KCB Group Plc – Q3'2021
19th November, 2021

Below is a summary of KCB Group's Q3'2021 performance:

Balance Sheet Items	Q3'2020	Q3'2021	y/y change
Net Loans and Advances	577.5	651.8	12.9%
Government Securities	236.2	252.4	6.9%
Total Assets	**972.0**	**1,122.5**	**15.5%**
Customer Deposits	772.7	859.1	11.2%
Total Liabilities	836.1	958.1	14.6%
Shareholders' Funds	**135.9**	**163.0**	**19.9%**

Balance Sheet Ratios	Q3'2020	Q3'2021	% point change
Loan to Deposit Ratio	74.7%	75.9%	1.2%
Return on average equity	13.1%	22.7%	9.6%
Return on average assets	1.9%	3.2%	1.3%

Income Statement	Q3'2020	Q3'2021	y/y change
Net Interest Income	47.9	56.4	17.9%
Net non-Interest Income	21.3	23.5	10.3%
Total Operating income	**69.1**	**79.9**	**15.6%**
Loan Loss provision	(20.0)	(9.3)	(53.4%)
Total Operating expenses	(52.0)	(44.1)	(15.2%)
Profit before tax	17.1	35.8	108.9%
Profit after tax	**10.9**	**25.2**	**131.4%**
Core EPS	**3.39**	**7.84**	**131.4%**

Income Statement Ratios	Q3'2020	Q3'2021	% point change
Yield from interest-earning assets	11.4%	10.9%	(0.5%)
Cost of funding	2.9%	2.6%	(0.3%)
Net Interest Spread	8.8%	8.3%	(0.5%)
Net Interest Margin	8.7%	8.4%	(0.3%)
Cost of Risk	28.9%	11.7%	(17.2%)
Net Interest Income as % of operating income	69.2%	70.6%	1.4%
Non-Funded Income as a % of operating income	30.8%	29.4%	(1.4%)
Cost to Income Ratio	75.2%	55.2%	20.0%

Capital Adequacy Ratios	Q3'2020	Q3'2021	% points change
Core Capital/Total Liabilities	17.3%	17.0%	(0.3%)
Minimum Statutory ratio	8.0%	8.0%	
Excess	**9.3%**	**9.0%**	**(0.3%)**
Core Capital/Total Risk Weighted Assets	17.8%	17.3%	(0.5%)
Minimum Statutory ratio	10.5%	10.5%	
Excess	**7.3%**	**6.8%**	**(0.5%)**
Total Capital/Total Risk Weighted Assets	19.6%	20.6%	1.0%
Minimum Statutory ratio	14.5%	14.5%	
Excess	**5.1%**	**6.1%**	**1.0%**
Liquidity Ratio	38.1%	41.3%	3.2%
Minimum Statutory ratio	20.0%	20.0%	
Excess	**18.1%**	**21.3%**	**3.2%**
Adjusted core capital/ total deposit liabilities	17.5%	17.1%	(0.4%)
Adjusted core capital/ total risk weighted assets	18.0%	17.4%	(0.6%)
Adjusted total capital/ total risk weighted assets	19.8%	20.7%	0.9%

Key Highlights Q3'2021

- KCB Group disclosed it had completed the acquisition of Banque De Populaire du Rwanda (BPR) in Rwanda and plans 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 BanABC’s acquisition, KCB will pay to the seller a cash consideration to be determined based on a price to book value ratio using a multiple of 0.4x of the net asset value of BancABC at completion. For more information on the acquisition, see our Cytonn Weekly #29/2021.

Income Statement

- Core earnings per share rose by 131.4% to Kshs 7.8, from Kshs 3.4 in Q3’2020, in line with our projections of a 130.6% increase to Kshs 7.8. The performance was driven by a 15.6% growth in total operating income to Kshs 79.9 bn, from Kshs 69.1 bn in Q3’2020, and a 15.2% decline in total operating expenses to Kshs 44.1 bn, from Kshs 52.0 bn in Q3’2020. Notably, Loan Loss Provisions declined by 53.4% to Kshs 9.3 bn, from Kshs 20.0 bn in Q3’2020 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 15.6% to Kshs 79.9 bn, from Kshs 69.1 bn in Q3’2020, driven by a 17.9% increase in Net Interest Income (NII) to Kshs 56.4 bn, from Kshs 47.9 bn in Q3’2020, coupled with a 10.3% increase in Non-Funded Income (NFI) to Kshs 23.5 bn, from Kshs 21.3 bn in Q3’2020,
- Interest income grew by 16.2% to Kshs 73.5 bn, from Kshs 63.3 bn in Q3’2020, mainly driven by a 16.8% increase in interest income from loans and advances to Kshs 53.4 bn, from Kshs 45.8 bn in Q3’2020, coupled with a 12.4% increase in interest income from government securities to Kshs 18.9 bn, from Kshs 16.8 bn in Q3’2020. Interest income from deposits and placements with banking institutions also rose, recording a 70.6% increase to Kshs 1.2 bn, from Kshs 0.7 bn in Q3’2020. The Yield on Interest-Earning Assets (YIEA) however declined to 10.9%, from 11.4% recorded in Q3’2020, attributable to the faster 20.4% growth in Average Interest Earning Assets, which outpaced the 14.9% growth in traillling interest income. Trailing Interest Income refers to the performance of the interest income for the past 12 consecutive months,
- Interest expense rose by 10.8% to Kshs 17.1 bn, from Kshs 15.4 bn in Q3’2020, following a 69.1% rise in Interest expense on deposits and placements to Kshs 2.4 bn, from Kshs 1.4 bn in Q3’2020, coupled with a 4.8% increase in interest expense on customer deposits to Kshs 14.7 bn, from Kshs 14.0 bn in Q3’2020. Cost of funds, on the other hand, declined marginally by 0.3% points to 2.6%, from 2.9% recorded in Q3’2020, following a faster 13.4% increase in average interest bearing liabilities, which outpaced the 7.7% increase in trailing interest expense. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Consequently, Net Interest Margin (NIM) declined to 8.4%, from 8.7% in Q3’2020 due to the faster 20.4% growth in average interest-earning assets, which outpaced the 17.1% increase in trailing Net Interest Income,
- Non-Funded Income increased by 10.3% to Kshs 23.5 bn, from Kshs 21.3 bn in Q3’2020, driven by a 35.4% increase in the group’s foreign exchange trading income to Kshs 4.5 bn, from Kshs 3.3 bn in Q3’2020, coupled with a 4.9% increase in income from other fees and commissions to Kshs 7.9 bn, from Kshs 7.5 bn in Q3’2020. The increase in NFI was however weighed down by a 3.0% decline in income from fees and commissions on loans and advances to Kshs 6.6 bn, from Kshs 6.8 bn recorded in Q3’2020. Notably, total fees and commissions increased by 1.2% to Kshs 14.5 bn, from Kshs 14.3 bn recorded in Q3’2020. The revenue mix shifted to 71:29 from 69:31 funded to non-funded income, owing to the faster 17.9% growth in NII compared to the 10.3% increase in NFI,
- Total operating expenses decreased by 15.2% to Kshs 44.1 bn, from Kshs 52.0 bn in Q3’2020, largely driven by a 53.4% decline in Loan Loss Provisions (LLP) to Kshs 9.3 bn, from Kshs 20.0 bn in Q3’2020. The reduced provision 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 22.0% to Kshs 18.6 bn from Kshs 15.2 bn in Q3’2020,
- Cost to Income Ratio (CIR) improved to 55.2%, from 75.2% in Q3’2020, owing to the 15.2% decline in total operating expenses to Kshs 44.1 bn, from Kshs 52.0 bn in Q3’2020, coupled with the 15.6% increase in total

operating income to Kshs 79.9 bn, from Kshs 69.1 bn in Q3'2020. Without LLP, Cost to Income ratio also improved to 43.5% from 46.3% in Q3'2020, an indication of improving efficiency,

- Profit before tax increased by 108.9% to Kshs 35.8 bn from Kshs 17.1 bn in Q3'2020 due to the 15.6% increase in total operating income to Kshs 79.9 bn, from Kshs 69.1 bn in Q3'2020. Profit after tax increased by 131.4% to Kshs 25.2 bn in Q3'2021, from Kshs 10.9 bn in Q3'2020, with the effective tax rate declining to 29.6%, from 36.5% in Q3'2020, and,
- The Board of Directors approved an interim dividend of Kshs 1.0 per ordinary share, which will be paid on or about 14th January 2022 to shareholders in the share register as at book closure on 9th December 2021.

Balance Sheet

- The balance sheet recorded an expansion as total assets grew by 15.5% to Kshs 1,122.5 bn, from Kshs 972.0 bn in Q3'2020. The growth was supported by a 12.9% loan book expansion to Kshs 651.8 bn, from Kshs 577.5 bn in Q3'2020, coupled with a 6.9% increase in government securities to Kshs 252.4 bn, from Kshs 236.2 bn in Q3'2020, 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 45.0 bn worth of assets in Q3'2021 to the Group,
- Total liabilities rose by 14.6% to Kshs 958.1 bn, from Kshs 836.1 bn in Q3'2020, driven by a 60.3% increase in placements due to other banking instituitions to Kshs 26.6 bn, from Kshs 16.6 bn in Q3'2020. Customer deposits increased as well by 11.2% to Kshs 859.1 bn, from Kshs 772.7 bn, with customer deposits from NBK amounting to Kshs 115.4 bn in Q3'2021. Deposits per branch decreased by 18.5% to Kshs 1.8 bn, from Kshs 2.2 bn in Q3'2020, with the number of branches increasing to 491, from 360 in Q3'2020. 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 2 branches in Uganda and 5 branches in Kenya during the period. We expect a further increase in the number of branches with the bank looking to finalize, later in the year, the aqcuisitions of African Banking Corporation Ltd Tanzania (ABC Tanzania),
- The faster 12.9% growth in loans as compared to the 11.2% growth in deposits led to an increase in the loan to deposit ratio to 75.9% from 74.7% in Q3'2020,
- Gross non-performing loans increased by 1.2% to Kshs 98.1 bn, from Kshs 97.0 bn in Q3'2020. The groups Asset Quality improved with the NPL ratio declining to 13.7% in Q3'2021, from 15.3% in Q3'2020, attributable to the faster 12.9% growth in loans, which outpaced the 1.2% growth in Non-Performing Loans. The rise in gross 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 17.9%, 10.7%, 9.1% and 2.8%, respectively,
- Loan Loss Provisions (LLP) decreased by 53.4% y/y to Kshs 9.3 bn in Q3'2021, from Kshs 20.0 bn in Q3'2020. The NPL coverage improved to 63.4% in Q3'2021 from 58.5% in Q3'2020, as general Loan Loss Provisions increased by 14.1% to Kshs 50.1 bn from Kshs 43.9 bn in Q3'2020,
- Shareholders' funds increased by 19.9% to Kshs 163.0 bn in Q3'2021, from Kshs 135.9 bn in Q3'2020, supported by a 22.6% increase in retained earnings to Kshs 132.9 bn, from Kshs 108.5 bn in Q3'2020,
- KCB Group remains sufficiently capitalized with a core capital to risk-weighted assets ratio of 17.3%, 6.8% points above the statutory requirement. In addition, the total capital to risk-weighted assets ratio came in at 20.6%, exceeding the statutory requirement by 6.1% points. Adjusting for IFRS 9, the core capital to risk-weighted assets stood at 17.4%, while total capital to risk-weighted assets came in at 20.7%, and,
- The bank currently has a Return on Average Assets (ROaA) of 3.2%, and a Return on Average Equity (ROaE) of 22.7%.

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 14.4% to the bank's Profit Before Tax (PBT) and 26.4% to the group's total asset base. Notably, NBK recorded a PBT growth of 164.0% to Kshs 1.4 bn from Kshs 0.5 bn in Q3'2020, while KCB Rwanda recorded a PBT increase of 110.0% to

Kshs 0.9 bn from Kshs 0.4 bn in Q3'2020. KCB Tanzania also recorded a siginificant PBT growth, rising by 96.0% to Kshs 0.7 bn from Kshs 0.4 bn in Q3'2020,

2. The group's asset quality improved, with the NPL ratio declining to 13.7% in Q3'2021, from 15.3% in Q3'2020. Key to note, KCB's NPL ratio of 13.7% is 0.1% point above the industry average of 13.6% as at September 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 17.9%, 10.7%, 9.1% and 2.8%, respectively. Additionally, the group's aset quality was weighed down by the high NPL ratios of KCB South Sudan and NBK, which recorded NPL ratios of 42.8% and 35.1%, respectively. Key to note, NBK's asset quality recorded an improvement y/y, with the NPL ratio declining to 35.1% from 41.9% in Q3'2020. On a q/q basis, KCB's Asset quality improved by 0.7% points to 13.7%, from 14.4% recorded in Q2'2021, attributable to declining credit risk on the back of increased business activities in 2021 driven by the gradual economic recovery. The NPL coverage, on the other hand, improved to 63.4% in Q3'2021 from 58.5% in Q3'2020, as general Loan Loss Provisions increased by 14.1% to Kshs 50.1 bn, from Kshs 43.9 bn in Q3'2020,
3. There was an improvement in efficiency levels as the cost to income ratio without LLP improved to 43.5% from 46.3% in Q3'2020, an indication of improving efficiency, and,
4. The group has leveraged on digital innovation which was necessitated by the onset of COVID-19 in the country. In Q3'2021, the value transacted through digital channels recorded a 56.0 y/y growth to Kshs 2.8 bn. Despite the increase in the value of mobile money transactions, revenue from digital channels recorded a 1.9% decline to Kshs 6.6 bn from Kshs 6.7 bn recorded in Q3'2020 attributable to the waiver of fees on mobile money transactions in the period.

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

I. Geographical Diversification – The bank has been aggressively expanding into other regions, namely Tanzania and Rwanda. On this front, the bank is set to acquire 100.0% of the share capital of African Banking Corporation Ltd Tanzania (ABC Tanzania). This will see the bank expand its operations in the Tanzanian and Rwandan Market thus enhancing the diversification of its revenue sources. 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 a "**BUY**" with a target price of Kshs 55.3, representing an upside of 20.5%, from the current price of Kshs 45.9 as of 19th November 2021, inclusive of a dividend yield of 7.6%,
- KCB Group is currently trading at a P/TBV of 0.9x and a P/E of 4.3x vs an industry average of 1.1x and 6.1x, respectively.