

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: 3Q22 EARNINGS UPDATE

Dear All,

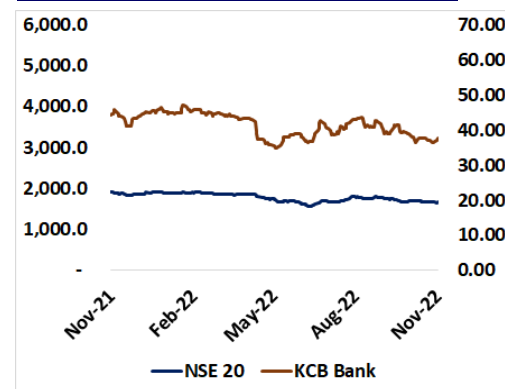
KCB Group released its 3Q22 results reporting a 21.4% y-o-y improvement in after tax profits to KES 30.6 BN. The improvement in the financial performance was powered by a 30.2% y-o-y rise in non-funded income to KES 30.6 BN, a 9.1% y-o-y upswing in net interest income to KES 61.6 BN and a 22.1% y-o-y decline in loan loss provisions to KES 7.3 BN. EPS for the period went up by 21.1% y-o-y to KES 12.64. **The board has approved an interim dividend per share of KES 1.00 (3Q21: KES 1.00).** If approved, the dividend will be payable on or about 13th January 2023 to shareholders on the share register at the close of business on 8th December, 2022.

Below please find key highlights:

Net interest income inched higher by 9.1% y-o-y to KES 61.6 BN, led by a 13.6% y-o-y growth in total interest income to KES 83.5 BN against a 28.4% y-o-y climb in total interest expenses to KES 21.9 BN. The annualized yield on interest earning assets eased by 18 bps y-o-y to settle at 10.6% in contrast with the annualized cost of funds which increased by 41 bps y-o-y to 3.0%. The group's management had earlier attributed the higher cost of funds to the continuing impact of an elevated interest rate environment both globally and domestically. As a result, the group's net interest margin (NIM) declined by 59 bps y-o-y to 7.6%.

Interest income arising from loans and advances improved by 10.2% y-o-y to KES 58.9 BN bolstered by a 16.4% y-o-y growth in the net loan book to KES 758.8 BN but curtailed by a 48 bps y-o-y decline in the annualized yield on loans to 10.9%. Income arising from investments in government securities went up by 28.2% y-o-y to KES 24.3 BN fueled by a 9.8% y-o-y rise in the group's holding of government and investment securities to KES 277.1 BN and a 79 bps y-o-y growth in the annualized yield on government securities to 11.7%.

KCB GROUP: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

PRICE	ABSOLUTE	EXCESS
RETURN	RETURN	RETURN
3 months (%)	(12.3)	(5.2)
6 months (%)	5.9	10.4
12 months (%)	(15.1)	(1.6)

KEY METRICS

Current Price (KES)	37.65
52 week Range (KES)	35.00 - 47.00
YTD Return (%)	(17.2)
Issued Shares (Mn)	3,213.5
Market Cap (USD Mn)	992.5

Trailing EPS (KES)	12.84
NAV (KES)	58.43
Trailing P/E (x)	3.1
Trailing P/B (x)	0.6
Dividend Yield (%)	2.7

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Interest expenses linked to customer deposits climbed by 21.7% y-o-y to KES 17.8 BN in line with a 7.4% y-o-y growth in customer deposits to KES 922.3 BN and a 30 bps y-o-y rise in the annualized cost of customer deposits to 2.7%.

Non-funded income trended higher, rising by 30.2% y-o-y to KES 30.6 BN lifting the contribution of non-funded income to total operating income by 378 bps y-o-y to 33.2% (3Q21: 29.4%). The growth witnessed in non-funded income was largely driven by an 86.4% y-o-y jump in forex trading income to KES 9.1 BN, an 18.7% y-o-y rise in fees and commissions on loans and advances to KES 7.8 BN and a 16.1% y-o-y growth in other fees and commissions to KES 9.1 BN.

The group's operating expenses (sans provisions) climbed by 19.6% y-o-y to KES 41.6 BN mainly on the back of a 27.8% y-o-y increase in other expenses to KES 14.3 BN and a 15.6% y-o-y growth in staff costs to KES 21.3 BN. As a result of the faster rise in operating expenses (minus provisions) in comparison to total operating income (+15.3% y-o-y to KES 92.1 BN), the group's cost-to-income ratio rose by 161 bps y-o-y to 45.1% (3Q21: 43.5%).

The group's gross non-performing loans increased by 52.1% y-o-y to KES 149.3 BN (-13.9% q-o-q) while interest in suspense grew by 11.0% y-o-y to KES 13.5 BN, as a result, total NPLs (gross NPLs less interest in suspense) inched higher by 57.9% y-o-y to KES 135.8 BN. Consequently, **the group's NPL ratio rose by 335 bps y-o-y to 16.4%**. We however note that the NPL ratio eased by 275 bps on a q-o-q basis; the NPL ratio stood at 19.2% in 1H22 (as per in-house calculations).

Despite the jump in gross non-performing loans, loan loss provisions eased by 22.1% y-o-y to KES 7.3 BN placing the annualized cost of risk at 1.9%, 95 bps lower y-o-y. The group had earlier associated the lower provisioning in the face of deteriorating asset quality to robust collateral levels associated with the bad loans. The group's NPL coverage ratio contracted to 48.1% in 3Q22 from 58.2% in 3Q21.

Net loans and advances to customers rose by 16.4% y-o-y to KES 758.8 BN (+3.9% q-o-q). Government and investment securities however eased by 9.8% y-o-y to KES 277.1 BN (-2.8% q-o-q). **On the funding side, customer deposits increased by 7.4% y-o-y to KES 922.3 BN (+1.5% q-o-q).** Borrowed funds jumped by 77.7% y-o-y to KES 62.7 BN (+55.8% q-o-q). Loan-to-deposit ratio went up by 640 bps y-o-y to 82.3% in concert with the loan-to-deposit and borrowed funds ratio which climbed by 416 bps y-o-y to 77.0%.

KCB Group's core capital ratio (Core capital/TRWA) declined by 280 bps y-o-y to 14.5% while the total capital ratio (Total capital/TRWA) dwindled by 250 bps y-o-y to 18.1%. 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 260 bps y-o-y to 12.6% while the total capital ratio (Total capital/TRWA) contracted by 180 bps y-o-y to 17.0%.** Both ratios remain above the statutory minimum of 10.5% and 14.5% respectively. The group's liquidity ratio declined by 280 bps y-o-y to 38.5%, but remained above the statutory minimum requirement of 20.0%.

	Group	Min.	KCB KN	Min.
Core capital ratio(%)	14.5	10.5	12.6	10.5
Total capital ratio(%)	18.1	14.5	17.0	14.5

Source: Company

Outlook: In 1H22, the groups' management indicated that they had instituted several measures to improve asset quality. Some of the measures include: (i) fast tracking recovery efforts, (ii) writing off accounts with full provision, (iii) disposing high value collateral and (iv) engaging the National Treasury to release delayed cash flows. We note positively on the impact of these measures which have resulted in an improvement in asset quality on a q-o-q basis (the NPL ratio eased by 275 bps q-o-q to 16.4% from 19.2% in 1H22). According to management, the high NPL ratio witnessed in 1H22 marked a peak and is expected to decline going forward and settle at their target range of 15.0% to 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 3.1x against an industry median of 3.8x and a P/B multiple of 0.6x against an industry median of 0.7x. Its ROE stands at 21.0% while its ROA stands at 3.1%.

PROFIT AND LOSS SUMMARY (KES MN)

Year End: December	3Q22	3Q21	y-y% ch	3q22	2q22	3q21	y-y% ch	q-q% ch
Interest income	83,541	73,531	13.6	29,002	27,911	26,413	9.8	3.9
Interest expense	21,947	17,094	28.4	7,999	7,060	6,392	25.1	13.3
Net interest income	61,594	56,437	9.1	21,002	20,852	20,020	4.9	0.7
Other operating income	5,185	4,492	15.4	2,327	1,229	1,604	45.1	89.4
Fees and commission income	16,969	14,472	17.3	5,545	5,502	5,284	4.9	0.8
Net income from forex dealings	8,396	4,505	86.4	3,463	3,193	1,787	93.8	8.5
Total non-interest income	30,551	23,469	30.2	11,335	9,924	8,675	30.7	14.2
Total income	92,145	79,906	15.3	32,338	30,776	28,696	12.7	5.1
Less operating expenses	41,573	34,768	19.6	14,263	14,386	12,057	18.3	(0.9)
Operating profit	50,572	45,137	12.0	18,075	16,390	16,639	8.6	10.3
Bad debt charge	(7,268)	(9,328)	(22.1)	(2,949)	(2,243)	(2,745)	7.4	31.5
Exceptional items	-	-	-	-	-	-	-	-
Profit before tax	43,304	35,810	20.9	15,126	14,146	13,894	8.9	6.9
Less tax	(12,709)	(10,603)	19.9	(4,177)	(4,356)	(3,988)	4.7	(4.1)
Profit after tax	30,595	25,207	21.4	10,948	9,790	9,906	10.5	11.8
Attributable Income	30,459	25,173	21.0	10,812	9,858	9,872	9.5	9.7
EPS (KES)	12.64	10.44	21.1	0.5	(0.0)	0.9	(46.7)	(1,733.3)

(Source: Company, DBIB Research)

BALANCE SHEET SUMMARY (KES MN)

Year End: December	3Q22	1H22	3Q21	y-y% ch	q-q% ch
Total shareholder's equity	187,772	179,113	162,991	15.2	4.8
Minority interest	2,447	2,636	1,392	75.7	(7.2)
Total Equity	190,219	181,750	164,383	15.7	4.7
Deposits due to other banks	32,722	35,772	26,561	23.2	(8.5)
Customer deposits	922,304	908,573	859,103	7.4	1.5
Borrowed funds	62,688	40,244	35,273	77.7	55.8
Other liabilities	68,351	43,769	37,144	84.0	56.2
Total equity and liabilities	1,276,283	1,210,108	1,122,464	13.7	5.5
Central bank balances	73,137	50,748	68,091	7.4	44.1
Deposits due from banks	62,364	50,591	60,057	3.8	23.3
Investment securities	277,109	277,844	252,446	9.8	(0.3)
Held for dealing securities	-	7,130.11	-	-	-
Customer loans and advances	758,816	730,335	651,816	16.4	3.9
Other assets	78,462	64,715	64,230	22.2	21.2
Intangible assets	6,132	7,113	5,088	20.5	(13.8)
Fixed assets	20,263	21,631	20,735	(2.3)	(6.3)
Total assets	1,276,283	1,210,108	1,122,464	13.7	5.5

(Source: Company, DBIB Research)

INVESTMENT RETURN

	3Q22	1H22	3Q21	y-y bps ch	q-q bps ch
ROA (%)*	3.2	3.2	3.0	20	(5)
ROIC (%)*	3.5	3.5	3.2	30	(0)
ROE (%)*	21.4	21.6	20.4	93	(27)

(Source: Company, DBIB Research)

*Annualized

CAPITAL ADEQUACY, LIQUIDITY & ASSET QUALITY

	3Q22	1H22	3Q21	y-y bps ch	q-q bps ch
Core capital/TRWA (%)	12.6	15.0	15.2	(260)	(240)
Min. Statutory Ratio (%)	10.5	10.5	10.5	-	-
Total capital/TRWA (%)	17.0	19.5	18.8	(180)	(250)
Min. Statutory Ratio (%)	14.5	14.5	14.5	-	-
Liquidity Ratio (%)	34.6	35.0	36.8	(220)	(40)
Min. Statutory Ratio (%)	20.0	20.0	20.0	-	-
Leverage Ratio (%)	14.9	15.0	14.6	26	(12)
Equity-to-Loans Ratio (%)	25.1	24.9	25.2	(15)	18
NPL Ratio (%)	16.4	19.2	13.1	335	(275)
NPL Coverage Ratio (%)	48.1	40.9	58.2	(1008)	722
LT Debt to Total Liabilities and Equity (%)	4.9	3.3	3.1	177	159
NTA/share (KES)	52.9	49.8	44.7	819	306
Book value/share (KES)	59.2	56.6	51.2	804	264

(Source: Company, DBIB Research)

OPERATING PERFORMANCE

	3Q22	1H22	3Q21	y-y bps ch	q-q bps ch
Yield on interest earning assets (%)*	10.6	10.6	10.8	(18)	6
Cost of funds (%)*	3.0	2.9	2.6	41	9
Net Interest Margin (%)*	7.6	7.6	8.2	(59)	(3)
Loan-to-Deposits ratio (%)	82.3	80.4	75.9	640	189
Loan-to-Dep. & Borrowed Funds ratio (%)	77.0	77.0	72.9	416	6
Funded Income Generating Potential (%)	81.2	83.9	80.6	61	(274)
Funded Income Reliance (%)	66.8	67.9	70.6	(378)	(103)
Cost to income ratio (%)	45.1	45.7	43.5	161	(55)
Pre-tax margin (%)	47.0	47.1	44.8	218	(12)
PAT margin (%)	33.2	32.8	31.5	166	35

(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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