

KCB Group – 3Q18 Earnings Note

Net Earnings Shoot 23.2% y/y to KES 5.9B

KCB Groups' 3Q18 net earnings shot up 23.2% y/y to KES 5.9B (-14.4% q/q) fueled by a 7.8% y/y rise in non-interest income to KES 6.5B and a 6.2% y/y decline in operating expenses to KES 9.1B.

Headwinds

- The surprise retention of the interest rate cap by members of parliament and declining yields on government securities as demand outweighs supply. These have piled pressure on yields, thus, interest income grew marginally (+3.4% y/y to KES 17.0B).
- Interest expense rose significantly at 23.6% y/y to KES 4.8B in line with a 6.2% rise in customer deposits to KES 526.8B with cost of funds rising 30bps y/y to 3.2%. This is a probable indicator of challenges in mobilization of cheap deposits despite the removal of the floor on deposits in a continuously competitive environment.

Tailwinds

- Non interest income rose 7.8% y/y to KES 6.5B contributing over 33.3% of total asset book. Growth was fuelled by a 38.9% y/y increase in other income to KES 1.4B and a 5.2% y/y growth in gross fees and commissions to KES 4.2B. However, a 12.8% y/y decline in foreign exchange exerted negative pressure on non interest income.
- Total operating expenses dwindled 6.2% y/y to KES 9.1B cushioning the bottom line. This was driven by a decline in staff costs. A 13.6% y/y decline in loan loss provision expense further bulwarked the bottom line.
- Despite an industry wide snowball on NPLs with the industry NPL ratio standing at 12.7% (3Q18) the Group's gross NPLs have remained almost flat at KES 34.8B (+0.1% y/y) with the NPL ratio at 7.7% (below industry average).

4Q18 Expectations

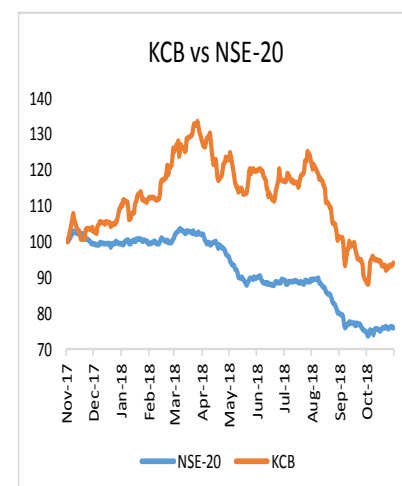
- ⇒ We are impressed with the Group's performance in 3Q18. A 33% y/y growth in international business PBT is expected to further enhance the Group's diversification efforts in the East African region. The region's GDP growth is expected to be about 6.3% premised on strong domestic private consumption, infrastructural development, a spur in manufacturing and increased agricultural production due to abundant rainfall.
- ⇒ We applaud KCB's efforts to minimise costs with a decline in staff costs stoked up by increasing digitization of transactions.
- ⇒ Despite the overall GDP target of 6.2% in Kenya we estimate that the actual growth rate may be lower than that premised on slowed private sector credit growth in the prevailing rate cap era. This is expected to further be driven down by the continued illiquidity due to constrained government spending and the continued cash crunch by Treasury. However, we expect that growth will be boosted by the continued cool political climate, a rise in agricultural exports and foreign inflows from diaspora remittances.

Bloomberg Ticker : KNCB.KN
Reuters Ticker: KCB.NR

Share Statistics

Current Price (KES)	39.00
Issued shares (M)	3066.1
Market cap (USD M)	1431.3
Year end	Dec
Foreign ownership (%)	29.4
Free float (%)	74.9
Av daily trading vol (USDk)	840.6

Price Trend



Source: Bloomberg

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- ⇒ The recent report by IMF that the shilling is overvalued by 17.5%, the expiry of the IMF KES 150B standby credit facility, the ongoing rise in trade deficit following increase in debt repayment obligations are expected to exert negative pressure on the shilling weakening it against the dollar. International oil prices have been coming off with heightened supply as oil exporting countries seek to plug deficits from Iran as US sanctions take effect. In addition, there is a lower than anticipated global demand on oil which has cooled off the prices. This may offer some reprieve to the weakening shilling which has already hit the KES 103.00 mark to the dollar.
- ⇒ Despite the expected macroeconomic shocks, the bank remains fundamentally sound. We encourage exposure in the counter given an alluring entry point and an **expected dividend yield of 5.1%** on the current price. **The counter is currently trading at KES 39.00 with a P/B of 1.1x against a Tier 1 average of 1.2x.**

	3Q17	1Q18	2Q18	3Q18	chg y/y	chg q/q
	KES M	KES M	KES M	KES M	%	%
Income Statement						
Interest Income	16,401	15,668	16,551	16,951	3.4	2.4
Interest Expense	3,877	4,242	3,832	4,791	23.6	25.0
Net Interest Income	12,524	11,426	12,719	12,159	-2.9	-4.4
Foreign Exchange Income	987	1,032	1,791	861	-12.8	-51.9
Gross Fees and Commission	4,022	3,622	3,153	4,230	5.2	34.1
Other Income	987	886	994	1,371	38.9	38.0
Non Interest Income	5,996	5,541	5,939	6,462	7.8	8.8
Total Operating Income	18,520	16,967	18,658	18,621	0.5	-0.2
Total Operating Expenses	9,730	8,883	8,828	9,128	-6.2	3.4
Loan Loss Provision Expense	1,124	600	227	972	-13.6	327.4
Operating Profit	8,790	8,084	9,829	9,493	8.0	-3.4
Profit Before Tax	7,665	7,484	9,611	8,513	11.1	-11.4
Current Tax	2,850	2,301	2,683	2,580	-9.5	-3.9
Profit After Tax	4,815	5,184	6,928	5,933	23.2	-14.4
EPS (KES)	6.56	6.76	7.90	7.85	19.7	-0.6
DPS (KES)			1.00			
Balance Sheet						
Total Shareholders' Equity	103,193	99,633	98,984	105,462	2.2	6.5
Deposits due to Banks & Fin Inst	10,501	9,522	8,570	12,641	20.4	47.5
Customer Deposits	496,305	496,366	524,939	526,844	6.2	0.4
Total Liabilities	540,640	547,840	568,698	578,704	7.0	1.8
Total Equity and Liabilities	643,833	647,474	667,682	684,165	6.3	2.5
Cash and CBK Balances	42,524	33,788	37,346	39,712	-6.6	6.3
Bal due from Banks & Fin Inst	42,280	37,078	49,637	39,507	-6.6	-20.4
Government Securities	103,647	112,116	112,545	119,529	15.3	6.2
Net Loans and Advances	419,494	418,618	421,509	435,281	3.8	3.3
Fixed Assets	9,307	10,990	10,329	10,431	12.1	1.0
Total Assets	643,833	647,474	667,682	684,165	6.3	2.5
Key Ratios						
Gross NPL (KES M)	34,731	43,775	37,628	34,780	0.1	-7.6
Interest In Suspense (KES M)	3,762	5,119	4,540	4,278	13.7	-5.8
Total NPL (KES M)	30,969	38,656	33,088	30,502	-1.5	-7.8
Loan Loss Provision (KES M)	19,832	20,544	19,374	16,732	-15.6	-13.6
Net NPL	11,137	18,112	13,714	13,770	23.6	0.4
NPL Ratio	7.9%	10.0%	8.5%	7.7%		
Coverage Ratio	57.1%	46.9%	51.5%	48.1%		
Cost of Risk	1.1%	0.6%	0.4%	0.4%		
Loan to Deposits	84.5%	84.3%	80.3%	82.6%		
Yield on Interest Earning Assets	11.6%	11.0%	11.0%	11.2%		
Cost of Funds	3.1%	3.4%	3.0%	3.2%		
NIM	8.5%	7.7%	8.0%	8.0%		
Non Funded/Total Income	32.4%	32.7%	32.2%	33.1%		
Cost to Income Ratio	52.5%	52.4%	49.7%	49.5%		
ROE	18.7%	20.8%	24.5%	25.7%		
ROA	3.0%	3.2%	3.6%	4.0%		
Core Capital/TRWA	17.4%	15.1%	15.7%	16.3%		
Total Capital/TRWA	18.7%	15.3%	17.2%	17.8%		
Liquidity Ratio	37.7%	33.9%	35.3%	33.7%		
P/E (x)				4.9		
P/B (x)				1.1		

Source: Company Filings, ApexAfrica Research

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