KCB Group Plc – Q1’2021

28th May, 2021

Below is a summary of KCB Group’s Q1’2021 performance:

Balance Sheet Items	Q1'2020	Q1'2021	y/y change
Net Loans and Advances	553.9	597.1	7.8%
Government Securities	202.6	212.1	4.7%
Total Assets	**947.1**	**977.5**	**3.2%**
Customer Deposits	740.4	749.4	1.2%
Total Liabilities	811.5	830.0	2.3%
Shareholders’ Funds	**135.5**	**147.5**	**8.8%**

Balance Sheet Ratios	Q1'2020	Q1'2021	% point change
Loan to Deposit Ratio	74.8%	79.7%	4.9%
Return on average equity	20.1%	13.9%	(6.2%)
Return on average assets	3.1%	2.0%	(1.1%)

Income Statement	Q1'2020	Q1'2021	y/y change
Net Interest Income	15.1	16.7	11.1%
Net non-Interest Income	7.9	6.3	(20.0%)
Total Operating income	**23.0**	**23.0**	**0.4%**
Loan Loss provision	(2.90)	(2.86)	(1.3%)
Total Operating expenses	(14.0)	(13.9)	(0.8%)
Profit before tax	8.9	9.1	2.2%
Profit after tax	**6.3**	**6.4**	**1.8%**
Core EPS	**1.95**	**1.98**	**1.8%**

Income Statement Ratios	Q1'2020	Q1'2021	%point change
Yield from interest-earning assets	10.8%	10.9%	0.1%
Cost of funding	2.8%	2.6%	(0.2%)
Net Interest Spread	8.0%	8.3%	0.3%
Net Interest Margin	8.1%	8.4%	0.3%
Cost of Risk	12.6%	12.4%	(0.2%)
Net Interest Income as % of operating income	65.6%	72.6%	7.0%
Non-Funded Income as a % of operating income	34.4%	27.4%	(7.0%)
Cost to Income Ratio	61.1%	60.4%	(0.7%)

Capital Adequacy Ratios	Q1'2020	Q1'2021
Core Capital/Total Liabilities	17.1%	19.2%
Minimum Statutory ratio	8.0%	8.0%
Excess	**9.1%**	**11.2%**
Core Capital/Total Risk Weighted Assets	17.1%	18.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.6%**	**7.7%**
Total Capital/Total Risk Weighted Assets	19.0%	21.8%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.5%**	**7.3%**
Liquidity Ratio	40.1%	37.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**20.1%**	**17.3%**
Adjusted core capital/ total deposit liabilities	17.5%	19.4%
Adjusted core capital/ total risk weighted assets	17.5%	18.3%
Adjusted total capital/ total risk weighted assets	19.4%	21.9%

Key Highlights Q1’2021

- KCB Group’s restructured loan book stands at Kshs 102.5 bn, representing 18.8% of its loan book which stood at Kshs 597.1 bn as at Q1’2021. This is in line with the CBK’s emergency measures for COVID-19 related loan restructuring which ran from March 18th 2020 to 2nd March 2021 in order to provide relief to borrowers during the pandemic. Real estate and Tourism, restaurants and hotels contributed to the highest percentage of restructured loans in KCB’s loan book in Q1’2021, coming in at Kshs 29.6 bn and Kshs 16.9 bn respectively while Personal and Manufacturing sectors contributed Kshs 13.5 bn each, and,
- KCB Group disclosed it has received approval for increasing the acquisition the stake in Banque De Populaire du Rwanda (BPR) in Rwanda to up to 100.0% from 62.1% in addition to the proposed 100.0% stake acquisition in African Banking Corporation Ltd Tanzania (ABC Tanzania). KCB will pay a cash consideration which shall be determined based on a price to book value ratio using a multiple of 1.1x of the net asset value of BPR at completion. For BanABC’s acquisition, KCB will pay to the seller a cash consideration to be determined based on a price to book value ratio using a multiple of 0.4x of the net asset value of BancABC at completion. For more information on the acquisition, see our Cytonn Weekly #19/2021

Income Statement

- Core earnings per share rose by 1.8% to Kshs 1.98, from Kshs 1.95 in Q1’2020, not in line with our projections of a 14.9% increase to Kshs 2.24. The performance was driven by a 0.4% growth in total operating income to Kshs 23.04 bn from Kshs 22.95 bn in Q1’2020, and a 0.8% decline in total operating expenses to Kshs 13.9 bn, from Kshs 14.0 bn in Q1’2020. The increase in the core earnings per share was lower than our projected increase of 14.9% as the lender had a slower 0.4% growth in Total Operating income, compared to our projection of a 30.9% increase,
- Total operating income increased by 0.4% to Kshs 23.04 bn, from Kshs 22.95 bn in Q1’2020 driven by an 11.1% increase in Net Interest Income (NII) to Kshs 16.7 bn, from Kshs 15.1 bn in Q1’2020. The growth was however weighed down by a 20.0% decline in Non-Funded Income (NFI) to Kshs 6.3 bn, from Kshs 7.9 bn in Q1’2020,
- Interest income grew by 8.7% to Kshs 22.0 bn, from Kshs 20.2 bn in Q1’2020, mainly driven by a 12.9% increase in interest income from government securities which increased to Kshs 6.0 bn, from Kshs 5.3 bn in Q1’2020, coupled with a 7.9% increase in interest income from loans and advances, which increased to Kshs 15.8 bn from Kshs 14.7 bn in Q1’2020. The increase was however weighed down by a 26.7% decline in income from deposits and placements with banking institutions to Kshs 0.2 bn, from Kshs 0.3 bn in Q1’2020. The yield on interest-earning assets increased to 10.9% from 10.8% in Q1’2020, attributable to the faster 16.4% growth in trailling interest income, which outpaced the 14.8% growth in average interest earning assets. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense rose by 1.8% to Kshs 5.24 bn, from Kshs 5.15 bn in Q1’2020, following a 51.1% rise in Interest expense on deposits and placements to Kshs 0.7 bn, from Kshs 0.5 bn in Q1’2020. The growth in interest expense was however mitigated by the 3.2% decline in Interest expense on customer deposits to Kshs 4.5 bn. from Kshs 4.7 bn in Q1’2020. Cost of funds declined marginally by 0.2% points to 2.6% from 2.8% recorded in Q1’2020, following a faster 17.4% increase in average interest bearing liabilities that outpaced the 1.8% increase in interest expense. Net Interest Margin (NIM) on the other hand, increased to 8.4%, from 8.1% in Q1’2020 due to the faster 19.0% growth in trailing Net Interest Income that outpaced the 14.8% increase in average interest-earning assets,
- Non-Funded Income declined by 20.0% to Kshs 6.3 bn, from Kshs 7.9 bn in Q1’2020, driven by a 44.4% decrease in the group’s income from fees and commissions on loans and advances to Kshs 1.5 bn, from Kshs 2.7 bn in Q1’2020, coupled with a 19.6% decline in foreign exchange trading income to Kshs 1.2 bn from Kshs 1.5 bn in Q1’2020 and an 8.9% decline in other fees and commissions to Kshs 2.5 bn from Kshs 2.7 bn in Q1’2020. The decline in fees and commissions from loans and advances and other fees and commissions is attributable to a slowdown in digital lending during the period and service fees waivers to cushion clients from the pandemic. The decline in NFI was however mitigated by a 13.4% increase in other income to Kshs 1.2 bn, from Kshs 1.0 bn in Q1’2020. Notably, total fees and commissions declined by 26.5% to Kshs 4.0 bn, from Kshs

5.4 bn recorded in Q1’2020. The revenue mix shifted to 73:27 from 66:34 funded to non-funded income, owing to the faster 11.1% growth in NII compared to the 20.0% decline in NFI,

- Total operating expenses decreased by 0.8% to Kshs 13.9 bn, from Kshs 14.0 bn in Q1’2020, largely driven by a 1.3% decline in Loan Loss Provisions (LLP) to Kshs 2.86 bn, from Kshs 2.90 bn in Q1’2020. Staff costs increased by 4.2% to Kshs 6.1 bn from Kshs 5.8 bn in Q1’2020,
- Cost to Income Ratio (CIR) improved to 60.4%, from 61.1% in Q1’2020 owing to the 0.8% decline in total operating expenses to Kshs 13.9 bn from Kshs 14.0 bn in Q1’2020 coupled with the 0.4% increase in total operating income to Kshs 23.04 bn from Kshs 22.95 bn in Q1’2020. Without LLP, cost to income ratio improved as well to 48.0% from 48.5% in Q1’2020, an indication of improving efficiency, and,
- Profit before tax increased by 2.2% to Kshs 9.1 bn from Kshs 8.9 bn in Q1’2020 due to the 0.8% decrease in total operating expenses to Kshs 13.9 bn, from Kshs 14.0 bn in Q1’2020. Profit after tax increased by 1.8% to Kshs 6.4 bn in Q1’2021, from Kshs 6.3 bn in Q1’2020, with the effective tax rate increasing to 30.1%, from 29.8% in Q1’2020.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 3.2% to Kshs 977.5 bn, from Kshs 947.1 bn in Q1’2020. The growth was supported by a 7.8% loan book expansion to Kshs 597.1 bn, from Kshs 553.9 bn in Q1’2020, coupled with a 4.7% increase in government securities to Kshs 212.1 bn, from Kshs 202.6 bn in Q1’2020. Notably, the lender disclosed that they restructured 18.8% of the total loan book amounting to Kshs 102.5 bn. Of the restructured loans, the Real Estate Sector accounted for the highest amount of restructured loans at Kshs 29.6 bn during the period,
- Total liabilities rose by 2.3% to Kshs 830.0 bn, from Kshs 811.5 bn in Q1’2020, driven by a 63.7% rise in borrowings to Kshs 36.0 bn, from Kshs 22.0 bn in Q1’2020. Customer deposits increased by 1.2% to Kshs 749.4 bn from Kshs 740.4 bn, with customer deposits from NBK amounting to Kshs Kshs 99.1 bn in Q1’2021. Deposits per branch decreased by 1.9% to Kshs 2.1 bn from Kshs 2.2 bn in Q1’2020, with the number of branches increasing to 355 as at the end of Q1’2021, from 344 in Q1’2020, due to the group increasing 10 branches in Kenya, 2 branches in South Sudan and 1 branch in Rwanda. The group however closed 2 branches in Uganda in the period,
- The faster 7.8% growth in loans as compared to the 1.2% growth in deposits led to an increase in the loan to deposit ratio to 79.7% from 74.8% in Q1’2020,
- Gross non-performing loans increased by 48.1% to Kshs 98.0 bn in Q1’2021 from Kshs 66.2 bn in Q1’2020. Consequently, the NPL ratio rose to 14.9% in Q1’2021, from 11.1% in Q1’2020, attributable to the faster 48.1% growth in Non-Performing Loans, which outpaced the 7.8% growth in loans. The rise in non-performing loans was mainly attributable to the poor performance from the Corporate segment, MSME segment, mortgage segment and Check-Off loans recording NPL ratios of 19.3%, 13.6%, 9.6% and 2.8%, respectively,
- Loan Loss Provisions (LLP) decreased by 1.3% y/y to Kshs 2.86 bn in Q1’2021, from Kshs 2.90 bn in Q1’2020. The NPL coverage on the other hand improved marginally to 61.6% in Q1’2021 from 61.3% in Q1’2020, as general Loan Loss Provisions increased by 52.3% to Kshs 47.1 bn from Kshs 30.9 bn in Q1’2020, attributable to the deterioration in the group’s asset quality with the NPL ratio rising to 14.9% from 11.1% in Q1’2020,
- Shareholders’ funds increased by 8.8% to Kshs 147.5 bn in Q1’2021, from Kshs 135.5 bn in Q1’2020, supported by a 17.6% increase in retained earnings to Kshs 116.2 bn, from Kshs 98.8 bn in Q1’2020,
- KCB Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.2%, 7.7% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 21.8%, exceeding the statutory requirement by 7.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 18.3%, while total capital to risk-weighted assets came in at 21.9%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.0%, and a Return on Average Equity (ROaE) of 13.9%.

Key Take-Outs:

1. The group’s asset quality deteriorated, with the NPL ratio rising to 14.9% in Q1’2021, from 11.1% in Q1’2020. Key to note, KCB’s NPL ratio of 14.9% is 0.4% points above the industry average of 14.5% as at February 2021. The rise in the group’s NPL ratio can be attributed to National Bank’s high NPL ratio which came in at 35.7%, which has improved from 39.6% in Q1’2020. The rise in non-performing loans was also attributable to the poor performance from the Corporate segment, MSME segment, mortgage segment and Check-Off loans recording NPL ratios of 19.3%, 13.6%, 9.6% and 2.8%, respectively. Asset quality deteriorated marginally by 0.1% points q/q to 14.9%, from 14.8% recorded in FY’2020. NPL coverage, on the other hand, improved to 61.6% in Q1’2021 from 61.3% in Q1’2020, as general Loan Loss Provisions increased by 52.3% to Kshs 47.1 bn from Kshs 30.9 bn in Q1’2020,
2. There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 48.0% from 48.5% in Q1’2020, an indication of improving efficiency,
3. The group has leveraged on digital innovation which was necessitated by the onset of COVID-19 in the country. In Q1’2021, 97.0% of transactions were performed outside the branch, with mobile banking, agency banking and ATM banking accounting for 79.0%, 16.0% and 2.0%, respectively. Key to note, the value of Mobile transactions increased by 181.0%% in Q1’2021 to Kshs 655.0 bn, from Kshs 233.0 bn in Q1’2020. Despite the increase in the value of mobile transactions, mobile revenue declined by 42.6% to Kshs 1.4 bn, from Kshs 2.5 bn in Q1’2020 attributable to the waiver of fees on monile money transactions in the period, and,
4. The BPR and ABC acquisition will bring KCB’s market share to 17.5% and 3.0% in Rwanda and Tanzania respectively from 6.4% and 1.0% respectively. The two entities will add Kshs 63.0 bn to KCB’s balance sheet as per FY’2020 financials, taking KCB’S total asset base to Kshs 1.0 tn.

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

I. Geographical Diversification – The bank has been aggressively expanding into other regions, namely Tanzania and Rwanda. On this front, the bank is set to acquire 100.0% of the share capital of Banque De Populaire du Rwanda (BPR) in Rwanda and African Banking Corporation Ltd Tanzania (ABC Tanzania). This will see the bank expand its operations in the Tanzanian and Rwandan Market thus enhancing the diversification of its revenue sources. The bank is also planning on expanding into the Ethiopian market, further expanding its presence in the region. This is also expected to drive growth in the near future.

Valuation Summary

- We are of the view that KCB Group is a “**BUY**” with a target price of Kshs 52.0, representing an upside of 22.7%, from the current price of Kshs 42.4 as of 28th May 2021, inclusive of a dividend yield of 8.3%,
- KCB Group is currently trading at a P/TBV of 1.0x and a P/E of 6.9x vs an industry average of 1.1x and 8.3x, respectively.