Below is a summary of NCBA Group H1'2021 performance;

Balance Sheet (bns)	H1'2020	H1'2021	y/y change
Net Loans and Advances	248.3	239.6	(3.5%)
Total Assets	**514.0**	**542.6**	**5.6%**
Customer Deposits	390.5	437.3	12.0%
Total Liabilities	443.7	468.2	5.5%
Shareholders' Funds	**70.1**	**74.3**	**6.0%**

Balance sheet ratios	H1'2020	H1'2021	% point change
Loan to Deposit Ratio	63.6%	54.8%	(8.8%)
Return on average equity	23.7%	9.1%	(14.6%)
Return on average assets	3.3%	1.2%	(2.1%)

Income Statement(mns)	H1'2020	H1'2021	y/y change
Net Interest Income	11.2	13.4	19.7%
Net non-Interest Income	10.1	10.7	6.2%
Total Operating income	**21.3**	**24.1**	**13.4%**
Loan Loss provision	7.6	5.9	(22.4%)
Total Operating expenses	17.0	16.3	(3.9%)
Profit before tax	3.9	7.4	89.8%
Profit after tax	**2.6**	**4.7**	**76.9%**
Core EPS	**1.6**	**2.8**	**76.9%**

Income Statement Ratios	H1'2020	H1'2021	y/y change
Yield from interest-earning assets	10.9%	10.2%	(0.7%)
Cost of funding	5.3%	4.2%	(1.1%)
Net Interest Spread	5.6%	6.0%	0.4%
Net Interest Margin	5.7%	6.1%	0.4%
Cost of Risk	35.8%	24.5%	(11.3%)
Net Interest Income as % of operating income	52.7%	55.6%	3.0%
Non-Funded Income as a % of operating income	47.3%	44.4%	(3.0%)
Cost to Income Ratio	79.8%	67.7%	(12.2%)

Capital Adequacy Ratios	H1'2020	H1'2021
Core Capital/Total Liabilities	16.9%	16.8%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.9%**	**8.8%**
Core Capital/Total Risk Weighted Assets	18.5%	19.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.0%**	**8.7%**
Total Capital/Total Risk Weighted Assets	18.5%	19.4%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.0%**	**4.9%**
Liquidity Ratio	54.9%	60.3%
Minimum Statutory ratio	20.0%	20.0%
Excess	**34.9%**	**40.3%**
Adjusted Core Capital/Total Liabilities	17.1%	17.0%

Adjusted Core Capital/Total RWA	17.7%	19.4%
Adjusted Total Capital/Total RWA	18.7%	19.6%

Key Highlights H1’2021

- In H1’2021, NCBA Bank disbursed Kshs 272.0 bn in digital loans in line with its digitization agenda and in honour of the bank’s commitment towards supporting SMEs and individual customers recover from the adverse effects of the pandemic.

Income Statement

- Core earnings per share rose by 76.9% to Kshs 2.83, from Kshs 1.6 in H1’2020, slightly lower than our expectations of a 77.5% increase to Kshs 2.84. The performance was driven by the 13.4% growth in total operating income to Kshs 24.1 bn, from Kshs 21.3 bn in H1’2020, coupled with the 3.9% decline in total operating expenses to Kshs 16.3 bn, from 17.0 bn in H1’2020. The variance in the core earnings per share increase against our expectation was mainly attributable to the slower 6.2% increase in Non-Funded Income(NFI) to Kshs 10.70 bn, from Kshs 10.1 bn recorded in H1’2020, against our expectations of a 6.5% increase to Kshs 10.73 bn in H1’2021,
- Total operating income rose by 13.4% to Kshs 24.3 bn in H1’2021, from Kshs 21.3 bn in H1’2020 driven by a 19.7% increase in Net Interest Income (NII) to Kshs 13.4 bn, from Kshs 11.2 bn recorded in H1’2020, coupled with a 6.2% increase in Non-Funded Income (NFI) to Kshs 10.7 bn, from the Kshs 10.1 bn recorded in H1’2020,
- Interest income rose by 8.7% to Kshs 22.5 bn, from Kshs 20.7 bn in H1’2020 mainly driven by a 13.6% growth in interest income from government securities to Kshs 9.3 bn, from Kshs 8.2 bn in H1’2020, coupled with a 7.7% rise in interest income from loans and advances to Kshs 13.0 bn, from Kshs 12.0 bn in H1’2020. However, the growth was weighed down by a 59.1% decline in interest income from deposits and placements with banking institutions to Kshs 173.2 mn, from Kshs 423.5 mn in H1’2020. Consequently, the yield on interest-earning assets decreased by 0.7% points to 10.2% in H1’2021, from 10.9% in H1’2020, attributable to the faster 6.9% growth in average interest-earning assets to Kshs 453.1 bn, from Kshs 423.9 bn in H1’2020, which outpaced the 0.3% decline in trailing interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense declined by 4.4% to Kshs 9.0 bn, from Kshs 9.5 bn in H1’2020, mainly attributable to a 69.2% decline in interest expense on placements from banking institutions to Kshs 70.1 mn, from Kshs 227.5 mn in H1’2020. The decline was weighed down by a 4.6% growth in interest expense on customer deposits to Kshs 8.8 bn, from Kshs 8.4 bn in H1’2020. Cost of funds decreased by 1.1% point to 4.2% from 5.3% in H1’2020 owing to the 15.3% decline in trailing interest expense that was outpaced by the 6.9% growth in average interest bearing liabilities, an indication that the Bank was able to mobilize cheaper deposits. The Net Interest Margin increased by 0.4% points to 6.1%, from 5.7% recorded in H1’2020, due to the faster 12.9% growth in trailing Net Interest Income, compared to the 6.9% growth seen in the average interest-earning assets,
- Non-Funded Income rose by 6.2% to Kshs 10.7 bn, from Kshs 10.1 bn in H1’2020, driven by a 23.5% increase in foreign exchange trading income to Kshs 2.4 bn, from Kshs 1.9 bn in H1’2020 coupled with a 16.7% increase in fees and commissions on loans and advances to Kshs 5.5 bn, from Kshs 4.7 bn in H1’2020. The growth in NFI was however weighed down by a 28.1% decrease in income from other fees and commissions to Kshs 1.8 bn, from Kshs 2.5 bn in H1’2020. Total fees and commissions declined by 1.0% to Kshs 7.3 bn, from Kshs 7.2 bn in H1’2020. Consequently, the revenue mix shifted to 56:44 from 53:47 funded to non-funded income, owing to the faster 19.7% growth in NII compared to the 6.2% growth in NFI,
- Total operating expenses declined by 3.9% to Kshs 16.3 bn, from Kshs 17.0 bn in H1’2020, largely driven by the 22.4% decrease in loan loss provision to Kshs 5.9 bn, from Kshs 7.6 bn in H1’2020. The decline in the provisioning levels by the lender can be partly attributable to improved business environment.

However, the decline in total operating expenses was weighed down by a 10.7% increase in staff costs to Kshs 3.9 bn, from Kshs 3.5 bn recorded in H1’2020,

- The Cost to Income ratio improved to 67.7%, from 79.8% in H1’2020 attributable to the 13.4% growth in total operating income to Kshs 24.1 bn, from Kshs 21.3 bn in H1’2020 coupled with the 3.9% decline in total operating expenses to Kshs 16.3 bn, from 17.0 bn in H1’2020. Similarly, without LLP, the cost to income ratio also improved to 43.1%, from 44.0% in H1’2020, pointing towards reduced operational costs and improved efficiency levels by the group,
- Profit before tax rose by 89.8% to Kshs 7.4 bn, from Kshs 3.9 bn in H1’2020. Profit after tax also increased by 76.9% to Kshs 4.7 bn, from Kshs 2.6 bn in H1’2020 with the effective tax rate increasing to 37.2%, from 32.6% recorded in H1’2020, and,
- Notably, the board recommend an interim dividend payment of Kshs 1.7 for each ordinary share of Kshs 5.0 on the issued and paid up share capital taking the dividend yield to 2.8%.

Balance Sheet

- The balance sheet recorded an expansion with total assets growing by 5.6% to Kshs 542.6 bn, from Kshs 514.0 bn in H1’2020. This growth was largely driven by a 100.3% increase in bank placements to Kshs 39.1 bn, from Kshs 19.5 bn in H1’2020, coupled with a 12.9% increase in investments in government securities to Kshs 190.8 bn, from the Kshs 169.0 bn recorded in H1’2020. On the other hand, the loan book contracted by 3.5% to Kshs 239.6 bn, from Kshs 248.3 bn in H1’2020, partly attributable to the bank’s cautious lending due to elevated credit risk as new variants of the COVID-19 virus continue to emerge posing a threat to the economy,
- Total liabilities rose by 5.5% to Kshs 468.2 bn, from Kshs 443.7 bn in H1’2020, driven by a 12.0% growth in customer deposits to Kshs 437.3 bn, from Kshs 390.5 bn in H1’2020. The growth in the group’s total liabilities was mitigated by the 45.4% decline in Placements liabilities to Kshs 7.1 bn recorded in H1’2021, from Kshs 13.1 bn in H1’2020. Deposits per branch declined by 4.3% to Kshs 4.6 bn, from Kshs 4.8 bn in H1’2021, with the number of branches increasing by 14 to 96 branches from 82 branches in H1’2020. The group intends to open 9 more branches in Kenya by the end of 2021,
- The faster 12.0% growth in deposits compared to the 3.5% decline in loans led to a decline in the loan to deposit ratio to 54.8%, from 63.6% in H1’2020,
- Gross non-performing loans (NPLs) rose by 16.5% to Kshs 45.0 bn in H1’2021, from Kshs 38.7 bn in H1’2020 taking the NPL ratio to 16.7% in H1’2021, from 14.5% in H1’2020, the highest it has ever been. The deterioration in the group’s asset quality is mainly attributable to the faster 16.5% increase in NPLs that outpaced the 1.2% increase in gross loans. The bank lends to SMEs and offers construction loans, sectors which were hard hit by the pandemic hence the increase in NPLs. With the General loan loss provisions increasing by 62.5% to Kshs 23.0 bn, from Kshs 14.2 bn in H1’2020, higher than the 16.5% growth in gross NPLs, the NPL coverage rose to 68.0% in H1’2021, from 53.2% in H1’2020,
- Shareholders’ funds increased by 6.0% to Kshs 74.3 bn, from Kshs 70.1 bn in H1’2020, mainly supported by a 10.8% increase in the retained earnings to Kshs 43.8 bn, from Kshs 39.5 bn in H1’2020,
- NCBA Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 19.2%, 8.7% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 19.4%, exceeding the statutory requirement by 4.9%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 19.4%, while total capital to risk weighted assets came in at 19.6%,
- NCBA Group currently has a return on average assets (ROaA) of 1.2% and a return on average equity (ROaE) of 9.1%.

Key Take-Outs:

i. **Asset quality**: The group’s asset quality deteriorated, with the NPL ratio increasing to 16.7%, from 14.5% in H1’2020. The massive erosion in the bank’s asset quality can be attributable to the 16.5% increase in gross NPLs as the bank lends to SMEs and offers construction loans, sectors which were hard hit by the pandemic. This is the highest it has been in over a decade owing to the faster 16.5% increase in NPLs that outpaced the 1.2% increase in gross loans, and,

ii. **Operating Efficiency** - The bank's operating efficiency improved as evidenced by the decline in cost to income ratio to 67.7% from 79.8% in H1'2020. Additionally, cost to income without LLP, also improved to 43.1% from 44.0% in H1'2020, which indicates reduced operational costs. However, the bank is investing more in additional branches and is rehiring some of its employees that were laid off in 2020. We expect the move to increase the operational cost as staff cost will increase.

Going forward, we expect the bank's growth to be further driven by:

i. The bank is focusing on solidifying its strength in asset finance and growing its property finance business through partnerships. The bank is also expected to perform better as the economy gradually recovers and as the outcomes of the group's focus on strategic initiatives anchored on customer experience continue to unveil. Additionally, the bank has embarked on a bold branch expansion and digital transformation in order to deliver better customer propositions and to structurally improve efficiency and agility.

Valuation Summary

- We are of the view that NCBA Group is a "**Accumulate**" with a target price of Kshs 30.4, representing an upside of 11.9%, from the current price of Kshs 27.2 as of 3rd September 2021,
- NCBA Group is currently trading at P/TBV of 0.6x and a P/E of 6.2x vs an industry average of 1.0x and 7.8x, respectively.