KCB Group – H1’2023
25th August, 2023

Below is a summary of KCB Group H1’2023 performance:

Balance Sheet Items	H1'2022	H1'2023	y/y change
Government Securities	246.3	320.3	30.1%
Net Loans and Advances	730.3	964.8	32.1%
Total Assets	**1,210.1**	**1,864.6**	**54.1%**
Customer Deposits	908.6	1,471.2	61.9%
Deposits per branch	1.8	2.4	32.3%
Total Liabilities	1,028.4	1,646.6	60.1%
Shareholders’ Funds	**179.1**	**211.2**	**17.9%**

Balance Sheet Ratios	H1'2022	H1'2023	% y/y change
Loan to Deposit Ratio	80.4%	65.6%	(14.8%)
Government Securities to Deposit ratio	27.1%	21.8%	(5.3%)
Return on average equity	23.2%	19.1%	(4.1%)
Return on average assets	3.5%	2.4%	(1.0%)

Income Statement	H1'2022	H1'2023	y/y change
Net Interest Income	40.6	45.5	12.1%
Net non-Interest Income	19.2	27.6	43.4%
Total Operating income	**59.8**	**73.1**	**22.2%**
Loan Loss provision	(4.3)	(10.2)	136.0%
Total Operating expenses	(31.6)	(50.6)	60.0%
Profit before tax	28.2	22.5	(20.3%)
Profit after tax	**19.6**	**16.1**	**(18.3%)**
Core EPS	**6.11**	**5.00**	**(18.3%)**

Income Statement Ratios	H1'2022	H1'2023	y/y change
Yield from interest-earning assets	11.3%	9.8%	(1.5%)
Cost of funding	3.0%	3.3%	0.2%
Net Interest Spread	8.3%	6.6%	(1.7%)
Net Interest Margin	8.5%	6.7%	(1.7%)
Cost of Risk	7.2%	13.9%	6.7%
Net Interest Income as % of operating income	67.9%	62.3%	(5.6%)
Non-Funded Income as a % of operating income	32.1%	37.7%	5.6%
Cost to Income Ratio	52.9%	69.3%	16.4%

Capital Adequacy Ratios	H1'2022	H1'2023	% points change
Core Capital/Total Liabilities	17.3%	14.4%	(2.9%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	**9.3%**	**6.4%**	**(2.9%)**
Core Capital/Total Risk Weighted Assets	17.7%	15.0%	(2.7%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**7.2%**	**4.5%**	**(2.7%)**
Total Capital/Total Risk Weighted Assets	21.6%	18.4%	(3.2%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	**7.1%**	**3.9%**	**(3.2%)**
Liquidity Ratio	39.0%	52.1%	13.1%
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	**19.0%**	**32.1%**	**13.1%**

Income Statement

- Core earnings per share declined by 18.3% to Kshs 5.0, from Kshs 6.1 in H1’2022, driven by the 60.0% growth in total operating expenses to Kshs 50.6 bn, from Kshs 31.6 bn in H1’2022, which outpaced the 22.2% growth in total operating income to kshs 73.1 bn, from kshs 59.8 bn in H1’2022,
- The 22.2% growth in total operating income was mainly driven by a 12.1% growth in Net Interest Income to Kshs 45.5 bn, from Kshs 40.6 bn in H1’2022, coupled with a 43.4% growth in Non funded Income (NFI) to Kshs 27.6 bn, from Kshs 19.2 bn in H1’2022,
- Interest income grew by 28.6% to Kshs 70.1 bn from Kshs 54.5 bn in H1’2022, mainly driven by a 33.4% growth in interest income from loans and advances to Kshs 51.2 bn from Kshs 38.4 bn in H1’2022, coupled with a 14.2% increase in interest from government securities to kshs 18.1 bn, from kshs 15.9 bn in H1’2022. However, the Yield on Interest-Earning Assets (YIEA) declined by 1.5% points to 9.8% from 11.3% recorded in H1’2022, mainly attributable to the faster 40.8% growth in average interest earning assets to kshs 1359.4 bn, from kshs 965.7 bn in H1’2022 compared to a 21.7% increase in trailing interest income to Kshs 133.4 bn, from Kshs 109.6 bn in H1’2022,
- Interest expenses rose by 76.6% to Kshs 24.6 bn, from Kshs 13.9 bn in H1’2022, driven by 43.3% increase in interest expense on customer deposits to Kshs 16.5 bn, from Kshs 11.5 bn in H1’2022, coupled with a 269.9% increase in interest expense from deposits and placements to Kshs 7.9 bn in H1’2023, from Kshs 2.1 sbn recorded in H1’2022. Consequently, Cost of funds (COF) increased by 0.3% points to 3.3% from 3.0% recorded in H1’2022, owing to a faster 45.0% increase in Trailing interest expense to Kshs 91.6 bn, from Kshs 63.1 bn recorded in H1’2022, faster than the 21.5% increase in average interest bearing liabilities to Kshs 1248.6 bn from Kshs 1027.8 bn in H1’2022.Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) decreased by 1.7% points to 6.7% from 8.5% in H1’2022, attributable to a 40.8% increase in average interest earning assets to kshs 1359.4 bn, from kshs 965.7 bn in H1’2022 which outpaced the 11.8% growth in trailing net interest income to Kshs 91.6 bn from Kshs 81.9 bn recorded in H1’2022,
- Non-Funded Income (NFI) increased by 43.4% to Kshs 27.6 bn from Kshs 19.2 bn in H1’2022, mainly driven by a 56.1% increase in total fees and commissions to 17.8 bn from 11.4 bn in H1’2022, coupled by a 19.8% increase in the foreign exchange trading income to Kshs 5.9 bn from Kshs 4.9 bn in H1’2022, highlighting the bank’s increased foreign exchange margins. The revenue mix shifted to 62:38 from 68:32 for the funded to Non-funded income owing to the 12.1% growth in Funded Income slower than the 43.4% growth in the Non Funded Income,
- Total operating expenses increased by 60.0% to Kshs 50.6 bn from Kshs 31.6 bn in H1’2022, driven by 136.0% increase in loan loss provisions to Kshs 10.2 bn from Kshs 4.3 bn recorded in H1’2022, and coupled with a 23.9% increase in staff costs to Kshs 17.5 bn from Kshs 14.1 bn in H1’2022. The increase in provisioning is partly attributable to rising credit risk as a result deteriorioted economic environment as evidenced by the average Purchasing Managers Index (PMI) of 48.7 in H1’2023, down from an average of 49.3 in H1’2022,
- Cost to Income Ratio (CIR) increased to 69.3% from 52.9% in H1’2022, owing to the 60.0% increase in total operating expense, which outpaced the 22.2% increase in total operating income. Notably, CIR without LLP increased by 9.7% points to 55.3% from 45.7% recorded in H1’2022, and,
- Profit before tax decreased by 20.3% to Kshs 22.5 bn from Kshs 28.2 bn in H1’2022, with effective tax rate decreasing to 28.5% in H1’2023 from 30.3% in H1’2022. Similarly, profit after tax decreased by 18.3% to kshs 16.1 bn, from kshs 19.6 bn in H1’2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 54.1% to Kshs 1864.6 bn, from Kshs 1210.1 bn in H1’2022, driven by a 32.1% loan book expansion to Kshs 946.8 bn, from Kshs 730.3 bn in H1’2022, coupled with a 30.1% increase investment in government securities to Kshs 320.3 bn from Kshs 246.3 bn in H1’2022,

- Total liabilities rose by 60.1% to Kshs 1646.6 bn from Kshs 1028.4 bn in H1’2022, driven by a 61.9% growth in customer deposits to Kshs 1471.2 bn, from Kshs 908.6 bn in H1’2022, coupled with a 35.9% increase in placements to 48.6 bn, from Kshs 35.8 bn recorded in H1’2022. With 607 branches countrywide compared to 496 branches in H1’2022, deposits per branch increased by 32.3% to Kshs 2.4 bn, from Kshs 1.8 bn in H1’2022,
- The faster 61.9% growth in customer deposits as compared to the 32.1% growth in loans led to a decline in the loan to deposits ratio to 65.6%, from 80.4% in H1’2022,
- The bank’s Asset Quality improved, with Gross NPL ratio decreasing to 17.2% in H1’2023 from 21.4% in H1’2022, attributable to 30.6% increase in Gross loans to Kshs 1057.9 bn, from Kshs 809.8 bn in H1’2022, which outpaced the 4.9% increase in gross non-performing loans to Kshs 182.0 bn, from Kshs 173.4 bn recorded in H1’2022,
- General Provisions (LLP) increased by 15.7% to Kshs 75.3 bn in H1’2023 from Kshs 65.1 bn in H1’2022. The NPL coverage increased to 51.1% in H1’2023, from 45.8% in H1’2022, attributable to the 136.0% growth in loan loss provisions to kshs 10.2 bn, from kshs 4.3 bn in H1’2022, which outpaced the 4.9% increase in gross non-performing loans to Kshs 182.0 bn from kshs 173.4 bn recorded in H1’2022.
- Shareholders’ funds increased by 17.9% to Kshs 211.2 bn in H1’2023, from Kshs 179.1 bn in H1’2022, supported by a 15.8% increase in retained earnings to Kshs 166.3 bn, from Kshs 143.5 bn in H1’2022,
- KCB Group remained capitalized with a core capital to risk-weighted assets ratio of 15.0%, 4.5% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 18.4% exceeding the statutory requirement of 14.5% by 3.9% points, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.4%, and a Return on Average Equity (ROaE) of 19.1%.

Key Take-Outs:

1. **Decline in earnings -** Core earnings per share (EPS) declined by 18.3% to Kshs 5.0, from Kshs 6.1 in H1’2022, driven by the 60.0% growth in total operating income to Kshs 50.6 bn, from Kshs 31.6 bn in H1’2022, which outpaced the 22.2% growth in total operating income to kshs 73.1 bn, from kshs 59.8 bn in H1’2022,
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 15.7% to Kshs 75.3 bn from Kshs 65.1 bn recorded in H1’2022, and,
3. **Improved Lending –** The Group’s loan book increased by 32.1% to kshs 964.8 bn, from kshs 730.3 bn in H1’2022, which outpaced the 30.1% growth in government securities to kshs 320.3 bn, from kshs 246.3 bn in H12022, highlighting the Group’s strategy to increase lending while at the same time managing its non performing loan book,
4. **Revenue Diversification –** The Group’s Non-Funded income increased by 43.4% to Kshs 27.6 bn in H1’2023, from Kshs 19.2 bn in H1’2022, which resulted to a shift in revenue mix to 62:38 in H1’2023 from 68:32 in H1’2022. The increase was mainly attributable to a faster 43.4% increase in non-funded income to Kshs 27.6 bn, from Kshs 19.2 bn in H1’2022, compared to the 12.1% increase in Funded income to kshs 45.5 bn, from kshs 40.6 bn in H1’2022.

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

- **Continued Digitization** - The Group has continued to maximize on digital trasformation. As of FY’2022, 99.0% of the transactions were done through the non-branch channels. The growth is also to be supported by the continued growth in mobile lending such as Fuliza and KCB Mpesa. The digital channel transactions has led to increase in NFI by 43.4% in H1’2023 to kshs 27.6 bn, from kshs 19.2 bn in H1’2022, mainly on the back of increased mobile and internet banking.

Valuation Summary

- We are of the view that KCB Group is a “buy” with a target price of Kshs 36.0 representing an upside of 51.3%, from the current price of Kshs 23.8, inclusive of a dividend yield of 8.4%.
- KCB Group is currently trading at a P/TBV of 0.4x and a P/E of 1.9x vs an industry average of 0.8x and 3.5x respectively.