NCBA Group Plc – Q3'2022
25th November, 2022

Below is a summary of NCBA Group's Q3'2022 performance:

Balance Sheet Items	Q3'2021	Q3'2022	y/y change
Net Loans and Advances	238.2	266.1	11.7%
Government Securities	189.6	206.8	9.1%
Total Assets	**562.6**	**595.4**	**5.8%**
Customer Deposits	447.6	462.1	3.2%
Deposits per branch	4.6	4.4	(4.6%)
Total Liabilities	487.7	514.5	5.5%
Shareholders' Funds	**74.8**	**80.9**	**8.1%**

Balance Sheet Ratios	Q3'2021	Q3'2022	% points change
Loan to Deposit Ratio	53.2%	57.6%	4.4%
Return on average equity	13.8%	21.2%	7.4%
Return on average assets	1.8%	2.8%	1.0%

Income Statement	Q3'2021	Q3'2022	y/y change
Net Interest Income	20.2	23.2	15.1%
Net non-Interest Income	16.1	22.5	40.1%
Total Operating income	**36.3**	**45.8**	**26.2%**
Loan Loss provision	9.2	8.3	(9.2%)
Total Operating expenses	**24.7**	**26.9**	**8.9%**
Profit before tax	11.1	18.2	64.5%
Profit after tax	**6.5**	**12.8**	**96.2%**
Core EPS	**4.0**	**7.8**	**96.2%**

Income Statement Ratios	Q3'2021	Q3'2022	% points change
Yield from interest-earning assets	10.0%	10.1%	0.1%
Cost of funding	4.1%	4.4%	0.3%
Net Interest Spread	5.9%	5.7%	(0.2%)
Net Interest Margin	6.1%	6.0%	(0.1%)
Cost of Risk	25.3%	18.2%	(7.1%)
Net Interest Income as % of operating income	55.7%	50.8%	(4.9%)
Non-Funded Income as a % of operating income	44.3%	49.2%	4.9%
Cost to Income Ratio	68.0%	58.7%	(9.3%)
Cost to Income Ratio without LLP	42.7%	40.5%	(2.2%)

Capital Adequacy Ratios	Q3'2021	Q3'2022	% points change
Core Capital/Total Liabilities	16.8%	16.9%	0.1%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**8.8%**	**8.9%**	**0.1%**
Core Capital/Total Risk Weighted Assets	19.0%	18.4%	(0.6%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**8.5%**	**7.9%**	**(0.6%)**
Total Capital/Total Risk Weighted Assets	19.1%	18.4%	(0.7%)
Minimum Statutory ratio	14.5%	14.5%	
Excess	**4.6%**	**3.9%**	**(0.7%)**
Liquidity Ratio	61.7%	55.6%	(6.1%)
Minimum Statutory ratio	20.0%	20.0%	
Excess	**41.7%**	**35.6%**	**(6.1%)**

Adjusted core capital/ total deposit liabilities	**17.5%**	**17.5%**	**(0.1%)**
Adjusted core capital/ total risk weighted assets	**19.8%**	**19.0%**	**(0.9%)**
Adjusted total capital/ total risk weighted assets	**19.9%**	**19.0%**	**(0.8%)**

Income Statement

- Core earnings per share rose by 96.2% to Kshs 7.8, from Kshs 4.0 in Q3’2021, higher than our expectations of a 60.5% increase to Kshs 6.4. The performance was driven by the 26.2% growth in total operating income to Kshs 45.8 bn, from Kshs 36.3 bn in Q3’2021, which outpaced the 8.9% growth in total operating expenses to Kshs 26.9 bn, from Kshs 24.7 bn in Q3’2021,
- Total operating income increased by 26.2% to Kshs 45.8 bn, from Kshs 36.3 bn in Q3’2021, driven by a 15.1% increase in Net Interest Income (NII) to Kshs 23.2 bn, from Kshs 20.2 bn in Q3’2021, coupled with a 40.1% increase in Non-Funded Income (NFI) to Kshs 22.5 bn, from Kshs 16.1 bn in Q3’2021,
- Interest income grew by 13.3% to Kshs 38.8 bn, from Kshs 34.2 bn in Q3’2021, mainly driven by a 23.8% increase in interest income from government securities to Kshs 18.2 bn, from Kshs 14.7 bn in Q3’2021, coupled with a 5.0% increase in interest income from loans and advances, to Kshs 20.0 bn, from Kshs 19.1 bn in Q3’2021. The Yield on Interest-Earning Assets (YIEA) increased to 10.1% from 10.0% recorded in Q3’2021, attributable to an 8.3% increase in trailing interest income to Kshs 51.1 bn, from Kshs 47.2 bn in Q3’2021 which outpaced the 5.6% growth in interest earning assets to Kshs 518.6 bn, from Kshs 491.0 bn recorded in Q3’2021. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expenses rose by 10.8% to Kshs 15.5 bn, from Kshs 14.0 bn in Q3’2021, following a 8.9% increase in interest expense on customer deposits to Kshs 14.8 bn, from Kshs 13.6 bn in Q3’2021, coupled with a 182.9% increase in Interest expense on deposits and placements to Kshs 0.5 bn, from Kshs 0.2 bn in Q3’2021. On the other hand, the Cost of funds (COF) increased by 0.3% points to 4.4%, from 4.1% recorded in Q3’2021, following a 14.0% increase in Trailing interest expense to Kshs 21.0 bn, from Kshs 18.4 bn in Q3’2021 which outpaced the 2.6% growth in interest bearing liabilities to Kshs 479.6 bn, from Kshs 467.4 bn recorded in Q3’2021, Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) declined to 6.0%, from 6.1% in Q3’2021 attributable to a faster increase in average interest earning assets by 6.4% to Kshs 501.4 bn, from Kshs 471.2 bn in Q3’2021 compared to 4.7% growth in trailing Net Interest Income,
- Non-Funded Income (NFI) increased by 40.1% to Kshs 22.5 bn, from Kshs 16.1 bn in Q3’2021, mainly driven by a significant increase of 162.9% in the group’s foreign exchange trading income to Kshs 9.2 bn, from Kshs 3.5 bn in Q3’2021, highlighting the group’s increased foreign exchange margins, coupled with 4.0% increase in interest income from fees and commissions on loans and advances to Kshs 8.5 bn in Q3’2022, from Kshs 8.2 bn recorded in Q3’2021 Notably, Total fees and commissions increased by 5.2% to Kshs 11.5 bn in Q3’2022 from Kshs 10.9 bn recorded in Q3’2021. The revenue mix moved to 51:49 from 56:44 for the funded to Non-funded income owing to the 40.1% growth in non-funded income which outpaced the 15.1% growth in funded income,
- Total operating expenses increased by 8.9% to Kshs 26.9 bn, from Kshs 24.7 bn in Q3’2021, largely driven by a 19.9% increase in staff costs to Kshs 7.1 bn, from Kshs 5.9 bn in Q3’2021. The increase in staff costs was mitigated by a 9.2% decline in Loan Loss Provisions (LLP), to Kshs 8.3 bn, from Kshs 9.2 bn in Q3’2021,
- Cost to Income Ratio (CIR) improved to 58.7%, from 68.0% in Q3’2021, owing to the 26.2% increase in total operating income, which outpaced the 8.9% increase in total operating expenses. Similarly, without LLP, Cost to Income ratio improved to 40.5% from 42.7% in Q3’2021, an indication of improved efficiency, and,
- Profit before tax increased by 64.5% to Kshs 18.2 bn, from Kshs 11.1 bn in Q3’2021, with the effective tax rate declining to 29.6%, from 41.0% in Q3’2021. Similarly, Profit after tax increased by 96.2% to Kshs 7.8 bn from Kshs 4.0 bn in Q3’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 5.8% to Kshs 595.4 bn, from Kshs 562.6 bn in Q3’2021, driven by a 11.7% growth in the loan book to Kshs 266.1 bn, from Kshs 238.2 bn in Q3’2021, coupled with a 9.1% increase in government securities to Kshs 206.8 bn, from Kshs 189.6 bn in Q3’2021,
- Total liabilities rose by 5.5% to Kshs 514.5 bn, from Kshs 487.7 bn in Q3’2021, driven by a 3.2% growth in customer deposits to Kshs 462.1 bn, from Kshs 447.6 bn. Placements due to other banking institutions also increased by 2.9% to Kshs 13.0 bn, from Kshs 12.6 bn in Q3’2021. However, deposits per branch declined by 4.6% to Kshs 4.4 bn in Q3’2022, from Kshs 4.6 bn in Q3’2021, with the number of branches increasing to 105, from 97 branches in Q3’2021,
- The faster 11.7% growth in loans as compared to the 3.2% growth in deposits led to an increase in the loan to deposits ratio to 57.6%, from 53.2% in Q3’2021,
- The bank’s Asset Quality improved significantly, with NPL ratio declining to 12.6% in Q3’2022, from 17.0% in Q3’2021, attributable to 20.9% decline in gross non-performing loans to Kshs 36.4 bn, from Kshs 46.0 bn in Q3’2021, with gross loans increasing by 7.2% to Kshs 289.9 bn in Q3’2022, from Kshs 270.5 bn in Q3’2021,
- The NPL coverage declined to 65.3% in Q3’2022, from 70.2% in Q3’2021, attributable to a 30.5% decline in general provisions (LLP) to Kshs 16.8 bn, from Kshs 24.2 bn in Q3’2021 and a 20.9% decrease in gross non-performing loans to Kshs 36.4 bn in Q3’2022, from Kshs 46.0 bn in Q3’2021,
- Shareholders’ funds increased by 8.1% to Kshs 80.9 bn in Q3’2022, from Kshs 74.8 bn in Q3’2021, supported by a 21.7% increase in retained earnings to Kshs 54.1 bn, from Kshs 44.4 bn in Q3’2021,
- NCBA Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.%, 7.9% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 18.4%, exceeding the statutory requirement of 14.5% by 3.9% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 19.0%, while total capital to risk-weighted assets came in at 19.0%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.8%, and a Return on Average Equity (ROaE) of 21.2%.

Key Take-Outs:

1. **Improvement in Asset Quality** - The group’s asset quality improved, with the gross non performing ratio declining to 12.6% from 17.0% recoded in Q3’2021, with gross non-performing loans declining by 20.9% to Kshs 36.4 bn from Kshs 46.0 bn recorded in Q3’2021. This follows the bank’s announcement to write off more than Kshs 5.5 bn of the non-performing loans under its digital lending platforms, a move in line with the Central Bank of Kenya credit repair framework which will see mobile phone digital borrowers removed from negative listing on credit reference bureaus
2. **Significant increase in Non-Funded Income** – The banks NFI recorded a y/y increase of 40.1% to Kshs 22.5 bn in Q3’2022, mainly attributable to a significant increase in Foreign Exchange income by 162.9% to Kshs 9.2 bn, from Kshs 3.5 bn recorded in Q3’2022. In our view, the significant increase in foreign exchange is partly attributable to the volatility of exchange rates following the continued weakening of the shilling against the dollar.
3. **Decline in Deposits per Branch** – As part of the Group’s growth strategy to increase its footprint in the market, there was an increase in the number of branches by 8 branches to 105 branches in Q3’2022 from 97 branches in Q3’2021. As such, this resulted to a 4.6% decline in deposits per branch to Kshs 4.4 bn in Q3’2022, from Kshs 4.6 bn in Q3’2021.

Going forward, the factor that would drive the bank’s growth would be:

I. **Regional Diversification**. The group has continued to embrace digital lending and currently controls the largest share in digital lending market in Kenya. The bank boost of the popular mobile lending and credit products Mshwari and Fuliza and it recently announced plans to expand into eight African markets using the mobile and digital banking platforms. Currently, the group is already awaiting license to start lending in Ghana at the beginning of Q1’2023. Having recorded strong performance in Q3’2022, we expect that the move will have be a key driver to its interest income.

Valuation Summary

- We are of the view that NCBA Group is a “buy” with a target price of Kshs 38.9, representing an upside of 18.5%, from the current price of 32.9 as of 25th November 2022, inclusive of a dividend yield of 9.1%,
- NCBA Group is currently trading at a P/TBV of 0.8x and a P/E of 3.3x vs an industry average of 0.7x and 4.0x, respectively.