

KCB GROUP PLC

“Asset quality improves, net income soars.”

KCB Group PLC (KCB) announced 1H18 earnings this morning posting **18.0% y/y growth in net earnings to KES 12.1B**. The uplift in bottom line was on the back of a **4.3% y/y rise in net interest income, a 1.0% y/y decline in opex and a 58.9% y/y reduction in provisions**. The bank declared a **KES 1.00 Interim Dividend**; similar to last year. Key highlights are as follows;

Customer deposits marked a 5.8% q/q increase (8.7% y/y) to KES 524.9B as the bank secured more corporate deposits, which saw the share of corporate deposits to total deposits increase to 52%. Despite this, **a shift in the deposit mix with term deposits declining 100bps to 6%** saw cost of funds decline 40bps q/q to 2.9%. This resulted in an 80bps q/q growth in the net interest margin to 8.1%. As such, **net interest income accelerated 11.3% q/q (4.3% y/y) to KES 24.1B**.

Non-funded income was surprisingly beleaguered, declining 10bps y/y to KES 11.5B on the back of a decline in lending fees. Forex trading income was up 6.8% y/y to KES 2.8B while other income grew 15.1% y/y to KES 1.9B, supported by income trading of government securities.

Owing to restructuring efforts put in place in FY17, operating expenses declined 100bps y/y (-70bps q/q) to KES 17.7B, which saw the **cost to income ratio shed 190bps y/y to 49.7%**.

Loans and advances grew 3.6% y/y to KES 407.0B supported by increased lending appetite in Kenya (both retail and corporate) as well as stellar growth in all the subsidiaries, with the exception of Uganda. Government securities declined 2.8% y/y to KES 112.5B which could be an indicator of a shift in strategy as yields on government securities continue to come down.

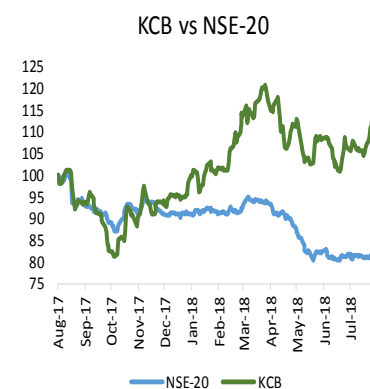
After being on an upward trajectory all for five consecutive quarters, **asset quality marked an improvement in 2Q18 with the NPL ratio easing 130bps q/q to 7.5%**. This was attributable to a 320bps decline in corporate NPLs to 11.6%. Loan loss provisions declined 58.9% y/y (-62.1% q/q), a key driver of the surge in net earnings. The coverage ratio improved 540bps q/q to 58.6%.

Market reaction to earnings: So far, supply seems to be building up with the counter shedding KES 0.50 to KES 49.00. In our opinion, the earnings were fairly good especially the growth in interest income and reduction in opex. We were rather disappointed in non funded income performance as we expected it to be a key earnings driver for the bank. The uncertainties surrounding the rate cap repeal continue to keep investors at bay and as such, we may see the price fall further. Over the long term, we remain bullish on KCB as highlighted in our research update with a BUY recommendation based on a target price of KES 57.00.

Bloomberg Ticker : KNCB KN
Reuters Ticker: KCBK.NR

Share Statistics	
Current Price (KES)	49.50
Issued shares (m)	3,066
Market cap (USDm)	1,517
Year end	Dec
Foreign ownership (%)	26.4
Av daily trading vol (USD)	840,600

Price Trend



Source: Bloomberg

Research Analyst

Joy D'Souza
Head of Research
jdsouza@apexafrica.com
+254 723 420204

Financials

Income statement (KES m)	1H17	FY17	1Q18	2Q18	1H18	y/y%ch	q/q%ch
Interest income	30,363	63,673	15,668	16,551	32,220	6.1	5.6
Interest expense	(7,214)	(15,288)	(4,242)	(3,832)	(8,074)	11.9	-9.7
Net interest income	23,149	48,385	11,426	12,719	24,145	4.3	11.3
Foreign exchange income	2,645	4,665	1,032	1,791	2,824	6.8	73.5
Gross fees and commissions	7,210	14,694	3,622	3,153	6,776	-6.0	-12.9
Other income	1,633	3,641	886	994	1,880	15.1	12.2
Non interest income	11,488	23,001	5,541	5,939	11,480	-0.1	7.2
Total operating income	34,637	71,386	16,967	18,658	35,625	2.9	10.0
Total operating expenses	(17,872)	(36,357)	(8,883)	(8,819)	(17,702)	-1.0	-0.7
Operating profit	16,765	35,029	8,084	9,838	17,923	6.9	21.7
Exceptional items	-	-	-	-	-	-	-
Provisions for bad debt	(2,013)	(5,914)	(600)	(227)	(828)	-58.9	-62.1
Profit before tax	14,752	29,114	7,484	9,611	17,095	15.9	28.4
Tax	(4,491)	(9,409)	(2,301)	(2,683)	(4,984)	11.0	16.6
Profit after tax	10,261	19,705	5,184	6,928	12,111	18.0	33.7
EPS (KES)	3.35	6.43	1.69	2.26	3.95	18.0	33.7
DPS (KES)	1.00	3.00			1.00	0.0	
Number of shares (m)	3,066	3,066	3,066	3,066	3,066	0.0	0.0

Balance sheet (KES m)	1H17	FY17	1Q18	2Q18	1H18	y/y%ch	q/q%ch
Total shareholder's equity	98,331	105,966	99,633	98,984	98,984	0.7	-0.7
Deposits from other banks	15,419	11,039	9,522	8,570	8,570	-44.4	-10.0
Customer deposits	482,845	499,549	496,366	524,939	524,939	8.7	5.8
Borrowed funds	16,733	14,895	22,520	20,699	20,699	23.7	-8.1
Other liabilities	17,281	15,220	19,433	14,491	14,491	-16.1	-25.4
Total equity and liabilities	630,608	646,669	647,474	667,682	667,682	5.9	3.1
Cash and CBK balances	29,893	29,091	33,788	37,346	37,346	24.9	10.5
Balances with other institutions	43,271	43,335	37,078	49,637	49,637	14.7	33.9
Government and other securities	115,795	110,007	112,116	112,545	112,545	-2.8	0.4
Net loans and advances	406,976	422,685	418,618	421,509	421,509	3.6	0.7
Fixed assets	9,494	10,454	10,990	10,329	10,329	8.8	-6.0
Other assets	25,180	31,097	34,885	36,316.29	36,316.29	44.2	4.1
Total assets	630,608	646,669	647,474	667,682	667,682	5.9	3.1

Key Ratios	1H17	FY17	1Q18	2Q18	1H18	y/y%ch	q/q%ch
Gross NPL (KES m)	33,249	37,496	43,775	37,628	37,628	13.2	-14.0
Interest in suspense (KES m)	4,919	5,125	5,119	4,540	4,540	-7.7	-11.3
Total NPL (KES m)	28,330	32,371	38,656	33,088	33,088	16.8	-14.4
Loan loss provision (KES m)	19,104	20,351	20,544	19,374	19,374	1.4	-5.7
Net NPL (KES m)	9,227	12,020	18,112	13,714	13,714	48.6	-24.3
NPL ratio (%)	6.6	7.3	8.8	7.5	7.5	0.9	-1.3
Coverage ratio (%)	67.4	62.9	53.1	58.6	58.6	-8.9	5.4
Loan to deposits (%)	84.3	84.6	84.3	80.3	80.3	-4.0	-4.0
Loan to deposits & borrowed funds (%)	81.5	82.2	80.7	77.3	77.3	-4.2	-3.4
Yield on interest earning assets (%)	10.7	11.1	11.0	11.3	11.0	0.3	0.3
Cost of funds (%)	2.8	2.9	3.2	2.8	2.9	0.1	-0.4
NIM (%)	7.9	8.1	7.8	8.6	8.1	0.2	0.8
Non funded/Total income (%)	33.2	32.2	32.7	31.8	32.2	-0.9	-0.8
Cost to income ratio (%)	51.6	50.9	52.4	47.3	49.7	-1.9	-5.1
ROE (%)	20.9	18.6	20.8	28.0	24.5	3.6	7.2
ROA (%)	3.3	3.0	3.2	4.2	3.6	0.4	0.9
Core capital/TRWA (%)	17.4	15.4	15.1	15.7	15.7	-1.7	0.6
Total capital/TRWA (%)	18.7	16.6	15.3	17.2	17.2	-1.5	1.9
P/E (x)	7.0						
P/B (x)	1.5						
Dividend yield (%)	6.1						

Source: Company Filings & ApexAfrica Capital

Appendix

Investment ratings

- ✦ **Buy:** A total return is anticipated in excess of the market's long-term historic annual rate (approximately 10%). Total return expectations should be higher for stocks that possess greater risk.
- ✦ **Hold:** Hold the shares with neither a materially positive total return nor a materially negative total return anticipated.
- ✦ **Sell:** Stock should be sold as materially negative total return is anticipated.

Disclaimer

ApexAfrica and its parent company Axys Group seek to do business with companies covered in their research reports. Consequently, a conflict of interest may arise that could affect the objectivity of this report. This document should only be considered a single factor used by investors in making their investment decisions. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. The opinions and information portrayed in this report may change without prior notice to investors.

This publication may not be distributed to the public media or quoted or used by the public media without prior and express written consent of ApexAfrica or Axys Group.

This document does not constitute an offer, or the solicitation of an offer, for the sale or purchase of any security. Whilst every care has been taken in preparing this document, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by Apex Africa or any of its employees as to the accuracy of the information contained and opinions expressed in this report.

ApexAfrica Capital Ltd
A The Riverfront, 1st Floor, Prof. David Wasawo Drive, Off Riverside Drive | P.O. Box 43676-00100 | Nairobi | Kenya |
T: +254-20-2226440 | Fax: +254-20-2319092 | Cell: +254-723-420204|
W : www.apexafrica.com
Part of Axys Group
W : www.axys-group.com