KCB Group Plc – FY’2022

17th December, 2022

Below is a summary of KCB Group’s FY’2022 performance:

Balance Sheet Items	FY’2021	FY’2022	y/y change
Net Loans and Advances	675.5	863.3	27.8%
Government Securities	270.8	278.0	2.7%
Total Assets	**1,139.7**	**1,554.0**	**36.4%**
Customer Deposits	837.1	1,135.4	35.6%
Total Liabilities	966.2	1,347.8	39.5%
Shareholders’ Funds	**171.7**	**200.2**	**16.6%**

Balance Sheet Ratios	FY’2021	FY’2022	% y/y change
Loan to Deposit Ratio	80.7%	81.3%	0.6%
Return on average equity	21.8%	22.0%	0.2%
Return on average assets	3.2%	3.0%	(0.2%)

Income Statement	FY’2021	FY’2022	y/y change
Net Interest Income	77.7	86.7	11.5%
Net non-Interest Income	30.9	43.3	39.8%
Total Operating income	**108.6**	**129.9**	**19.6%**
Loan Loss provision	(13.0)	(13.2)	1.7%
Total Operating expenses	(60.8)	(72.6)	19.3%
Profit before tax	47.8	57.3	19.9%
Profit after tax	**34.2**	**40.8**	**19.5%**
Core EPS	**10.63**	**12.7**	**19.5%**

Income Statement Ratios	FY’2021	FY’2022	y/y change
Yield from interest-earning assets	11.1%	10.1%	(1.0%)
Cost of funding	2.8%	2.9%	0.1%
Net Interest Spread	8.3%	7.3%	(1.0%)
Net Interest Margin	8.4%	7.5%	(0.9%)
Cost of Risk	12.0%	10.2%	(1.8%)
Net Interest Income as % of operating income	71.5%	66.7%	(4.8%)
Non-Funded Income as a % of operating income	28.5%	33.3%	4.8%
Cost to Income Ratio	56.0%	55.9%	(0.1%)

Capital Adequacy Ratios	FY’2021	FY’2022	% points change
Core Capital/Total Liabilities	18.7%	15.3%	(3.4%)
Minimum Statutory ratio	8.0%	8.0%	
Excess	**10.7%**	**7.3%**	**(3.4%)**
Core Capital/Total Risk Weighted Assets	18.0%	13.9%	(4.1%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**7.5%**	**3.4%**	**(4.1%)**
Total Capital/Total Risk Weighted Assets	21.7%	17.1%	(4.6%)
Minimum Statutory ratio	14.5%	14.5%	
Excess	**7.2%**	**2.6%**	**(4.6%)**
Liquidity Ratio	39.1%	40.9%	1.8%
Minimum Statutory ratio	20.0%	20.0%	
Excess	**19.1%**	**20.9%**	**1.8%**

Key FY’2022 highlights:

- On 14th December 2022, KCB Group announced that it had completed the acquisition of 85.0% stake in DRC based Trust Merchant Bank (TMB) after receiving all the regulatory approvals. This marks the second Kenyan banking group to enter the DRC banking market after Equity Group Holdings. For this acquisition, KCB agreed to pay a cash consideration based on the net asset value of TMB at completion of the proposed transaction using a Price to Book (P/B) multiple of 1.5x, this was done after all the approvals. As was expected, the acquisition has boosted KCB’s regional presence and accelerated its growth as evidenced by customer deposits hitting a Kshs 1.0 tn mark and a 36.4% growth of assets to Kshs 1.6 tn from Kshs 1.1 tn in FY’2021. TMB brought on board 105 branches taking the current branches to 603 with the bank currently boosting of 32.4 mn customers. For more information on the acquisition, please see our Cytonn Weekly #31 2022.

Income Statement

- Core earnings per share rose by 19.5% to Kshs 12.7 from Kshs 10.6 in FY’2021, higher than our expectations of a 16.2% increase to Kshs 12.4, with the variance stemming from the 19.6% increase in total operating income, which was slightly higher than our projection of a 17.7% increase. The performance was driven by the 19.6% growth in total operating income to Kshs 129.9 bn, from Kshs 108.6 bn in FY’2021, which outpaced the 19.3% growth in total operating expenses to Kshs 72.6 bn, from Kshs 60.8 bn in FY’2021,
- Total operating income increased by 19.6% to Kshs 129.9 bn, from Kshs 108.6 bn in FY’2021, driven by an 11.5% increase in Net Interest Income (NII) to Kshs 86.7 bn, from Kshs 77.7 bn in FY’2021, coupled with a 39.8% increase in Non-Funded Income (NFI) to Kshs 43.3 bn, from Kshs 30.9 bn in FY’2021,
- Interest income grew by 15.3% to Kshs 117.8 bn, from Kshs 102.2 bn in FY’2021, mainly driven by a 13.8% increase in interest income from loans and advances, to Kshs 84.2 bn, from Kshs 74.0 bn in FY’2021, coupled with a 23.8% increase in interest income from government securities to Kshs 32.9 bn, from Kshs 26.5 bn in FY’2021. The Yield on Interest-Earning Assets (YIEA) declined by 1.0% points to 10.1%, from 11.1% in FY’2021 attributable to the faster 26.3% growth in Average Interest Earning Assets (AIEA) following the acquisition of TMB Bank in DRC which outpaced the 15.1% growth in trailing interest income with the group yet to optimize the TMB Balance sheet. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expenses rose by 27.1% to Kshs 31.1 bn, from Kshs 24.5 bn in FY’2021, following a 23.0% increase in interest expense on customer deposits to Kshs 25.2 bn, from Kshs 20.5 bn in FY’2021, coupled with a 57.1% increase in Interest expense on deposits and placements to Kshs 5.4 bn, from Kshs 3.4 bn in FY’2021. Consequently, the Cost of funds (COF) increased slightly by 0.1% points to 2.9%, from 2.8% recorded in FY’2021, following a faster 27.1% increase in Trailing interest expense, which outpaced the 20.6% increase in average interest bearing liabilities. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) declined to 7.5%, from 8.4% in FY’2021 due to the faster 26.3% increase in average interest-earning assets, compared to the 11.5% growth in trailing Net Interest Income,
- Non-Funded Income (NFI) increased by 39.8% to Kshs 43.3 bn, from Kshs 30.9 bn in FY’2021, driven by a significant 69.2% increase in the group’s foreign exchange trading income to Kshs 11.1 bn, from Kshs 6.5 bn in FY’2021, highlighting the group’s increased foreign exchange margins, coupled with a 20.6% increase in income from fees and commissions on loans and advances to Kshs 10.6 bn, from Kshs 8.8 bn in FY’2021. Other fees and commission income also increased by 16.9% to Kshs 12.3 bn from Kshs 10.6 bn in FY’2021. As such, the total fees and commissions increased by 18.6% to Kshs 23.0 bn, from the Kshs 19.4 bn recorded in FY’2021. The revenue mix shifted to 67:33 from 72:28 funded to non-funded income, owing to the faster 39.8% growth in NFI compared to the 11.5% increase in NII,
- Total operating expenses increased by 19.3% to Kshs 72.6 bn, from Kshs 60.8 bn in FY’2021, largely driven by a 26.0% increase in other operating expenses to Kshs 29.1 bn, from Kshs 23.1 bn in FY’2021 coupled with a 22.4%

increase in staff costs to Kshs 30.3 bn from Kshs 24.7 bn in FY’2021. Loan Loss Provisions (LLP) also increased marginally by 1.7% to Kshs 13.2 bn, from Kshs 13.0 bn in FY’2021,

- Cost to Income Ratio (CIR) improved marginally to 55.9%, from 56.0% in FY’2021, owing to the 19.6% increase in total operating income, which outpaced the 19.3% increase in total operating expenses. Without LLP, Cost to Income ratio deteriorated to 45.7% from 44.0% in FY’2021, an indication of reduced efficiency, and,
- Profit before tax increased by 19.9% to Kshs 57.3 bn, from Kshs 47.8 bn in FY’2021, with the effective tax rate increasing slightly to 28.8%, from 28.5% in FY’2021. Similarly, Profit after tax increased by 19.5% to Kshs 40.8 bn in FY’2022, from Kshs 34.2 bn in FY’2021.
- The KCB Group’s directors recommended a final dividend per share of Kshs 1.0 in FY’2022, adding to the interim dividend per share of Kshs 1.0 issued in FY’2021. The total dividend of Kshs 2.0 per share represents a dividend yield of 6.5% as of 17th March, 2023. This is a 33.3% decline from the dividend per share of Kshs 3.0 issued in FY’2021. Additionally, the dividend payout ratio declined to 15.7% in FY’2022, from 28.2% in FY’2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 36.4% to Kshs 1,554.0 bn, from Kshs 1,139.7 bn in FY’2021, driven by a 27.8% growth in the loan book to Kshs 863.3 bn, from Kshs 675.5 bn in FY’2021, coupled with a 2.7% increase in government securities to Kshs 278.0 bn, from Kshs 270.8 bn in FY’2021. The significant growth in the balance sheet is also attributable to full consolidation of TMB’s balance sheet items,
- Total liabilities rose by 39.5% to Kshs 1,347.8 bn, from Kshs 966.2 bn in FY’2021, driven by a 35.6% growth in customer deposits to Kshs 1,135.4 bn, from Kshs 837.1 bn, with customer deposits from NBK amounting to Kshs 105.7 bn in FY’2022. Placements due to other banking instituitions also increased by 25.4% to Kshs 55.6 bn, from Kshs 44.3 bn in FY’2021. Deposits per branch increased by 10.7% to Kshs 1.9 bn, from Kshs 1.7 bn in FY’2021, with the number of branches increasing to 603, from 492 in FY’2021. This comes after KCB acquired TMB Bank with 105 branches,
- The faster 35.6% growth in deposits as compared to the 27.8% growth in loans led to a decline in the loan to deposits ratio to 76.0%, from 80.7% in FY’2021,
- Gross non-performing loans increased by 31.2% to Kshs 161.2 bn, from Kshs 122.9 bn in FY’2021. Consequently, the group’s Asset Quality deteriorated, with the NPL ratio increasing to 17.0% in FY’2022, from 16.6% in FY’2021, attributable to the faster 31.2% growth in Non-Performing loans, which outpaced the 28.0% growth in gross loans. The increase in gross non-performing loans was driven by a 40.0% increase in KCB-Kenya’s gross NPLs to Kshs 129.1 bn from Kshs 92.2 bn in FY’2021 following an increase in NPL stock and reclassifications in sectors such as building and construction, manufacturing, and Transport and communication during the year. As such KCB-Kenya’s NPL ratio deteriorated to 19.1% in FY’2022 from 16.0% in FY’2021, 5.8% points higher than the Kenya’s banking sector NPL ratio which came in at 13.3% in FY’2022. Similarly, National Bank of Kenya’s NPL ratio continued to weigh down the group, coming in at 22.1%, despite being an improvement from 31.9% from FY’2021. However, on a q/q basis, the asset quality improved, with the NPL ratio improving to 17.0% in FY’2022 from 17.8% in Q3’2022,
- General Provisions (LLP) increased by 35.0% y/y to Kshs 70.6 bn in FY’2022, from Kshs 52.3 bn in FY’2021. The NPL coverage declined slightly to 52.4% in FY’2022, from 52.9% in FY’2021, attributable to the faster 35.0% growth in general Loan Loss Provision which outpaced the 31.2% growth in Gross non-performing loans. In light of the prevailing credit risk and asset quality deterioration, we expect to see robust increase in provisioning going forward,
- Shareholders’ funds increased by 16.6% to Kshs 200.2 bn in FY’2022, from Kshs 171.7 bn in FY’2021, supported by an 11.9% increase in retained earnings to Kshs 147.2 bn, from Kshs 131.6 bn in FY’2021,
- KCB Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 13.9%, 3.4% points above the statutory requirement of 10.5% and 4.1% points lower than 18.1% in FY’2021. In addition, the total capital to risk-weighted assets ratio came in at 17.1%, exceeding the statutory requirement of 14.5% by 2.6% points and registered a decline of 4.6% points compared to 21.7% in FY’2021. Adjusting for IFRS 9, the core

capital to risk-weighted assets stood at 13.9% compared to the 18.1% in FY’2021, while total capital to risk-weighted assets came in at 17.1% compared to 21.8% in FY’2021, and,

- The bank currently has a Return on Average Assets (ROaA) of 3.0%, and a Return on Average Equity (ROaE) of 22.0%.

Key Take-Outs:

1. **Earnings Growth –** Core earnings per share rose by 19.5% to Kshs 12.7 from Kshs 10.6 in FY’2021, higher than our expectations of a 16.2% increase to Kshs 12.4, with the variance stemming from the 19.6% increase in total operating income, which was slightly higher than our projection of a 17.7% increase. The performance was driven by the 19.6% growth in total operating income to Kshs 129.9 bn, from Kshs 108.6 bn in FY’2021, which outpaced the 19.3% growth in total operating expenses to Kshs 72.6 bn, from Kshs 60.8 bn in FY’2021,
2. **Increased Customer Deposit** – KCB Group’s customer deposits base increased significantly by 35.6% to Kshs 1,135.4 bn from Kshs 837.1 bn in FY’2021 and is the second banking group in Kenya after Equity Group to cross the Kshs 1.0 tn mark, mainly attributable to the completion of the acquisition of TMB Bank and the organic growth in the existing business,
3. **Deteriorated Asset Quality** – KCB group’s asset quality deteriorated y/y to 17.0% from 16.6% in FY’2021 driven by a 31.2% increase in gross non-performing loans to Kshs 161.2 bn, from Kshs 122.9 bn in FY’2021, which outpaced the 28.0% growth in gross loans. The increase in gross non-performing loans was driven by a 40.0% increase in KCB-Kenya’s gross NPLs to Kshs 129.1 bn from Kshs 92.2 bn in FY’2021 following an increase in NPL stock and reclassifications in sectors such as building and construction, manufacturing, and Transport and communication during the year. As such KCB-Kenya’s NPL ratio deteriorated to 19.1% in FY’2022 from 16.0% in FY’2021, 5.8% points higher than the Kenya’s banking sector NPL ratio which came in at 13.3% in FY’2022. Similarly, National Bank of Kenya’s NPL ratio continued to weigh down the group, coming in at 22.1%, despite being an improvement from 31.9% from FY’2021. However, on a q/q basis, the asset quality improved, with the NPL ratio improving to 17.0% in FY’2022 from 17.8% in Q3’2022,
4. **Impaired Yield on Interest Earning Assets ratio –** The group recorded a 1.0% decline in its Yield on Interest Earning Ratio to 10.1% from 11.1% driven by the faster 26.3% growth in Average Interest Earning Assets (AIEA) following the acquisition of TMB Bank in DRC which outpaced the 15.1% growth in trailing interest income with the group yet to optimize the TMB Balance sheet to generate interest income.

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

I. **Geographical Expansion and Diversification** – The bank has continoued with its expansion in the region, as evidenced by the completion of the 85.0% acquisition of Trust Merchant Bank (TMB) in DRC in 2022. The acquisition has boosted KCB’s regional presence and participation, as well as accelerated its growth as evidenced by customer deposits hitting a Kshs 1.0 tn mark and a 36.4% growth of assets to Kshs 1.6 tn. Notably, proportion of assets from subsidiaries outside KCB Kenya increased to 37.5% from 27.5% in 2021 with newly acquired TMB contributing 13.5% of the Group’s total assets. Profit Before Tax (PBT) contributions from subsidiaries outside of KCB-K increased to 17.0% from 13.9% in 2021. The Group is also planning on expanding into the Ethiopian market, further expanding its presence in the region and consequently drive growth in the near future.

II. **Continued Digitization** - The Group’s profit would also be supported by the continued digitization. As of FY’2022, 99.0% of the transactions were done through the non-branch channels with 47.0% year-on-year increase in number of non-branch transactions to 713.3 mn as the branch transactions continoue to decline. The growth is also to be supported by the continued growth in mobile lending such as Fuliza and KCB Mpesa. The digital channel transactions has led to increase in NFI by 39.8% in FY’2022 with NFI from digital channels growing by 21.0% mainly on the back of increased mobile and internet banking.

Valuation Summary

- We are of the view that KCB Group is a "BUY" with a target price of Kshs 49.8, representing an upside of 60.6%, from the current price of Kshs 31.0 as of 17th March 2022, inclusive of a dividend yield of 2.5%,
- KCB Group is currently trading at a P/TBV of 0.5x and a P/E of 2.6x vs an industry average of 0.9x and 5.0x, respectively.