

NIC Group Earnings Note– Q3'2019

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Key Highlights Q3'2018

- NIC Group finalized on the proposed merger with CBA Bank to form NCBA Group. The combined entity commenced operations on 1st October 2019 operating under the newly formed entity

Income Statement

- Core earnings per share declined by 3.3% to Kshs 4.4 from Kshs 4.6 in Q3'2018. The performance was driven by a 22.9% increase in total operating expenses to Kshs 8.2 bn from Kshs 6.6 bn in Q3'2018, this was mitigated by the 15.2% increase in total operating income,
- Total operating income increased by 15.2% to Kshs 12.6 bn from Kshs 11.0 bn in Q3'2018. This was driven by both, a 10.6% increase in Net Interest Income (NII) to Kshs 8.4 bn from Kshs 7.6 bn in Q3'2018, and a 25.6% increase in Non-Funded Income (NFI) to Kshs 4.3 bn from Kshs 3.4 bn in Q3'2018,
- Interest income increased by 3.4% to Kshs 14.7 bn from Kshs 14.2 bn in Q3'2018. Interest income on government securities increased by 5.1% to Kshs 5.3 bn in Q3'2019 from Kshs 5.0 bn in Q3'2018, while that on loans and advances increased by 1.8% to Kshs 9.2 bn from Kshs 9.1 bn in Q3'2018. The yield on interest-earning assets, however, declined to 7.9% in Q3'2019 from 8.3% in Q3'2018,
- Interest expense decreased by 4.7% to Kshs 6.4 bn from Kshs 6.7 bn in Q3'2018, as interest expense on customer deposits decreased by 4.9% to Kshs 5.3 bn from Kshs 5.5 bn in Q3'2018. The cost of funds fell to 3.4% from 3.9% in Q3'2018, while the Net interest margin increased to 6.1% from 6.0% in Q3'2018,
- Non-Funded Income increased by 25.6% to Kshs 4.3 bn from Kshs 3.4 bn in Q3'2018. The increase in NFI was mainly driven by a 91.4% increase in Other Income to Kshs 1.1 bn from Kshs 0.6 bn in Q3'2018, coupled with a 19.4% increase in Fees & commissions on loans and advances to Kshs 1.3 bn from Kshs 1.1 bn in Q3'2018. Forex trading came in at Kshs 1.1 bn, compared to Kshs 1.0 bn in Q3'2018. The revenue mix shifted to 66:34 funded to non-funded income in Q3'2019 from 69:31 in Q3'2018, owing to the higher increase in NFI,
- Total operating expenses increased by 22.9% to Kshs 8.2 bn from Kshs 6.6 bn, largely driven by a 44.4% increase in loan loss provision (LLP) to Kshs 2.3 bn in Q3'2019 from Kshs 1.6 bn in Q3'2018. Staff costs, also increased by 10.8% to Kshs 2.9 bn in Q3'2019 from Kshs 2.6 bn in Q3'2018,
- The cost to income ratio deteriorated to 64.6% from 60.6% in Q3'2018. Without LLP, the cost to income ratio also deteriorated to 46.3% from 46.0% in Q3'2018,
- NIC Group incurred an exceptional item of Kshs 344.2 mn following the integration, advisory and legal expenses related to the merger with CBA,
- Profit before tax decreased by 4.5% to Kshs 4.1 bn from Kshs 4.3 bn in Q3'2018. Profit after tax decreased by 3.3% to Kshs 3.1 bn in Q3'2019 from Kshs 3.2 bn in Q3'2018, with the difference being a decline in the effective tax rate to 35.9% from 42.9% in Q3'2018.

Balance Sheet

- The balance sheet recorded an expansion with total assets growth of 7.0% to Kshs 215.9 bn from Kshs 201.8 bn in Q3'2018. This growth was largely driven by a 9.4% increase in government securities to Kshs. 65.8 bn from Kshs. 60.2 bn in Q3'2018,
- The loan book expanded by 4.3% to Kshs 119.9 bn in Q3'2019 from Kshs 114.9 bn in Q3'2018,
- Total liabilities rose by 5.6% to Kshs 177.4 bn from Kshs 167.9 bn in Q3'2018, driven by a 9.2% increase in customer deposits to Kshs 158.2 bn from Kshs 145.0 bn in Q3'2018. This was however mitigated by a 46.8% decline in borrowings to Kshs 8.4 bn from Kshs 15.8 bn in Q3'2018. Deposits per branch stood at Kshs. 3.8 bn with the bank operating 42 branches,
- The faster growth in deposits compared to the growth in loans led to a slight decline in the loan to deposit ratio to 75.8% from 79.3% in Q3'2018,
- Gross non-performing loans increased by 13.8% to Kshs 18.7 bn in Q3'2019 from Kshs 16.4 bn in Q3'2018. Consequently, the NPL ratio deteriorated to 14.6% in Q3'2019 from 13.3% in Q3'2018. General Loan loss provisions decreased by 19.2% to Kshs 5.3 bn from Kshs 6.6 bn in Q3'2018. Consequently, the NPL coverage deteriorated to 45.9% in Q3'2019 from 51.4% in Q3'2018,
- Shareholders' funds increased by 14.4% to Kshs 38.3 bn in Q3'2019 from Kshs 33.5 bn in Q3'2018,
- NIC Group is currently sufficiently capitalized with a core capital to risk-weighted assets ratio of 19.6%, 9.1% above the statutory requirement. In addition, the total capital to risk-weighted assets ratio was 20.3%, exceeding the statutory requirement by 5.8%. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 20.4%, while total capital to risk-weighted assets came in at 21.9%,
- NIC Group currently has a return on average assets of 1.0% and a return on average equity of 5.4%.

Key Take-Outs:

- NIC Group's operating income increased by 15.2% to Kshs 12.6 bn from Kshs 11.0 bn in Q3'2018, mainly supported by the 25.6% increase in non-funded income for the period ending 30th September 2019. This shows improved diversification with the bank improving its alternative sources of income.

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

- The merger with CBA will likely enable NIC to mobilize cheaper funding, leveraging on the scale and market reach of the combined entity as well as the digital channels. We expect NCBA Group Plc to focus on branding and increased consumer awareness campaigns in the near term, as they endeavor to minimize service disruptions to clientele as well as highlight the synergies and benefits expected to be reaped from the merger

Balance Sheet Items	Q3'2018	Q3'2019	y/y change
Net Loans and Advances	114.9	119.9	4.3%
Total Assets	201.8	215.9	7.0%
Customer Deposits	145.0	158.2	9.2%
Total Liabilities	167.9	177.4	5.6%
Shareholders' Funds	33.5	38.3	14.4%

Balance Sheet Ratios	Q3'2018	Q3'2019	% y/y change
Loan to Deposit Ratio	79.3%	75.8%	(3.5%)

Balance Sheet Ratios	Q3'2018	Q3'2019	% y/y change
Return on average equity	13.0%	5.4%	(7.6%)
Return on average assets	2.2%	1.0%	(1.2%)

Income Statement	Q3'2018	Q3'2019	y/y change
Net Interest Income	7.6	8.4	10.6%
Net non-Interest Income	3.4	4.3	25.6%
Total Operating income	11.0	12.6	15.2%
Loan Loss provision	1.6	2.3	44.4%
Total Operating expenses	6.6	8.2	22.9%
Profit before tax	4.3	4.1	(4.5%)
Profit after tax	3.2	3.1	(3.3%)
Core EPS	4.6	4.4	(3.3%)

Income Statement Ratios	Q3'2018	Q3'2019	y/y change
Yield from interest-earning assets	8.3%	7.9%	(0.4%)
Cost of funding	3.9%	3.4%	(0.5%)
Net Interest Spread	4.4%	4.5%	0.1%
Net Interest Margin	6.0%	6.1%	0.1%
Cost of Risk	14.6%	18.3%	3.7%
Net Interest Income as % of operating income	69%	66%	(2.8%)
Non-Funded Income as a % of operating income	31%	34%	2.8%
Cost to Income Ratio	60.6%	64.6%	4.0%
Cost to Income Ratio without LLP	46.0%	46.3%	0.3%

Capital Adequacy Ratios	Q3'2018	Q3'2019
Core Capital/Total Liabilities	21.4%	22.3%
Minimum Statutory ratio	8.0%	8.0%
Excess	13.4%	14.3%
Core Capital/Total Risk Weighted Assets	18.1%	19.6%
Minimum Statutory ratio	10.5%	10.5%
Excess	7.6%	9.1%

Capital Adequacy Ratios	Q3'2018	Q3'2019
Total Capital/Total Risk Weighted Assets	20.1%	20.3%
Minimum Statutory ratio	14.5%	14.5%
Excess	5.6%	5.8%
Liquidity Ratio	49.3%	48.4%
Minimum Statutory ratio	20.0%	20.0%
Excess	29.3%	28.4%
Adjusted core capital/ total deposit liabilities	21.8%	23.6%
Adjusted core capital/ total risk weighted assets	19.3%	20.5%
Adjusted total capital/ total risk weighted assets	21.2%	21.2%

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