Below is a summary of KCB Group’s Q1’2023 performance:

Balance Sheet Items	Q1’2022	Q1’2023	y/y change
Net Loans and Advances	704.4	928.8	31.9%
Government Securities	240.6	252.1	4.8%
Total Assets	**1,166.9**	**1,630.6**	**39.7%**
Customer Deposits	845.8	1,196.6	41.5%
Deposit per Branch	1.7	2.0	15.6%
Total Liabilities	**983.2**	**1,415.8**	**44.0%**
Shareholders’ Funds	**181.8**	**208.1**	**14.5%**

Balance Sheet Ratios	Q1’2022	Q1’2023	% y/y change
Loan to Deposit Ratio	83.3%	77.6%	(5.7%)
Return on average equity	22.9%	20.9%	(2.0%)
Return on average assets	3.5%	2.9%	(0.6%)

Income Statement	Q1’2022	Q1’2023	y/y change
Net Interest Income	19.7	22.1	11.8%
Net non-Interest Income	9.3	14.8	59.2%
Total Operating income	**29.0**	**36.9**	**26.9%**
Loan Loss provision	(2.1)	(4.1)	98.4%
Total Operating expenses	(15.0)	(23.0)	53.3%
Profit before tax	14.0	13.9	(1.3%)
Profit after tax	**9.9**	**9.8**	**(1.0%)**
Core EPS	**3.07**	**3.0**	**(1.0%)**

Income Statement Ratios	Q1’2022	Q1’2023	y/y change
Yield from interest-earning assets	11.4%	10.2%	(1.2%)
Cost of funding	3.0%	3.2%	0.2%
Net Interest Spread	8.4%	7.1%	(1.3%)
Net Interest Margin	8.6%	7.3%	(1.3%)
Cost of Risk	7.1%	11.2%	4.1%
Net Interest Income as % of operating income	68.0%	59.9%	(8.1%)
Non-Funded Income as a % of operating income	32.0%	40.1%	8.1%
Cost to Income Ratio	51.7%	62.4%	10.7%

Capital Adequacy Ratios	Q1’2022	Q1’2023	% points change
Core Capital/Total Liabilities	19.7%	15.0%	(4.7%)
Minimum Statutory ratio	8.0%	8.0%	
Excess	**11.7%**	**7.0%**	**(4.7%)**
Core Capital/Total Risk Weighted Assets	19.2%	13.6%	(5.6%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**8.7%**	**3.1%**	**(5.6%)**
Total Capital/Total Risk Weighted Assets	22.8%	17.0%	(5.8%)
Minimum Statutory ratio	14.5%	14.5%	
Excess	**8.3%**	**2.5%**	**(5.8%)**
Liquidity Ratio	36.9%	43.7%	6.8%
Minimum Statutory ratio	20.0%	20.0%	
Excess	**16.9%**	43.7%	6.8%
Adjusted core capital/ total deposit liabilities	19.7%	15.0%	(4.7%)
Adjusted core capital/ total risk weighted assets	19.3%	13.6%	(5.7%)
Adjusted total capital/ total risk weighted assets	22.9%	17.0%	(5.9%)

Income Statement

- Core earnings per share declined by 0.1% to Kshs 3.03 from Kshs 3.07 in Q1’2022, lower than our expectations of a 10.1% increase to Kshs 10.9, with the variance stemming from the 53.3% increase in total operating expenses, which was higher than our projection of a 35.8% increase. The performance was weighed down by the 53.3% growth in total operating expense to Kshs 23.0 bn, from Kshs 15.0 bn in Q1’2022, which outpaced the 26.9% growth in total operating Income to Kshs 36.9 bn, from Kshs 29.0 bn in Q1’2022,
- Total operating income increased by 26.9% to Kshs 36.9 bn, from Kshs 29.0 bn in Q1’2022, driven by an 11.8% increase in Net Interest Income (NII) to Kshs 22.1 bn, from Kshs 19.7 bn in Q1’2022, coupled with a 59.2% increase in Non-Funded Income (NFI) to Kshs 14.8 bn, from Kshs 9.3 bn in Q1’2022,
- Interest income grew by 26.2% to Kshs 33.6 bn, from Kshs 26.6 bn in Q1’2022, mainly driven by a 31.4% increase in interest income from loans and advances to Kshs 24.7 bn, from Kshs 18.8 bn in Q1’2022, coupled with a 14.6% increase in interest income from government securities to Kshs 8.8 bn, from Kshs 7.7 bn in Q1’2022. However, the Yield on Interest-Earning Assets (YIEA) declined by 1.2% points to 10.2%, from 11.4% in Q1’2022 attributable to the faster 30.4% growth in Average Interest Earning Assets (AIEA) following the acquisition of TMB Bank in DRC which outpaced the 16.8% growth in trailing interest income with the group yet to optimize the TMB Balance sheet. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expenses rose by 67.7% to Kshs 11.6 bn, from Kshs 6.9 bn in Q1’2022, following a 36.1% increase in interest expense on customer deposits to Kshs 7.8 bn, from Kshs 5.7 bn in Q1’2022, coupled with a 249.4% increase in Interest expense on deposits and placements to Kshs 3.7 bn, from Kshs 1.0 bn in Q1’2022. Consequently, the Cost of funds (COF) increased slightly by 0.2% points to 3.2%, from 3.0% recorded in Q1’2022, following a faster 37.0% increase in Trailing interest expense, which outpaced the 29.4% 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) declined to 7.3%, from 8.6% in Q1’2022 due to the faster 30.4% increase in average interest-earning assets, compared to the 10.2% growth in trailing Net Interest Income,
- Non-Funded Income (NFI) increased by 59.2% to Kshs 14.8 bn, from Kshs 9.3 bn in Q1’2022, driven by a significant 111.4% increase in the group’s other fees and commissions income to Kshs 7.1 bn, from Kshs 3.3 bn in Q1’2022 coupled with a 52.1% increase in foreign exchange trading income to Kshs 2.6 bn, from Kshs 1.7 bn in Q1’2022, highlighting the group’s increased foreign exchange margins. Other income also increased by 43.8% to Kshs 2.3 bn from Kshs 1.6 bn in Q1’2022. As such, the total fees and commissions increased by 65.5% to Kshs 9.8 bn, from the Kshs 5.9 bn recorded in Q1’2022. The revenue mix shifted to 60:40 from 68:32 funded to non-funded income, owing to the faster 59.2% growth in NFI compared to the 11.8% increase in NII,
- Total operating expenses increased by 53.3% to Kshs 23.0 bn, from Kshs 15.0 bn in Q1’2022, largely driven by a 53.4% increase in other operating expenses to Kshs 9.5 bn, from Kshs 6.2 bn in Q1’2022 coupled with a 39.3% increase in staff costs to Kshs 9.4 bn from Kshs 6.7 bn in Q1’2022. Loan Loss Provisions (LLP) also increased significantly by 98.4% to Kshs 4.1 bn, from Kshs 2.1bn in Q1’2022, an indication of increased provisioning by the Group,
- Cost to Income Ratio (CIR) deteriorated to 62.4% from 51.7% in Q1’2022, owing to the 53.3% increase in total operating expense, which outpaced the 26.9% increase in total operating income. Without LLP, Cost to Income ratio also deteriorated to 51.2% from 44.5% in Q1’2022, an indication of reduced efficiency, and,
- Profit before tax decreased by 1.3% to Kshs 13.9 bn, from Kshs 14.0 bn in Q1’2022, with the effective tax rate decreasing slightly to 29.6%, from 29.8% in Q1’2022. Similarly, Profit after tax decreased by 0.1% to Kshs 9.8 bn in Q1’2023, from Kshs 9.9 bn in Q1’2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 39.7% to Kshs 1,630.6 bn, from Kshs 1,166.9 bn in Q1’2022, driven by a 31.9% growth in the loan book to Kshs 928.8 bn, from Kshs 704.4 bn in Q1’2022, coupled with a 4.8% increase in government securities to Kshs 252.1 bn, from Kshs 240.6 bn in Q1’2022. The significant growth in the balance sheet is also attributable to full consolidation of TMB’s balance sheet items,
- Total liabilities rose by 44.0% to Kshs 1,415.8 bn, from Kshs 983.2 bn in Q1’2022, driven by a 41.5% growth in customer deposits to Kshs 1,196.6 bn, from Kshs 845.8 bn, with customer deposits from NBK amounting to Kshs 99.8 bn in Q1’2022. Placements due to other banking instituitions also increased by 34.7% to Kshs 61.0 bn, from Kshs 45.3 bn in Q1’2022. Deposits per branch increased by 15.6% to Kshs 2.0 bn, from Kshs 1.7 bn in Q1’2022, with the number of branches increasing to 607, from 496 in Q1’2022. This comes after KCB acquired TMB Bank with 105 branches,
- The faster 41.5% growth in deposits as compared to the 31.9% growth in loans led to a decline in the loan to deposits ratio to 77.6%, from 83.3% in Q1’2022,
- Gross non-performing loans increased by 34.8% to Kshs 176.5 bn, from Kshs 130.9 bn in Q1’2022, while Gross loans increased by 33.2% to Kshs1029.9 bn, from Kshs 773.3 bn. Consequently, the group’s Asset Quality deteriorated, with the NPL ratio slightly increasing to 17.1% in Q1’2023, from 16.9% in Q1’2022, attributable to the faster 34.8% growth in Non-Performing loans, which outpaced the 33.2% growth in gross loans. The increase in NPLs was mainly skewed by KCB-K whose NPL ratio increased by 2.5% points to 19.0% from 16.5% in Q1’2022 attributable to loan stocks from sectors such as building and construction, manufacturing, and Transport and communication during the year. On the other hand, NPL ratio for NBK improved to 2.4% from 32.9% in Q1’2022 as a result of efforts to reduce the non-performing loan stock.
- General Provisions (LLP) increased by 54.6% y/y to Kshs 85.7 bn in Q1’2023, from Kshs 55.4 bn in Q1’2022. Consequently, the NPL coverage Increased to 57.3% in Q1’2023, from 52.7% in Q1’2022, attributable to the 54.6% growth in general Loan Loss Provision which outpaced the 34.8% growth in Gross non-performing loans. In light of the prevailing credit risk and asset quality deterioration, we expect to see robust increase in provisioning going forward,
- Shareholders’ funds increased by 14.5% to Kshs 208.1 bn in Q1’2023, from Kshs 181.8 bn in Q1’2022, supported by an 5.8% increase in retained earnings to Kshs 154.4 bn, from Kshs 146.1 bn in Q1’2022,
- KCB Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 13.6%, 3.1% points above the statutory requirement of 10.5%. In addition, the total capital to risk-weighted assets ratio came in at 17.0%, exceeding the statutory requirement of 14.5% by 2.5% points and registered a decline of 4.6% points compared to 22.8% in Q1’2022. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 13.6% compared to the 19.3% in Q1’2022, while total capital to risk-weighted assets came in at 17.0% compared to 22.9% in Q1’2022. The decline in the Group’s Capital adequacy levels can be linked to the acquisition of TMB Bank, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.9%, and a Return on Average Equity (ROaE) of 20.9%.

Key Take-Outs:

1. **Decline in Earnings -** Core earnings per share declined by 0.1% to Kshs 3.03 from Kshs 3.07 in Q1’2022, mainly as a result of the 53.3% growth in total operating expense to Kshs 23.0 bn, from Kshs 15.0 bn in Q1’2022, which outpaced the 26.9% growth in total operating Income to Kshs 36.9 bn, from Kshs 29.0 bn in Q1’2022
2. **Improved Lending** – The Group’s loan book increased in Q1’2023 as seen by a significant 31.9% growth in loans which outpaced the 4.8% growth in government securities highlighting the Group’s strategy to increase lending while at the same time managing its non performing loan book,
3. **Revenue diversification** – The Group’s non-funded income increased by 59.2% to Kshs 14.8 bn, from Kshs 9.3 bn in Q1’2022, which resulted to a shift in revenue mix to 60:40 from 68:32 funded to non-funded income. This is attributable to a 38.0% increase in non-funded income from digital channels due to increased usage of internet banking, mobile banking and merchant POS terminal, and,

4. **Increased Customer Deposit** – KCB customer deposit increased significantly hitting Kshs 1.2 tn mark for the first time. Customer deposits increased by 41.5% to Kshs 1,196.6 bn from Kshs 845.8 bn in Q1’2022 mainly attributable to the completion of the acquisition of TMB Bank and the organic growth in the existing business.

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

I. **Geographical Expansion and Diversification** – The bank has continoued with its expansion in the region, as evidenced by the completion of the 85.0% acquisition of Trust Merchant Bank (TMB) in DRC in 2022. The acquisition has boosted KCB’s regional presence and participation, as well as accelerated its growth as evidenced by customer deposits hitting a Kshs 1.2 tn mark with 16.0% of the total customer deposit from TMB and a 39.7% growth of assets to Kshs 1.6 tn. Notably, proportion of assets from subsidiaries outside KCB Kenya increased to 38.2% from 26.4% in Q1’2023 with newly acquired TMB contributing 14.0% of the Group’s total assets. Profit Before Tax (PBT) contributions from subsidiaries outside of KCB-K increased to 35.0% from 17.2% in Q1’2022. The Group is also planning on expanding into the Ethiopian market, further expanding its presence in the region and consequently drive growth in the near future, and, ~~.~~

II. **Continued Digitization** - The Group’s profit would also be supported by the continued digitization. As of FY’2022, 99.0% of the transactions were done through the non-branch channels with 61.0% year-on-year increase in number of non-branch transactions to 247.5 mn as the branch transactions increasing marginally by 5.0% to Kshs 2.7 mn. 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 59.2% in Q1’2023 with NFI from digital channels growing by 38.0% 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 49.8, representing an upside of 32.5%, from the current price of Kshs 39.2 as of 26~~7~~th May 2023, inclusive of a dividend yield of 6.4%,
- KCB Group is currently trading at a P/TBV of 0.5x and a P/E of 2.4x vs an industry average of 0.8x and 3.5x, respectively.