

## 2023 BANKS EARNINGS REVIEW: WE RETAIN OUR BUY RECOMMENDATION, DESPITE THE RUN-UP IN PRICES

In this note, we review FY23 earnings performance for banks in our coverage universe, against our forecasts and historical performance. We also review guidance provided by Equity (EQBK KN) and KCB (KNCB KN) - the only two banks that provide comprehensive 12-month forward management guidance. The review of management guidance first allows us to assess the quality of guidance and second, management's expectations versus past performance.

### Earnings Analysis – better than expected FY23 earnings performance, despite slowdown

- FY23 earnings grew, on average, by 14.8%, powered by growth in net interest income (+21.5% y/y, asset growth & partly, margins expansion) and non-funded income (+17.0% y/y, FX & fee income growth). NCBA bank registered the fastest EPS growth (+55.7% y/y) while KCB bank marked the largest EPS drop (-8.3% y/y). Notably, only KCB bank (-8.3% y/y) and Equity bank (-6.6% y/y) posted declines in FY23 EPS numbers, largely on account of above-average cost of risk and costs escalation.
- Against our FY23 earnings forecasts, the banks beat our estimates by 14.1%, on average. Net interest income (+7.4%), driven by loan growth (+4.8%), as well as lower-than-expected cost of risk (-60bps), explain the better-than-expected earnings performance. Against our forecasts, only Stanbic bank (-11.2%) and DTB bank (-7.5%) underperformed.
- FY23's average earnings growth of 14.8% lagged the 5-year historical average earnings growth of 20.5%. On average, FY23 NIMs were 90bps lower and the cost of risk 30bps higher.
- **Looking ahead, we forecast a 3-year average industry EPS growth of 10.2%, mainly on account of measured non-funded income growth (on normalization of FX income) and elevated cost of risk as NPLs remain sticky at the double-digit level. We expect earnings performance to be driven by a recovery in margins (on gradual decline in cost of deposits & continued re-pricing of loans within the risk-based pricing models) and steady asset growth (as regional operations continue to scale following completed series of M&As).**

### Assessment of Equity and KCB Management Guidance – ROE outcome has mostly underperformed guidance

- An analysis of Equity's and KCB's management guidance revealed mixed outcomes - 83% of the times, Equity missed its ROE guidance while KCB missed its ROE guidance 50.0% of the times. In FY23, Equity & KCB missed their ROE targets by 170bps and 20bps, respectively. Over the last 4 years, for Equity, margins have shown the least variability from guidance, while the highest miss has been on deposits. Similarly, for KCB, NIMs have shown the least variability from guidance, while the highest miss has been on deposits.
- **For FY24, both banks guide for above historical average ROE, 27.5% by Equity and 24.6% by KCB. Both banks expect balance sheet growth to slow, NIMs to remain steady (for Equity) but grow (for KCB) and cost of risk and NPLs to decline. Our forecast FY24 ROEs stand at 17.8% and 12.1% for Equity and KCB, respectively.**

### Recommendation – prices have run-up in 1Q24, but we still see value

- We re-iterate our BUY recommendation, based on our market-cap weighted price return of 24.7%. Our target return is lower than our 49.8% return estimate at the start of FY24 - this has been chipped at by the rally in banking stocks in 1Q24. Given our expectation of earnings slowing (3-year average EPS growth of 10.2%) and our average exit PB multiple (used to compute our terminal values) of 0.7x versus realized historical average of 1.0x, our BUY recommendation is not a stretch in our view.

Valuation and Rating

	FV (KES)	Upside/(downside)	YTD performance	Recommendation
Equity	48.38	4.2%	38.0%	HOLD
KCB	52.77	75.6%	37.2%	BUY
Co-op	22.60	59.1%	24.6%	BUY
DTB	127.90	154.5%	11.5%	BUY
I&M	37.48	72.7%	24.0%	BUY
NCBA	44.81	0.7%	14.2%	HOLD
Stanbic	120.24	2.1%	8.3%	HOLD
ABSA	14.45	6.7%	18.3%	HOLD
StanChart	152.76	-23.3%	23.0%	SELL

Source: Company, Kestrel Research

Key Performance drivers

Bank	FY23 performance drivers	FY24 performance drivers
Equity	Fee & FX income growth, lower effective tax; Opex growth & provisions	Margins expansion & asset growth
KCB	Asset growth, fee income growth (digitally led), lower effective tax; Opex growth (one-offs, TMB, legal claim) & loan loss provisions	Margins expansion & asset growth
Co-op	Asset growth, fee income growth; contained operating costs, reduced loan loss provisions	Margins expansion & asset growth
DTB	Fee & FX income growth, lower effective tax; Other Opex growth & increased provisions	Margins expansion & asset growth
I&M	Asset growth, Fee income growth; Opex growth & increased provisions	Margins expansion & asset growth
NCBA	Asset growth, Fee income growth, lower effective tax; Opex growth & reduced provisions	Margins expansion & asset growth
Stanbic	Fee income growth; Opex growth & increased provisions	Margins expansion
ABSA	Fee income growth; Opex growth & increased provisions	Margins expansion
StanChart	Asset growth, Fee & FX income growth, Reduced interest expense; Opex Growth & increased provisions	Margins expansion

Source: Company, Kestrel Research

FY23 PERFORMANCE ANALYSIS

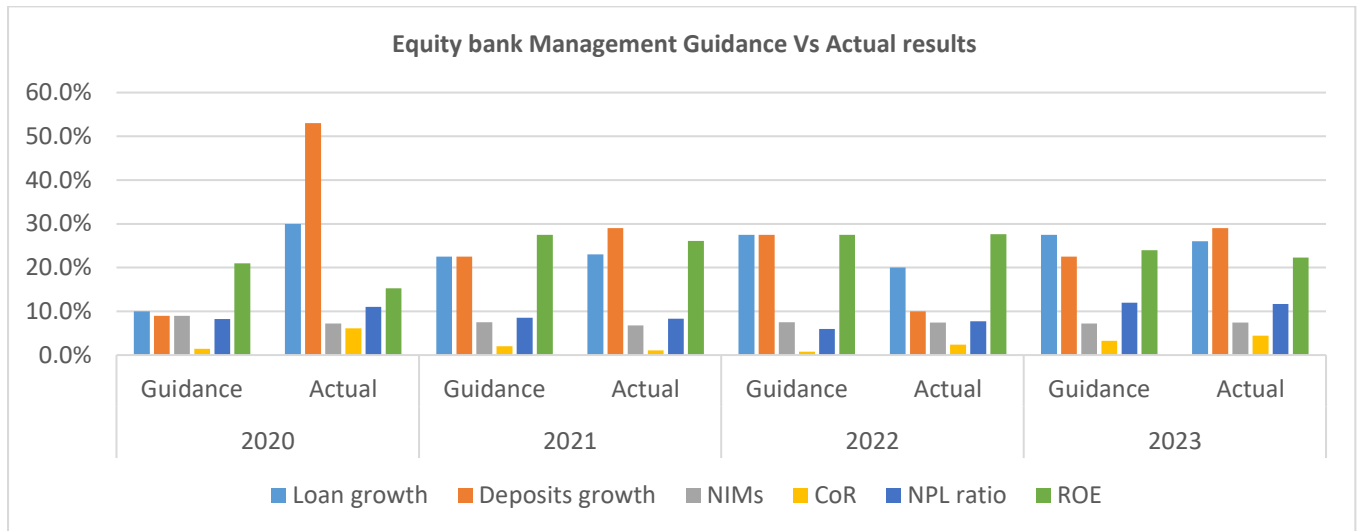
METRIC	Equity	KCB	Co-op	DTB	I&M	NCBA	SBIC	ABSA	SCBK	Avg.	5-yr avg.	3-yr Forward
NIM	6.5%	5.4%	7.1%	4.9%	5.6%	4.9%	5.5%	8.4%	8.0%	6.3%	7.2%	7.3%
NII growth	21.2%	23.9%	-0.6%	20.5%	24.8%	12.8%	35.0%	23.9%	32.0%	21.5%	9.6%	11.5%
NFI mix	42.9%	35.0%	36.9%	30.6%	32.9%	45.7%	37.9%	26.6%	29.7%	35.4%	34.9%	32.6%
NFI growth	30.7%	33.9%	2.8%	34.3%	15.8%	-3.9%	22.4%	11.6%	5.5%	17.0%	11.4%	2.8%
CoR	3.5%	2.6%	1.4%	2.9%	2.0%	2.4%	2.5%	2.5%	1.9%	2.4%	2.1%	2.2%
CTI	52.3%	50.3%	47.0%	51.7%	47.6%	45.7%	43.5%	39.7%	44.8%	47.0%	47.2%	47.3%
Opex growth	34.9%	40.1%	1.4%	37.5%	31.2%	17.0%	17.9%	16.0%	20.2%	24.0%	10.5%	9.7%
EPS growth	-6.6%	-8.3%	5.1%	13.5%	12.7%	55.7%	34.2%	12.1%	14.9%	14.8%	20.5%	10.2%
DPS	4.00	0.00	1.50	6.00	2.55	3.00	14.20	1.55	29.00	6.87		
Net loan growth	25.6%	27.0%	10.3%	21.6%	30.5%	20.8%	10.4%	19.4%	17.0%	20.3%	11.8%	10.9%

April 2024

METRIC	Equity	KCB	Co-op	DTB	I&M	NCBA	SBIC	ABSA	SCBK	Avg.	5-yr avg.	3-yr Forward
Deposit growth	29.1%	48.9%	6.6%	25.4%	33.4%	15.3%	17.3%	18.4%	22.9%	24.1%	13.5%	10.1%
NPL ratio	11.4%	16.0%	15.2%	12.4%	10.2%	11.7%	9.2%	9.5%	9.6%	11.7%	11.1%	12.0%
NPL coverage	43.9%	57.9%	53.6%	40.8%	49.7%	43.7%	61.9%	59.1%	70.8%	53.5%	56.9%	63.4%
ROE	21.0%	16.4%	20.4%	12.2%	15.3%	24.0%	20.4%	23.7%	22.5%	19.5%	16.4%	17.1%

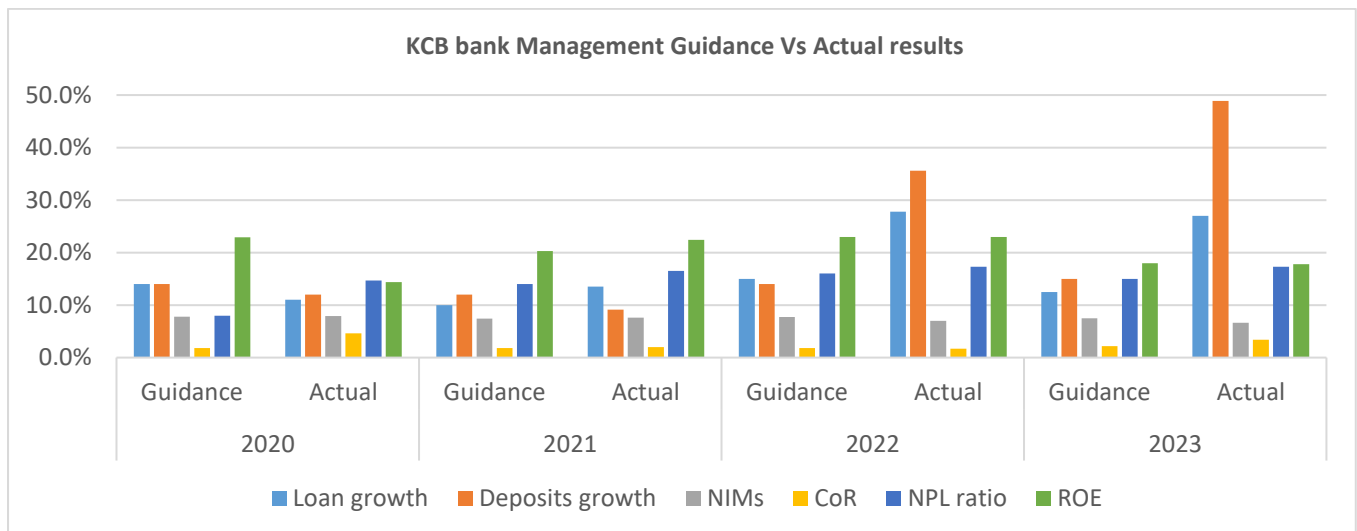
Source: Company, Kestrel Research

**Equity bank missed its ROE targets 83% of the times**



Source: Company, Kestrel Research

**KCB bank missed its ROE targets 50% of the times**



Source: Company, Kestrel Research

Equity & KCB largely optimistic on cost efficiency & improvement in asset quality

	ASSESSMENT OF MANAGEMENT GUIDANCE					
	Equity bank			KCB bank		
	2023		2024	2023		2024
	Guidance	Actual	Guidance	Guidance	Actual	Guidance
Loan growth	27.5%	26.0%	17.5%	12.5%	27.0%	16.0%
Deposits growth	22.5%	29.0%	17.5%	15.0%	48.9%	13.0%
NIMs	7.3%	7.4%	7.4%	7.5%	6.6%	7.1%
CoR	3.3%	4.4%	2.3%	2.2%	3.4%	2.0%
NPL ratio	12.0%	11.7%	10.0%	15.0%	17.3%	13.5%
ROE	24.0%	22.3%	27.5%	18.0%	17.8%	24.6%

Source: Company, Kestrel Research

FY23 VARIANCE ANALYSIS: ACTUAL VS FORECASTS

METRIC	Equity	KCB	Co-op	DTB	I&M	NCBA	SBIC	ABSA	SCBK	Avg.
NIM	-0.3%	-0.3%	-0.6%	-0.4%	-0.4%	-1.3%	1.2%	0.3%	0.9%	-0.1%
NII growth	13.4%	18.7%	-3.2%	0.2%	14.7%	4.8%	-1.5%	0.5%	18.7%	7.4%
NFI mix	2.5%	-1.6%	-2.0%	1.5%	-3.5%	-2.8%	-3.9%	-1.6%	-8.3%	-2.2%
NFI growth	25.8%	12.5%	-6.9%	9.8%	-3.4%	-7.1%	-16.1%	-8.9%	-25.6%	-2.2%
CoR	0.2%	-1.1%	-0.9%	0.0%	-0.4%	-1.7%	0.7%	-1.2%	-0.7%	-0.6%
CTI	4.5%	-4.9%	-0.5%	4.2%	0.7%	-1.4%	0.0%	1.8%	-0.8%	0.4%
Opex growth	29.8%	6.6%	-2.5%	14.1%	11.0%	-4.9%	-8.4%	3.0%	1.1%	5.5%
EPS growth	13.4%	40.0%	10.1%	-7.5%	24.7%	40.7%	-11.2%	6.3%	10.1%	14.1%
DPS	9.7%	100.0%	0.0%	-11.8%	21.7%	1.1%	-19.4%	9.5%	26.4%	15.2%
Net loan growth	-1.3%	9.6%	-1.3%	5.8%	16.0%	10.2%	-0.7%	-0.7%	5.8%	4.8%
Deposit growth	6.4%	3.3%	-5.3%	9.5%	20.1%	7.3%	12.2%	-4.6%	14.8%	7.1%
NPL ratio	-5.8%	-1.2%	0.6%	0.5%	-1.7%	0.1%	-1.7%	-0.1%	-7.6%	-1.9%
NPL coverage	-2.9%	21.8%	-2.3%	-5.3%	-15.7%	-7.2%	-8.9%	-10.2%	18.8%	1.3%
ROE	2.2%	3.8%	2.6%	2.1%	2.9%	6.5%	-4.2%	0.8%	0.3%	1.9%

Source: Company, Kestrel Research

## Disclaimer

**Note:** Readers should be aware that Kestrel Capital (EA) Ltd does and seeks to do business with companies covered in its research reports. Consequently, a conflict of interest may arise that could affect the objectivity of this report. This document should only be considered a single factor used by investors in making their investment decisions. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions.

The opinions and information portrayed in this report may change without prior notice to investors. This publication may not be distributed to the public media or quoted or used by the public media without prior and express written consent of Kestrel Capital (EA) Ltd.

Directors, staff of Kestrel Capital (EA) Ltd and their family members, may from time to time hold shares in the company it recommends to either buy or sell and as such the investor should determine for themselves the applicability of this recommendation.

This document does not constitute an offer, or the solicitation of an offer, for the sale or purchase of any security. Whilst every care has been taken in preparing this document, no representation, warranty or undertaking (express or implied) is given and no responsibility or liability is accepted by Kestrel Capital or any employee of Kestrel Capital as to the accuracy of the information contained and opinions expressed herein.

**Kestrel Capital E.A. Ltd.**

Orbit Place, 1<sup>st</sup> Floor  
Westlands Road

Tel: +254 20 2251758

research@kestrelcapital.com  
www.kestrelcapital.com

**Bloomberg: KEST <GO>**

---

### Equity Sales & Trading

**Sally Kotut**  
sallyk@kestrelcapital.com

**Chris Miriti**  
chrism@kestrelcapital.com

**Amanda Onyango**  
amandao@kestrelcapital.com

---

### Research

**Ephantus Maina**  
ephantusm@kestrelcapital.com

---

### Fixed Income Sales & Trading

**Alexander Muiruri**  
alexanderm@kestrelcapital.com

**Edwin Muthaura**  
edwinm@kestrelcapital.com

---

### Executive Director

**Francis Mwangi, CFA**  
francism@kestrelcapital.com