INVESTMENT BANKING EARNINGS UPDATE

KCB GROUP FY 2023 EARNINGS UPDATE

KCB released its financial results posting an 8% decline in profit after tax to **KES 37.5Bn** attributable to the increase in operating expenses largely driven by increase in loan loss provisions by 155% y/y. The Return on Equity saw a slight decline to 17% from 19% and **Earnings per share** saw a decline to KES 11.66 from KES 12.71 recorded in the previous financial year. The board did not recommend payment of a dividend for the year.

Share Data	KCB Group
Ticker	KCB KN
RECOMMENDATION	SELL
Current Price (KES)	24.15
Target Price (KES)	21.05
Upside	(12.8%)
52WK High (KES)	39.50
52WK Low (KES)	15.00
Market Cap (KES Bn)	77.61
Dividend Yield	-
P/B	0.3x
P/E	2.1x
Current Price = as of March 21, 2024	

Source: Bloomberg, NSE, NCBA IB Research

FY2023 Performance - KCB (% = y/y performance)

- **Earnings:** Net operating income grew by 27% to KES 165.2Bn mainly driven by a 43% growth in interest income to KES 168.1Bn coupled with a 34% rise in non-funded income to KES 57.9Bn. This was largely attributable to rising interest rates. Relatedly, fees and commission income grew by 67% to KES 38.4Bn. On the other hand, foreign exchange trading income declined by 2% to KES 10.8Bn.

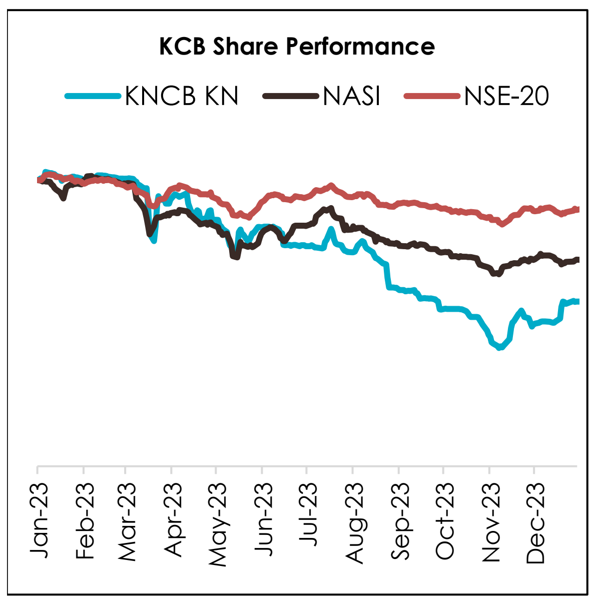
- **Loan book**: The bank's loans and advances to customers grew by 27% to KES 1.1Tn boosting overall assets, which grew by 40% to KES 2.2Tn attributable to the banks' aggressive lending as well as inorganic growth from the subsidiaries. The growth was largely driven by lending in consumer and SME sectors.

- **Customer deposits** grew by 49% to KES 1.7Tn faster than the growth in loans indicating the bank leveraged more on deposits to fund its loan book. The cost of funds rose to 4% as interest expense shot up by 96% KES 60.8Bn reflective of the expensive deposits.
  Consequently, the loan to deposit ratio declined to 65% from 76% recorded in the previous financial year.

- **Government securities:** Investment in government securities rose by 38% to KES 348.9Bn as the bank seemed to leverage on attractive interest rates.

- **Efficiency:** Cost to income ratio rose to 50% from 46% driven by the increase in operating expenses by 61% to KES 116.8Bn.

- **Asset Quality:** The NPL ratio rose to 17% from 15% in FY2022. Gross NPL's rose by 29% to KES 208.3Bn as the challenging macroeconomic environment impacted the lender. Loan loss provisions increased by 155% to KES 33.6Bn from KES 13.2Bn in FY2022 to cover the increased credit risk.



Source: NSE, NCBA IB Research

Financial Summary

KCB Group	Key Metrics Y/Y
Loans and Advances	Up 27% to KES 1.1Tn
Customer Deposits	**Up 49% to KES 1.7Tn**
Government Securities	Up 38% to KES 348.9Bn
Net Interest Income	**Up 24% to KES 107.3Bn**
Non-Funded Income	Up 34% to KES 57.9Bn
Forex trading income	**Down 2% to KES 10.8Bn**
Fees income	Up 67% to KES 38.4Bn
Loan Loss Provisions	**Up 155% to KES 33.6Bn**
Profit before tax	Down 15% to KES 48.5Bn
Profit after tax	**Down 8% to KES 37.5Bn**
EPS	Down 8% to KES 11.66

Source: Company financials, NCBA IB Research

KCB Group	Key Ratios Y/Y
Loan Deposit ratio	Down to 65% from 76%
Cost to Income	**Up to 50% from 46%**
Net Interest Margin	Down to 5% from 6%
Cost of funds	**Up to 4% from 3%**
NPL Ratio	Up to 17% from 15%
Cost of Risk	**Up to 3% from 2%**
ROE	Down to 17% from 19%
Current Market Price	KES 24.15
P/E	**2.1x**
P/B	**0.3x**
Dividend	None

Outlook

We expect KCB to record steady growth boosted by:

1. **Subsidiaries performance and contribution:** The bank is placing its faith in regional subsidiaries as they accounted for 37.0% in profit before tax, up from 17% in 2022. The lender's hinges its future on becoming a significant regional player, especially with the DRC unit becoming its second most profitable subsidiary. the restructuring of some of its units such as its investment bank and asset management will help grow their revenue streams in the remainder of the year.

2. **Revenue Diversification:** The bank is a strong player in financial inclusion with their digital platforms, Fuliza and KCB Mobi loan which saw a 48% growth in value of transactions, coupled with other digital strides will allow the bank diversity its revenues.

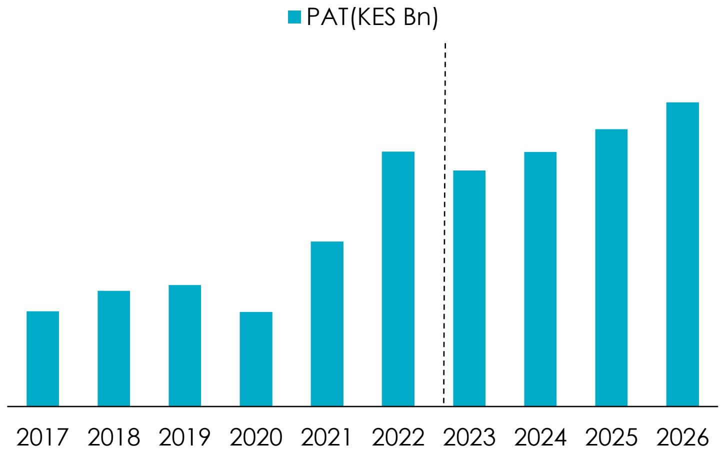
3. **Loans growth:** The bank's focus on digital lending through its automated business loan product will support NFI line growth. The bank's focus on co-creating solutions with customers to grow the loan book and increase product holding will see the loan book grow.

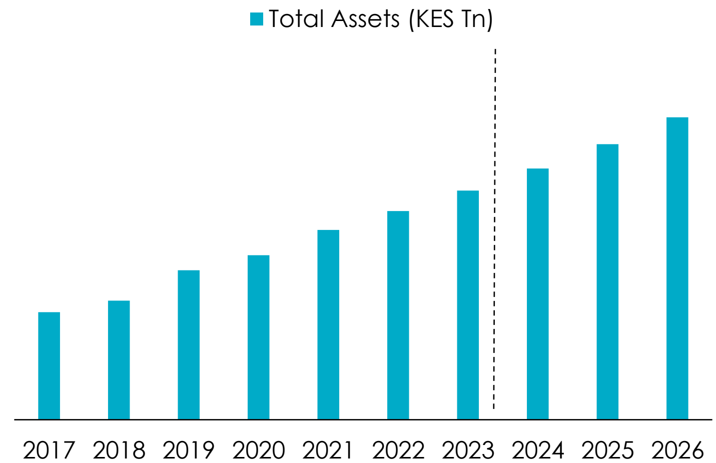
Investment recommendation:

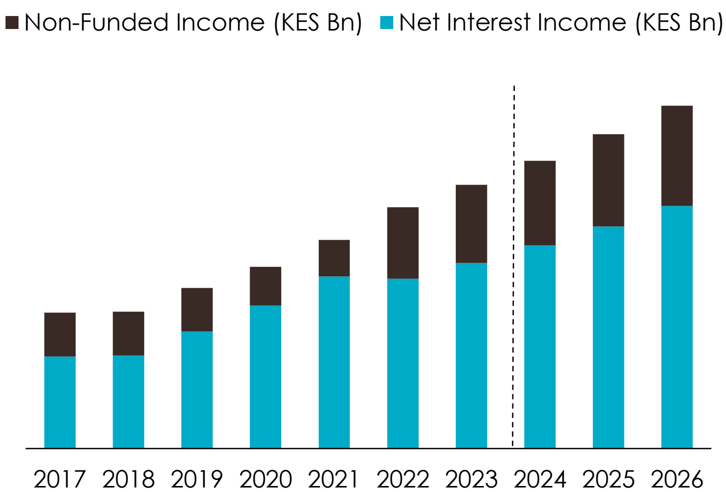
We expect the bank to register long-term profitability based on its revenue diversification and maintain a cautiously optimistic stance on the NBK divestiture.

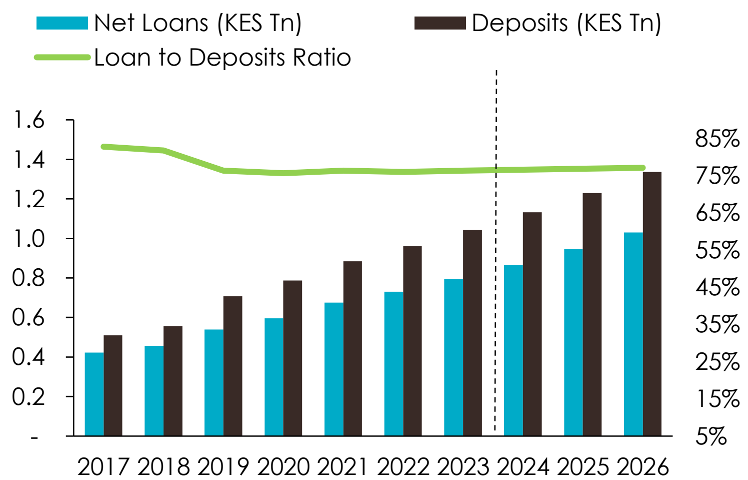
At the current market price, we believe the stock is within its fair value but presents a value pick for long-term investors owing to its growth prospects.

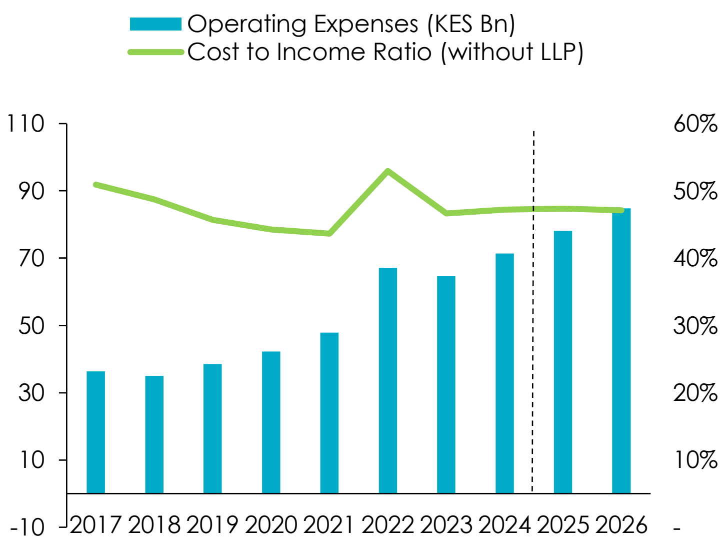
Financial highlights and forecasts- KCB Group PLC

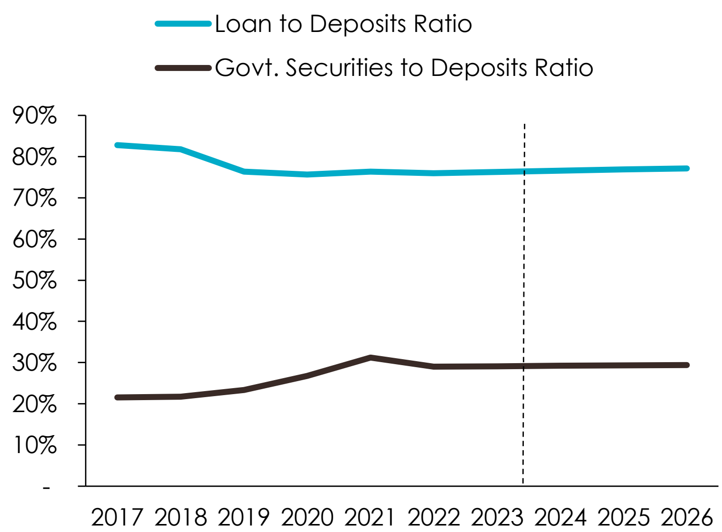












Valuation and Investment Guidance

Following the FY2023 earnings release, and given some of the key business announcements by the company since our last publication, we have reviewed our forecasts and subsequently our valuation of the stock.

From our estimates and assumptions, we see a significant downside potential and maintain a **SELL** recommendation with a target price of **KES 21.05.** The target price implies a downside of 13% to the current trading price of KES 24.15 as of 21st March 2024.

We used four valuation methodologies to arrive at our fair value estimate:

1. Residual Income
2. Price to Book Valuation
3. Price to earnings Valuation

Assumptions

- Risk free rate of 15.76% based on the 10-year Treasury bond average historical yields.
- Tax rate of 30%
- Equity risk premium of 9.5%
- Beta of 1.49 on stock's relative volatility on the index.
- Long term growth rate of 5.0% based on average GDP forecast.

Valuation Methodology	Implied Price	Weighting	Weighted Value
Residual Income	17.91	40%	7.17
P/B	24.45	40%	9.78
P/E	20.55	20%	4.11
Fair Value		**100%**	**21.05**
Current Price 21.03.2024			**24.15**
Upside/(Downside)			(12.8%)

Source: NCBA IB Research Estimates

About NCBA Investment Bank

NCBA Investment Bank is a subsidiary of NCBA Group. The services offered by the brokerage department include equities trading for listed securities, fixed income trading for both corporate and government bonds, Over the Counter (OTC) equity transactions as well as execution of equities transactions across the East African countries. Additionally, NCBA Investment Bank backs these activities with solid advice from the research team to enable investors meet their return objectives. NCBA Investment Bank deploys simple and convenient client driven technologies, robust risk management, highly competent and experienced staff and has the backing of robust research capabilities to differentiate itself from other players in the market.

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The following analyst(s) who prepared this research report: Victoria Mututu hereby certifies(y) that:

(i) All of the views and opinions expressed in this research report accurately reflect the research analyst's(s') personal views about the subject investment(s) and companies (y)

(ii) No part of the analyst's(s') compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed by the analyst(s) in this research report.

Rating Definitions

BUY – Total expected 12-month return (incl. dividends) **greater than 20%**
ACCUMULATE - Total expected 12-month return (incl. dividends) between **10% - 20%**
HOLD – Total expected 12-month return (incl. dividends) between **0% -10%**
SELL – Total expected 12-month return (incl. dividends) **less than 0%**

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