KCB GROUP – FY2012 UPDATE

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Investment Summary

LONG TERM BUY recommendation maintained

We maintain our LONG TERM BUY recommendation of the KCB group with a target price of KES 39.26.

We remain of the view that the gains we are likely to see from KCB Group's strategy are going to trickle down to the company in the medium to long term, hence our LONG TERM BUY recommendation.

Key results highlight includes:

High yield driving interest income growth

High yield drive interest income growth: Total interest income went up by 51.2% to KES 43.1 billion compared to KES 28.5 billion recorded during the previous financial year. The yield on investment in government securities stood at 10.4% compared to 10.2% recorded in FY2011.

High interest rate environment drives up NIM: During the financial year under review, net interest margin went up to 10.9% compared to 10.1% recorded in FY2011.

Cost to income ratio on the decline

Cost to Income ratio on a downward trend: Total operating costs went up by 17.2% to KES 29.0 billion compared to KES 24.8 billion recorded during the previous financial year.

Going forward, we highlight the following key growth drivers:

- ✓ **Cost to Income:** We are likely to see the gains being made by the bank in terms of reduction of its cost to income ratio to continue in the short to medium term.
- ✓ **Regional branches:** During the financial year under review, the international business contributed KES 1.4 billion to the bottom line, a 40.0% increase from KES 1.0 billion contributions in FY2011.

Year to 31 Dec	2011A	2012A	2013F
Net Income (KES '000,000)	23,885	30,636	34,871
EPS (KES)	3.78	4.11	4.26
P/E	10.62	9.61	9.28
P/B	2.64	2.20	2.14
ROE	18.3%	24.8%	23.1%
ROA	2.9%	3.3%	3.1%
C/I	60.3%	57.4%	54.4%

Source: company reports & FIB estimates

KCB	Kshs '000		
Income statement	**FY2011**	**FY2012**	**% Growth**
Net Interest Income	23,885,146	30,636,232	28.3%
Fees and commissions	9,184,839	9,612,985	4.7%
Total income	*39,907,811*	*46,257,118*	15.9%
Loan loss provisions	(2,494,817)	(3,756,642)	50.6%
Operating expenses	(22,283,620)	(25,292,333)	13.5%
Profit before tax	*15,129,374*	*17,208,143*	*13.7%*
Tax	(4,148,328)	(5,004,612)	20.6%
Profit after tax	***10,981,046***	***12,203,531***	***11.1%***
Earnings Per Share(EPS)- Basic& Diluted	**3.78**	**4.11**	**8.7%**

Balance Sheet	**Sep-12**	**Dec-12**	**% Growth**
Total Assets	***322,462,058***	***367,379,285***	***13.9%***
Loan book	193,888,733	211,664,226	9.2%
Government securities	43,591,000	86,992,000	99.6%
Total customer Deposits	252,388,364	288,037,367	14.1%
Total Liabilities	*281,450,967*	*314,039,726*	*11.6%*
Shareholder funds & non controlling int.	*41,011,091*	*53,339,559*	*30.1%*
Total shareholder and liability funds	***322,462,058***	***367,379,285***	***13.9%***

Profit after tax up by 13.7%

KCB released its FY2012 results which showed a 13.7% increase in profit after tax to KES 17.2 billion compared to KES 15.1 billion recorded during the previous financial year. This was in line with our end of year forecast of KES 17.0 billion in our banking sector report, "The innovation imperative…".

The earnings per share stood at KES 4.11 compared to KES 3.78 recorded in FY2011. Our forecast for EPS stood at KES 4.13.

Total interest income went up by 51.2%

High yield drive interest income growth: Total interest income went up by 51.2% to KES 43.1 billion compared to KES 28.5 billion recorded during the previous financial year. This was driven by a 104.3% rise in interest income on government securities to KES 7.6 billion compared to KES 3.7 billion recorded in FY2011. Investment in government securities increased by 99.6% to KES 87.0 billion compared to KES 43.6 billion recorded during the previous financial year.

The yield on this investment in government securities stood at 10.4% compared to 10.2% recorded in FY2011.

Yield on loans and advances up to 16.1%

Interest on loans and advances went up by 43.9% to KES 34.0 billion compared to KES 23.6 billion recorded in FY2011. Yield on loans and advances went up to 16.1% compared to 11.9% recorded during the previous financial year.

High interest rate environment drives up NIM: During the financial year under review, net interest margin went up to 10.9% compared to 10.1% recorded in FY2011. This is despite the high interest rate environment which saw the bank's cost of funds go up to 4.2% compared to 1.9% recorded in FY2011.

The net interest income went up by 28.3% to KES 30.6 billion compared to KES 23.9 billion recorded during the previous financial years.

Other income dropped by 28.0%

Non Interest revenue under pressure: Total non interest income dropped by 2.5% to KES 15.6 billion compared to KES 16.0 billion recorded in FY2011. This was largely driven by a 28.0% drop in other income to KES 2.3 billion compared to

KES 3.2 billion recorded during the previous financial year. Fees and commissions on loans and advances also dropped by 11.6% which we attribute to the slow growth of the loan book, 6.5% y-o-y.

Cost to Income ratio on a downward trend: Total operating costs went up by 17.2% to KES 29.0 billion compared to KES 24.8 billion recorded during the previous financial year. This saw the cost to income ratio drop by 290 basis points to 57.4% from 60.3% recorded in FY2011.

Balance Sheet

Asset growth buoyed by loan book growth: Total assets for the bank grew by 13.9% on a q-o-q basis to KES 367.4 billion compared to KES 322.5 billion.

The bank's loan book grew by a moderate 9.2% during the same period to KES 211.7 billion from KES 193.9 billion recorded in 3Q2012, KES 17.8 billion. The loan book grew by 6.5% from 198.7 billion y-o-y.

Customer deposits up by 14.1%: Total liabilities went up by 11.6% to KES 314.0 billion from KES 281.5 billion recorded in 3Q2012.

Customer deposits also went up by 14.1% to KES 288.0 billion from KES 252.4 billion during the last three months of the financial year. Customer deposits grew by 11.1% from KES 259.3 billion.

Outlook

Going forward, we see KCB's growth drivers highlighted in the banking sector report, "An innovation imperative…" remain strong and there are gains to be made by the bank in the short to medium term.

Some of these growth drivers include:

- ✓ **Cost to Income:** We are likely to see the gains being made by the bank in terms of reduction of its cost to income ratio in the short to medium term. This is going to be driven by revenue growth, especially from non interest revenue, coupled with cost containment. During FY2013 the bank does not plan on opening any new branches and instead plans to focus on growing agency and mobile banking. During the year under review, the total number of agents grew by 77% to 4,627 agents which saw 5% of the bank's retail transactions done through the agency. Additionally, 10% of the bank's retail transactions are now being done through mobile banking.

- ✓ **Regional branches:** During the financial year under review, the international business contributed KES 1.4 billion to the bottom line, a 40.0% increase from KES 1.0 billion contributions in FY2011. We are likely to see the contribution continue to improve going forward as efficiency gains and optimization of the Burundi branch continues.

Therefore, we maintain our LONG TERM BUY recommendation of the KCB group with a target price of KES 39.26.

We maintain our LONG TERM BUY recommendation

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