NIC Group PLC – FY’2017
22nd March, 2018

Valuation Summary

- We are of the view that NIC Group PLC stock is a “Buy”, with a target price of Kshs 61.1 representing an upside of 49.8%, from the current price of Kshs 40.75, as at 22th March, inclusive of a dividend yield of 2.5%,
- NIC Group is currently trading at a P/TBV of 0.8x and a P/E of 6.3x, vs an industry average of 1.7x and 9.6x, respectively.

Key highlights during FY’2017

- There was a Flight to safety after Chase and Imperial banks were put under receivership of NIC Group, the group responded by embarking on growth strategy and strengthening customer relationship which saw the group open 6 branches within the year,
- Following the Banking (Amendment) Act 2016,the group increased focus on cross-selling/ NFI ,executed a reduction in workforce program and slowed down on unsecured lending,
- NIC Group PLC was approved as a non-operating holding company following the transfer of Kenyan banking business and net assets to NIC Bank Kenya PLC (The new bank) .This was on completion of the group reorganization effective from 1st September 2017,
- Establishment of NIC Ventures, a subsidiary focused on investing in/ partnering with Financial Technology Firms. Three digital solutions were launched; NIC NOW App, NIC SASA, and Bills Boss,
- Appointment of new Directors namely; Wakini Ndegwa, Jonathan Somen, Philip Lopokoiyit and David Abwoga,
- The Group received several awards; (i) The Banker East Africa Awards Best Customer Service Kenya (2017) -Winner, (ii) Africa Technology Innovation Awards Best Branch Automation Project (2017)-Winner, (iii) The Banker East Africa Awards Best Customer Service- East Africa (2017) Winner, (iv) COG Awards Finance and Investment Sector (2017) Winner, (v) Institute of Pension Management Custodian Bank of the Year (2017) 1st Runners Up and (vi) COG Awards Overall Champion of Governance (2017) -Winner.

Income Statement

- Total operating revenue declined by 7.7% to Kshs 14.9 bn from Kshs 16.2 bn, driven by an 11.5% decline in Net Interest Income (NII), despite a 3.6% increase in Non-Funded income (NFI). NII declined by 11.5% to Kshs 10.8 bn from Kshs 12.2 bn in FY`2016, while NFI rose by 3.6% to Kshs 4.2 bn from Kshs 4.0 bn in FY'2016,
- Interest Income declined by 3.2% to Kshs 18.4 bn from Kshs 19.0 bn in FY’2016. The interest income on loans and advances alone declined by 13.2% to Kshs 13.1 bn from Kshs 15.2 bn, while interest income on government securities grew by 39.5% to Kshs 5.2 bn from Kshs 3.7 bn. However, the growth in interest income on government securities was not sufficient to offset the decline in interest income on loans. As a result, the yield on interest-earning assets declined to 10.8% from 12.5% in FY’2016,
- Interest expense grew by 11.5% to Kshs 7.6 bn from Kshs 6.9 bn in FY’2016, as a result of a 10.9% increase in interest expense on customer deposits to Kshs 6.0 bn from Kshs 5.4 bn. The cost of funds came in at 5.0% from 5.1% in FY’2016. The Net Interest Margin thus declined to 6.3% from 8.0% in FY'2016 as a result of a decline in interest income and an increase in interest expenses,
- Non-Funded Income (NFI) recorded a growth of 3.6% to Kshs 4.2 bn from Kshs 4.0 bn in FY'2016. The growth in NFI was driven by a 15.6% increase in other fees and commissions to Kshs 1.4 bn from Kshs 1.2 bn in FY'2016, and a 4.9% increase in forex trading income to Kshs 0.9 bn from Kshs 0.8 bn in FY`2016. The current revenue mix stands at 72:28 Funded to Non-Funded Income from 75:25 in FY`2016, due to an increase in NFI and a decline in NII,
- Total operating expenses declined by 6.8% to Kshs 9.3 bn from Kshs 10.0 bn, driven by a 20.5% decrease in Loan Loss Provisions to Kshs 3.0 bn from Kshs 3.7 bn in FY'2016. Staff costs remained flat at Kshs 3.2 bn as a result of a restructuring process that led to a number of staff who were declared redundant during the year being offset by new hires in FY’2017,
- The Cost to Income ratio deteriorated to 62.5% from 61.9% in FY'2016. Without LLP, the Cost to Income ratio also deteriorated to 42.6% from 38.7% in FY'2016,
- Profit before tax declined by 9.2% to Kshs 5.6 bn from Kshs 6.2 bn, while profit after tax declined by 4.3% to Kshs 4.1 bn from Kshs 4.3 bn. The effective tax rate came in at 37.9% from 52.3% in FY`2016,
- The group recommended a first and final dividend of Kshs 1.0 per share, lower than last year's 1.25 translating to a dividend yield of 2.4%. In addition, the NIC Group proposed a bonus issue of 1 share for 10 held,

Balance Sheet

- Total assets increased by 21.7% to Kshs 206.2 bn from Kshs 169.5 bn in FY'2016. This growth was driven by an increase in government securities and other securities that rose by 77.9% to Kshs 54.2 bn from Kshs 30.5 bn in FY'2016. The loan book also rose by 4.6% to Kshs 119.8 bn from Kshs 114.5 bn in FY'2016,
- Total liabilities rose by 23.2% to Kshs 171.5 bn from Kshs 139.1 bn in FY'2016, driven by a 24.2% increase in deposits to Kshs 138.9 bn from Kshs 111.8 bn in FY'2016. Deposits per branch increased by 8.0% to Kshs 3.0 bn from Kshs 2.8 bn in FY`2016 due to addition of 6 new branches during the year
- The deposit mix remained relatively stable, with corporate having the highest share over retail segment. In terms of deposits by type, term deposit accounts increased to 56% from 55% while current and savings accounts declined to 41% and 3% from 43% and 4%, respectively in FY`2016 of total deposit amounts,
- The loan to deposit ratio declined to 86.2% from 102.4% in FY`2016, due to deposits growing faster than the loan book ,
- Gross NPLs increased by 3.7% to Kshs 11.9 bn from Kshs 11.4 bn in FY`2016 due to a tough business environment during the year. The NPL ratio however remained steady at 11.1%, compared to 11.2% in FY'2016. Gross coverage ratio improved to 48.6% from 32.8% due to increased focus on collections and the setting up of a credit advisory group (CRAG) division that worked with struggling clients to ensure that the outstanding loan is paid. The NPL by business area breakdown is at 67.7%, 21.8% and 10.5% for corporate, SME and retail, respectively,
- Shareholders' funds for the whole group increased by 14.8% to Kshs 34.2 bn from Kshs 29.8 bn in FY'2016. However, shareholders' funds for the bank declined by 4.3% due to restructuring of the group as certain assets were retained in the group,
- NIC Group is currently sufficiently capitalized with a core capital to total liabilities at 21.4%, 13.4% above the statutory requirement, with core capital to total risk weighted assets at 16.3%, 5.8% above the statutory requirement, total capital to total risk weighted assets at 19.6%, 5.1% above the minimum statutory requirement.
- NIC Group currently has a return on average assets of 2.2% and a return on average equity of 12.9%,

Take out:

Going forward, we expect NIC Group's growth to be propelled by looking at the following areas;

(i) NIC Group's NFI is way below industry average, yet it has fee income businesses such as NIC Securities and NIC Capital. NIC Group is really performing way below its potential on fee income businesses and this should be a key area of focus to improve profitability,

(ii) Improvements in asset quality, with the establishment of the Credit Advisory Group (CRAG) division expected to improve the credit appraisal process, and in turn reduce NIC Group's NPLs. NIC Group's Gross Non-Performing Loans ratio came in at 11.1%, which is way above industry average of 8.2%,

(iii) Better deployment of deposits, which grew strongly by 24.2% leading to an 11.5% growth in interest expense, but the bank was not able to deploy the strong deposit growth into yielding assets, leading to an 11.5% drop in NII , and

(iv) Leveraging on their diversification strategy to grow their Non-Funded Income to contribute more to total revenue, including asset finance where the bank maintains a pole position in the industry, and bancassurance through its NIC Insurance Agents.

Below is a summary of the key line items in the balance sheet and income statement

Figures in Kshs billions unless otherwise stated

Balance Sheet Items	FY`2016	FY`2017	y/y change	FY`2017e	Projected %y/y change	Variance in Growth Actual vs. Expected
Government Securities	30.5	54.2	77.9%	50.7	66.4%	11.5%
Net Loans and Advances	114.5	119.8	4.6%	120.1	4.9%	(0.3%)

Total Assets	**169.5**	**206.2**	**21.7%**	**195.6**	**15.4%**	**6.3%**
Customer Deposits	111.8	138.9	24.2%	133.4	19.3%	4.9%
Total Liabilities	139.1	171.5	23.2%	161.6	16.2%	7.1%
Shareholders' Funds	**29.8**	**34.2**	**14.8%**	**33.4**	**11.9%**	**2.8%**

Balance Sheet Ratios	FY\` 2016	FY\`2017	y/y change
Loan to Deposit Ratio	102.4%	86.2%	(16.2%)
Return on average equity	15.5%	12.9%	(2.6%)
Return on average assets	2.6%	2.2%	(0.4%)

Income Statement	FY\`2016	FY\`2017	y/y change	FY\`2017e	Projected %y/y change	Variance in Growth Actual vs. Expected
Net Interest Income	12.2	10.8	(11.5%)	11.3	(7.0%)	(4.5%)
Net non-Interest Income	4.0	4.2	3.6%	4.3	7.2%	(3.6%)
Total Operating income	**16.2**	**14.9**	**(7.7%)**	**15.6**	**(3.4%)**	**(4.3%)**
Loan Loss provision	3.7	3.0	(20.5%)	3.2	(14.3%)	(6.2%)
Total Operating expenses	**10.0**	**9.3**	**(6.8%)**	**9.7**	**(3.3%)**	**(3.5%)**
Profit before tax	6.2	5.6	(9.2%)	5.9	(3.7%)	(5.5%)
Profit after tax	**4.3**	**4.1**	(4.3%)	**4.2**	(4.0%)	(0.3%)

Income Statement Ratios	FY\`2016	FY\`2017	y/y change
Yield from interest-earning assets	12.5%	10.8%	(1.7%)
Cost of funding	5.1%	5.0%	(0.3%)
Net Interest Spread	7.4%	6.1%	(1.4%)
Net Interest Margin	8.0%	6.3%	(1.7%)
Cost of Risk	23.2%	19.9%	(3.2%)
Net Interest Income as % of operating income	75.2%	72.1%	(3.0%)
Non-Funded Income as a % of operating income	24.8%	27.9%	3.0%

Cost to Income Ratio	61.9%	62.5%	0.6%
Cost to Income Ratio (less LLP)	38.7%	42.6%	3.8%
Cost to Assets	5.9%	4.5%	(1.4%)

Capital Adequacy Ratios	FY`2016	FY`2017
Core Capital/Total Liabilities	24.1%	21.4%
Minimum Statutory ratio	8.0%	8.0%
Excess	**16.1%**	**13.4%**
Core Capital/Total Risk Weighted Assets	19.2%	16.3%
Minimum Statutory ratio	10.5%	10.5%
Excess	**8.7%**	**5.8%**
Total Capital/Total Risk Weighted Assets	22.3%	19.6%
Minimum Statutory ratio	14.5%	14.5%
Excess	**7.8%**	**5.1%**
Liquidity Ratio	48.2%	45.8%
Minimum Statutory ratio	20.0%	20.0%
Excess	**28.2%**	**25.8%**