Genghis Capital

KCB BANK EARNINGS NOTE.

research@genghis-capital.com

KCB Group 3Q23 Earnings Note

30 November 2023

KCB Group (KCB) 3Q23 net earnings printed at KES 12.75 per share (31.3%q/q; 0.87%y/y). Kenya contributed to 66.4% of the nominal year-on-year growth in net profits. Kenya's earnings momentum was dampened in the quarter, outpaced by revenue growth in the subsidiaries of the group with the Uganda subsidiary posting revenue growth of 63%y/y to KES 3.3Bn and the Tanzanian subsidiary posting revenue growth of 56% y/y to KES 4.5Bn. The Kenyan subsidiaries were able to post a 29%y/y increase in non-banking revenue to KES 1.1Bn with KCB Bank Kenya posting revenue growth of 5%y/y to KES 71.6Bn. National Bank of Kenya was the only subsidiary to post a 1% y/y decline in revenue to KES 8.3B.

Overall, group earnings during the quarter were driven by:

- A 38.7%y/y (53.8%q/q) growth in non-funded income largely driven by other fees and commission income increasing by 62.7% during the quarter, accounting for nearly a half of total non-funded income portfolio.
- A 36.37%y/y (62.4%q/q) growth in funded income on account of annuity income from investment securities growing by 22.8%y/y (64.5%q/q) as the bank continued to allocate liquidity to government debt. The ratio of Investment securities to total assets stood at 17.7% representing a 37.57% y/y increase from Q3 2022.
- Interest on net loans and advances increased by 39.1%y/y (59.9%q/q) bolstered by the value of net loans crossing the one trillion shillings mark a first in the region signaling the bank's increased market penetration.
- High efficiency levels. We note that the bank's cost-to-income ratio dropped to 65.38% from 69.26% in Q2 2023, driven by technology as non-branch transactions continue to top charts with the group expected to continue leveraging on the use of technology to reduce operating costs and improve customer interactions.

Loanbook growth during the quarter was optimal (+38%y/y), largely driven by both the corporate and retail segments. The corporate book accounts grew by KES197 Bn y/y while retail accounts grew by KES 101Bn in the same period. Mortgages on the other hand witnessed a marginal increase of KES 19Bn largely driven by depressed demand on account of rising interest rates. Furthermore, we made the following observations:

- Gross NPLs ratio declined by 180bps y/y from a peak of 21.5% to 16.4%. This comes as the current banking industry NPLs average increased to 15% as of August 2023 up from 14.2% in August 2022.The sustained drop in the NPL ratios is attributable to improvement in corporate banking in KCB Bank Kenya coupled with a drop in gross NPLs in NBK, South Sudan, Tanzania and Burundi subsidiaries. Although the bank's NPL ratios witnessed a decline, this can also be attributed to the increase in total loans by the bank as the value of total NPLs stood at KES 187Bn up from KES149.3Bn in Q3 2022.
- Balance sheet funding costs rose in the period with interest on deposits rising on account of raised interest rate in the region as customer deposits represented. 78.9% of the funding mix while the remaining were purchased wholesale funds. *Nonetheless, the bank recorded a strong 79.6%y/y growth in customer deposits during the quarter.*

Key Statistics	
Latest Closing Price	19.15
Bloomberg Code	KNCB KN
Reuters Code	KCB.NR
NSE Code	KCB
Free Float	2560.0%
Price Change YTD (%)	-49.7%
52 Wk High/Low	43.0 - 18.95
Market Cap (KES Bn)	61.50
Dividend Yield	6.7%
P/E	1.5x
P/B	0.3x

Source: Genghis Research, Bloomberg & NSE

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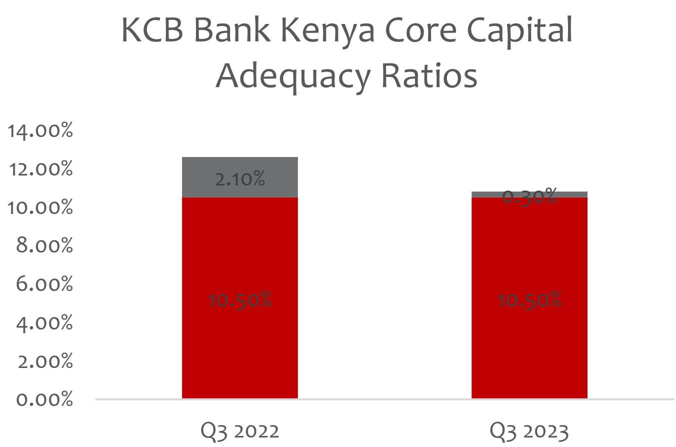
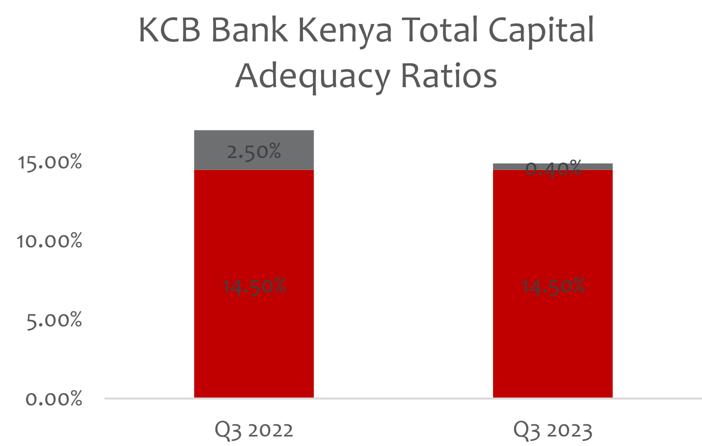
Key Takeaways

1. Drop in capital buffers

In the period all subsidiaries of the group except for National Bank of Kenya (NBK) were compliant with core capital and total capital requirements and were adequately capitalized to drive growth of risk weighted assets. However, there was a notable drop in the overall headroom in capital adequacy ratios. KCB Bank Kenya witnessed a decrease of 180bps in core capital to 10.8% this quarter down from 12.6% in Q3 2022.In terms of total capital adequacy ratios KCB Bank Kenya witnessed a decrease of 210bps to 14.9% down from 17% in Q3 2022.NBK on the other hand recorded core and total capital adequacy ratios of 3.6% and 2.9% below the required minimums respectively. This was as a result of the loss registered in 2023 with management exploring options to correct this position. The overall thinning of capital buffers was as a result of a faster growth in risk weighted assets driven by lending in the period. Management projects core capital headroom to improve by the end of the financial year due to an improvement in net earnings in the period.





2. Growth in operating costs

Operating costs grew by 57% y/y (51.48% q/q) to KES 76.7Bn in the period driven by exceptional cost items from the consolidation of DRC-based lender Trust Merchant Bank (TMB), provision for NBK court ruling and the ongoing staff rationalization program. One-off exceptional costs amounted to KES 16.8Bn while normalized costs amounted to KES44Bn a 6% y/y growth from KES 41.6Bn in Q3 2022.Loan loss provisions also witnessed a 118% y/y increase to KES 15.8Bn from KES 7.3Bn in 2022 as the group set out to build up coverage for downgraded facilities and offset the impact of currency depreciation on USD denominated loans in Kenya. Management maintained their resolve to build loan loss provisions without impacting shareholder value by tapping into the pre-provision operating profit that witnessed a 12% y/y growth to KES 56Bn.

FY 2023 outlook

We expect the growth of KCB in the remainder of the year to be driven by continued improving performance of subsidiaries as they expand their regional presence - leading to a continued increase in loan growth and net interest payments. The group is also expected to step up loan loss recovery efforts in a bid to further reduce the NPL ratio as well as continue to its turnaround program for NBK in a bid to return the subsidiary to profitability in the medium term. However, the group is expected to encounter headwinds in its recovery efforts with depreciation of local currencies exacerbating inflationary pressures in the region coupled with fiscal pressures that lift operating costs on account of a rising tax environment.

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INCOME STATEMENT

KES Bn	3Q22	FY22	1Q23	2Q23	3Q23	Y/Y	Q/Q
Interest Income	83,540,662.00	117,751,440.00	33,612,552.00	70,143,502.00	113,924,933.00	36.4%	62.4%
Interest Expense	21,946,668.00	31,098,131.00	11,552,593.00	24,635,171.00	39,051,407.00	77.9%	58.5%
Net Interest Income	**61,593,994.00**	**86,653,309.00**	**22,059,959.00**	**45,508,331.00**	**74,873,526.00**	**21.6%**	**64.5%**
Fees and commissions on loan and advances	7,833,454.00	10,639,803.00	2,720,692.00	5,551,179.00	8,116,960.00	3.6%	46.2%
Other fees and commissions	9,135,994.00	12,347,508.00	7,080,655.00	12,283,788.00	19,993,744.00	118.8%	62.8%
Foreign Exchange Income	8,395,739.00	11,078,891.00	2,646,032.00	5,908,379.00	8,192,185.00	-2.4%	38.7%
Other Income	5,185,472.00	9,185,313.00	2,342,914.00	3,816,676.00	6,085,441.00	17.4%	59.4%
Non-Interest Income	**30,550,659.00**	**43,251,515.00**	**14,790,293.00**	**27,560,022.00**	**42,388,330.00**	**38.7%**	**53.8%**
Total Operating Income	**92,144,653.00**	**129,904,824.00**	**36,850,252.00**	**73,068,353.00**	**117,261,856.00**	**27.3%**	**60.5%**
Loan Loss Provisions	7,267,757.00	13,206,881.00	4,118,282.00	10,191,358.00	15,848,572.00	118.1%	55.5%
Staff Costs	21,287,766.00	30,262,179.00	9,359,554.00	17,461,120.00	26,671,161.00	25.3%	52.7%
Directors' emoluments	547,949.00	536,697.00	236,355.00	449,211.00	657,661.00	20.0%	46.4%
Rental charges	406,648.00	464,550.00	199,006.00	410,360.00	371,246.00	-8.7%	-9.5%
Depreciation charge on property and equipment	2,920,335.00	3,990,091.00	1,154,647.00	3,887,036.00	6,020,884.00	106.2%	54.9%
Amortisation charges	2,124,309.00	2,624,814.00	525,301.00	1,110,392.00	1,626,139.00	-23.5%	46.4%
Other Operating Expenses	14,285,942.00	21,488,259.00	7,403,051.00	17,101,495.00	25,472,085.00	78.3%	48.9%
Total Operating Expenses	**48,840,706.00**	**72,573,471.00**	**22,996,196.00**	**50,610,972.00**	**76,667,748.00**	**57.0%**	**51.5%**
Profit Before Tax	43,303,947.00	57,331,353.00	13,854,056.00	22,457,381.00	40,594,108.00	-6.3%	80.8%
Income Tax Expense: Current tax	(12,624,996.00)	(17,034,861.00)	(5,435,484.00)	(10,768,961.00)	(9,859,783.00)	-21.9%	-8.4%
Deferred tax	(84,123.00)	541,243.00	1,334,238.00	4,368,984.00	(13,015.00)	-84.5%	-100.3%
Profit After Tax	**30,594,828.00**	**40,837,735.00**	**9,752,810.00**	**16,057,404.00**	**30,721,310.00**	**0.4%**	**91.3%**

BALANCE SHEET

KES Bn	3Q22	FY22	1Q23	2Q23	3Q23	Y/Y	Q/Q
Loans and Advances	758,815,986.00	863,268,077.00	928,824,144.00	964,808,684.00	1,047,865,745.00	38.1%	8.6%
Government Securities	269,887,440.00	278,020,336.00	297,718,620.00	362,422,826.00	371,273,544.00	37.6%	2.4%
Total Assets	**1,028,703,426.00**	**1,141,288,413.00**	**1,226,542,764.00**	**1,327,231,510.00**	**1,419,139,289.00**	**38.0%**	**6.9%**
Customer Deposits	922,303,721.00	1,135,417,382.00	1,196,587,247.00	1,471,246,362.00	1,656,369,728.00	79.6%	12.6%
Total Liabilities	1,086,064,187.00	1,347,753,705.00	1,415,758,095.00	1,646,593,661.00	1,873,448,129.00	72.5%	13.8%
Total Shareholder's Equity	**187,771,581.00**	**200,200,416.00**	**208,144,935.00**	**211,232,039.00**	**218,818,737.00**	**16.5%**	**3.6%**

KEY RATIOS

	3Q22	FY22	1Q23	2Q23	3Q23
NIM	7.95%	10.45%	2.49%	4.97%	7.75%
NIR/Total Income	89.1%	88.9%	79.8%	83.0%	85.1%
CTI	69.2%	73.8%	68.3%	60.9%	60.2%
NPL Ratio	23.9%	22.8%	23.1%	22.7%	21.3%
LDR	61.1%	78.2%	103.5%	113.3%	151.5%
ROaE	19.8%	26.4%	6.2%	10.1%	19.4%
Cost of Risk	1.3%	2.0%	0.6%	1.4%	2.0%

NB: Calculations are based on TTM Data

Contacts:

Research

Tahnia Oginga
toginga@genghis-capital.com

Teddy Irungu
tirungu@genghis-capital.com

Retail Investment Banking

Beatrice Kuria
clientrelations@genghis-capital.com

Strategic Businesss Partnerships

Tabitha Mukami
sbp@genghis-capital.com

Dealing

Faith Mukeli
fmukeli@genghis-capital.com

Wanjira Njaga
wnjaga@genghis-capital.com

Ian Waihenya
iwaihenya@genghis-capital.com

Belinda Mokua
bmokua@genghis-capital.com

Corporate Finance

Isaac Munene
corpfinance@genghis-capital.com

Asset Management

John Ndua
Lydia Wangare
Roy Macharia
amclientrelations@genghis-capital.com

CEO

Edward Wachira
info@genghis-capital.com

Phone: +254 709 185 000
research@genghis-capital.com
Website: www.genghis-capital.com

@GenghisCapital