

Below is a summary of KCB Group's H1'2024 performance:

Balance Sheet Items	H1'2023	H1'2024	y/y change
Government Securities	362.4	357.1	(1.5%)
Net Loans and Advances	1,032.2	1,032.6	0.0%
Total Assets	1,864.6	1,976.9	6.0%
Customer Deposits	1,471.2	1,490.6	1.3%
Deposits per Branch	2.5	2.6	7.0%
Total Liabilities	1,646.6	1,728.6	5.0%
Shareholders' Funds	211.2	241.0	14.1%

Key Ratios	H1'2023	H1'2024	% point change
Loan to Deposit ratio	70.2%	67.8%	(2.4%)
Government Securities to Deposits ratio	24.6%	24.0%	(0.7%)
Return on Average Equity	19.1%	22.7%	3.6%
Return on Average Assets	2.4%	2.7%	0.2%

Income Statement	H1'2023 (Kshs bn)	H1'2024 (Kshs bn)	y/y change
Net interest Income	45.5	61.3	34.8%
Net non-interest income	27.6	33.3	20.8%
Total Operating income	73.1	94.6	29.5%
Loan loss provision	(10.2)	(12.2)	19.7%
Total Operating expenses	(50.6)	(56.5)	11.7%
Profit before tax	22.5	38.1	69.7%
Profit after tax	16.1	29.9	86.4%
Core EPS	5.0	9.3	86.4%

Income Statement Ratios	H1'2023	H1'2024	y/y change
Yield from interest-earning assets	9.6%	11.3%	1.7%
Cost of funding	3.3%	4.6%	1.3%
Net Interest Spread	6.3%	6.7%	0.4%
Net Interest Margin	6.6%	7.1%	0.5%
Cost of Risk	13.9%	12.9%	(1.1%)
Net Interest Income as % of operating income	62.3%	64.8%	2.5%
Non-Funded Income as a % of operating income	37.7%	35.2%	(2.5%)
Cost to Income Ratio	69.3%	59.7%	(9.5%)
Cost to Income Ratio (without LLP)	55.3%	46.8%	(8.5%)

Capital Adequacy Ratios	H1'2023	H1'2024	% points change
Core Capital/Total Liabilities	14.4%	15.8%	1.4%
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	6.4%	7.8%	1.4%
Core Capital/Total Risk Weighted Assets	15.0%	17.8%	2.8%
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	4.5%	7.3%	2.8%
Total Capital/Total Risk Weighted Assets	18.4%	20.3%	1.9%
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	3.9%	5.8%	1.9%
Liquidity Ratio	52.1%	47.0%	(5.1%)
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	32.1%	27.0%	(5.1%)

Income Statement

- Core earnings per share grew by 86.4% to Kshs 29.9, from Kshs 16.1 in H1'2023, driven by the 29.5% increase in total operating income to Kshs 94.6 bn, from Kshs 73.1 bn in H1'2023. However, the performance was weighed down by an 11.7% increase in total operating expenses to Kshs 56.5 bn from Kshs 50.6 bn in H1'2023,
- The 29.5% increase in total operating income was mainly driven by a 34.8% growth in Net Interest Income (NII) to Kshs 61.3 bn, from Kshs 45.5 bn in H1'2023, coupled with the 20.8% increase in Non Interest Income (NFI) to Kshs 33.3 bn from Kshs 27.6 bn in H1'2023,
- Interest income grew by 38.9% to Kshs 97.4 bn from Kshs 70.1 bn in H1'2023, mainly driven by a 35.1% growth in interest income from loans and advances to Kshs 69.2 bn from Kshs 51.2 bn in H1'2023, coupled with a 40.6% increase in interest income from government securities to Kshs 25.5 bn, from Kshs 18.1 bn in H1'2023. As such, the Yield on Interest-Earning Assets (YIEA) increased to 11.3% from 9.6% recorded in H1'2023, mainly attributable to the faster 46.6% growth in trailing interest income to Kshs 123.2 bn, from Kshs 91.6 bn in H1'2023 compared to a 24.7% increase in average interest earning assets to Kshs 1,737.1 bn, from Kshs 1,393.1 bn in H1'2023,
- Interest expenses rose by 46.5% to Kshs 36.1 bn from Kshs 24.6 bn in H1'2023, mainly driven by a 54.5% increase in interest expense on customer deposits to Kshs 25.6 bn from Kshs 16.5 bn in H1'2023, coupled with a 30.9% increase in interest expense from placements to Kshs 10.3 bn, from Kshs 7.9 bn recorded in H1'2023. Consequently, Cost of funds (COF) increased by 1.3% points to 4.6% from 3.3% recorded in H1'2023, owing to a faster 73.0% increase in Trailing interest expense to Kshs 72.3 bn from Kshs 41.8 bn recorded in H1'2023, compared to a 23.3% increase in average interest bearing liabilities to Kshs 1,584.7 bn from Kshs 1,285.1 bn in H1'2023. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) increased by 0.5% points to 7.1% from 6.6% in H1'2023, attributable to a faster 34.5% increase in trailing net interest income to Kshs 123.2 bn from Kshs 91.6 bn recorded in H1'2023 which outpaced the 24.7% growth in average interest earning assets,
- Non-Funded Income (NFI) increased by 20.8% to Kshs 33.3 bn from Kshs 27.6 bn in H1'2023, mainly driven by a 68.8% increase in forex trading income to Kshs 10.0 bn , from Kshs 5.9 bn in H1'2023, highlighting the bank's increased foreign exchange margins, coupled with a 16.7% increase in income from other fees and commissions to Kshs 14.3 bn, from 12.3 bn in H1'2023. Total fees and commissions also increased by 1.5% to remain relatively unchanged at Kshs 5.6 bn in H1'2023. The revenue mix shifted to 65:35 from 62:38 for the funded to Non-funded income owing to the faster 34.8% growth in Funded Income compared to a 20.8% increase in the Non Funded Income,
- Total operating expenses increased by 11.7% to Kshs 56.5 bn from Kshs 50.6 bn in H1'2023, driven by a 10.4% increase in staff costs to Kshs 19.3 bn from Kshs 17.5 bn recorded in H1'2023, coupled with a 9.0% increase in other operating expenses to Kshs 25.0 bn, from Kshs 23.0 bn recorded in H1'2023 together with the 19.7% increase in loan loss provisions to Kshs 12.2 bn, from Kshs 10.2 bn recorded in H1'2023. The increase in provisioning is despite the reducing credit risk as a result of improved economic environment as evidenced by the average H1'2024 Purchasing Managers Index (PMI) of 50.0, up from an average of 48.7 in H1'2023,
- Cost to Income Ratio (CIR) decreased by 9.5% points to 59.7% from 69.3% in H1'2023, owing to the slower 11.7% increase in total operating expenses, which was outpaced by the 29.5% increase in total operating income. Notably, CIR without LLP decreased by 8.5% points to 46.8% from 55.3% recorded in H1'2023, and,
- Profit before tax increased by 69.7% to Kshs 38.1 bn, from Kshs 22.5 bn recorded in H1'2023, with effective tax rate decreasing to 21.5% in H1'2024 from 28.5% in H1'2023, leading to an 86.4% increase in profit after tax to Kshs 29.9 bn in H1'2024, from Kshs 16.1 bn in H1'2023.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 6.0% to Kshs 1,976.9 bn, from Kshs 1,864.6 bn in H1'2024, driven by a 7.3% increase in placements to Kshs 357.1 bn, from 332.7 bn in H1'2023, coupled with

a 28.3% increase in cash and cash balances to Kshs 82.6 bn, from Kshs 64.4 bn in H1'2023,

- Total liabilities rose by 5.0% to Kshs 1,728.6 bn from Kshs 1,646.6 bn in H1'2024, driven by a 1.3% growth in customer deposits to Kshs 1,490.6 bn, from Kshs 1,471.2 bn in H1'2023, which outpaced the 10.4% decline in borrowings to Kshs 58.8 bn, from Kshs 65.6 bn in H1'2023. With 566 branches, compared to 594 branches in H1'2023, deposits per branch increased by 7.0% to Kshs 2.6 bn, from Kshs 2.5 bn in H1'2023,
- The faster 1.3% growth in customer deposits as compared to the slower 0.04% increase in loans led to a decrease in the loan to deposits ratio to 67.8%, from 70.2% in H1'2023,
- The bank's Asset Quality deteriorated, with Gross NPL ratio increasing to 18.1% in H1'2024, from 16.2% in H1'2023, attributable to a 16.5% increase in Gross non-performing loans to Kshs 212.1 bn, from Kshs 182.0 bn in H1'2023, compared to the 4.2% increase in gross loans to Kshs 1,172.3 bn, from Kshs 1,125.2 bn recorded in H1'2023,
- General Provisions (LLP) increased by 46.8% to Kshs 110.6 bn in H1'2024 from Kshs 75.3 bn in H1'2023. The NPL coverage ratio increased to 65.9% in H1'2024, from 51.1% in H1'2023, attributable to the 46.8% increase in general provisions which was outpaced by the 64.5% increase in interest in suspense to Kshs 29.2 bn, from Kshs 17.7 bn in H1'2023, coupled with the 16.5% increase in gross non performing loans,
- Shareholders' funds increased by 14.1% to Kshs 241.0 bn in H1'2024, from Kshs 211.2 bn in H1'2023, supported by a 36.0% increase in retained earnings to Kshs 226.1 bn, from Kshs 166.3 bn in H1'2023,
- KCB Group remains capitalized with a core capital to risk-weighted assets ratio of 17.8%, 7.3% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 20.3%, exceeding the statutory requirement of 14.5% by 5.8% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.7%, and a Return on Average Equity (ROaE) of 22.7%.

Key Take-Outs:

- 1. Increased earnings** - Core earnings per share (EPS) grew by 86.4% to Kshs 29.9, from Kshs 16.1 in H1'2023, driven by the 29.5% increase in total operating income to Kshs 94.6 bn, from Kshs 73.1 bn in H1'2023.
- 2. Deteriorated asset quality** – The bank's Asset Quality deteriorated, with Gross NPL ratio increasing to 18.1% in H1'2024, from 16.2% in H1'2023, attributable to a 16.5% increase in Gross non-performing loans to Kshs 212.1 bn, from Kshs 182.0 bn in H1'2023, compared to the 4.2% increase in gross loans to Kshs 1,172.3 bn, from Kshs 1,125.2 bn recorded in H1'2023,
- 3. Expanded Balanced sheet** - The balance sheet recorded an expansion as total assets grew by 6.0% to Kshs 1,976.9 bn, from Kshs 1,864.6 bn in H1'2024, driven by a 7.3% increase in placements to Kshs 357.1 bn, from 332.7 bn in H1'2023, coupled with a 28.3% increase in cash and cash balances to Kshs 82.6 bn, from Kshs 64.4 bn in H1'2023,

Going forward, the factors that would drive the bank's growth would be:

- **Continued Digitization** - The Group has continued to maximize on digital transformation. As of FY'2023, 99.0% of the transactions by number were done through the non-branch channels. Notably, the Group witnessed 77.0% growth in the value of mobile loans disbursed mainly driven by Fuliza, introduction of term loans on KCB Mobi and new mobile lending products for small businesses. The value of mobile loans disbursed reached an all time high of Kshs 337.0 bn in FY'2023, accounting for 78.0% growth in Non-Funded Income from digital channels in 2023.

Valuation Summary

- We are of the view that KCB Group is a "buy" with a target price of Kshs 45.1 representing an upside of 27.3%, from the current price of 32.0 as of 23rd August 2024, inclusive of an annualized dividend yield of 10.0% and a payout ratio of 16.1%
- KCB Group is currently trading at a P/TBV of 0.5x and a P/E of 2.7x vs an industry average of 0.8x and 3.6x

respectively.