Earnings Update Q1-2018:

KNCB KN

18 May 2018

AIB Capital Ltd.

Your Vision… Our Mission

Recommendation:

BUY

Target Price: **KES 56.64**

Price on 17th May 2018:
KES 50.50

52-week Trading Range:
KES 23.00 to KES 55.00

Last 12 Months EPS:
KES 6.61

P/E
7.6

ROaE
20.2%

ROaA
3.2%

Dividend Yield:
5.9%

Market cap:
KES 154.84Bn

Estimated Free float:
82.5%

Shares Outstanding:
3,066.1 Million

Latest Full Year Results:
The full Year 2017

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KCB Group PLC

Re-Positioning the Balance Sheet

We amend our recommendation on KCB Group from HOLD to BUY at a valuation of KES 56.64 from KES 52.65 as per our FY-17 earning updates. This reflects a potential 12.2% upside from the current KES 50.50. This is in lieu of the company structuring its loan book to enable it to increase interest income in the era of interest rate capping law while positioning its balance sheet to take advantage of any reviews or repealing of the same law. KCB Group posted a 13.5% increase in Quarter One 2018 (Q1-18) Profits Before Tax (PBT) to KES 7.48Bn from KES 6.59Bn in Q1-17. Profits After Tax (PAT) stood at KES 5.18Bn a 14.1% growth from KES 4.54Bn.

Revamp of Interest Income: The Q1-18 performance was driven by an **11.0%** growth in Interest Income form **14.11Bn** to **KES 15.67Bn.** Net Interest Income advanced at a slower rate of **10.5%** due to Interest expense growing faster at **12.6%** to **KES 4.24BN** from **KES 3.77Bn** in Q1-17. This was due to increase in the cost of funding from growing deposits and change in deposit structure as Savings Deposit contribution increased to **5%** from **4%**, Call Deposits were up to **7%** from **5%** while term deposits and deposit demand shrunk to **64%** and **24%** from **66%** and **25%** respectively. Net Interest Margins (NIMs) advanced to **8.2%** in Q1-18 from **7.9%** in Q1-16.

Non-Funded Income (NFI) dropped marginally by **0.4%** to **KES 5.54Bn** from **KES 5.56Bn.** The drop was driven by **19.7%** and **2.3%** slip in forex trading income and fees and commissions on loans and advances. NFIs contribution to total Income eased to **32.7%** from **35.0%** in Q1-17.

Profit margins stood at **33.1%** from **32.2%.** Operating expense saw a slight **1.8%** upwards bumps in Q1-18 to **KES 9.48Bn** from **KES 9.32Bn** aided by **37.3%** shrink loan loss provision and a **0.2%** flat growth in staff costs. The Q1-18, Cost to Income Ration (CTI) eased to **48.3%** from **52.5%.** The ration excluded restructuring costs.

Balance Sheet Restructure: Balance sheet swelled by **6.9%** boosted by **5.8%** expansion in loan book to **KES 418.62Bn** from **KES 395.49Bn** while investments in government securities improved by **5.8%** to **KES 112.12Bn** from **KES 105.97Bn.** This was funded by an **8.7%** growth in customer deposits from **KES 496.37Bn** from **KES 456.82Bn.** Advance to Deposit (AD) Ratio eased to **84.3%** in Q1-18 from **86.6%** over the same period 2017 on slower growth of loan book compared to deposits. The bank has strategically positioned its balance sheet to take advantage of review or repealing of the interest rate cap law by shrinking its holdings in government securities held to maturity by **19.1%** while increasing available for sale security by **21.6%.**

Loan book continues to be dominated by the more secured personal loans mostly made of check-off loans. These grew by **KES 17Bn** compared to growth of **KES 13BN** and **KES 5Bn** in corporate and mortgages respectively. Groups Non Performing Loans (NPLs) increase to **9.8%** **(**Kenya Subsidiary **10%**) from **7.9%** while NPL coverage worsened to **64.0%** against **79.6%** same period 2017. This was driven by an increase in NPLs in trade and manufacturing which hold **8.6%** and **10.9%** of the total loan books. This is also reflected by an increase in corporate Micro and SME NPLs to **14.8%** and **16.3%** versus **10.4%** and **13.1%** respectively in Q1-17. Return on Average Equity (ROaE) remained flat at **20.2%** against **22.3%** FY-17.

The lender remains well-covered capital wise with Core Capital/Total deposits Liabilities at **17.1%**, Core Capital / total risk-weighted assets **15.1%**, and Total Capital/total risk-weighted assets **15.3%.** The Adjusted Capital Ratios include the expected credit loss provisions added back to Capital in line with the CBK Guidance Note issued in April 2018 on the implementation of IFRS 9 stood at **15%**, **15.9%** and **16.1%** respectively.

Forecast 2018: With a recovering economy, GDP projected growth of **5.5%,** positive producer's sentiments, we anticipate a decline in NPLs especially trade and manufacturing NPLs. Further growth in loan book (FY-18F**12%**) growth will be matched by growth in deposits. Cost of funds is set to remain stable at **3.1%** with Q1-18 debt to equity easing to **22.6%** from **23.3%.**

CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 2

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