KCB Group Plc – FY’2021
18th March, 2022

Below is a summary of KCB Group’s FY’2021 performance:

Balance Sheet Items	FY'2020	FY'2021	y/y change
Net Loans and Advances	595.3	675.5	13.5%
Government Securities	208.8	270.8	29.7%
Total Assets	**987.8**	**1,139.7**	**15.4%**
Customer Deposits	767.2	837.1	9.1%
Total Liabilities	845.4	966.2	14.3%
Shareholders’ Funds	**142.4**	**171.7**	**20.6%**

Balance Sheet Ratios	FY'2020	FY'2021	% point change
Loan to Deposit Ratio	77.6%	80.7%	3.1%
Return on average equity	14.4%	21.8%	7.4%
Return on average assets	2.1%	3.2%	1.1%

Income Statement	FY'2020	FY'2021	y/y change
Net Interest Income	67.9	77.7	14.4%
Net non-Interest Income	28.5	30.9	8.8%
Total Operating income	**96.4**	**108.6**	**12.7%**
Loan Loss provision	(27.5)	(13.0)	(52.8%)
Total Operating expenses	(70.7)	(60.8)	(13.9%)
Profit before tax	25.7	47.8	85.9%
Profit after tax	**19.6**	**34.2**	**74.3%**
Core EPS	**6.10**	**10.63**	**74.3%**

Income Statement Ratios	FY'2020	FY'2021	% point change
Yield from interest-earning assets	11.1%	11.1%	0.0%
Cost of funding	2.7%	2.8%	0.1%
Net Interest Spread	8.4%	8.3%	(0.1%)
Net Interest Margin	8.5%	8.4%	(0.1%)
Cost of Risk	28.5%	12.0%	(16.5%)
Net Interest Income as % of operating income	70.5%	71.5%	1.0%
Non-Funded Income as a % of operating income	29.5%	28.5%	(1.0%)
Cost to Income Ratio	73.3%	56.0%	(17.3%)

Capital Adequacy Ratios	FY'2020	FY'2021	% points change
Core Capital/Total Liabilities	18.7%	18.7%	0.0%
Minimum Statutory ratio	8.0%	8.0%	
Excess	**10.7%**	**10.7%**	**0.0%**
Core Capital/Total Risk Weighted Assets	18.2%	18.0%	(0.2%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**7.7%**	**7.5%**	**(0.2%)**
Total Capital/Total Risk Weighted Assets	21.6%	22.1%	0.5%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**7.1%**	**7.6%**	**0.5%**
Liquidity Ratio	36.1%	39.1%	3.0%
Minimum Statutory ratio	20.0%	20.0%	
Excess	**16.1%**	**19.1%**	**3.0%**
Adjusted core capital/ total deposit liabilities	18.9%	18.8%	(0.1%)
Adjusted core capital/ total risk weighted assets	18.4%	18.1%	(0.3%)
Adjusted total capital/ total risk weighted assets	21.8%	20.3%	(1.5%)

Key Highlights FY’2021

- On 5th May 2021, KCB Group disclosed that it received regulatory approval to increase their acquisition 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),
- On 25th August 2021, KCB Group disclosed that it had completed the acquisition of Banque De Populaire du Rwanda (BPR) in Rwanda and planed to increase its stake in the bank to up to 100.0% from 76.0% 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 more information on the acquisition, see our Cytonn Weekly #29/2021, and,
- On 2nd December 2021, KCB announced the termination of their initial plans to acquire a 100.0% stake in African Banking Corporation Limited (ABC Tanzania) following the failure to receive certain regulatory approvals. In November 2020, KCB Group and Atlas Mara Limited came to an agreement for KCB to acquire a 62.1% stake in Banque Populaire Du Rwanda (BPR) and a 100.0% stake in Africa Banking Corporation Tanzania Limited (BancABC), subject to shareholder and regulatory approval in the respective countries. The transaction would have seen KCB spend collectively USD 56.9 mn (Kshs 6.4 bn) in the acquisition of Banque Populaire du Rwanda Plc (BPR) Rwanda and African Banking Corporation (ABC) Tanzania. However, despite the cancellation of the acquisition plans, KCB has assured its shareholders that it will continue pursuing attractive regional expansion opportunities to enhance their regional participation and accelerate growth. For more information on, see our Cytonn Monthly – November.

Income Statement

- Core earnings per share rose by 74.3% to Kshs 10.6, from Kshs 6.1 in FY'2020, lower than our expectations of a 92.5% increase to Kshs 11.7, with the variance stemming from the 12.7% increase in total operating income, which was lower than our projection of a 16.0% increase. The performance was driven by the 12.7% growth in total operating income to Kshs 108.6 bn, from Kshs 96.4 bn in FY'2020, and a 13.9% decline in total operating expenses to Kshs 60.8 bn, from Kshs 70.7 bn in FY'2020. Notably, Loan Loss Provisions declined by 52.8% to Kshs 13.0 bn, from Kshs 27.5 bn in FY'2020 attributable to the declining credit risk in the market on the back of increased business activities in 2021 driven by the gradual economic recovery,
- Total operating income increased by 12.7% to Kshs 108.6 bn, from Kshs 96.4 bn in FY'2020, driven by a 14.4% increase in Net Interest Income (NII) to Kshs 77.7 bn, from Kshs 67.9 bn in FY'2020, coupled with an 8.8% increase in Non-Funded Income (NFI) to Kshs 30.9 bn, from Kshs 28.5 bn in FY'2020,
- Interest income grew by 15.1% to Kshs 102.2 bn, from Kshs 88.7 bn in FY'2020, mainly driven by a 14.2% increase in interest income from loans and advances, which increased to Kshs 74.0 bn, from Kshs 64.8 bn in FY'2020, coupled with a 14.5% increase in interest income from government securities which increased to Kshs 26.5 bn, from Kshs 23.2 bn in FY'2020. The Yield on Interest-Earning Assets (YIEA) rose marginally by 0.02% points to 11.11%, from 11.09% recorded in FY'2020, attributable to the faster 15.1% growth in trailling interest income which slightly outpaced the 14.9% growth in Average Interest Earning Assets (AIEA). Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense rose by 17.6% to Kshs 24.5 bn, from Kshs 20.8 bn in FY'2020, following a 76.6% rise in Interest expense on deposits and placements to Kshs 3.4 bn, from Kshs 2.0 bn in FY'2020, coupled with an 8.7% increase in interest expense on customer deposits to Kshs 20.5 bn, from Kshs 18.9 bn in FY'2020. Consequently, Cost of funds (COF) increased marginally by 0.1% points to 2.8%, from 2.7% recorded in FY'2020, following a faster 17.6% increase in Trailing interest expense, which outpaced the 12.3% increase in average interest bearing liabilities. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) therefore declined to 8.4%, from 8.5% in FY'2020 due to the faster 14.9% growth in average interest-earning assets, which outpaced the 14.4% increase in trailing Net Interest Income,
- Non-Funded Income (NFI) increased by 8.8% to Kshs 30.9 bn, from Kshs 28.5 bn in FY'2020, driven by a 21.5% increase in the group's foreign exchange trading income to Kshs 6.5 bn, from Kshs 5.4 bn in FY'2020, coupled with a 17.5% increase in income from fees and commissions on loans and advances to Kshs 8.8 bn, from Kshs 7.5

bn in FY'2020. Notably, total fees and commissions increased by 9.0% to Kshs 19.4 bn, from the Kshs 17.8 bn recorded in FY'2020, attributable to the expiry of the waiver on charging fees and commissions on transactions on 31st December 2020. The revenue mix shifted to 72:28 from 70:30 funded to non-funded income, owing to the faster 14.4% growth in NII compared to the 8.8% increase in NFI,

- Total operating expenses decreased by 13.9% to Kshs 60.8 bn, from Kshs 70.7 bn in FY'2020, largely driven by a 52.8% decline in Loan Loss Provisions (LLP) to Kshs 13.0 bn, from Kshs 27.5 bn in FY'2020. The reduced provisioning level was due to declining credit risk on the back of increased business activities in 2021 driven by the gradual economic recovery. Staff costs increased by 20.9% to Kshs 24.7 bn, from Kshs 20.5 bn in FY'2020,
- Cost to Income Ratio (CIR) improved to 56.0%, from 73.3% in FY'2020, owing to the 13.9% decline in total operating expenses to Kshs 60.8 bn, from Kshs 70.7 bn in FY'2020, coupled with the 12.7% increase in total operating income to Kshs 108.6 bn, from Kshs 96.4 bn in FY'2020. Without LLP, Cost to Income ratio also improved to 44.0% from 44.8% in FY'2020, an indication of improving efficiency,
- Profit before tax increased by 85.9% to Kshs 47.8 bn, from Kshs 25.7 bn in FY'2020 due to the 12.7% increase in total operating income to Kshs 108.6 bn, from Kshs 96.4 bn in FY'2020. Profit after tax increased by 74.3% to Kshs 34.2 bn in FY'2021, from Kshs 19.6 bn in FY'2020, with the effective tax rate increasing to 28.5%, from 23.8% in FY'2020, and,
- The Board of Directors recommended a final dividend per share of Kshs 2.0, subject to shareholders' approval, having paid an interim dividend of Kshs 1.0 per ordinary share, with the total dividend per share for FY'2021 coming in at Kshs 3.0 per share and amounting to Kshs 9.6 bn. At the current price of Kshs 44.6, this translates to a dividend yield of 6.7%. The final dividend will be payable to shareholders in the share register as at book closure on 25th April 2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 15.4% to Kshs 1,139.7 bn, from Kshs 987.8 bn in FY'2020. The growth was supported by a 13.5% loan book expansion to Kshs 675.5 bn, from Kshs 595.3 bn in FY'2020, coupled with a 29.7% increase in government securities to Kshs 270.8 bn, from Kshs 208.8 bn in FY'2020. The significant expansion in the balance sheet is also partly attributable to the acquisition of Banque Populaire du Rwanda (BPR) in August 2021. BPR Rwanda contributed Kshs 48.0 bn worth of assets in FY'2021 to the Group,
- Total liabilities rose by 14.3% to Kshs 966.2 bn, from Kshs 845.4 bn in FY'2020, driven by a 125.3% increase in placements due to other banking instituitions to Kshs 44.3 bn, from Kshs 19.7 bn in FY'2020. Customer deposits increased as well by 9.1% to Kshs 837.1 bn, from Kshs 767.2 bn, with customer deposits from NBK amounting to Kshs 106.1 bn in FY'2021. Deposits per branch decreased by 20.4% to Kshs 1.7 bn, from Kshs 2.1 bn in FY'2020, with the number of branches increasing to 492, from 359 in FY'2020. The group acquired 137 branches in Rwanda following the acquisition of BPR Rwanda during the period in addition to opening 1 branch in South Sudan. The group however closed 5 branches in Kenya during the period,
- The faster 13.5% growth in loans as compared to the 9.1% growth in deposits led to an increase in the loan to deposit ratio to 80.7%, from 77.6% in FY'2020,
- Gross non-performing loans increased by 27.2% to Kshs 122.9 bn, from Kshs 96.6 bn in FY'2020. The group's Asset Quality therefore deteriorated, with the NPL ratio increasing to 16.6% in FY'2021, from 14.8% in FY'2020, attributable to the faster 27.2% growth in Non-Performing loans, which outpaced the 13.5% growth in loans. The deterioration in asset quality was mainly attributable to increased defaults from manufacturing, building and construction and hospitality sectors. Broken down by segment, the rise in gross non-performing loans was attributable to the poor performance from the corporate, mortgage, MSME and Check-Off loans segments which recorded NPL ratios of 18.9%, 11.6%, 8.5% and 2.3%, respectively,
- Loan Loss Provisions (LLP) decreased by 52.8% y/y to Kshs 13.0 bn in FY'2021, from Kshs 27.5 bn in FY'2020. The NPL coverage decreased to 52.9% in FY'2021, from 59.8% in FY'2020, attributable to the faster 27.2% growth in Gross non-performing loans, which outpaced the 13.9% growth in general Loan Loss Provisions,
- Shareholders' funds increased by 20.6% to Kshs 171.7 bn in FY'2021, from Kshs 142.4 bn in FY'2020, supported by a 16.6% increase in retained earnings to Kshs 131.6 bn, from Kshs 112.8 bn in FY'2020,

- KCB Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 18.0%, 10.7% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 22.1%, exceeding the statutory requirement by 7.6% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 18.1%, while total capital to risk-weighted assets came in at 20.3%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.2%, and a Return on Average Equity (ROaE) of 21.8%.

Key Take-Outs:

1. The Group's geographical diversification strategy has continued to emerge as a net positive, with the bank's various subsidiaries in Rwanda, South Sudan, Tanzania, Burundi and Uganda cumulatively contributing 13.7% to the bank's Profit Before Tax (PBT) and 27.5% to the group's total asset base. Notably, NBK recorded a PBT growth of 343.7% to Kshs 1.4 bn, from Kshs 0.3 bn in FY'2020, while KCB Rwanda recorded a PBT increase of 71.0% to Kshs 1.1 bn from Kshs 0.6 bn in FY'2020. KCB Tanzania also recorded a siginificant PBT growth, rising by 117.2% to Kshs 1.1 bn from Kshs 0.5 bn in FY'2020. Of the group's regional subsidiaries, only KCB Uganda recorded a decline, with its PBT declining by 33.0% to Kshs 0.4 bn from Kshs 0.5 bn recorded in FY'2020,
2. The group's asset quality deteriorated, with the NPL ratio increasing to 16.6% in FY'2021, from 14.8% in FY'2020. Key to note, KCB's NPL ratio of 16.6% is 3.5% points above the industry average of 13.1% as at December 2021. The performance of non-performing loans was mainly attributable to the poor performance from the corporate segment, mortgage segment, MSME segment, and Check-Off loans which recorded NPL ratios of 18.9%, 11.6%, 8.5% and 2.3%, respectively. Additionally, the group's asset quality was weighed down by the high NPL ratios of NBK and KCB South Sudan which recorded NPL ratios of 31.6% and 29.6%, respectively. Key to note, NBK's asset quality recorded an improvement y/y, with the NPL ratio declining to 29.6% from 37.2% in FY'2020. On a q/q basis, KCB's Asset quality deteriorated by 2.8% points to 16.6%, from 13.7% recorded in Q3'2021, attributable to increased defaults from manufacturing, building and construction and hospitality sectors. The NPL coverage, on the other hand, decreased to 52.9% in FY'2021 from 59.8% in FY'2020, attributable to the faster 27.2% growth in Gross non-performing loans, which outpaced the 13.9% growth in general Loan Loss Provisions. With the slow recovery in some sectors locally and the high NPL ratios in some of the group's subsidiaries, we expected the group to provision more to cater for the prevailing credit risk,
3. There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 44.0% from 44.8% in FY'2020, an indication of improving efficiency. Key to note, the cost to income ratio deteriorated by 0.5% points on a q/q basis to 44.0% from 43.5% recorded in Q3'2021,
4. The group has leveraged on digital innovation which was necessitated by the onset of COVID-19 in the country. In FY'2021, the value transacted through digital channels recorded a 21.0 y/y growth to Kshs 4.1 bn. Despite the increase in the value of mobile money transactions, revenue from digital channels recorded a 5.9% decline to Kshs 9.0 bn, from Kshs 9.6 bn recorded in FY'2020 attributable to the waiver of fees on mobile money transactions in the period, and,
5. The deterioration in asset quality led the group to shy away from lending in FY'2021, as evidenced by the faster 29.7% growth in government securities to Kshs 270.8 bn, from Kshs 208.8 bn in FY'2020, which outpaced the 13.5% loan book expansion to Kshs 675.5 bn, from Kshs 595.3 bn in FY'2020,

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

I. Geographical Diversification – The bank has been aggressively expanding in the region, as evidenced by the completion of the acquisition of Banque De Populaire du Rwanda (BPR) in Rwanda. Although KCB cancelled its plans to acquire African Banking Corporation Tanzania Limited (BancABC), the lender disclosed that it will explore other expansion opportunities in order to enhance its regional participation and accelerate growth. 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 an **"ACCUMULATE"** with a target price of Kshs 50.5, representing an upside of 19.9%, from the current price of Kshs 44.6 as of 18th March 2022, inclusive of a dividend yield of 6.7%,
- KCB Group is currently trading at a P/TBV of 0.9x and a P/E of 4.2x vs an industry average of 1.1x and 5.7x, respectively.