Q1 2025 Kenya Banks Earnings Update - KCB Group Plc

- KCB Group Plc Q1 2025 **Profit After Tax (PAT)** performance remained steady at KES.16.5Bn Year on Year (Yoy).
- **Earnings Per Share (EPS)** - Largely remained flat at KES.20.03 (Q1 2024 - KES.20.52).
- **Total Assets** - Flat at KES.2Tn. This however excludes impact of the reclassification of NBK's assets and liabilities to other assets and other liabilities respectively on the Group consolidated numbers.
- **Loan and advances** - Steady at KES.1Tn taking note that disbursements were in priority segments in Kenya, Tanzania, Burundi and Uganda.
- **Holdings of Government securities** - Declined 12.1% to KES.309.2Bn from KES.351.9Bn over the same period in 2024.
- **Customer deposits** - Down 6.7% to KES.1.4Tn (Q1 2024 - KES.1.5Tn) as a result of strategic decision to rebalance Government to Government (G2G) oil supply deal market share.
- **Total Interest Income** - Up by a meager 2.2% to KES.50.2Bn (Q1 2024 - KES.49.1Bn) following lag from **Interest income from Government securities** which declined 7.5% to KES.12.3Bn (Q1 2024 - KES.13.3Bn). This would be as a result of both decline in **Holdings of Government securities** and yields on the said securities.
- **Interest income from loans and advances** - Increased 5.7% to KES.35.5Bn from KES.33.6Bn Q1 2024.
- **Total Interest expense** - Down 8.3% to KES.16.5Bn (Q1 2024 - KES.18Bn) which would largely be as a result of decline in both bank and customer deposits given **Cost of Funds (CoFs)** remained flat at 4.1% Yoy.
- However, **Net Interest Margins (NIM's)** expanded to 7.8% (Q1 2024 - 6.6%) given stronger growth in asset yield to 12% from 10.7% over the same period when compared to CoFs.
- **Non-Funded Income (NFI)** - Declined 9.8% to KES.15.7Bn (Q1 2024 - KES.17.4Bn) driven by 35.4% reduction in Foreign Exchange (FX) trading income to KES.3.1Bn (Q1 2024 - KES.4.8Bn).
- We take note that **Fees and commission income from loans and advances** - grew 7.1% to KES.3Bn (Q1 2024 - KES.2.8Bn) while **other fees and commissions income** declined 1.4% to KES.7.1Bn from KES.7.2Bn in Q1 2024.
- **Operating income** - Up 1.9% to KES.49.4Bn (Q1 2024 - KES.48.5Bn) due to the aforementioned factors.
- **Operating expenses (OPEX) without provisions** - Up 8.1% to KES.22.7Bn (Q1 2024 - KES.21Bn) while **OPEX including provisions** increased 3.7% to KES.28.3Bn (Q1 2024 - KES.27.3Bn) given 11.1% decline in provisions to KES.5.6Bn (Q1 2024 - KES.6.3Bn).
- The Group's **Cost to Income Ratio (CIR) without provisions** was 46% (Q1 2024 - 43.3%) while the **CIR with provisions** at 57.3% compared to 56.3% in Q1 2024. Both metrics increased primarily as a result of weaker operating income growth.
- **Asset Quality** - **Gross Non-Performing Loans (NPLs)** - Increased 13.6% from KES.233.3Bn to KES.205.3Bn mainly driven by downgrades in Agriculture, Construction and Real estate sectors.
- **Gross Non-Performing Loan (NPL) Ratio** - Deteriorated further to 19.3%. Q1 2024, HY2024, Q3 2024 and FY2024 at 18.2%, 18.5%, 18.5% and 19.2% respectively with the ratio remaining higher than industry average of 17.2% as at February 2025.
- KCB Kenya and NBK are the key contributors of the high NPLs with stock at KES.184.3Bn and KES.32.2Bn representing 79% and 13.8% of the group gross NPLs.

- The Group's **Return on Equity** (RoE) declined to 23.3% (Q1 2024 - 28.7%) Yoy given flat PAT performance.
- Mark-to-market gains relating to the Group's holdings of investment securities through other comprehensive income (securities held for sale) amounted to KES.9.4Bn (Q1 2024 - KES.2Bn), showing the positive effect of declining interest rates on bond valuations.
- Core and Total capital adequacy ratios deteriorated slightly to 16.7% and 19.7% from 17.6% and 20% Q1 2024; minimum statutory ratio at 10.5% and 14.5% respectively.
- **Dividend** - No interim dividend was declared.

Subsidiary Performance

- **Asset base** - The contribution of KCB's subsidiaries (NBK, Tanzania, Rwanda, Uganda, South Sudan, Burundi and Democratic Republic of Congo) to the Group performance improved to 34.9% Yoy from 33.5% in Q1 2024.
- **PAT** - KCB's subsidiaries (NBK, Tanzania, Rwanda, Uganda, South Sudan, Burundi and Congo) percentage contribution to the Group remained steady at 35% over period under review.

FY2025 Outlook

- Our overall view of KCB Group remains broadly positive and is consistent with our previous assessment following the FY2024 results.
- As was indicated, interest income will remain under pressure FY2025 due to anticipated further decline in interest rates and ongoing uncertainty around lending in current tough macroeconomic environment.
- This is particularly in light of the potential shift from banks' risk-based credit pricing models to the Central Bank of Kenya's (CBK's) proposed lending framework, which aims to align lending rates more closely with monetary policy action.
- Although we noted in our FY2024 update that KCB's strong treasury function would continue to support NFI performance, the reduction in FX trading activities driven by a more stable KES and fewer trade opportunities, is expected to weigh on FX income and overall NFI in FY2025.
- We also note that tensions in the Democratic Republic of Congo (DRC) partly accounted for the flat TMB Q1 2025 PAT performance, as several banks in conflict-affected areas remained closed for the majority of the quarter.
- We will continue to closely monitor the evolution of these conflicts, as they remain a key determinant of TMB's performance in FY2025.
- The Group currently has two key transactions underway, both expected to conclude by June 2025: the sale of NBK and the 75% acquisition of Riverbank Solutions. The latter is aimed at enhancing the Group's distribution network.
- As highlighted in the shareholder circular dated 7th May 2025, certain assets and liabilities of NBK will be transferred to KCB Bank Kenya in a Hive-Out transaction expected to be concluded before 30th June 2025.
- We speculate that a portion of NBK's NPLs will be absorbed by KCB Bank Kenya which may further strain its asset quality considering the Bank's NPL stock stood at KES.184.3Bn as at Q1 2025.
- Retaining NBK as a subsidiary would have required additional capital infusion beyond the KES.14.6Bn already invested, an option deemed strategically unviable given NBK's historically low and expected future return on investment.
- During the FY2024 results briefing, management indicated that proceeds from the NBK sale

would be re-invested into the Group to support ongoing initiatives and provide capital injections into subsidiaries to further strengthen their capital buffers.

- Consequently, we anticipate stronger contributions from subsidiaries to the Group's overall performance in the long term.
- Additional growth opportunities for the Group include market entry into Ethiopia and the potential acquisition of the remaining 15% stake in Trust Merchant Bank (TMB).
- However, management has also indicated that reducing the Group's stake in TMB is under consideration.
- Given these investment priorities, we assess that there is a medium to low likelihood of a special dividend distribution to shareholders from the NBK transaction.
- Asset quality remains a key concern for the Bank, though the anticipated payment of pending Government bills should offer some relief.

Management's FY2025 guidance

- A comparison of management's FY2025 guidance to actual performance is highlighted on the table below:

Financial Metric	FY2025 Management Guidance (%)	Q1 2025 Actual (%)
NFI Ratio	33 - 34	31.8
Cost to Income Ratio	43 - 45	45.8
NPL Ratio	14 - 16	19.3
Cost of Risk	2.2 - 2.4	1.9
Cost of Funds	3.8 - 4.2	4.1
NIMs	6.6 - 7.4	7.8
Asset Yield	10.8 - 11.2	12
Loan Growth*	8 - 10	8.9
Deposit Growth*	9 - 11	-2.3
RoE	22 - 24	23.3

Source: Q1 2025 financial results presentation

*: Excluding impact of the reclassification of NBK

- The above guidance is based on expected macroeconomic conditions and KCB's internal growth projections.
- We see a moderate to high possibility of this guidance being achieved.
- We are currently revising our forecasts to reflect recent financial performance and will share an updated version of our fair value estimate in due course.