KCB GROUP – 1Q2013 Results Note

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Investment Summary

We place a **BUY RECOMMENDATION** on KCB.

This based on our valuation of **KES 47.25** per share representing a **19.6% upside** from the current share price of KES 41.25 (17th May 2013). We arrived at our price target using the trailing P/B and forecasted 2013 BVPS.

Key Highlights

- **3.2% q-o-q drop in interest income to KES 9.7 billion in 1Q2013:** Total interest income dropped by 3.2% from KES 10.1 billion (1Q2012) to KES 9.7 billion (1Q2013).
- **Lower cost of funds led to decreased interest expenses:** Total interest expenses dropped by 23.6% to KES 2.4 billion (1Q2013) from KES 3.1 billion (1Q2012).
- **Total operating expenses decreased by 0.3%:** Total operating expenses dropped by 0.3% to KES 7.1 billion (1Q2013) from KES 7.2 billion (1Q2012).
- **Marginal drop in customer deposits:** Customer deposits dropped by 0.3% to KES 287 billion (1Q2013) from KES 288 billion (FY2012).

KCB GROUP 1Q2013 Earnings Update

Income statement (KES '000)	1Q2012	1Q2013	% Change
Interest income	**10,069,353**	**9,742,657**	**-3.2%**
Interest expense	3,098,418	2,368,334	-23.6%
Net Interest Income	6,970,935	7,374,323	5.8%
Other operating income	3,578,075	4,022,331	12.4%
Total Income	**10,549,010**	**11,396,654**	**8.0%**
Loan loss provision	793,673	573,774	-27.7%
Total operating expenses	7,155,983	7,133,992	-0.3%
Profit before tax (PBT)	**3,393,027**	**4,262,662**	**25.6%**
Profit after tax (PAT)	**2,426,548**	**3,033,619**	**25.0%**
Total comprehensive income for the year	**3,122,041**	**1,824,481**	**-41.6%**
Earnings Per Share (EPS)	**3.27**	**4.09**	**25.1%**
Cost/Income Ratio	**60.3%**	**57.6%**	
Balance Sheet (KES '000)	**FY2012**	**1Q2013**	**% Change**
ASSETS			
Kenya Government Securities (Held to maturity)	51,095,443	40,790,439	-20.2%
Kenya Government Securities (Available for sale)	13,618,250	13,321,940	-2.2%
Deposits and balances due from foreign banking institutions	20,477,204	16,730,523	-18.3%
Loans and advances to customers (net)	211,664,226	211,859,383	0.1%
Total Assets	**367,379,285**	**369,544,873**	**0.6%**
LIABILITIES			
Customer deposits	288,037,367	287,317,169	-0.3%
Borrowed funds	8,923,312	8,952,214	0.3%
Total Liabilities	**314,039,726**	**314,380,833**	**0.1%**
Total shareholders' Funds	**53,339,559**	**55,164,040**	**3.4%**
Loan/deposit ratio	**73.5%**	**73.7%**	
Liquidity ratio	**33.5%**	**37.1%**	

Source: Company Release

25.6% growth in profit before tax to KES 4.3 billion

KCB Group posted a 25.6% jump in profit before tax to KES 4.3 billion (1Q2013) from KES 3.4 billion (1Q2012). This was on the back of increased income from foreign exchange trading, increased income from other fees and commissions and a significant drop in interest expenses incurred on customer deposits.

3.2% q-o-q drop in interest income to KES 9.7 billion in 1Q2013: Total interest income dropped by 3.2% from KES 10.1 billion (1Q2012) to KES 9.7 billion (1Q2013).

Interest income from loans and advances dropped by 9.5% to KES 7.7 billion

Interest income from loans and advances dropped by 9.5% to KES 7.7 billion (1Q2013) from KES 8.5 billion (1Q2012). This could have been occasioned by the Kenya bank's decision to lower lending rates in December 2012 by 200 bps to 17.0% following a recent cut in the Central Bank Rate. The new rates were to be effective at the beginning of the current financial year. As a result, the yield on loans and advances dropped by 70 bps to 3.6%. It is worthy to note that the bank grew it's loan book by 8.5% from KES 195.3 billion in 1Q2012 to KES 211.9 billion in 1Q2013. However, there was marginal growth of 0.1% to KES 211.9 billion in 1Q2013 from KES 211.7 billion in FY2012.

Interest income from government securities increased by 21.2% q-o-q

Interest income from government securities increased by 21.2% q-o-q to KES 1.7 billion (1Q2013). The yield on government securities dropped by 40 bps to 3.2%.

Interest income from deposits and placements with banking institutions increased by 58.5% to KES 239 million (1Q2013). The yield on placemens with other banks dropped by 10 bps to 0.4% (1Q2013).

Interest expenses dropped by 23.6% to KES 2.4 billion

Lower cost of funds led to decreased interest expenses: Total interest expenses dropped by 23.6% to KES 2.4 billion (1Q2013) from KES 3.1 billion (1Q2012). Drop in interest rates led to the bank benefitting from cheap deposits and high interest rate spreads. Interest expenses on customer deposits dropped by 24.5% to KES 2.1 billion (1Q2013) from KES 2.8 billion (1Q2012). The cost of customer deposits dropped 30 bps to 0.7% (1Q2013) from 1.1% (1Q2012).

Interest expenses incurred on deposits and placements from banking institutions dropped by 15.5% to KES 276 million (1Q2013) from KES 327 million (1Q2012).

Fees and commissions on loans and advances dropped by 47.6%

Other operating income registered a 12.4% increase: Total non-interest income registered a 12.4% growth to KES 4.0 billion (1Q2013) from KES 3.6 billion (1Q2012). Fees and commissions on loans and advances dropped by 47.6% to KES 865 million (1Q2013) from KES 1.7 billion (1Q2012). This was despite an 8.5% rise in loans and advances to KES 211.9 billion (1Q2013) from KES 195.3 billion (1Q2012).

Other fees and commissions increased by 109.6% to KES 1.5 billion

Other fees and commissions increased by 109.6% to KES 1.5 billion (1Q2013) from KES 746 million (1Q2012). The increase could be attributed to the mobile banking platform (over 800,000 customers) and the agency banking partners (over 5,000 agents) which contributed 15.0% of the total business transactions.

Foreign exchange trading income increased by 26.9% to KES 1.0 billion (1Q2013) from KES 825 million (1Q2012).

Bad debts recovered increased by 6.0%

27.7% decrease in loan loss provision: Loan loss provision decreased by 27.7% to KES 574 million (1Q2013) from KES 794 million (1Q2012). Bad debts recovered increased by 6.0% to KES 265 million (1Q2013) from KES 250 million (1Q2012). However, the ratio of gross non-performing loans to the loan book increased by 120 bps to 7.6% (1Q2013) from 6.4% (1Q2012).

Total operating expenses decreased by 0.3%: Total operating expenses dropped by 0.3% to KES 7.1 billion (1Q2013) from KES 7.2 billion (1Q2012). The bank's operating efficiency is improving with the cost to income ratio dropping to 59.6% (1Q2013) from 62.0% (1Q2012).

Staff costs increased marginally by 1.8% to KES 3.6 billion (1Q2013) while rental charges dropped by 21.6% to KES 264 million.

Balance Sheet

Loans and advances to customers increased marginally by 0.1%

Total assets increased by 0.6% to KES 370 billion (1Q2013) from KES 367 billion (FY2012): Loans and advances to customers (net) increased marginally by 0.1% (KES 195 million) to KES 212 billion (1Q2013). The loan/deposit ratio increased by 20 bps to 73.7% in 1Q2013 from 73.5% in FY2012.

Kenya government securities (Held to maturity) reduced by 20.2% from KES 51.1 billion (FY2012) to KES 40.8 billion (1Q2013). Kenya government securities (Available for sale) decreased by 2.2% from KES 13.6 billion (FY2012) to KES 13.3 billion (1Q2013).

Customer deposits dropped by 0.3%

Marginal drop in customer deposits: Customer deposits dropped by 0.3% to KES 287 billion (1Q2013) from KES 288 billion (FY2012). Borrowed funds increased by 0.3% to KES 9.0 billion (1Q2013) from KES 8.9 billion (FY2012).

Customer deposits comprise Current (49.0%), Call (5.0%), FDR (23.0%), Transaction (20%) and Savings (3.0%). The bank continues to focus on retail deposits to drive down the overall cost of funds.

Increase in core capital/total risk weighted assets: Core capital/total risk weighted assets increased to 19.2% in 1Q2013 from 18.8% in FY2012 (minimum statutory ratio is 10.5%). Total capital/total risk weighted assets increased to 23.4% (1Q2013) from 21.5% (FY2012).

Outlook

Central Bank Rate cut to 8.5%

Following the rate cut by the Kenya central bank Monetary Policy Committee to 8.5% and the stable macro-economic environment, we expect to see an increased uptake of loans in the near future.

The group has placed emphasis on optimizing its subsidiaries ensuring consolidation and increased profitability going forward. There was strong growth in international business with an increase of 51.0% in pre-tax profit to KES 0.6 billion (1Q2013) from KES 0.4 billion (1Q2012). Contribution to profit before tax of subsidiaries stood at 14.2% (1Q2013) from 11.8% (1Q2012).

Further more, the group has outlined six key areas in which it intends to work on in its future outlook. These include:

- ✓ Strong perfomance driven by technology and innovation
- ✓ Top-line growth leveraging on non funded income
- ✓ Reduction in the NPL (Non Performing Loans) ratio
- ✓ Recoveries of NPLs
- ✓ Leverage on strong talent across the group business
- ✓ Focus on reduction of cost to income

Recommendation

We recommend a **BUY** on the counter

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