

Below is a summary of NCBA Group Q1'2023 performance:

Balance Sheet (Amount in Kshs bn)	Q1'2022	Q1'2023	y/y change
Net Loans and Advances	243.9	287.2	17.7%
Government Securities	194.7	207.1	6.4%
Total Assets	587.4	628.8	7.1%
Customer Deposits	465.5	499.7	7.3%
Deposits Per Branch	4.5	5.8	7.3%
Total Liabilities	507.1	540.9	6.7%
Shareholders' Funds	80.2	87.9	9.6%

Key Ratios	Q1'2022	Q1'2023	% point change
Loan to Deposit Ratio	52.4%	57.5%	5.1%
Government Securities to Deposit ratio	41.8%	41.4%	(0.4%)
Return on average equity	14.0%	18.4%	4.4%
Return on average assets	1.9%	2.5%	0.6%

Income Statement (Amount in Kshs bn)	Q1'2022	Q1'2023	y/y change
Net Interest Income	7.1	8.4	18.0%
Net non-Interest Income	6.1	7.2	18.5%
Total Operating income	13.1	15.5	18.2%
Loan Loss provision	2.5	2.0	(22.6%)
Total Operating expenses	8.1	9.2	12.8%
Profit before tax	4.8	6.4	31.9%
Profit after tax	3.4	5.1	48.5%
Core EPS	2.1	3.1	48.5%

Income Statement Ratios	Q1'2022	Q1'2023	% point change
Yield from interest-earning assets	9.8%	10.4%	0.6%
Cost of funding	4.3%	4.6%	0.3%
Net Interest Spread	5.5%	5.7%	0.2%
Net Interest Margin	5.7%	6.0%	0.3%
Cost of Risk	19.2%	12.6%	(6.6%)
Net Interest Income as % of operating income	53.9%	53.8%	(0.1%)
Non-Funded Income as a % of operating income	46.1%	46.2%	0.1%
Cost to Income Ratio	61.7%	58.9%	(2.8%)
Cost to Income Ratio without LLP	42.5%	46.3%	3.8%

Capital Adequacy Ratios	Q1'2022	Q1'2023	% points change
Core Capital/Total Liabilities	15.9%	16.8%	0.9%
Minimum Statutory ratio	8.0%	8.0%	
Excess	7.9%	8.8%	0.9%
Core Capital/Total Risk Weighted Assets	18.0%	17.7%	(0.3%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	7.5%	7.2%	(0.3%)
Total Capital/Total Risk Weighted Assets	18.0%	17.8%	(0.2%)
Minimum Statutory ratio	14.5%	14.5%	
Excess	3.5%	3.3%	(0.2%)
Liquidity Ratio	63.0%	53.1%	(9.9%)
Minimum Statutory ratio	20.0%	20.0%	
Excess	43.0%	33.1%	(9.9%)
Adjusted core capital/ total deposit liabilities	16.0%	16.8%	0.8%

Adjusted core capital/ total risk weighted assets	18.6%	17.7%	(0.9%)
Adjusted total capital/ total risk weighted assets	18.6%	17.8%	(0.8%)

Income Statement

- Core earnings per share rose by 48.5% to Kshs 3.1, from Kshs 2.1 in Q1'2022, lower than our projected growth to Kshs 3.4 in Q1'2023, with the variance stemming from the lenders' 18.2% growth in total operating income to Kshs 15.5 bn, from Kshs 13.1 bn in Q1'2022 which was in contrast to our projection of an increase to Kshs 21.3 bn. The lender's growth in total operating income was driven by 18.0% growth in Net Interest Income to Kshs 8.4 bn, from Kshs 7.1 bn in Q1'2022, coupled with an 18.5% increase in Non-Funded Income to Kshs 7.2 bn, from Kshs 6.1 bn in Q1'2022. However, the overall performance was weighed down by a 12.8% growth in total operating expenses to Kshs 9.2 bn, from Kshs 8.1 bn in Q1'2022,
- Interest income grew by 21.0% to Kshs 14.7 bn, from Kshs 12.2 bn in Q1'2022, mainly driven by a 24.3% growth in interest on loans and advances to Kshs 7.8 bn, from Kshs 6.3 bn in Q1'2022, coupled with 14.8% growth in interest income from government securities to Kshs 6.6 bn from Kshs 5.8 bn in Q1'2022. As such, the Yield on Interest-Earning Assets (YIEA) increased to 10.4% from 9.8% recorded in Q1'2022, mainly attributable to the faster 15.3% growth in trailing interest income compared to a 7.7% increase in average interest earning assets to Kshs 530.6 bn, from Kshs 485.0 bn in Q1'2022,
- Interest expenses rose by 25.2% to Kshs 6.3 bn, from Kshs 5.1 bn in Q1'2022, driven by 22.8% increase in interest expense on customer deposits to Kshs 5.9 bn, from Kshs 4.8 bn in Q1'2022, coupled with a 378.5% increase in interest expense from deposits and placements to Kshs 0.2 bn in Q1'2023, from Kshs 0.1 bn recorded in Q1'2022. Consequently, Cost of funds (COF) increased by 0.3% points to 4.6%, from 4.3% recorded in Q1'2022, owing to a faster 14.2% increase in Trailing interest expense to Kshs 23.0 bn, from Kshs 20.1 bn recorded in Q1'2022, compared to a 6.5% increase in average interest bearing liabilities to Kshs 497.1 bn from Kshs 466.6 bn in Q1'2022. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) increased by 0.3% points to 6.0% from 5.7% in Q1'2022, attributable to a 16.0% increase in trailing net interest income to Kshs 32.0 bn, from Kshs 27.5 bn recorded in Q1'2022 which outpaced the 7.7% growth in average interest earning assets,
- Non-Funded Income (NFI) increased by 18.5% to Kshs 7.2 bn, from Kshs 6.1 bn in Q1'2022, mainly driven by a 63.8% increase in the foreign exchange trading income to Kshs 2.7 bn, from Kshs 1.6 bn in Q1'2022, highlighting the group's increased foreign exchange margins. Total fees and commissions increase by 9.1% to Kshs 4.0 bn, from Kshs 3.7 bn in Q1'2022. The revenue mix remained unchanged at 54:46 for the funded to Non-funded income owing to the 18.0% growth in Net Interest Income compared to 18.5% growth in the Non-Funded Interest Income,
- Total operating expenses increased by 12.8% to Kshs 9.2 bn, from Kshs 8.1 bn in Q1'2022, driven by 35.2% increase in staff costs to Kshs 2.9 bn, from Kshs 2.2 bn recorded in Q1'2022, and coupled with a 24.7% increase in other expenses to Kshs 4.3 bn from Kshs 3.4 bn in Q1'2022. However, loan loss provisions decreased by 22.6% to Kshs 2.0 bn from Kshs 2.5 bn in Q1'2022 and indication of reduced credit risk in the bank's loan portfolio,
- Cost to Income Ratio (CIR) decreased to 58.9%, from 61.7% in Q1'2022, owing to the 18.2% increase in total operating income, which outpaced the 12.8% increase in total operating expense. Notably, CIR without LLP also declined by 3.8% points to 46.3%, from 42.5% recorded in Q1'2022 an indication of improved efficiency, and,
- Profit before tax increased by 31.9% to Kshs 6.4 bn, from Kshs 4.8 bn in Q1'2022, with effective tax rate decreasing to 20.0% in Q1'2023, from 29.6% in Q1'2022, leading to an 48.5% increase in profit after tax to Kshs 5.1 bn in Q1'2023, from Kshs 3.4 bn in Q1'2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets growing by 7.1% to Kshs 628.8 bn, from Kshs 587.4 bn in Q1'2022, driven by a 17.7% loan book expansion to Kshs 287.2 bn, from Kshs 243.9 bn in Q1'2022, coupled with a 6.4% increase in investment in government securities to Kshs 207.1 bn from Kshs 194.7 bn in Q1'2022,
- Total liabilities rose by 6.7% to Kshs 540.9 bn, from Kshs 507.1 bn in Q1'2022, driven by a 7.3% growth in customer deposits to Kshs 499.7 bn, from Kshs 465.5 bn in Q1'2022, coupled with a 3.4% increase in placements to 9.6 bn, from Kshs 9.2 bn recorded in Q1'2022. With 86 branches countrywide, compared to 104 branches in Q1'2022, deposits per branch increased by 29.8% to Kshs 5.8 bn, from Kshs 4.5 bn in Q1'2022,
- The faster 17.7% growth in loans as compared to the 7.3% growth in deposits led to an increase in the loan to deposits ratio to 57.5%, from 52.4% in Q1'2022,
- The group's Asset Quality improved, with Gross NPL ratio decreasing to 12.8% in Q1'2023, from 16.3% in Q1'2022, attributable to 11.9% decrease in Gross non-performing loans to Kshs 39.7 bn, from Kshs 45.1 bn in Q1'2022, coupled with 12.0% increase in gross loans to Kshs 309.7 bn, from Kshs 276.7 bn recorded in Q1'2022,
- General Provisions (LLP) decreased by 40.0% to Kshs 14.5 bn in Q1'2023, from Kshs 24.2 bn in Q1'2022. The NPL coverage decreased to 56.8% in Q1'2023, from 72.6% in Q1'2022, attributable to the 40.0% decrease in provisions coupled with 6.0% decrease in interest in suspense to Kshs 8.1 bn from 8.6 bn in Q1'2022, compared to the 11.9% decrease in Gross Non-Performing loans,
- Shareholders' funds increased by 9.6% to Kshs 87.9 bn in Q1'2023, from Kshs 80.2 bn in Q1'2022, supported by a 17.6% increase in retained earnings to Kshs 56.3 bn, from Kshs 47.9 bn in Q1'2022,
- NCBA Group remains capitalized with a core capital to risk-weighted assets ratio of 17.7%, 7.2% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 17.8%, exceeding the statutory requirement of 14.5% by 3.3% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 17.7%, while total capital to risk-weighted assets came in at 17.8%, and,
- The group currently has a Return on Average Assets (ROaA) of 2.5%, and a Return on Average Equity (ROaE) of 18.4%.

Key Take-Outs:

1. **Strong earnings growth** – Strong earnings growth - Core earnings per share rose by 48.5% to Kshs 3.1, from Kshs 2.1 in Q1'2022, driven by 18.2% growth in total operating income to Kshs 15.5 bn from Kshs 13.1 bn in Q1'2022. The lender's growth in total operating income was driven by 18.0% growth in Net Interest Income to Kshs 8.4 bn, from Kshs 7.1 bn in Q1'2022, coupled with an 18.5% increase in Non-Funded Income to Kshs 7.2 bn from Kshs 6.1 bn in Q1'2022,
2. **Improved Asset Quality** – The Group's Asset Quality improved, with Gross NPL ratio declining to 12.8% in Q1'2023, from 16.3% in Q1'2022. This was mainly attributable to 11.9% decrease in Gross non-performing loans to Kshs 39.7 bn, from Kshs 45.1 bn in Q1'2022, coupled with 12.0% increase in gross loans to Kshs 309.7 bn, from Kshs 276.7 bn recorded in Q1'2022, and,
3. **Aggressive lending** – The Group's increased its lending in Q1'2023 with the loan book recording a 17.7% increase to Kshs 287.2 bn, from Kshs 243.9 bn in Q1'2022, highlighting the Group's aggressive lending despite the tough operating business. Consequently, the loan to deposit ratio increased by 5.1% to 57.1% from 52.4% in Q1'2022.

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

- **Digital transformation.** The group has continued to embrace digital lending and currently controls the largest share in digital lending market in Kenya. The bank boost of the popular mobile lending and credit products Mshwari and Fuliza. During the release of its previous year financial results, the lender disclosed plans to expand into eight African markets using the mobile and digital banking platforms. We therefore expect that the move will have be a key driver to its interest income.

Valuation Summary

- We are of the view that NCBA Group is a “buy” with a target price of Kshs 49.2 representing an upside of 54.4%, from the current price of 34.6 as of 26th May 2023, inclusive of a dividend yield of 12.3%.
- NCBA Group is currently trading at a P/TBV of 0.7x and a P/E of 4.1x vs an industry average of 0.7x and 3.3x respectively.