Cytonn INVESTMENTS

NCBA Group - Q1'2021

28st May 2021

Below is a summary of NCBA Group Q1'2021 performance;

Balance Sheet (bns)	Q1'2020	Q1'2021	y/y change
Net Loans and Advances	245.9	243.1	(1.1%)
Total Assets	**509.6**	**542.1**	**6.4%**
Customer Deposits	390.5	434.2	11.2%
Total Liabilities	440.8	467.5	6.1%
Shareholders' Funds	**68.6**	**74.4**	**8.5%**

Balance sheet ratios	Q1'2020	Q1'2021	% point change
Loan to Deposit Ratio	63.0%	56.0%	(7.0%)
Return on average equity	10.7%	8.1%	(2.6%)
Return on average assets	1.5%	1.1%	(0.4%)

Income Statement(mns)	Q1'2020	Q1'2021	y/y change
Net Interest Income	5.5	6.6	19.9%
Net non-Interest Income	5.4	5.2	(3.3%)
Total Operating income	**10.9**	**11.8**	**8.3%**
Loan Loss provision	3.8	2.6	(30.1%)
Total Operating expenses	8.3	7.8	(6.5%)
Profit before tax	2.4	3.9	60.2%
Profit after tax	**1.6**	**2.8**	**73.8%**
Core EPS	**1.0**	**1.7**	**73.8%**

Income Statement Ratios	Q1'2020	Q1'2021	y/y change
Yield from interest-earning assets	6.3%	10.0%	3.7%
Cost of funding	3.1%	4.2%	1.1%
Net Interest Spread	3.2%	5.8%	2.5%
Net Interest Margin	3.3%	5.9%	2.6%
Cost of Risk	34.6%	22.3%	(12.3%)
Net Interest Income as % of operating income	50.3%	55.7%	5.3%
Non-Funded Income as a % of operating income	49.7%	44.3%	(5.3%)
Cost to Income Ratio	76.1%	65.6%	(10.4%)

Capital Adequacy Ratios	Q1'2020	Q1'2021
Core Capital/Total Liabilities	17.4%	15.6%
Minimum Statutory ratio	8.0%	8.0%
Excess	**9.4%**	**7.6%**
Core Capital/Total Risk Weighted Assets	17.9%	18.2%
Minimum Statutory ratio	10.5%	10.5%
Excess	**7.4%**	**7.7%**
Total Capital/Total Risk Weighted Assets	18.5%	18.3%
Minimum Statutory ratio	14.5%	14.5%
Excess	**4.0%**	**3.8%**
Liquidity Ratio	50.8%	58.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	**30.8%**	**38.7%**
Adjusted Core Capital/Total Liabilities	17.7%	15.8%

Adjusted Core Capital/Total RWA	18.2%	18.4%
Adjusted Total Capital/Total RWA	18.8%	18.6%

Income Statement

- Core earnings per share rose by 73.8% to Kshs 1.7, from Kshs 1.0 in Q1'2020, driven by the 8.3% growth in total operating income to Kshs 11.8 bn, from Kshs 10.9 bn in Q1'2020 coupled with the 6.5% decline in total operating expenses to Kshs 7.8 bn, from 8.3 bn in Q1'2020,
- Total operating income rose by 8.3% to Kshs 11.8 bn in Q1'2021, from Kshs 10.9 bn in Q1'2020. This was due to a 19.9% increase in Net Interest Income (NII) to Kshs 6.6 bn, from Kshs 5.5 bn recorded in Q1'2020. This was however weighed down by a 3.3% decline in Non-Funded Income (NFI) to Kshs 5.2 bn, from the Kshs 5.4 bn recorded in Q1'2020,
- Interest income rose by 8.1% to Kshs 11.0 bn, from Kshs 10.2 bn in Q1'2020 mainly driven by a 14.7% growth in interest income from government securities to Kshs 4.4 bn, from Kshs 3.8 bn in Q1'2020, coupled with a 5.4% rise in interest income from loans and advances to Kshs 6.5 bn, from Kshs 6.1 bn in Q1'2020. However, the growth was weighed down by a 61.5% decline in interest income from deposits and placements with banking institutions to Kshs 51.5 mn, from Kshs 133.7 mn in Q1'2020. Consequently, the yield on interest-earning assets increased by 3.7% points to 10.0% in Q1'2021, from 6.3% in Q1'2020, attributable to the slower 9.3% increase in average interest-earning assets to Kshs 450.9 bn, from Kshs 412.4 bn in Q1'2020, which was outpaced by the 72.3% increase in trailing interest income,
- Interest expense declined by 5.7% to Kshs 4.4 bn, from Kshs 4.7 bn in Q1'2020, mainly attributable to an 88.9% decline in interest expense on deposits and placements from banking institutions to Kshs 12.3 mn, from Kshs 111.2 mn in Q1'2020. The decline was weighed down by a 3.5% increase in interest expense on customer deposits to Kshs 4.3 bn, from Kshs 4.2 bn in Q1'2020. Cost of funds increased by 1.1% point to 4.2% from 3.1% in Q1'2020 owing to the 47.5% increase in trailing interest expense that outpaced the 6.7% growth in average interest bearing liabilities. This points out that the Bank was unable to mobilize cheaper deposits. The Net Interest Margin increased by 2.6% points to 5.9% from 3.3% seen in Q1'2020, due to the faster 72.3% growth in trailing Net Interest Income, compared to the 9.3% growth seen in the average interest-earning assets,
- Non-Funded Income declined by 3.3% to Kshs 5.2 bn, from Kshs 5.4 bn in Q1'2020, driven by a 13.8% decrease in fees and commissions loans and advances to Kshs 2.7 bn, from Kshs 3.2 bn in Q1'2020. The decline in NFI was however mitigated by a 15.2% increase in foreign exchange trading income to Kshs 1.2 bn, from Kshs 1.0 bn in Q1'2020, and 13.6% increase in income from other fees and commissions to Kshs 0.8 bn, from Kshs 0.9 bn in Q1'2020. Total fees and commissions declined by 8.1% to Kshs 3.7 bn, from Kshs 4.0 bn in Q1'2020. Consequently, the revenue mix shifted to 56:44 from 50:50 funded to non-funded income in Q1'2020, owing to the faster growth in NII compared to NFI,
- Total operating expenses declined by 6.5% to Kshs 7.8 bn, from Kshs 8.3 bn in Q1'2020, largely driven by the 30.1% decrease in loan loss provision to Kshs 2.6 bn, from Kshs 3.8 bn in Q1'2020. However, the decline in interest expenses was weighed down by a 16.8% increase in staff costs to Kshs 2.0 bn, from Kshs 1.7 bn recorded in Q1'2020 and a 10.9% decline in other expenses to Kshs 3.2 bn from Kshs 2.9 bn,
- The cost to income ratio improved to 65.6% from 76.1% in Q1'2020 attributable to the 8.3% growth in total operating income to Kshs 11.8 bn, from Kshs 10.9 bn in Q1'2020 which outpaced the 6.5% decline in total operating expenses to Kshs 7.8 bn, from 8.3 bn in Q1'2020. Additionally, without LLP, the cost to income ratio also improved to 41.5% from 43.3% in Q1'2020, pointing towards reduced operational costs and improved efficiency levels by the group, and,
- Profit before tax rose by 60.2% to Kshs 3.9 bn, from Kshs 2.4 bn in Q1'2020. Profit after tax also increased by 73.8% to Kshs 2.8 bn from Kshs 1.6 bn in Q1'2020 with the effective tax rate decreasing to 26.8% from 32.5% recorded in Q1'2020.

Balance Sheet

- The balance sheet recorded an expansion with total assets growing by 6.4% to Kshs 542.1 bn, from Kshs 509.6 bn in Q1’2020. This growth was largely driven by a 93.1% increase in bank placements to Kshs 57.2 bn, from Kshs 29.6 bn in Q1’2020 coupled with a 15.1% increase in government securities to Kshs 157.1 bn, from the Kshs 136.5 bn recorded in Q1’2020. On the other hand, the loan book contracted by 1.1% to Kshs 243.1 bn, from Kshs 245.9 bn in Q1’2020, partly attributable to the bank’s cautious lending due to elevated credit risk emanating from the subdued operating environment,
- Total liabilities rose by 6.1% to Kshs 467.5 bn, from Kshs 440.8 bn in Q1’2020, driven by an 11.2% growth in customer deposits to Kshs 434.2 bn, from Kshs 390.5 bn in Q1’2020. However, Placements declined by 41.1% to the Kshs 5.2 bn recorded in Q1’2021, from Kshs 8.9 bn in Q1’2020. Deposits per branch increased by 11.2% to Kshs 6.2 bn, from Kshs 5.6 bn in Q1’2021, with the number of branches remaining unchanged at 70,
- The faster 11.2% growth in deposits compared to the 1.1% decline in loans led to a decline in the loan to deposit ratio to 56.0%, from 63.0% in Q1’2020,
- Gross non-performing loans (NPLs) rose by 1.9% to Kshs 39.6 bn in Q1’2021, from Kshs 38.8 bn in Q1’2020 taking the NPL ratio to 14.7% in Q1’2021, from 14.5% in Q1’2020. The deterioration in the group’s asset quality is mainly attributable to the faster 1.9% increase in NPLs that outpaced the 0.7% increase in gross loans. With the General loan loss provisions increasing by 35.6% to Kshs 18.7 bn, from Kshs 13.8 bn in Q1’2020, higher than the 1.9% growth in gross NPLs, the NPL coverage rose to 65.0% in Q1’2021, from 54.5% in Q1’2020,
- Shareholders’ funds increased by 8.5% to Kshs 74.4 bn, from Kshs 68.6 bn in Q1’2020, mainly supported by an 8.8% increase in the retained earnings to Kshs 42.0 bn from Kshs 38.6 bn in Q1’2020,
- NCBA Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 18.2%, 7.7% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 18.3%, exceeding the statutory requirement by 3.8%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 18.4%, while total capital to risk weighted assets came in at 18.6%,
- NCBA Group currently has a return on average assets (ROaA) of 1.1% and a return on average equity (ROaE) of 8.1%.

Key Take-Outs:

i. **Asset quality**: The group’s asset quality deteriorated on the back of the increased NPL ratio to 14.7%, from 14.5% in Q1’2020, attributable to the faster 1.9% increase in NPLs that outpaced the 0.7% increase in gross loans which came in at Kshs 261.8 bn in Q1’2021, from the Kshs 259.6 bn in Q1’2020 This is the highest it has been in over a decade owing to the subdued growth in the loan book which recorded a 1.1% decline to Kshs 243.1 bn, from Kshs 245.9 bn in Q1’2020 an indication of the bank’s rising aversion to credit risk,

ii. **Operating Efficiency** - The bank’s operating efficiency improved as evidenced by the decline in cost to income ratio to 65.6% from 76.1% in Q1’2020. Additionally, cost to income without LLP, also improved to 41.5% from 43.3% in Q1’2020, which indicates reduced operational costs.

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

i. The Bank is projected to maintain its synergy as it remains cautious and vigilant, as it continues focusing on priorities, re-evaluating and re-aligning operations to reflect the economic climate. The bank is also focusing on product diversification to cater for its clients during this difficult circumstances. This follows after NCBA Bank Kenya PLC launched a logbook loan product that will enable Kenyans access up to 50.0% financing against an owned vehicle.

Valuation Summary

- We are of the view that NCBA Group is a "**Buy**" with a target price of Kshs 32.4, representing an upside of 27.3%, from the current price of Kshs 25.5 as of 28th May 2021,
- NCBA Group is currently trading at P/TBV of 0.5x and a P/E of 6.6x vs an industry average of 0.9x and 7.4x, respectively.