

Valuation Summary

- We are of the view that NIC Group is a “Buy” with a target price of Kshs 30.5, representing an upside of 32.8%, from the current price of Kshs 23.0 as of 27th November 2020,
- NIC Group is currently trading at P/TBV of 0.6x and a P/E of 21.1x vs an industry average of 0.9x and 5.9x, respectively.

Key Highlights Q3'2020

- Since the advent of COVID-19 the bank has so far restructured loans amounting to Kshs 58.0 bn (23.0% of the bank's loan book), to help struggling businesses stay afloat during the current period of uncertainty.

Notably, the financial statements of the bank have been prepared on a prospective basis (assuming a continuation of CBA), representing Q3'2020 results of NCBA bank (merged bank) with prior year comparatives (Q3'2019) being those of CBA bank. Hence, the results are not comparable on a like for like basis. As such we have used proforma combined financials for the two entities.

Income Statement

- Core earnings per share declined by 67.3% to Kshs 1.7 from Kshs 5.1 in Q3'2019 which was not in line with our projections of an 88.9% decline to Kshs 0.6. The variance can be attributed to our expectations of a 17.7% decline in total operating income, which was not in line with the actual growth of 8.4%. The performance can be attributed to the 8.4% increase in total operating income, but was weighed down by the 51.2% growth in total operating expenses,
- Total operating income rose by 8.4% to Kshs 33.1 bn in Q3'2020 from Kshs 30.5 bn in Q3'2019. This was due to an 11.8% increase in Non-Funded Income (NFI) to Kshs 16.1 bn in Q3'2020, from Kshs 14.4 bn recorded the previous year, coupled with a 5.3% increase in Net Interest Income (NII) to Kshs 17.0 bn from the Kshs 16.1 bn recorded in Q3'2019,
- Interest income rose by 4.8% to Kshs 31.2 bn, from Kshs 29.8 bn in Q3'2019. This was mainly driven by a 17.3% rise in interest income from government securities to Kshs 12.6 bn from Kshs 10.8 bn in Q3'2019. This was however weighed down by a 2.0% decline in interest income from loans and advances to Kshs 17.9 bn, from Kshs 18.3 bn, and a 17.4% decline in other interest income to Kshs 80.3 mn in Q3'2020, from Kshs 97.2 mn. Despite this, the yield on interest-earning assets declined to 6.1% in Q3'2020 from 9.7% in Q3'2019, due to the faster 6.8% growth in average interest-earning assets to Kshs 436.7 bn from Kshs 408.7 bn in Q3'2019, compared to the 31.8% decline in trailing Interest Income,
- Interest expense rose by 4.1% to Kshs 14.2 bn from Kshs 13.6 bn in Q3'2019, mainly attributable to a 10.3% increase in interest expense on customer deposits to Kshs 12.7 bn from Kshs 11.5 bn in Q3'2019, but the increase was mitigated by the 35.3% decline in other interest expenses to Kshs 1.1 bn in Q3'2020, from Kshs 1.8 bn the previous year. The cost of funds fell to 3.1% from 4.6% in Q3'2019 owing to the decline of 28.9% in trailing interest expense compared to the 8.4% growth recorded on average interest-bearing liabilities to Kshs 420.0 bn in Q3'2020, from Kshs 387.3 bn in Q3'2019. This points out that the Bank was able to mobilize deposits at relatively lower rates. The Net Interest Margin came in at 3.2%, lower than the 5.3% seen in 2019, due to the 5.3% decline in NII compared to the 6.8% growth seen in the average interest-earning assets,

- Non-Funded Income rose by 11.8% to Kshs 16.1 bn from Kshs 14.4 bn in Q3'2019. The increase in NFI was driven by a 47.7% increase in fees and other commissions to Kshs 9.5 bn from Kshs 6.4 bn in Q3'2019, coupled with a 3.6% increase in income from foreign exchange trading to Kshs 3.1 bn from Kshs 3.0 bn in Q3'2019. Consequently, the revenue mix shifted to 51:49 funded to non-funded income in Q3'2020 from 53:47 in Q3'2019, owing to the faster increase in NFI compared to NII,
- Total operating expenses rose by 51.2% to Kshs 28.6 bn, from Kshs 18.9 bn in Q3'2019, largely driven by the 210.6% increase in loan loss provision to Kshs 13.4 bn in Q3'2020 from Kshs 4.3 bn in Q3'2019, coupled with other operating expenses which increased by 18.4% to Kshs 10.0 bn in Q3'2020 from Kshs 8.4 bn in Q3'2019. The high increase in Loan loss provision was driven by the expectations of a significant increase in NPLs due to the economic fallouts of the Coronavirus. Staff costs, on the other hand, declined by 14.7% to Kshs 5.3 bn, from Kshs 6.2 bn recorded in Q3'2019,
- The cost to income ratio deteriorated steeply to 86.5% from 62.0% in Q3'2019. However, without LLP, the cost to income ratio improved to 46.2% from 48.0% in Q3'2019, pointing towards improved efficiency,
- Profit before tax declined by 65.3% to Kshs 3.8 bn from Kshs 10.9 bn in Q3'2019. Profit after tax declined by 67.3% to Kshs 2.5 bn in Q3'2020 from Kshs 7.7 bn in Q3'2019. The effective tax rate decreased to 33.5% from 29.3% recorded in Q3'2019.

Balance Sheet

- The balance sheet recorded an expansion with a total assets growth of 6.4% to Kshs 519.2 bn from Kshs 487.9 bn in Q3'2019. This growth was largely driven by a 12.5% increase in government securities to Kshs 166.2 bn, from the Kshs 147.7 bn recorded in Q3'2019. The loan book on the other hand expanded by 0.4% to Kshs 249.7 bn in Q3'2020 from Kshs 248.8 bn in Q3'2019,
- Total liabilities rose by 7.6% to Kshs 448.5 bn from Kshs 416.9 bn in Q3'2019, driven by an 8.1% increase in customer deposits to Kshs 402.6 bn from Kshs 372.4 bn in Q3'2019. Placements increased by 48.5% from the Kshs 7.9 bn recorded in Q3'2019 to Kshs 11.7 bn in Q3'2020. Deposits per branch increased by 30.4% from Kshs 4.5 bn, to Kshs 5.9 bn in Q3'2020, with the number of branches declining to 68 from 82 branches,
- The faster growth in deposits compared to the growth in loans led to a decline in the loan to deposit ratio to 63.0% from 66.8% in Q3'2019,
- Gross non-performing loans (NPLs) rose by 15.3% to Kshs 38.4 bn in Q3'2020 from Kshs 30.3 bn in Q3'2019. Consequently, the NPL ratio deteriorated to 14.1% in Q3'2020 from 12.4% in Q3'2019 attributable to the faster 15.3% increase in NPLs that outpaced the 1.2% increase in gross loans which came in at Kshs 272.1 bn in Q3'2020, from the Kshs 268.8 bn in Q3'2019. General loan loss provisions increased by 15.7% from Kshs 13.8 bn, to Kshs 15.9 bn in Q3'2020. The NPL coverage fell to 58.3% in Q3'2020, from 60.2% owing to the slower 15.3% increase in general loan loss provisions, compared to the 15.7% growth in gross NPLs,
- Shareholders' funds declined marginally by 0.4% to Kshs 70.4 bn in Q3'2020 from Kshs 70.7 bn in Q3'2019, mainly supported by a marginal decline in retained earnings
- NCBA Group is currently sufficiently capitalized with a core capital to risk weighted assets ratio of 18.1%, 7.6% above the statutory requirement. In addition, the total capital to risk weighted assets ratio was 18.6%, exceeding the statutory requirement by 4.1%. Adjusting for IFRS 9, the core capital to risk weighted assets stood at 18.6%, while total capital to risk weighted assets came in at 19.1%,
- NCBA Group currently has a return on average assets of 0.5% and a return on average equity of 3.9%.

Key Take-Outs:

- i. **Asset quality:** The bank’s gross non-performing loans (NPLs) increased by 15.3% to Kshs 38.4 bn in Q3’2020 from Kshs 30.3 bn in Q3’2019. Consequently, the NPL ratio deteriorated to 14.1% in Q3’2020 from 12.4% in Q3’2019 attributable to the faster 15.3% increase in NPLs that outpaced the 1.2% increase in gross loans which came in at Kshs 272.1 bn in Q3’2020, from the Kshs 268.8 bn in Q3’2019. As a result, the NPL coverage fell to 58.3% in Q3’2020, from 60.2% owing to the slower 15.3% increase in general loan loss provisions, compared to the 15.7% growth in gross NPLs,
- ii. Non-Funded income rose by 11.8% to Kshs 16.1 bn from Kshs 14.4 bn in Q3’2019. The increase in NFI was driven by a 47.7% increase in fees and other commissions to Kshs 9.5 bn from Kshs 6.4 bn in Q3’2019, coupled with a 3.6% increase in income from foreign exchange trading. Consequently, the revenue mix shifted to 51:49 funded to non-funded income in Q3’2020 from 53:47 in Q3’2019, owing to the faster increase in NFI compared to NII, and,
- iii. The Bank recorded an expansion with a total assets growth of 6.4% to Kshs 519.2 bn from Kshs 487.9 bn in Q3’2019. This growth was largely driven by a 12.5% increase in government securities to Kshs 166.2 bn, from the Kshs 147.7 bn recorded in Q3’2019. The loan book on the other hand expanded by 0.4% to Kshs 249.7 bn in Q3’2020 from Kshs 248.8 bn in Q3’2019,

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

- i. The Bank is expected to continue increasing its synergy by capitalizing on the strengths of the previous entities where the use of their LOOP digital platform will allow the bank diversify its revenue streams and support the bank’s operation given the current situation surrounding the spread of the Novel Coronavirus

Below is a summary of the bank’s performance;

Balance Sheet Items	Q3’2019	Q3’2020	y/y change	Q3’2020f	Expected y/y change	Variance in Actual Growth vs Expected
Net Loans and Advances	248.8	249.7	0.4%	259.2	4.2%	(3.8%)
Total Assets	487.9	519.2	6.4%	518.7	6.3%	0.1%
Customer Deposits	372.4	402.6	8.1%	402.2	8.0%	0.1%
Total Liabilities	416.9	448.5	7.6%	450.5	8.0%	(0.5%)
Shareholders’ Funds	70.7	70.4	(0.4%)	67.9	(3.9%)	3.5%

Balance Sheet Ratios	Q3’2019	Q3’2020	y/y change
Loan to Deposit Ratio	66.8%	63.0%	(3.9%)
Return on average equity	14.9%	3.9%	(11.0%)
Return on average assets	2.2%	0.5%	(1.6%)

Income Statement	Q3’2019	Q3’2020	y/y change	Q3’2020f	Expected y/y change	Variance in Actual Growth vs Expected
Net Interest Income	16.1	17.0	5.3%	13.0	(19.6%)	24.9%
Net non-Interest Income	14.4	16.1	11.8%	12.2	(15.6%)	27.4%

Total Operating income	30.5	33.1	8.4%	25.1	(17.7%)	26.1%
Loan Loss provision	4.3	13.4	210.6%	7.8	82.4%	128.2%
Total Operating expenses	18.9	28.6	51.2%	20.4	7.8%	43.4%
Profit before tax	10.9	3.8	(65.3%)	4.7	(56.8%)	(8.5%)
Profit after tax	7.7	2.5	(67.3%)	3.2	(58.8%)	(8.5%)
Core EPS	5.1	1.7	(67.3%)	2.1	(80.6%)	13.3%

Income Statement Ratios	Q3'2019	Q3'2020	y/y change
Yield from interest-earning assets	9.7%	6.1%	(3.5%)
Cost of funding	4.6%	3.1%	(1.6%)
Net Interest Spread	5.0%	3.1%	(2.0%)
Net Interest Margin	5.3%	3.2%	(2.0%)
Cost of Risk	14.1%	40.4%	26.3%
Net Interest Income as % of operating income	52.8%	51.3%	(1.5%)
Non-Funded Income as a % of operating income	47.2%	48.7%	1.5%
Cost to Income Ratio	62.0%	86.5%	24.5%

Capital Adequacy Ratios	Q3'2019	Q3'2020
Core Capital/Total Liabilities	17.2%	16.9%
Minimum Statutory ratio	8.0%	8.0%
Excess	9.2%	8.9%
Core Capital/Total Risk Weighted Assets	16.6%	18.1%
Minimum Statutory ratio	10.5%	10.5%
Excess	6.1%	7.6%
Total Capital/Total Risk Weighted Assets	17.5%	18.6%
Minimum Statutory ratio	14.5%	14.5%
Excess	3.0%	4.1%
Liquidity Ratio	50.8%	54.7%
Minimum Statutory ratio	20.0%	20.0%
Excess	30.8%	34.7%
Adjusted core capital/ total deposit liabilities	13.4%	17.3%
Adjusted core capital/ total risk weighted assets	15.6%	18.7%
Adjusted total capital/ total risk weighted assets	17.2%	19.1%

***Note that the figures for Q3'2019 are combined from CBA's and NIC's Q3'2019 releases.**