NCBA Group - H1'2022
26th August 2022

Below is a summary of NCBA Group H1'2022 performance;

Balance Sheet Items	H1'2021	H1'2022	y/y change
Net Loans and Advances	239.6	250.5	4.5%
Government Securities	173.9	203.4	17.0%
Total Assets	**542.6**	**604.3**	**11.4%**
Customer Deposits	437.3	468.5	7.1%
Deposits per Branch	5.6	5.5	(1.1%)
Total Liabilities	468.2	524.0	11.9%
Shareholders' Funds	**74.3**	**80.2**	**8.0%**

Balance Sheet Ratios	H1'2021	H1'2022	% points change
Loan to Deposit Ratio	54.8%	53.5%	(1.3%)
Return on average equity	11.1%	18.2%	7.1%
Return on average assets	1.5%	2.5%	1.0%

Income Statement(Kshs bns)	H1'2021	H1'2022	y/y change
Net Interest Income	13.4	14.8	10.2%
Net non-Interest Income	10.7	14.2	32.5%
Total Operating income	**24.1**	**29.0**	**20.1%**
Loan Loss provision	5.9	5.6	(6.1%)
Total Operating expenses	**16.3**	**17.1**	**4.6%**
Profit before tax	7.4	11.2	50.8%
Profit after tax	**4.7**	**7.8**	**66.9%**
Core EPS	**2.8**	**4.7**	**66.9%**

Income Statement Ratios	H1'2021	H1'2022	y/y change
Yield from interest-earning assets	10.4%	10.3%	(0.1%)
Cost of funding	4.18%	4.33%	0.1%
Net Interest Spread	6.2%	6.0%	(0.2%)
Net Interest Margin	6.2%	6.0%	(0.2%)
Cost of Risk	24.5%	19.2%	(5.4%)
Net Interest Income as % of operating income	55.6%	51.1%	(4.6%)
Non-Funded Income as a % of operating income	44.4%	48.9%	4.6%
Cost to Income Ratio	67.7%	58.9%	(8.7%)
Cost to Income Ratio without LLP	43.1%	39.8%	(3.4%)

Capital Adequacy Ratios	H1'2021	H1'2022	% points change
Core Capital/Total Liabilities	16.8%	17.1%	0.3%
Minimum Statutory ratio	8.0%	8.0%	-
Excess	**8.8%**	**9.1%**	**0.3%**
Core Capital/Total Risk Weighted Assets	19.2%	21.8%	2.6%
Minimum Statutory ratio	10.5%	10.5%	-
Excess	**8.7%**	**11.3%**	**2.6%**
Total Capital/Total Risk Weighted Assets	19.4%	21.8%	2.4%
Minimum Statutory ratio	14.5%	14.5%	-

Excess	**4.9%**	**7.3%**	**2.4%**
Liquidity Ratio Minimum Statutory ratio	60.3% 20.0%	58.0% 20.0%	(2.3%) -
Excess	**40.3%**	**38.0%**	**(2.3%)**
Adjusted Core Capital/Total Liabilities Adjusted Core Capital/Total RWA Adjusted Total Capital/Total RWA	17.0% 19.4% 19.6%	17.7% 19.9% 19.9%	0.7% 0.5% 0.3%

Income Statement

- Core earnings per share rose by 66.9% to Kshs 4.7, from Kshs 2.8 in H1’2021, lower than our expectation of a 38.8% growth, driven by the 20.1% growth in total operating income to Kshs 29.0 bn, from Kshs 24.1 bn in H1’2021. However, the performance was weighed down by the 4.6% increase in total operating expenses to Kshs 17.1 bn, from 16.3 bn in H1’2021,
- Total operating income rose by 20.1% to Kshs 29.0 bn in H1’2022, from Kshs 24.1 bn in H1’2021. This was due to a 32.5% increase in Non-Funded Income (NFI) to Kshs 14.2 bn, from Kshs 10.7 bn recorded in H1’2021 coupled with a 10.2% increase in Net Interest Income (NII) to Kshs 14.8 bn, from the Kshs 13.4 bn recorded in H1’2021,
- Interest income rose by 10.9% to Kshs 24.9 bn, from Kshs 22.5 bn in H1’2021 mainly driven by a 28.1% growth in interest income from government securities to Kshs 11.9 bn, from Kshs 9.3 bn in H1’2021 coupled with a 29.5% increase in interest income from deposits and placements with banking institutions to Kshs 224.3 mn, from 173.2 mn in H1’2021. However, the growth was weighed down by a 1.6% decline in interest income from loans and advances to Kshs 12.8 bn, from Kshs 13.0 bn in H1’2021. Consequently, the yield on interest-earning assets decreased marginally by 0.1% points to 10.3% in H1’2022, from 10.4% in H1’2021, attributable to the faster 6.6% increase in average interest-earning assets to Kshs 474.1 bn, from Kshs 444.6 bn in H1’2021, which outpaced the 6.4% increase in trailing interest income,
- Interest expense increased by 12.0% to Kshs 10.1 bn, from Kshs 9.0 bn in H1’2021, mainly attributable to a 10.6% increase in interest expense on customer deposits to Kshs 9.7 bn, from Kshs 8.8 bn in H1’2021. Cost of funds increased by 0.1% points to 4.3% in H1’2022 from 4.2% in H1’2021 owing to the 12.1% increase in trailing interest expense that outpaced the 5.3% growth in average interest bearing liabilities, an indication that the bank was unable to mobilize cheaper deposits. The Net Interest Margin declined by 0.2% points to 6.0% in H1’2022 from 6.2% recorded in H1’2021, due to the slower 2.5% growth in trailing Net Interest Income, compared to the 6.6% growth seen in the average interest-earning assets,
- Non-Funded Income increased by 32.5% to Kshs 14.2 bn in H1’2022, from Kshs 10.7 bn in H1’2021, driven by a 121.9% increase in foreign exchange trading income to Kshs 5.3 bn, from Kshs 2.4 bn in H1’2021, and a 7.6% increase in income from other fees and commissions to Kshs 1.9 bn, from Kshs 1.8 bn in H1’2021. This was weighed down by a 5.2% decline in fees and commissions on loans and advances to Kshs 5.6 bn, from Kshs 5.9 bn in H1’2021. Total fees and commissions declined by 2.2% to Kshs 7.6 bn, from Kshs 7.7 bn recorded in H1’2021. Consequently, the revenue mix shifted to 51:49 in H1’2022 from 56:44 funded to non-funded income in H1’2021, owing to the faster growth in NFI compared to NII,
- Total operating expenses increased by 4.6% to Kshs 17.1 bn in H1’2022, from Kshs 16.3 bn in H1’2021, largely driven by the 16.2% increase in staff costs to Kshs 4.5 bn, from Kshs 3.9 bn recorded in H1’2021 and an 7.4% increase in other expenses to Kshs 7.0 bn from Kshs 6.5 bn. However, the increase in interest expenses was mitigated by a 6.1% decline in loan loss provision to Kshs 5.6 bn in H1’2022, from Kshs 5.9 bn in H1’2021.
- The cost to income ratio improved to 58.9% from 67.7% in H1’2021 attributable to the 20.1% growth in total operating income to Kshs 29.0 bn, from Kshs 24.1 bn in H1’2021, which outpaced the 4.6%

increase in total operating expenses to Kshs 17.1 bn, from Kshs 16.3 bn in H1’2021. Additionally, without LLP, the cost to income ratio also improved to 39.8% from 43.1% in H1’2021, pointing towards reduced operational costs and improved efficiency levels by the group,

- Profit before tax rose by 50.8% to Kshs 11.2 bn, from Kshs 7.4 bn in H1’2021. Profit after tax also increased by 66.9% to Kshs 7.8 bn from Kshs 4.7 bn in H1’2021 with the effective tax rate decreasing to 30.5% in H1’2022, from 37.2% recorded in H1’2021, and,
- The Board of Directors recommended an interim Dividend Per Share (DPS) of Kshs 2.0, translating to a total dividend payout of Kshs 0.4 bn. At the current price of Kshs 28.6, this translates to a dividend yield of 7.0%.

Balance Sheet

- The balance sheet recorded an expansion with total assets growing by 11.4% to Kshs 604.3 bn in H1’2022, from Kshs 542.6 bn in H1’2021. This growth was largely driven by a 4.5% increase in net loans and advances to Kshs 250.5 bn, from Kshs 239.6 bn in H1’2021 coupled with a 17.0% increase in government securities to Kshs 203.4 bn, from the Kshs 173.9 bn recorded in H1’2021. The subdued growth in the loan book is partly attributable to the bank’s cautious lending owing deteriorating business environment,
- Total liabilities rose by 11.9% to Kshs 524.0 bn in H1’2022, from Kshs 468.2 bn in H1’2021, driven by a 7.1% growth in customer deposits to Kshs 468.5 bn in H1’2022, from Kshs 437.3 bn in H1’2021, coupled with a 254.5% increase in Placements to the Kshs 25.3 bn recorded in H1’2022, from Kshs 7.1 bn in H1’2021. Deposits per branch declined by 1.1% to Kshs 4.5 bn, from Kshs 4.6 bn in H1’2022, with the number of branches increasing by 8 to 104 branches in H1’2022 from 96 branches in H1’2021. In its continued branch expansion strategy, the group plans to open 12 more branches in Kenya,
- The faster 7.1% growth in deposits compared to the 4.5% growth in loans led to a decline in the loan to deposit ratio to 53.5%, from 54.8% in H1’2021,
- Gross non-performing loans (NPLs) declined by 18.1% to Kshs 36.9 bn in H1’2022, from Kshs 45.0 bn in H1’2021 taking the NPL ratio to 13.5% in H1’2022, from 16.7% in H1’2021. The improvement in the group’s asset quality is mainly attributable to the 18.1% decline in NPLs combined with the 1.3% increase in gross loans. Additionally, the General loan loss provisions declined by 37.2% to Kshs 14.5 bn, from Kshs 23.0 bn in H1’2021 compared to an 18.1% decline in gross NPLs. The NPL coverage declined to 62.8% in H1’2022, from 68.0% in H1’2021,
- Shareholders’ funds increased by 8.0% to Kshs 80.2 bn, from Kshs 74.3 bn in H1’2021, mainly supported by a 19.4% increase in the retained earnings to Kshs 52.3 bn from Kshs 43.8 bn in H1’2021,
- NCBA Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 21.8%, 11.3% points above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 21.8%, exceeding the statutory requirement by 7.3% points. Adjusting for IFRS 9, the core capital to risk weighted assets and the total capital to risk weighted assets both came in at 19.9%,
- NCBA Group currently has a return on average assets (ROaA) of 2.5% and a return on average equity (ROaE) of 18.2%.

Key Take-Outs:

i. **Asset quality**: The group’s asset quality improved, as evidenced by the decline in NPL ratio to 13.5%, from 16.7% in H1’2021 driven by the 18.1% decline in NPLs to Kshs 36.9 bn from Kshs 45.0 bn. The improvement in the group’s asset quality is attributable to the 1.3% growth in gross loans coupled with the 18.1% decline in Gross Non-Performing Loans (NPLs). The 1.3% growth in gross loans is as a result of resumption in lending by the bank following an improvement in the business environment. Notably, the NPL ratio increased by 1.3% points from the 14.7% that was recorded in FY’2021. We expect NPLs to continue declining in the short term as the sectors recover in tandem with the economy as a whole. Risks however lie on the downside given the persistent high inflation, high government pending bills and geopolitical risks worsened by the Russian-Ukraine conflict,

ii. **Operating Efficiency** - The bank's operating efficiency improved as evidenced by the decline in cost to income ratio to 58.9%, from 67.7% in H1'2021, which indicates reduced operational costs and improved operational efficiency attributable to faster 20.1% increase in total operating income as compared to the 4.6% increase in the total operating expenses, and,
iii. **Loan Growth** - The group's loan book expanded by 4.5% to Kshs 250.5 bn, in H1'2022 from Kshs 239.6 bn in H1'2021, attributable to the group's increased lending given the decreased NPLs which have seen the group's asset quality improve. The group has also focused more on government securities. As such, the group is expected to improve their operating models for loans in other sectors, as well as improve a workflow management tool to aid credit and commercial units in collaborating more effectively.

Going forward, we expect the bank's growth to be further driven by:

i. **Digitization** – We anticipate the bank to continue with its digitization strategy by delivering ne digital and mobile capabilities to enhance customer experience. This will also diversify the revenue while also strengthening the group's position as a leader in asset finance and corporate banking. These efforts have seen NFI for the group improve by 32.5% to Kshs 14.2 bn in H1'2022. Additionally, the group intends to an employee culture of high performance to optimize financial performance and shareholder returns, and,
ii. **Improving Brand Recognition** – The group intend to improve its brand visibility backed by excellent customer service as it expands its retail banking operations, mainly through the expansion of its branch network to increase customer reach. So far, the group has 84 branches in Kenya, with 12 more expected by the end of 2022, for a total of 91 branches by the end of the financial year as it plans to close 5 branches that are in close proximity.

Valuation Summary

- We are of the view that NCBA Group is an "**Buy**" with a target price of Kshs 30.0, representing an upside of 5.1%, from the current price of Kshs 28.6 as of 26th August 2022,
- NCBA Group is currently trading at P/TBV of 0.6x and a P/E of 3.5x vs an industry average of 0.7x and 4.0x, respectively.