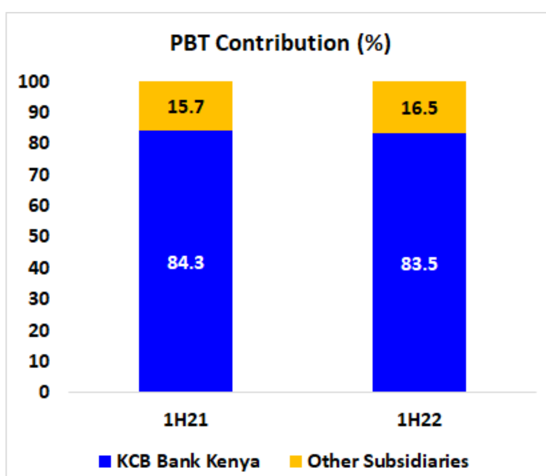
KCB Group's core capital ratio (Core capital/TRWA) declined by 90 bps y-o-y to 17.7% while the total capital ratio (Total capital/TRWA) dwindled by 30 bps y-o-y to 21.6%. Both ratios remain above the statutory minimum of 10.5% and 14.5% respectively. **KCB Bank Kenya's core capital ratio (Core capital/TRWA) eased by 160 bps y-o-y to 15.0% while the total capital ratio (Total capital/TRWA) contracted by 70 bps y-o-y to 19.5%**. Both ratios also remain above the statutory minimum of 10.5% and 14.5% respectively. The group's liquidity ratio declined by 110 bps y-o-y to 39.0%, while KCB Bank Kenya's liquidity ratio eased marginally by 10 bps y-o-y to 35.0% -- both ratios remain above the statutory minimum requirement of 20.0%.

	Group	Min.	Bank	Min.
Core capital ratio (%)	17.7	10.5	15.0	10.5
Total capital ratio (%)	21.6	14.5	19.5	14.5

Source: Company

The regional business contributed 27.0% of total assets (1H21: 24.0%) and 16.5% of total pre-tax earnings (1H21: 15.7%).





Source: Company

FY22's management guidance: The group reiterated its earlier guidance with the exception of the **NPL ratio** (which the group adjusted from 13.0% to a range of 15.0% - 17.0%) and **the cost of funds** (up to 2.7% from 2.6% communicated earlier).

	FY22 Outlook
NFI ratio (%)	33.0
Cost-to-income ratio (%)	44.0
NPL ratio (%)	**15.0 - 17.0**
Cost of risk (%)	1.8
Cost of funds (%)	**2.7**
NIM (%)	7.7
Asset yield (%)	10.4
Loan growth (%)	15.0
Deposit growth (%)	14.0
ROE (%)	23.0

Source: Company

Outlook: The group has put in place a number of measures to improve their asset quality performance and expects the group NPL ratio to reduce to their target range of 15.0% - 17.0% by FY22. The group expects to complete the Trust Merchant Bank (TMB) acquisition by 4Q22 and doesn't intend to rebrand the bank to KCB in order to maintain brand loyalty.

On a trailing basis, KCB Group is currently trading at a P/E multiple of 3.6x against an industry median of 3.6x and a P/B multiple of 0.8x against an industry median of 0.7x. Its ROE stands at 21.4% while its ROA stands at 3.2%.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	1H22	1H21	y-y % ch	2q22	1q22	2q21	y-y % ch	q-q % ch
Interest income	54,539	47,118	15.7	27,911.3	26,627.6	25,148.4	11.0	4.8
Interest expense	13,947	10,702	30.3	7,059.6	6,887.8	5,458.4	29.3	2.5
Net interest income	40,592	36,416	11.5	20,851.7	19,739.8	19,690.0	5.9	5.6
Other operating income	2,858	2,888	(1.0)	1,229.0	1,629.2	1,736.5	(29.2)	(24.6)
Fees and commission income	11,425	9,187	24.4	5,501.9	5,922.9	5,214.6	5.5	(7.1)
Net income from forex dealings	4,933	2,718	81.5	3,193.1	1,739.5	1,528.6	108.9	83.6
Total non-interest income	19,216	14,794	29.9	9,924.0	9,291.6	8,479.7	17.0	6.8
Total income	59,807	51,210	16.8	30,775.8	29,031.4	28,169.8	9.3	6.0
Less operating expenses	27,310	22,711	20.3	14,386.1	12,923.9	11,649.9	23.5	11.3
Operating profit	32,497	28,499	14.0	16,389.6	16,107.5	16,519.8	(0.8)	1.8
Bad debt charge	(4,319)	(6,583)	(34.4)	(2,243.3)	(2,075.4)	(3,722.1)	(39.7)	8.1
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	28,178	21,916	28.6	14,146.3	14,032.1	12,797.7	10.5	0.8
Less tax	(8,532)	(6,615)	29.0	(4,356.1)	(4,175.7)	(3,872.8)	12.5	4.3
Profit after tax	19,647	15,301	28.4	9,790.2	9,856.4	8,925.0	9.7	(0.7)
Attributable Income	19,647	15,301	28.4	9,857.7	9,788.9	8,925.0	10.5	0.7
EPS (KES)	12.15	9.52	27.6	(0.0)	12.18	1.6	(101.9)	(100.2)
DPS (KES)	-	-	-	-	-	-	-	-

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	1H22	1Q22	1H21	y-y % ch	q-q % ch
Total shareholder's equity	179,113	181,833	152,920	17.1	(1.5)
Minority interest	2,636	1,890	-	-	-
Total Equity	181,750	183,723	152,920	18.9	(1.1)
Deposits due to other banks	35,772	45,293	15,006	138.4	(21.0)
Customer deposits	908,573	845,817	786,035	15.6	7.4
Borrowed funds	40,244	37,843	35,042	14.8	6.3
Other liabilities	43,769	54,232	33,150	32.0	(19.3)
Total equity and liabilities	1,210,108	1,166,908	1,022,153	18.4	3.7
Central bank balances	50,748	44,454	63,282	(19.8)	14.2
Deposits due from banks	50,591	40,722	52,549	(3.7)	24.2
Investment securities	277,844	274,443	213,040	30.4	1.2
Held for dealing securities	7,130	7,365	-	-	(3.2)
Customer loans and advances	730,335	704,366	606,967	20.3	3.7
Other assets	64,715	66,486	63,052	2.6	(2.7)
Intangible assets	7,113	7,367	5,082	40.0	(3.4)
Fixed assets	21,631	21,705	18,181	19.0	(0.3)
Total assets	1,210,108	1,166,908	1,022,153	18.4	3.7

(Source: Company, DBIB Research)

INVESTMENT RETURN

	1H22	1H21	1Q22	y-y bps ch	q-q bps ch
ROA (%)*	3.2	3.0	3.4	25	(13)
ROIC (%)*	3.5	3.1	3.7	33	(22)
ROE (%)*	21.6	20.0	21.5	161	16

(*Source: Company, DBIB Research)*

**Annualized*

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	1H22	1H21	1Q22	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	15.0	16.6	15.7	(160)	(70)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	19.5	20.2	19.6	(70)	(10)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	35.0	35.1	33.1	(10)	190
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	15.0	15.0	15.7	6	(73)
Equity-to-Loans Ratio (%)	24.9	25.2	26.1	(31)	(120)
NPL Ratio (%)	19.2	13.8	15.7	537	351
NPL Coverage Ratio (%)	40.9	56.0	47.2	(1507)	(629)
LT Debt to Total Liabilities and Equity (%)	3.3	3.4	3.2	(10)	8
NTA/share (KES)	49.8	41.9	50.4	790	(59)
Book value/share (KES)	56.6	47.6	57.2	897	(61)
Payout ratio (%)	-	-	-	-	-

(Source: Company, DBIB Research)

***Total Loan Portfolio net of Interbank Lending*

OPERATING PERFORMANCE

	1H22	1H21	1Q22	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	10.6	10.9	10.5	(37)	5
Cost of funds (%)*	2.9	2.6	3.0	35	(5)
Net Interest Margin (%)*	7.6	8.4	7.5	(72)	10
Loan-to-Deposits ratio (%)	80.4	77.2	83.3	316	(289)
Loan-to-Dep.&Borrowed Funds ratio (%)	77.0	73.9	79.7	305	(274)
Funded Income Generating Potential (%)	83.9	80.2	84.5	368	(61)
Funded Income Reliance (%)	67.9	71.1	68.0	(324)	(12)
Cost to income ratio (%)	45.7	44.3	44.5	131	115
Pre-tax margin (%)	47.1	42.8	48.3	432	(122)
PAT margin (%)	32.8	29.9	34.0	297	(110)

(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