

Below is a summary of KCB Group Q3'2023 performance:

Balance Sheet Items (Kshs bn)	Q3'2022	Q3'2023	y/y change
Government Securities	236.8	325.6	37.5%
Net Loans and Advances	758.8	1,047.9	38.1%
Total Assets	1,276.3	2,099.5	64.5%
Customer Deposits	922.3	1,656.4	79.6%
Total Liabilities	1,086.1	1,873.4	72.5%
Shareholders' Funds	187.8	218.8	16.5%

Balance Sheet Ratios	Q3'2022	Q3'2023	% y/y change
Loan to Deposit Ratio	82.3%	63.3%	(19.0%)
Government Securities to Deposit Ratio	25.7%	19.7%	(6.0%)
Return on average equity	22.6%	20.2%	(2.4%)
Return on average assets	3.3%	2.4%	(0.9%)

Income Statement (Kshs bn)	Q3'2022	Q3'2023	y/y change
Net Interest Income	61.6	74.9	21.6%
Net non-Interest Income	30.6	42.4	38.7%
Total Operating income	92.1	117.3	27.3%
Loan Loss provision	(7.3)	(15.8)	118.1%
Total Operating expenses	(48.8)	(76.7)	57.0%
Profit before tax	43.3	40.6	(6.3%)
Profit after tax	30.6	30.7	0.4%
Core EPS (Kshs)	9.52	9.56	0.4%

Income Statement Ratios	Q3'2022	Q3'2023	y/y change
Yield from interest-earning assets	10.9%	10.1%	(0.8%)
Cost of funding	3.0%	3.5%	0.4%
Net Interest Spread	7.9%	6.6%	(1.3%)
Net Interest Margin	8.1%	6.8%	(1.3%)
Cost of Risk	7.9%	13.5%	5.6%
Net Interest Income as % of operating income	66.8%	63.9%	(3.0%)
Non-Funded Income as a % of operating income	33.2%	36.1%	3.0%
Cost to Income Ratio	53.0%	65.4%	12.4%

Capital Adequacy Ratios	Q3'2022	Q3'2023	% points change
Core Capital/Total Liabilities	15.6%	13.0%	(2.6%)
Minimum Statutory ratio	8.0%	8.0%	0.0%
Excess	7.6%	5.0%	(2.6%)
Core Capital/Total Risk Weighted Assets	14.5%	14.5%	0.0%
Minimum Statutory ratio	10.5%	10.5%	0.0%
Excess	4.0%	4.0%	0.0%
Total Capital/Total Risk Weighted Assets	18.1%	17.8%	(0.3%)
Minimum Statutory ratio	14.5%	14.5%	0.0%
Excess	3.6%	3.3%	(0.3%)
Liquidity Ratio	38.5%	50.3%	11.8%
Minimum Statutory ratio	20.0%	20.0%	0.0%
Excess	18.5%	30.3%	11.8%

Income Statement

- Core earnings per share increased marginally by 0.4% to Kshs 9.6, from Kshs 9.5 in Q3'2022, driven by the 27.3% growth in total operating income to Kshs 117.3 bn, from Kshs 92.1 bn in Q3'2022, which outweighed the 57.0% growth in total operating expenses to Kshs 76.7 bn, from kshs 48.8 bn in Q3'2022,
- The 27.3% growth in total operating income was mainly driven by a 21.6% growth in Net Interest Income to Kshs 74.9 bn, from Kshs 61.6 bn in Q3'2022, coupled with a 38.7% growth in Non funded Income (NFI) to Kshs 42.4 bn, from Kshs 30.6 bn in Q3'2022,
- Interest income increased by 36.4% to Kshs 113.9 bn from Kshs 83.5 bn in Q3'2022, mainly driven by a 39.1% growth in interest income from loans and advances to Kshs 81.9 bn from Kshs 58.9 bn in Q3'2022, coupled with a 22.8% increase in interest from government securities to kshs 29.8 bn, from kshs 24.3 bn in Q3'2022. However, the Yield on Interest-Earning Assets (YIEA) declined by 1.3% points to 6.5% from 7.8% recorded in Q3'2022, mainly attributable to the faster 63.0% growth in average interest earning assets to kshs 1,752.6 bn, from kshs 1,074.9 bn in Q3'2022 compared to a 36.4% increase in trailing interest income to Kshs 113.9 bn, from Kshs 83.5 bn in Q3'2022,
- Interest expenses rose by 77.9% to Kshs 39.1 bn, from Kshs 21.9 bn in Q3'2022, driven by 55.6% increase in interest expense on customer deposits to Kshs 27.8 bn, from Kshs 17.8 bn in Q3'2022, coupled with a 193.8% increase in interest expense from deposits and placements to Kshs 11.0 bn in Q3'2023, from Kshs 3.7 bn recorded in Q3'2022. Consequently, Cost of funds (COF) increased by 0.1% points to 2.3% from 2.2% recorded in Q3'2022, owing to a 77.9% increase in Trailing interest expense to Kshs 39.1 bn, from Kshs 21.9 bn recorded in Q3'2022, outpacing the 67.2% increase in average interest bearing liabilities to Kshs 1,674.1 bn from Kshs 1,001.2 bn in Q3'2022. Trailing interest expense refers to the performance of the interest expense for the past 12 consecutive months. Net Interest Margin (NIM) decreased by 1.3% points to 6.8% from 8.1% in Q3'2022, attributable to a 42.9% increase in average interest earning assets to Kshs 1,468.1 bn, from Kshs 1,027.7 bn in Q3'2022 which outpaced the 20.6% growth in trailing net interest income to Kshs 99.9 bn from Kshs 82.9 bn recorded in Q3'2022,
- Non-Funded Income (NFI) increased by 38.7% to Kshs 42.4 bn from Kshs 30.6 bn in Q3'2022, mainly driven by a 118.8% increase in other fees to 20.0 bn from 9.1 bn in Q3'2022, coupled by a 17.4% increase in other non interest income to Kshs 6.1 bn from Kshs 5.2 bn in Q3'2022. However, the growth in NFI was weighed down by the 2.4% decline in foreign exchange income to Kshs 8.2 bn from Kshs 8.4 bn in Q3'2022 pointing to a decline in the bank's foreign exchange margins. The revenue mix shifted to 64:36 from 67:33 for the funded to Non-funded income owing to the 38.7% growth in NFI which outpaced the 21.6% growth in funded income,
- Total operating expenses increased by 57.0% to Kshs 76.7 bn from Kshs 48.8 bn in Q3'2022, driven by 118.1% increase in loan loss provisions to Kshs 15.8 bn from Kshs 7.3 bn recorded in Q3'2022, and coupled with a 25.3% increase in staff costs to Kshs 26.7 bn from Kshs 21.3 bn in Q3'2022. The increase in provisioning is partly attributable to rising credit risk as a result deteriorated economic environment as evidenced by the average Purchasing Managers Index (PMI) of 48.0 in Q3'2023, which was below 50 point, despite the slight improvement from an average of 47.4 in Q3'2022,
- Cost to Income Ratio (CIR) increased to 65.4% from 53.0% in Q3'2022, owing to the 57.0% increase in total operating expense, which outpaced the 27.3% growth in total operating income. Notably, CIR without LLP increased by 6.7% points to 51.9% from 45.1% recorded in Q3'2022, and,
- Profit before tax decreased by 6.3% to Kshs 40.6 bn from Kshs 43.3 bn in Q3'2022, with effective tax rate decreasing to 24.3% in Q3'2023 from 29.3% in Q3'2022. Consequently, profit after tax increased marginally by 0.4% to kshs 30.7 bn, from kshs 30.6 bn in Q3'2022.

Balance Sheet

- The balance sheet recorded an expansion as total assets increased by 64.5% to Kshs 2,099.5 bn, from Kshs 1,276.3 bn in Q3'2022, driven by a 38.1% loan book expansion to Kshs 1,047.9 bn, from Kshs 758.8 bn in Q3'2022, coupled with a 37.5% increase investment in government securities to Kshs 325.6 bn from Kshs 236.8 bn in Q3'2022,

- Total liabilities rose by 72.5% to Kshs 1,873.4 bn from Kshs 1,086.1 bn in Q3'2022, driven by a 79.6% growth in customer deposits to Kshs 1,656.4 bn, from Kshs 922.3 bn in Q3'2022, coupled with a 10.4% increase in placements to 36.1 bn, from Kshs 32.7 bn recorded in Q3'2022,
- The faster 79.6% growth in customer deposits as compared to the 38.1% growth in loans led to a decline in the loan to deposits ratio to 63.3%, from 82.3% in Q3'2022,
- The bank's Asset Quality improved, with Gross NPL ratio decreasing to 16.1% in Q3'2023 from 17.8% in Q3'2022, attributable to 39.0% increase in Gross loans to Kshs 1,164.0 bn, from Kshs 837.7 bn in Q3'2022, which outpaced the 25.3% increase in gross non-performing loans to Kshs 187.0 bn, from Kshs 149.3 bn recorded in Q3'2022,
- General Provisions (LLP) increased by 47.9% to Kshs 96.7 bn in Q3'2023 from Kshs 65.4 bn in Q3'2022. The NPL coverage increased to 62.1% in Q3'2023, from 52.8% in Q3'2022, attributable to the 118.1% growth in loan loss provisions to kshs 15.8 bn, from kshs 7.3 bn in Q3'2022, which outpaced the 25.3% increase in gross non-performing loans to Kshs 187.0 bn from kshs 149.3 bn recorded in Q3'2022.
- Shareholders' funds increased by 16.5% to Kshs 218.8 bn in Q3'2023, from Kshs 187.8 bn in Q3'2022, supported by a 28.6% increase in retained earnings to Kshs 175.5 bn, from Kshs 136.5 bn in Q3'2022,
- KCB Group remained capitalized with a core capital to risk-weighted assets ratio of 14.5%, 4.0% 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, and,
- The bank currently has a Return on Average Assets (ROaA) of 2.4%, and a Return on Average Equity (ROaE) of 20.2%.

Key Take-Outs:

1. **Increase in earnings** - Core earnings per share (EPS) increased marginally by 0.4% to Kshs 9.6, from Kshs 9.5 in Q3'2022, driven by the 27.3% growth in total operating income to Kshs 117.3 bn, from Kshs 92.1 bn in Q3'2022, which outweighed the 57.0% growth in total operating expenses to Kshs 76.7 bn, from kshs 48.8 bn in Q3'2022,
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 47.9% to Kshs 96.7 bn from Kshs 65.4 bn recorded in Q3'2022, and,
3. **Improved Lending** – The Group's loan book increased by 38.1% to kshs 1,047.9 bn, from kshs 758.8 bn in Q3'2022, which slightly outpaced the 37.5% growth in government securities to kshs 325.6 bn, from kshs 236.8 bn in Q3'2022, 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 38.7% to Kshs 42.4bn in Q3'2023, from Kshs 30.6 bn in Q3'2022, which resulted to a shift in revenue mix to to 64:36 from 67:33 for the funded to Non-funded income in Q3'2022 following the 38.7% growth in NFI which outpaced the 21.6% growth in funded income.

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

- **Continued Digitization** - The Group has continued to maximize on digital transformation. 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 38.7% in Q3'2023 to kshs 42.4 bn, from kshs 30.6 bn in Q3'2022, 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 31.4 representing an upside of 57.8%, from the current price of Kshs 19.9, inclusive of a dividend yield of 10.1%.
- KCB Group is currently trading at a P/TBV of 0.3x and a P/E of 1.6x against an industry average of 0.8x and 3.5x respectively.