

Below is a summary of KCB Group FY'2023 performance:

Balance Sheet Items	FY'2022	FY'2023	y/y change
Government Securities	253.3	348.9	37.7%
Net Loans and Advances	863.3	1,095.9	27.0%
Total Assets	1,554.0	2,170.9	39.7%
Customer Deposits	1,135.4	1,690.9	48.9%
Deposits per branch	1.9	2.8	51.2%
Total Liabilities	1,347.8	1,934.5	43.5%
Shareholders' Funds	200.2	228.3	14.0%

Balance Sheet Ratios	FY'2022	FY'2023	% points change
Loan to Deposit Ratio	76.0%	64.8%	(11.2%)
Government Securities to Deposit Ratio	22.3%	20.6%	(1.7%)
Return on average equity	22.0%	17.5%	(4.5%)
Return on average assets	3.0%	2.0%	(1.0%)
Dividend Yield	6.5%	0.0%	(6.5%)
Dividend Payout ratio	15.7%	0.0%	(15.7%)

Income Statement	FY'2022	FY'2023	y/y change
Net Interest Income	86.7	107.3	23.9%
Net non-Interest Income	43.3	57.9	33.9%
Total Operating income	129.9	165.2	27.2%
Loan Loss provision	(13.2)	(33.6)	154.7%
Total Operating expenses	(72.6)	(116.8)	60.9%
Profit before tax	57.3	48.5	(15.5%)
Profit after tax	40.8	37.5	(8.3%)
Core EPS	12.7	11.7	(8.3%)

Income Statement Ratios	FY'2022	FY'2023	% points change
Yield from interest-earning assets	10.1%	10.3%	0.2%
Cost of funding	2.9%	4.0%	1.1%
Net Interest Spread	7.3%	6.4%	(0.9%)
Net Interest Margin	7.5%	6.6%	(0.9%)
Cost of Risk	10.2%	20.4%	10.2%
Net Interest Income as % of operating income	66.7%	65.0%	(1.7%)
Non-Funded Income as a % of operating income	33.3%	35.0%	1.7%
Cost to Income Ratio	55.9%	70.7%	14.8%

Capital Adequacy Ratios	FY'2022	FY'2023	% points change
Core Capital/Total Liabilities	15.6%	14.2%	(1.4%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	7.6%	6.2%	(1.4%)
Core Capital/Total Risk Weighted Assets	14.5%	12.2%	(2.3%)
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	4.0%	1.7%	(2.3%)
Total Capital/Total Risk Weighted Assets	18.1%	17.4%	(0.7%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	3.6%	2.9%	(0.7%)
Liquidity Ratio	40.5%	43.5%	3.0%
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	20.5%	23.5%	3.0%

Income Statement

- Core earnings per share declined by 8.3% to Kshs 11.7, from Kshs 12.7 in FY'2022, driven by the 60.9% growth in total operating expenses to Kshs 116.8 bn, from Kshs 72.6 bn in FY'2022, which outpaced the 27.2% growth in total operating income to Kshs 165.2 bn, from Kshs 129.9 bn in FY'2022,
- The 27.2% growth in total operating income was mainly driven by a 23.9% growth in Net Interest Income to Kshs 107.3 bn, from Kshs 86.7 bn in FY'2022, coupled with a 33.9% growth in Non funded Income (NFI) to Kshs 57.9 bn, from Kshs 43.3 bn in FY'2022,
- Interest income grew by 42.8% to Kshs 168.2 bn from Kshs 117.8 bn in FY'2022, mainly driven by a 44.5% growth in interest income from loans and advances to Kshs 121.6 bn from Kshs 84.2 bn in FY'2022, coupled with a 29.9% increase in interest from government securities to Kshs 42.7 bn, from Kshs 32.9 bn in FY'2022. Similarly, the Yield on Interest-Earning Assets (YIEA) increased by 0.2% points to 10.3% from 10.1% recorded in FY'2022, mainly attributable to the faster 42.8% growth in trailing interest income to Kshs 168.2 bn, from Kshs 117.8 bn in FY'2022 compared to the 40.1% increase in average interest-earning assets to Kshs 1,626.8 bn, from Kshs 1,161.1 bn in FY'2022,
- Interest expenses rose by 95.6% to Kshs 60.8 bn, from Kshs 31.1 bn in FY'2022, driven by 65.9% increase in interest expense on customer deposits to Kshs 41.8 bn, from Kshs 25.2 bn in FY'2022, coupled with a 242.4% increase in interest expense from deposits and placements to Kshs 18.5 bn in FY'2023, from Kshs 5.4 bn recorded in FY'2022. Consequently, Cost of funds (COF) increased by 1.1% points to 4.0%, from 2.9% recorded in FY'2022, owing to a faster 95.6% increase in Trailing interest expense to Kshs 60.8 bn, from Kshs 31.1 bn in FY'2022, compared to the 41.0% increase in average interest-bearing liabilities to Kshs 1,532.3 bn from Kshs 1,086.8 bn in FY'2022. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) decreased by 0.9% points to 6.6% from 7.5% in FY'2022, attributable to a 40.1% increase in average interest-earning assets to Kshs 1,626.8 bn, from Kshs 1,161.1 bn in FY'2022 which outpaced the 23.9% growth in trailing net interest income to Kshs 107.3 bn, from Kshs 86.7 bn recorded in FY'2022,
- Non-Funded Income (NFI) increased by 33.9% to Kshs 57.9 bn from Kshs 43.3 bn in FY'2022, mainly driven by a 67.2% increase in total fees and commissions to 38.4 bn from 23.0 bn in FY'2022. However, the performance was weighed down by a 2.1% decline in the foreign exchange trading income to Kshs 10.8 bn from Kshs 11.1 bn in FY'2022, highlighting the bank's decreased foreign exchange margins. The revenue mix shifted to 65:35 from 67:33 in FY'2022 for the funded to Non-funded income owing to the 23.9% growth in Funded Income slower than the 33.9% growth in the Non Funded Income,
- Total operating expenses increased by 60.9% to Kshs 116.8 bn from Kshs 72.6 bn in FY'2022, driven by 154.7% increase in loan loss provisions to Kshs 33.6 bn from Kshs 13.2 bn recorded in FY'2022, coupled with a 26.0% increase in staff costs to Kshs 38.1 bn from Kshs 30.3 bn in FY'2022. The increase in provisioning is partly attributable to rising credit risk as a result deteriorated economic environment as evidenced by the 2023 Purchasing Managers Index (PMI) averaging 48.1, down from an average of 49.2 in 2022,
- Cost to Income Ratio (CIR) increased to 70.7% from 55.9% in FY'2022, owing to the 60.9% increase in total operating expense, which outpaced the 27.2% increase in total operating income. Notably, CIR without LLP increased by 4.6% points to 50.3% from 45.7% recorded in FY'2022, and,
- Profit before tax decreased by 15.5% to Kshs 48.5 bn from Kshs 57.3 bn in FY'2022, with the effective tax rate decreasing to 22.7% in FY'2023 from 28.8% in FY'2022. Similarly, profit after tax decreased by 8.3% to Kshs 37.5 bn, from Kshs 40.8 bn in FY'2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 39.7% to Kshs 2,170.9 bn, from Kshs 1,554.0 bn in FY'2022, driven by a 27.0% loan book expansion to Kshs 1,095.9 bn, from Kshs 863.3 bn in FY'2022, coupled with a 37.7% increase investment in government securities to Kshs 348.9 bn from Kshs 253.3 bn in FY'2022,
- Total liabilities rose by 43.5% to Kshs 1,934.5 bn from Kshs 1,347.8 bn in FY'2022, driven by a 48.9% growth in customer deposits to Kshs 1,690.9 bn, from Kshs 1,135.4 bn in FY'2022, coupled with a 39.4% increase in borrowings to 88.7 bn, from Kshs 63.6 bn recorded in FY'2022. With 594 branches countrywide compared to 603 branches in FY'2022, deposits per branch increased by 51.2% to Kshs 2.8 bn, from Kshs 1.9 bn in FY'2022,
- The faster 48.9% growth in customer deposits as compared to the 27.0% growth in loans led to a decline in the loan to deposits ratio to 64.8%, from 76.0% in FY'2022,
- The bank's Asset Quality remained relatively unchanged, with Gross NPL ratio coming in at 17.0% in FY'2023, similar to FY'2022, attributable to 29.4% increase in Gross loans to Kshs 1,226.1 bn, from Kshs 947.7 bn in FY'2022, relative to the 29.2% increase in gross non-performing loans to Kshs 208.3 bn, from Kshs 161.1 bn recorded in FY'2022,
- General Provisions (LLP) increased by 52.0% to Kshs 107.3 bn in FY'2023 from Kshs 70.6 bn in FY'2022. The NPL coverage increased to 62.5% in FY'2023, from 52.4% in FY'2022, attributable to the 52.0% growth in general provisions coupled with the 65.0% increase in interest in suspense to Kshs 22.9 bn, from Kshs 13.8 bn in FY'2022 which outpaced the 29.2% increase in gross non-performing loans to Kshs 208.3 bn from Kshs 161.2 bn recorded in FY'2022,
- Shareholders' funds increased by 14.0% to Kshs 228.3 bn in FY'2023, from Kshs 200.2 bn in FY'2022, supported by a 30.1% increase in retained earnings to Kshs 191.6 bn, from Kshs 147.2 bn in FY'2022,
- KCB Group remained capitalized with a core capital to risk-weighted assets ratio of 12.2%, 1.7% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 17.4% exceeding the statutory requirement of 14.5% by 2.9% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.0%, and a Return on Average Equity (ROaE) of 17.5%.

Key Take-Outs:

1. **Decline in earnings** - Core earnings per share (EPS) declined by 8.3% to Kshs 11.7, from Kshs 12.7 in FY'2022, driven by the 60.9% growth in total operating expenses to Kshs 116.8 bn, from Kshs 72.6 bn in FY'2022, which outpaced the 27.2% growth in total operating income to Kshs 165.2 bn, from Kshs 129.9 bn in FY'2022,
2. **Increased Provisioning** – On the back of high credit risk occasioned by the deteriorated business environment, the bank increased its provisions holdings to cover for the anticipated losses in the future, with its provisions increasing by 52.0% to Kshs 107.3 bn from Kshs 70.6 bn recorded in FY'2022,
3. **Revenue Diversification** – The Group's Non-Funded income increased by 33.9% to Kshs 57.9 bn in FY'2023, from Kshs 43.3 bn in FY'2022, which resulted in a shift in revenue to 65:35 from 67:33 in FY'2022. The increase was mainly attributable to a faster 33.9% increase in non-funded income to Kshs 57.9 bn, from Kshs 33.9 bn in FY'2022, compared to the 23.9% increase in Funded income to Kshs 107.3 bn, from Kshs 86.7 bn in FY'2022, and,
4. **Lack of dividend Payout** – The Group's board of directors declined to announce any dividends for the FY'2023 citing the group's attempt to conserve capital. Notably, though the Group remains capitalized, the core capital to total risk-weighted assets declined by 2.3% points to 12.2% in FY'2023, from 14.5% in FY'2022 which is 1.7% above the statutory requirement of 10.5% compared to an excess of 4.0% points in FY'2022.

Going forward, the factors that would drive the bank's growth would be:

- **Continued Digitization** - The Group has continued to maximize digital transformation. As of FY'2023, 99.0% of the transactions by number were done through the non-branch channels. Notably, the Group witnessed 77.0% growth in the value of mobile loans disbursed mainly driven by Fuliza, the introduction of term loans on KCB Mobi, and new mobile lending products for small businesses. The value of mobile loans disbursed

reached an all-time high of Kshs 337.0 bn in FY'2023, accounting for 78.0% growth in Non-Funded Income from digital channels in 2023.

Valuation Summary

- We are of the view that KCB Group is an “accumulate” with a target price of Kshs 30.5 representing an upside of 19.4%, from the current price of Kshs 25.5 as of 22nd March 2024.
- KCB Group is currently trading at a P/TBV of 0.4x and a P/E of 2.2x vs an industry average of 0.8x and 4.0x respectively.