KCB Group-Plc-H1'2021-earnings-note

KCB Group-Plc-H1'2021-earnings-note

Below is a summary of KCB Group's H1'2021 performance:

Balance Sheet Items	**H1'2020**	**H1'2021**	**y/y change**
Net Loans and Advances	559.9	607.0	8.4%
Government Securities	208.5	213.0	2.2%
Total Assets	**953.1**	**1,022.2**	**7.2%**
Customer Deposits	758.2	786.0	3.7%
Total Liabilities	820.9	869.2	5.9%
Shareholders' Funds	**132.1**	**152.9**	**15.7%**

Balance Sheet Ratios	**H1'2020**	**H1'2021**	**% point change**
Loan to Deposit Ratio	73.8%	77.2%	3.4%
Return on average equity	16.0%	19.2%	3.2%
Return on average assets	2.4%	2.8%	0.4%

Income Statement	**H1'2020**	**H1'2021**	**y/y change**
Net Interest Income	31.1	36.4	17.2%
Net non-Interest Income	14.0	14.8	5.9%
Total Operating income	**45.0**	**51.2**	**13.7%**
Loan Loss provision	(11.0)	(6.6)	(40.3%)
Total Operating expenses	(32.2)	(29.3)	(9.0%)
Profit before tax	12.8	21.9	70.9%
Profit after tax	**7.6**	**15.3**	**101.9%**
Core EPS	**2.36**	**4.76**	**101.9%**

Income Statement Ratios	**H1'2020**	**H1'2021**	**% point change**
Yield from interest-earning assets	11.2%	11.2%	0.0%

Income Statement Ratios	**H1'2020**	**H1'2021**	**% point change**
Cost of funding	2.9%	2.6%	(0.3%)
Net Interest Spread	8.6%	8.6%	0.0%
Net Interest Margin	8.4%	8.7%	0.3%
Cost of Risk	24.5%	12.9%	(11.6%)
Net Interest Income as % of operating income	69.0%	71.1%	2.1%
Non-Funded Income as a % of operating income	31.0%	28.9%	(2.1%)
Cost to Income Ratio	(71.5%)	(57.2%)	14.3%

Capital Adequacy Ratios	**H1'2020**	**H1'2021**	**% points change**
Core Capital/Total Liabilities	17.5%	19.0%	1.5%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**9.5%**	**11.0%**	**1.5%**
Core Capital/Total Risk Weighted Assets	17.9%	18.6%	0.7%
Minimum Statutory ratio	10.5%	10.5%	
Excess	**7.4%**	**8.1%**	**0.7%**
Total Capital/Total Risk Weighted Assets	19.5%	21.9%	2.4%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**5.0%**	**7.4%**	**2.4%**
Liquidity Ratio	40.0%	40.1%	0.1%
Minimum Statutory ratio	20.0%	20.0%	
Excess	**20.0%**	**20.1%**	**0.1%**
Adjusted core capital/ total deposit liabilities	17.8%	19.2%	1.4%
Adjusted core capital/ total risk weighted assets	18.3%	18.7%	0.4%
Adjusted total capital/ total risk weighted assets	19.8%	22.0%	2.2%

Key Highlights H1’2021

- KCB Group disclosed that 89.3% of the restructure loans were performoing as normal with the number of restructured loans reducing by 22.4% to 6,576 in H1’2021 from a high of 8,478 in Q3’2020. The loan book restructuring was 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, 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 101.9% to Kshs 4.76, from Kshs 2.36 in H1’2020, higher than our projections of a 48.9% increase to Kshs 3.51. The performance was driven by a 13.7% growth in total operating income to Kshs 51.2 bn from Kshs 45.0 bn in H1’2020, and a 40.3% decline in Loan Loss Provisions to Kshs 6.6 bn, from Kshs 11.0 bn in H1’2020. Total operating expenses recorded a 9.0% decline to Kshs 29.3 bn, from Kshs 32.2 bn in H1’2020. The increase in the core earnings per share was higher than our projected increase of 48.9% as the lender had a faster 13.7% growth in Total Operating income, compared to our projection of a 9.4% increase,
- Total operating income increased by 13.7% to Kshs 51.2 bn, from Kshs 45.0 bn in H1’2020 driven by an 17.2% increase in Net Interest Income (NII) to Kshs 36.4 bn, from Kshs 31.1 bn in H1’2020,coupled with a 5.9% increase in Non-Funded Income (NFI) to Kshs 14.8 bn, from Kshs 14.0 bn in H1’2020,
- Interest income grew by 13.9% to Kshs 47.1 bn, from Kshs 41.4 bn in H1’2020, mainly driven by a 15.0% increase in interest income from loans and advances, which increased to Kshs 34.5 bn from Kshs 30.0 bn in H1’2020, coupled with an 11.6% increase in interest income from government securities which increased to Kshs 12.1 bn, from Kshs 10.8 bn in H1’2020. The increase was however weighed down by a 4.1% decline in income from deposits and placements with banking institutions to Kshs 0.58 bn, from Kshs 0.55 bn in H1’2020. The yield on interest-earning assets remained unchanged at 11.2% as recorded in H1’2020, attributable to a 15.2% growth in average interest earning assets, which matched the 15.0% growth in trailling interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense rose by 3.8% to Kshs 10.7 bn, from Kshs 10.3 bn in H1’2020, following a 54.7% rise in Interest expense on deposits and placements to Kshs 1.5 bn, from Kshs 1.0 bn in H1’2020. The growth in interest expense was however mitigated by the 1.7% decline in Interest expense on customer deposits to Kshs 9.2 bn, from Kshs 9.3 bn in H1’2020. Cost of funds declined to 2.6% from 2.9% recorded in H1’2020, following a faster 16.3% increase in average interest bearing liabilities, which outpaced the 3.8% increase in interest expense. Net Interest Margin (NIM) on the other hand, increased to 8.7%, from 8.4% in H1’2020 due to the faster 18.6% growth in trailing Net Interest Income that outpaced the 15.2% increase in average interest-earning assets,
- Non-Funded Income increased by 5.9% to Kshs 14.8 bn, from Kshs 14.0 bn in H1’2020, driven by a 16.2% increase in the group’s income from other fees and commissions to Kshs 5.2 bn, from Kshs 4.5 bn in H1’2020, coupled with an 11.8% increase in foreign exchange trading income to Kshs 2.7 bn from Kshs 2.4 bn in H1’2020 and a 35.3% increase in other income to Kshs 2.9 bn from Kshs 2.1 bn in H1’2020. The increase in NFI was however weighed down by an 18.9% decline in income from fees and commissions from loans and advances to Kshs 4.0 bn from Kshs 4.9 bn recorded in H1’2020. Notably, total fees and commissions declined by 2.2% to Kshs 9.2 bn, from Kshs 9.4 bn recorded in H1’2020. The revenue mix shifted to 71:29 from 69:31 funded to non-funded income, owing to the faster 17.2% growth in NII compared to the 5.9% increase in NFI,
- Total operating expenses decreased by 9.0% to Kshs 29.3 bn, from Kshs 32.2 bn in H1’2020, largely driven by a 40.3% decline in Loan Loss Provisions (LLP) to Kshs 6.6 bn, from Kshs 11.0 bn in H1’2020. Staff costs increased by 21.4% to Kshs 12.3 bn from Kshs 10.1 bn in H1’2020,
- Cost to Income Ratio (CIR) improved to 57.2%, from 71.5% in H1’2020 owing to the 9.0% decline in total operating expenses to Kshs 29.3 bn from Kshs 32.2 bn in H1’2020 coupled with the 13.7% increase in total operating income to Kshs 51.2 bn from Kshs 45.0 bn in H1’2020. Without LLP, cost to income ratio also improved to 44.3% from 47.0%

in H1'2020, an indication of improving efficiency, and,

- Profit before tax increased by 70.9% to Kshs 21.9 bn from Kshs 12.8 bn in H1'2020 due to the 9.0% decrease in total operating expenses to Kshs 29.3 bn, from Kshs 32.2 bn in H1'2020. Profit after tax increased by 101.9% to Kshs 15.3 bn in H1'2021, from Kshs 7.6 bn in H1'2020, with the effective tax rate declining to 30.2%, from 40.9% in H1'2020.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 7.2% to Kshs 1.0 tn, from Kshs 953.1 bn in H1'2020. The growth was supported by a 8.4% loan book expansion to Kshs 607.0 bn, from Kshs 559.9 bn in H1'2020, coupled with a 2.2% increase in government securities to Kshs 213.0 bn, from Kshs 208.5 bn in H1'2020,
- Total liabilities rose by 5.9% to Kshs 869.2 bn, from Kshs 820.9 bn in H1'2020, driven by a 63.9% rise in borrowings to Kshs 35.0 bn, from Kshs 21.4 bn in H1'2020. Customer deposits increased by 3.7% to Kshs 786.0 bn from Kshs 758.2 bn, with customer deposits from NBK amounting to Kshs Kshs 99.9 bn in H1'2021. Deposits per branch increased by 5.2% to Kshs 2.2 bn from Kshs 2.1 bn in H1'2020, with the number of branches declining to 354 as at the end of H1'2021, from 359 in H1'2020, due to the group closing 5 branches in Kenya, 1 in Rwanda and 1 in South Sudan in the period. The group however opened 2 branches in Uganda during the period. We expect a further increase in the number of branches with the bank looking to finalize, later in the year, the aqcuisitions of African Banking Corporation Ltd Tanzania (ABC Tanzania) and Rwanda's Banque De Populaire du Rwanda (BPR),
- The faster 8.4% growth in loans as compared to the 3.7% growth in deposits led to an increase in the loan to deposit ratio to 77.2% from 73.8% in H1'2020,

- Gross non-performing loans increased by 14.1% to Kshs 95.7 bn in H1'2021 from Kshs 83.9 bn in H1'2020. Consequently, the NPL ratio rose to 14.4% in H1'2021, from 13.8% in H1'2020, attributable to the faster 14.1% growth in Non-Performing Loans, which outpaced the 8.4% 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 which recorded NPL ratios of 17.9%, 11.8%, 10.5% and 2.8%, respectively,
- Loan Loss Provisions (LLP) decreased by 40.3% y/y to Kshs 6.6 bn in H1'2021, from Kshs 11.0 bn in H1'2020. The NPL coverage on the other hand improved to 61.6% in H1'2021 from 56.9% in H1'2020, as general Loan Loss Provisions increased by 29.6% to Kshs 46.8 bn from Kshs 36.1 bn in H1'2020, attributable to the deterioration in the group's asset quality with the NPL ratio rising to 14.4% from 13.8% in H1'2020,
- Shareholders' funds increased by 15.7% to Kshs 152.9 bn in H1'2021, from Kshs 132.1 bn in H1'2020, supported by a 20.2% increase in retained earnings to Kshs 126.5 bn, from Kshs 105.2 bn in H1'2020,
- KCB Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.6%, 8.1% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 21.9%, exceeding the statutory requirement by 7.4% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 18.7%, while total capital to risk-weighted assets came in at 22.0%, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.8%, and a Return on Average Equity (ROaE) of 19.2%.

Key Take-Outs:

1. The group's asset quality deteriorated, with the NPL ratio rising to 14.4% in H1'2021, from 13.8% in H1'2020. Key to note, KCB's NPL ratio of 14.4% is 0.4% points above the industry average of 14.0% as at June 2021. 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 17.9%, 11.8%, 10.5% and 2.8%, respectively. q/q, Asset quality

improved by 0.5% points to 14.4%, from 14.9% recorded in Q1’2021. The NPL coverage, on the other hand, improved to 61.6% in H1’2021 from 56.9% in H1’2020, as general Loan Loss Provisions increased by 29.6% to Kshs 46.8 bn from Kshs 36.1 bn in H1’2020,

2. There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 44.3% from 47.0% in H1’2020, an indication of improving efficiency, and,
3. The group has leveraged on digital innovation which was necessitated by the onset of COVID-19 in the country. In H1’2021, 98.0% of transactions were performed outside the branch, with mobile banking, agency banking and ATM banking accounting for 80.0%, 12.0% and 6.0%, respectively. Key to note, the value of Mobile transactions increased by 104.0% in H1’2021 to Kshs 1,121.0 bn, from Kshs 550.0 bn in H1’2020. Despite the increase in the value of mobile transactions, mobile revenue declined by 18.3% to Kshs 3.2 bn, from Kshs 3.9 bn in H1’2020 attributable to the waiver of fees on monile money transactions in the period.

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 “**HOLD**” with a target price of Kshs 52.5, representing an upside of 9.4%, from the current price of Kshs 48.0 as of 20th August 2021, inclusive of a dividend yield of 7.3%,
- KCB Group is currently trading at a P/TBV of 1.1x and a P/E of 7.8x vs an industry average of 1.2x and 9.2x, respectively.