NCBA Group Earnings Note – FY'2020
1st April 2021

Below is a summary of the bank's performance;

Balance Sheet Items	FY'2019	FY'2020	y/y change
Net Loans and Advances	249.4	248.5	(0.3%)
Total Assets	**494.8**	**528.0**	**6.7%**
Customer Deposits	378.2	421.5	11.4%
Total Liabilities	427.6	455.4	6.5%
Shareholders' Funds	**67.0**	**72.3**	**8.0%**

Balance Sheet Ratios	FY'2019	FY'2020	% point change
Loan to Deposit Ratio	66.7%	59.0%	(7.7%)
Return on average equity	13.7%	6.6%	(7.1%)
Return on average assets	2.0%	0.9%	(1.1%)

Income Statement	FY'2019	FY'2020	y/y change
Net Interest Income	13.3	25.5	91.1%
Net non-Interest Income	20.3	20.9	3.1%
Total Operating income	**33.7**	**46.4**	**38.0%**
Loan Loss provision	6.3	20.4	227.0%
Total Operating expenses	20.4	40.0	96.7%
Profit before tax	11.3	5.0	(56.0%)
Profit after tax	**7.8**	**4.6**	**(41.7%)**
Core EPS	**11.1**	**6.5**	**(41.7%)**

Income Statement Ratios	FY'2019	FY'2020	% point change
Yield from interest-earning assets	6.3%	10.1%	3.9%
Cost of funding	3.1%	4.4%	1.3%
Net Interest Spread	3.2%	5.7%	2.5%
Net Interest Margin	3.3%	5.8%	2.6%
Cost of Risk	18.6%	44.0%	25.5%
Net Interest Income as % of operating income	39.6%	54.9%	15.3%
Non-Funded Income as a % of operating income	60.4%	45.1%	(15.3%)
Cost to Income Ratio	60.5%	86.2%	25.7%

Capital Adequacy Ratios	FY'2019	FY'2020
Core Capital/Total Liabilities	16.9%	15.4%
Minimum Statutory ratio	8.0%	8.0%
Excess	**8.9%**	**7.4%**
Core Capital/Total Risk Weighted Assets	16.6%	17.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	**6.1%**	**6.8%**

Total Capital/Total Risk Weighted Assets	17.3%	17.5%
Minimum Statutory ratio	14.5%	14.5%
Excess	**2.8%**	**3.0%**
Liquidity Ratio	50.8%	55.1%
Minimum Statutory ratio	20.0%	20.0%
Excess	**30.8%**	**35.1%**
Adjusted core capital/ total deposit liabilities	17.8%	15.6%
Adjusted core capital/ total risk weighted assets	17.5%	17.5%
Adjusted total capital/ total risk weighted assets	18.2%	17.7%

Note that the figures are extracts from the books of NCBA Group PLC.

Key Highlights FY'2020

- Since the advent of COVID-19 the bank has so far restructured loans amounting over Kshs 78.0 bn(31.4% of the bank's loan book), to consumers, and waived digital lending fees to help struggling businesses stay afloat during the current period of uncertainty.

Income Statement

- Core earnings per share declined by 41.7% to Kshs 6.5 from Kshs 11.1 in FY'2019 which was not in line with our projections of an 81.4% decline to Kshs 2.1. This decline in the earnings per share was driven by the 96.7% growth in total operating expenses to Kshs 40.0 bn, from Kshs 20.4 bn in FY'2019,
- Total operating income rose by 38.0% to Kshs 46.4 bn in FY'2020, from Kshs 33.7 bn in FY'2019. This was due to a 91.1% increase in Net Interest Income (NII) to Kshs 25.5 bn, from Kshs 13.3 bn recorded in FY'2019, coupled with a 3.1% increase in Non-Funded Income (NFI) to Kshs 20.9 bn, from the Kshs 20.3 bn recorded in FY'2019,
- Interest income rose by 73.4% to Kshs 44.2 bn, from Kshs 25.5 bn in FY'2019 mainly driven by an 83.4% growth in interest income from government securities to Kshs 16.8 bn, from Kshs 9.2 bn in FY'2019, coupled with a 69.8% rise in interest income from loans and advances to Kshs 26.7 bn, from Kshs 15.7 bn in FY'2019. Consequently, the yield on interest-earning assets increased by 3.8% points to 10.1% in FY'2020, from 6.3% in FY'2019, due to the slower 7.5% growth in average interest-earning assets to Kshs 436.8 bn, from Kshs 406.5 bn in FY'2019, compared to the 73.4% growth in trailing Interest Income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense rose by 54.0% to Kshs 18.8 bn, from Kshs 12.2 bn in FY'2019, mainly attributable to a 62.5% increase in interest expense on customer deposits to Kshs 17.1 bn, from Kshs 10.6 bn in FY'2019, coupled with a 3.2% increase in deposits and placements from banking institutions to Kshs 302.5 mn, from Kshs 293.1 mn in FY'2019. The growth was mitigated by a 3.5% decline in other interest expenses to Kshs 1.26 bn in FY'2020, from Kshs 1.30 bn the previous year. Cost of funds rose to 4.4% from 3.1% in FY'2019 owing to the faster 54.0% increase in trailing interest expense compared to the 7.3% growth recorded on average interesting bearing liabilities. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. This points out that the Bank was unable to mobilize cheaper deposits. The Net Interest Margin came in at 5.8%, higher than the 3.3% seen in 2019, due to the faster 91.1% growth in Net Interest Income, compared to the 7.5% growth seen in the average interest-earning assets,
- Non-Funded Income rose by 3.1% to Kshs 20.9 bn, from Kshs 20.3 bn in FY'2019, driven by a 15.4% increase in fees and other commissions to Kshs 10.8 bn, from Kshs 9.4 bn in FY'2019, coupled with a 66.6% increase

in income from foreign exchange trading to Kshs 4.7 bn from Kshs 2.8 bn in FY’2019. This was however weighed down by the 63.6% decline in other income to Kshs 2.0 bn, from Kshs 5.6 bn in FY’2019. Total fees and commissions increased by 19.2% to Kshs 14.2 bn from Kshs 11.9 bn despite the waiver on mobile banking fees. Consequently, the revenue mix shifted to 55:45 from 40:60 funded to non-funded income in FY’2019, owing to the faster growth in NII compared to NFI,

- Total operating expenses rose by 96.7% to Kshs 40.0 bn, from Kshs 20.4 bn in FY’2019, largely driven by the 227.0% increase in loan loss provision to Kshs 20.4 bn, from Kshs 6.3 bn in FY’2019. The high increase in Loan loss provision was driven by the expectations of a significant increase in NPLs due to the subdued operating environment. Staff costs increased by 29.6% to Kshs 7.2 bn, from Kshs 5.6 bn recorded in FY’2019,
- The cost to income ratio deteriorated steeply to 86.2% from 60.5% in FY’2019 attributable to the faster 96.7% growth in total operating expenses to Kshs 40.0 bn, from Kshs 20.4 bn in FY’2019 which outpaced the 38.0% growth in total operating income to Kshs 46.4 bn, from 33.7 bn in FY’2019. Additionally, without LLP, the cost to income ratio also deteriorated to 42.2% from 41.9% in FY’2019, pointing towards increased operational costs and reduced efficiency levels by the group,
- Profit before tax declined by 56.0% to Kshs 5.0 bn, from Kshs 11.0 bn in FY’2019. Profit after tax declined by 41.7% to Kshs 4.6 bn from Kshs 7.8 bn in FY’2019. The effective tax rate decreased to 33.5% from 29.3% recorded in FY’2019, and,
- The Board of Directors recommended a final Dividend per Share (DPS) of Kshs 1.5, translating to a total dividend payout of Kshs 2.3 bn. At the current price of Kshs 25.4, this translates to a dividend yield of 5.9%.

Balance Sheet

- The balance sheet recorded an expansion with a total assets growth of 6.7% to Kshs 528.0 bn, from Kshs 494.8 bn in FY’2019. This growth was largely driven by a 12.8% increase in government securities to Kshs 163.6 bn, from the Kshs 145.0 bn recorded in FY’2019. The loan book on the other hand, contracted by 0.3% to Kshs 248.5 bn, from Kshs 249.4 bn in FY’2019, as the bank adopted a conservative lending approach amid the elevated credit risk emanating from the subdued operating environment,
- Total liabilities rose by 6.5% to Kshs 455.4 bn, from Kshs 427.6 bn in FY’2019, driven by an 11.4% growth in customer deposits to Kshs 421.5 bn, from Kshs 378.2 bn in FY’2019. Placements declined by 42.1% to the Kshs 6.3 bn recorded in FY’2020, from Kshs 10.9 bn in FY’2019. Deposits per branch increased by 11.4% to Kshs 6.0 bn, from Kshs 5.4 bn in FY’2020, with the number of branches remaining at 70,
- The faster growth in deposits compared to the growth in loans led to a decline in the loan to deposit ratio to 59.0%, from 66.7% in FY’2019,
- Gross non-performing loans (NPLs) rose by 19.0% to Kshs 40.1 bn in FY’2020, from Kshs 33.7 bn in FY’2019. Consequently, the NPL ratio rose to 15.0% in FY’2020, from 12.6% in FY’2019 attributable to the faster 19.0% increase in NPLs that outpaced the 1.8% increase in gross loans which came in at Kshs 272.1 bn in FY’2020, from the Kshs 268.8 bn in FY’2019. General loan loss provisions increased by 47.2% to Kshs 17.8 bn, from Kshs 12.1 bn in FY’2019. The NPL coverage rose to 60.9% in FY’2020, from 55.9% owing to the faster 47.2% increase in general loan loss provisions, compared to the 19.0% growth in gross NPLs,
- Shareholders’ funds declined by 8.0% to Kshs 72.3 bn, from Kshs 67.0 bn in FY’2019, mainly supported by a 55.5% decline in retained earnings to Kshs 2.3 bn from Kshs 5.2 bn,
- NCBA Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 17.3%, 6.8% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 17.5%, exceeding the statutory requirement by 3.5%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 17.5%, while total capital to risk weighted assets came in at 17.7%, and,
- NCBA Group currently has a return on average assets of 0.9% and a return on average equity of 6.6%.

Key Take-Outs:

i. **Asset quality**: The group's asset quality deteriorated, as evidenced by the rise in NPL ratio to 14.7%, from 12.6% in FY'2019 driven by the 19.0% increase in NPLs to Kshs 40.1 bn from Kshs33.7 bn. Key to note, this is the highest it has been in over a decade owing to the subdued economic environment that led to increased defaults on corporate and SME credit as a consequence of the pandemic,

ii. Non-Funded Income rose by 3.1% to Kshs 20.9 bn, from Kshs 20.3 bn in FY'2019, despite the waiver of banking and transaction fees seen during the year. The increase in NFI was driven by a 15.4% increase in fees and other commissions to Kshs 10.8 bn from Kshs 9.4 bn in FY'2019, coupled with a 66.6% increase in income from foreign exchange trading to Kshs 4.7 bn from Kshs 2.8 bn in FY'2019. Consequently, the revenue mix shifted to 55:45 funded to non-funded income in FY'2020 from 40:60 in FY'2019, owing to the faster increase in NII compared to NFI, and,

iii. The group's loan book contracted by 0.3% to Kshs 248.5 bn, in FY'2020 from Kshs 249.4 bn in FY'2019, attributable to a reduction in economic activity which saw sectors like manufacturing, transport and communication, wholesale & retail trade and hotels as well as individual businesses decline following the COVID-19 control measures put in place by the government that affected the loan book as these are the key sectors the group lends to.

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

i. The Bank is expected to continue increasing it synergy as it remains cautious and observant while the Board focuses on the Group's priorities and continues to re-assess and re-align operations to match the economic environment. This is on the back of expressed confidence by the Board on the group's capital strength to withstand any anticipated shocks and the ability to achieve its long-term objectives amidst challenging times.

Valuation Summary

- We are of the view that NCBA Group is a "**Buy**" with a target price of Kshs 31.8, representing an upside of 25.5%, from the current price of Kshs 25.4 as of 1st March 2021, and,
- NCBA Group is currently trading at P/TBV of 0.6x and a P/E of 8.3x vs an industry average of 0.9x and 7.5x, respectively.