Kenya Listed Commercial Banks Analysis

Cytonn FY'2015 Banking Sector Report

"A Sector In Volatile Transition"

5th April, 2016

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I: Overview of the Firm

100 Members, 1 Agenda – The Client

Introduction to Cytonn Investments

Cytonn Investments is an independent investments management company

- Our mission is that ***"we work to deliver innovative & differentiated financial solutions that speak to our clients needs***"

- Cytonn Investments is differentiated in several respects:

1. **Independence & Investor Focus:** Cytonn is solely focused on serving the interest of clients, which is best done on an independent investment management platform to minimize conflicts of interest

2. **Alternative Investments:** Specialized focus on alternative assets - real estate, private equity, and structured products

3. **Partnerships with Global Institutional Investors:** Such as Taaleritehdas of Finland

4. **Strong Alignment:** Every staff member participates in ownership. When clients do well, the firm does well; and when the firm does well, staff do well

Cytonn INVESTMENTS

Cytonn's Corporate Structure – Kshs 57 Bn Under Mandate

Cytonn Investments

Kenya

Cytonn Investments Ltd

- Independent investment management company, serving HNW & institutional clients

Cytonn Real Estate

- Development affiliate providing investment grade real estate development solutions

Private Equity

- Financial Services
- Education
- Technology

United States

Cytonn Diaspora

- Diaspora platform connecting investors in the diaspora with opportunities in the East African Region

Cytonn Investments LLC

- US advisory and investment management company

Board of Directors

The board is comprised of 10 members from diverse backgrounds, each bringing in unique skill-sets

Prof. Daniel Mugendi,
Chairman

Antti – Jussi Ahveninen,
Non-executive Director

Madhav Bhalla,
Non-executive Director

James Maina,
Non-executive Director

Nasser Olwero,
Non-executive Director

Kenneth Ndura
Non-executive Director

Mike Bristow,
Non-executive Director

Edwin H. Dande,
Managing Partner & CEO

Elizabeth N. Nkukuu,
Partner & CIO

Patricia N. Wanjama,
Partner & Head of Legal

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The Management Team

The team brings in diverse global and local experience

Edwin H. Dande,
Managing Partner & CEO

Elizabeth N. Nkukuu,
Partner & CIO

Patricia N. Wanjama,
Partner & Head of Legal

Maurice Oduor,
Finance and Investment Manager

Johnson Denge,
Real Estate Services Manager

Robert M Mwebi,
Project Manager

Martin Gitonga
Project Manager

Shiv Arora,
Head of Private Equity Real Estate

Gaurang Chavda,
Head of Private Wealth Management

Winfred Ndung'u,
Brand & Business Administration Manager

Beverlyn Naliaka,
PR & Communication

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Cytonn Investment Solutions

We offer differentiated investment solutions in four main areas

High Yield Solutions

- The Team's expertise and market knowledge enable us to offer investors higher yields than the market average
- Regular credit analysis, quick dealing capability and the large banking spread in the market allow the team to capitalize on investment opportunities

Real Estate Investment Solutions

- Our unique strategic partnerships with Cytonn Real Estate, our development affiliate, enables us to find, evaluate, structure and deliver world class real estate investment products for investors
- Our platform connects global capital seeking attractive return with institutional grade development opportunities in the East African region

Private Regular Investment Solutions

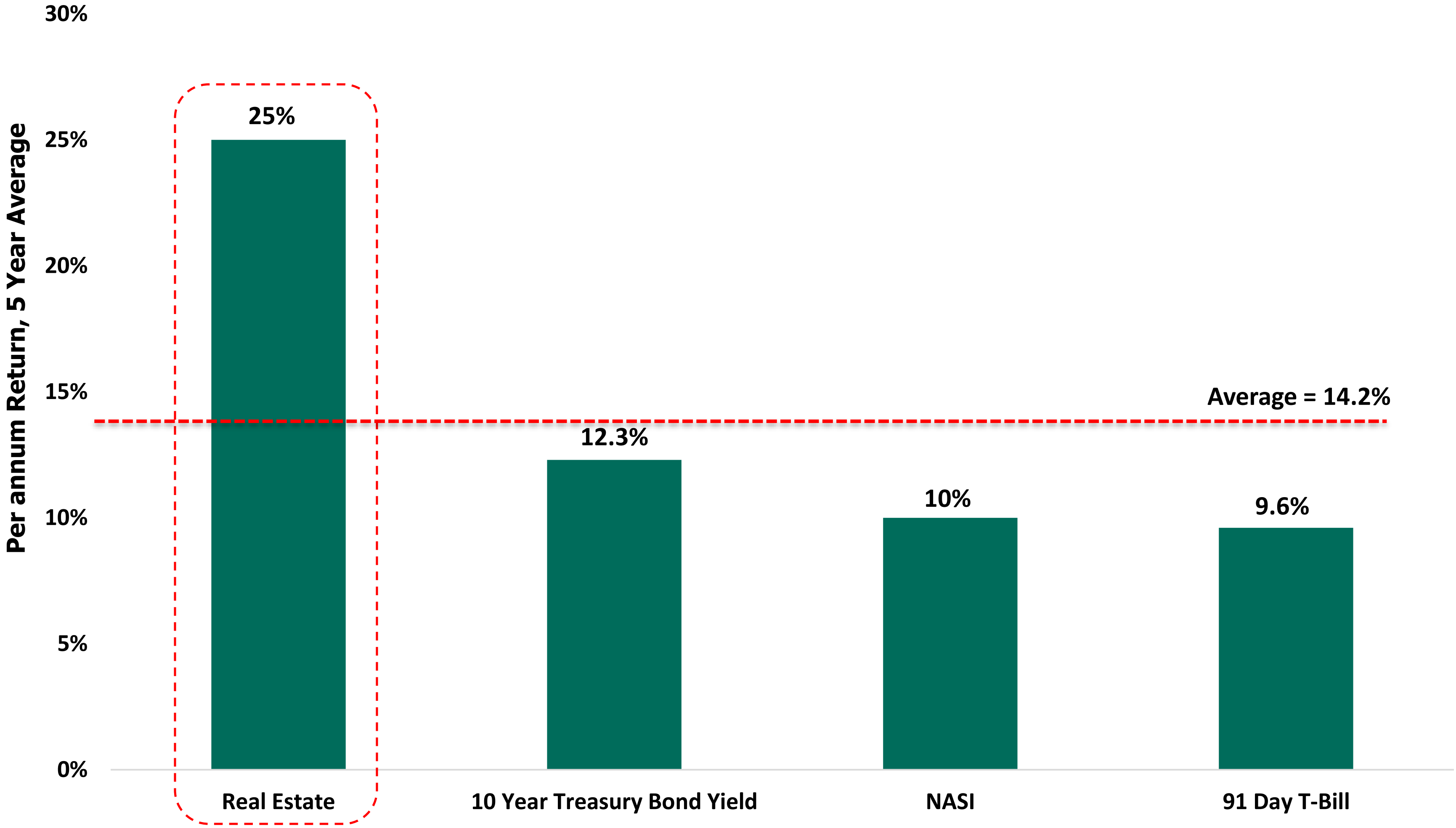
- We understand that investors have varying financial goals. Our highly customized and simple to understand investment products will enable you to achieve your investment objective
- We offer solutions to both local investors, and those in the diaspora interested in the investment opportunities back in Kenya and the region

Private Equity

- Cytonn seeks to unearth value by identifying potential companies and growing them through capital provision and partnering with their management to drive strategy
- We primarily invest in the Financial Services, Education and Technology sectors

Cytonn focuses on the highest returning Asset Class

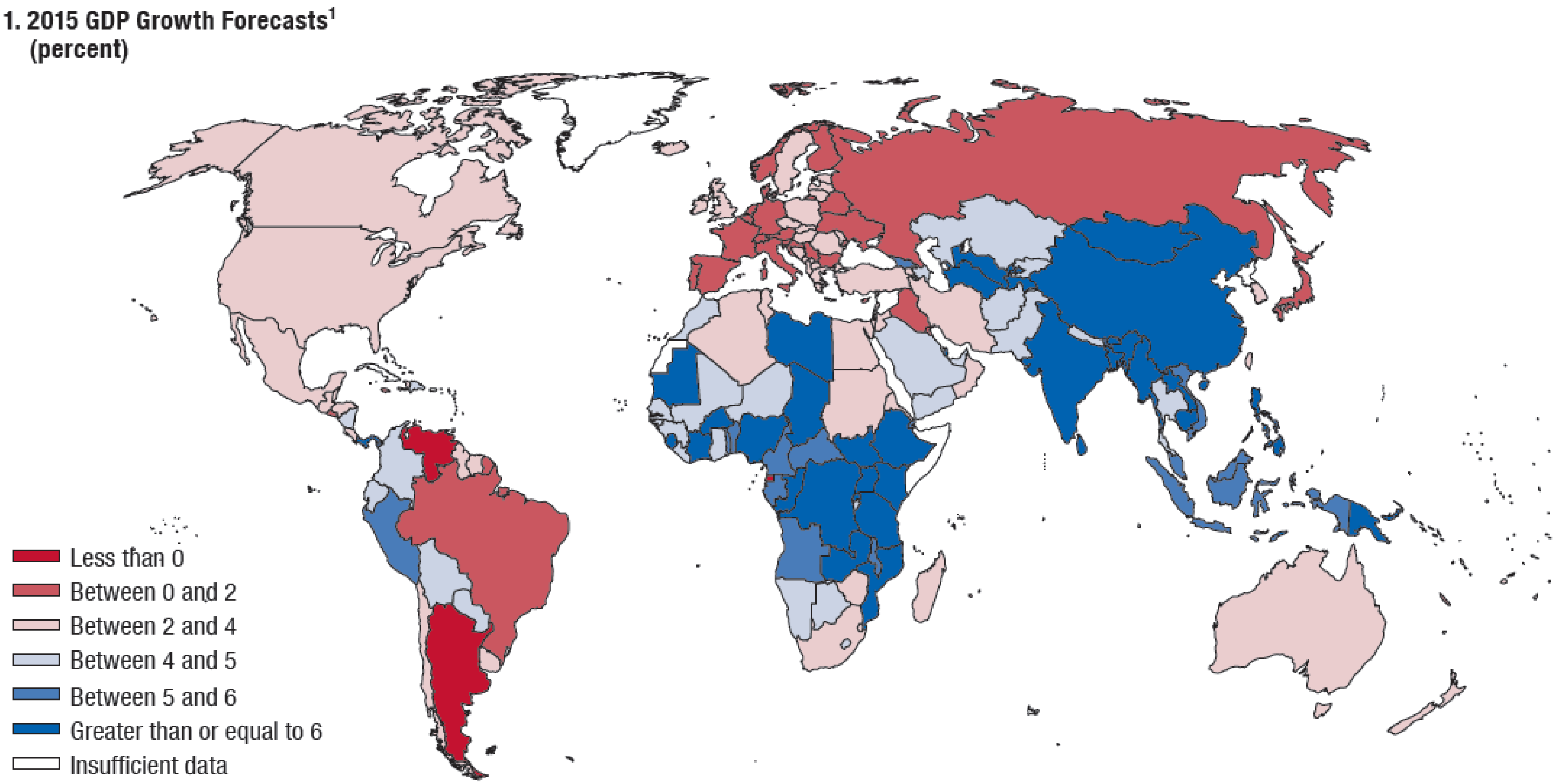
Traditional investments returning 10% compared to 25% for real estate, & projected to continue



Global view of economic growth determines regions of focus

There is demand from global capital (light colors) looking for attractive returns (dark colors)

Figure 2.1. 2015 GDP Growth Forecasts and the Effects of a Plausible Downside Scenario



Key themes driving our property development

A large housing deficit, growth of the middle class and demographic trends are just a few on the factors driving our thematic investments in Real Estate

KEY THEME	REAL ESTATE SECTOR PROVIDING EXPOSURE TO KEY THEME				
	Master Planned Communities	**Commercial Office Parks**	**Commercial Mixed-Use**	**Suburban Malls**	**Three Star Hotels**
1. Large Housing Deficit	✓		✓		
2. Growth of Middle Class	✓	✓	✓	✓	✓
3. Demographic Trends	✓	✓	✓	✓	✓
4. Improved Infrastructure	✓	✓	✓	✓	✓
5. Political Decentralization	✓	✓	✓	✓	✓
6. Kenya as a Regional Hub	✓	✓	✓	✓	✓

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Deal pipeline overview – 85% to low and mid-income housing

Kshs 57 Billion Deal Pipeline

Low to mid-income Housing
85%

- Masterplanned Development
- Comprehensive Development
- Low to mid-income Modular Housing

Prime Residential and Mixed-use
15%

- High Density Integrated Mixed-use
- Gated Communities

Summary of Projects - Kshs 57 bn Deal Pipeline Details

- **Set 1:** Real estate projects where the design, concept, agreements and funding are all secured, and have ground broken or in the process of ground breaking
- **Set 2:** Real estate projects where the Cytonn Real Estate team is in advanced stages of negotiations with the landowners, and where consultants have been appointed to begin market research and concept design

all values in Kshs Millions unless stated

Projects	Concept	Project Size
SET 1		
Amara Ridge	Gated community	625.0
Situ Village	Gated masterplanned community	4,500.0
The Alma	Middle-class residential development	2,744.0
Athi Sharpland	Site & Service Scheme	644.7
Project Hurlingham	Mixed Use Development	4,045.0
Ruaka 2	Middle-Class Residential development	522.9
Rongai Sharpland	Site & Service Scheme	375.5
Sub - Total		**13,457.1**
SET 2		
Project Mombasa	High density mixed-use development	3,750.0
Kiambu Road	Middle-class gated community	3,832.0
Project Kitale	Masterplanned development	700.0
Project Mavoko	Low to mid income masterplanned city	12,500.0
Project Lukenya	Low to mid income masterplanned city	22,500.0
Sub - Total		**43,282.0**
TOTAL		**56,511.7**

Cytonn's strategy brings three key pillars together

Financing Capability

Development Capability

1. Creating Jobs
2. Growing the Economy
3. Improving the standards of living

Landowners

I. Economic Review and Outlook

Summary Economic Outlook

Key indicators point to a pick-up in economic performance in 2016

Macro-Economic Indicators	2015 Experience	2016 YTD Experience	Going Forward	Outlook
GDP	Kenya's GDP for the full year 2015 is expected to average 5.5% as per local, IMF and World Bank projections	Expected to improve with a conducive and stable macroeconomic environment and tea exports improving for the year	We project the 2016 GDP to come in at an average 5.8%	**Positive**
Interest Rates	The CBR increased 300 bps to 11.5% in August 2015 with the 91-day starting the year at a rate of 11.7%	There has been a downward pressure on interest rates in January and February given reduced pressure on government borrowing. The CBR and KBRR rates were maintained by the MPC	Interest rates expected to remain on downward trend that will persist for the better part of the year	**Neutral**
Inflation	(i) December inflation at 8.0% (highest for year)	Inflation declined from the high of 8.01% in December through January to March at 6.5%	Expected to remain within the CBK target rising in September when additional VAT on petroleum is introduced	**Neutral**
Exchange Rate	The shilling depreciated 13.0% against the dollar from 90.70 in Jan to 102.30 in Dec The foreign reserves improved to 4.5months by Dec 2015	The shilling has remained stable supported high forex reserves translating to 4.7 months of import cover as a result of the reducing current a/c deficit. Kenya has received an increased credit facility by IMF to the value of USD 1.5 bn	Shilling to remain stable in the short term but will be under pressure in the long term against major currencies and expectation of Fed rate hikes	**Neutral**

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Summary Economic Outlook, continued…

Key indicators point to a pick up in economic performance

Macro-Economic Indicators	2015 Experience	2016 YTD Experience	Going Forward	Outlook
Corporate Earnings	The year experienced weak earnings from the listed banking sector with Core EPS growth of 2.8% in 2015. 17 listed and 1 unlisted company issued profit warnings as a result of a tough operating environment	Several companies have released positive FY'2015 results, mainly manufacturing companies. Bamburi, BAT, EABL and Kengen and banks KCB, I&M, Co-operative and DTB with profits ranging between 10%-20%	To improve due to the relatively improving interest rate environment, stable shilling and improvement in credit growth	**Positive**
Foreign Investor Sentiment	Increased flows out of Kenya owing to the US interest rate hike compared to inflows into equity markets as a result of volatility in interest rates	Investor sentiment has been high with foreign investors being net buyers in Q1'2016 with net inflows of Kshs 498.0 mn	Chinese economic slowdown and devaluation of their currency may lead to poor performance of most emerging and frontier market indices. However, Kenya's NSE still remains attractive to foreign investors	**Neutral**
Security & Political Environment	Improvement witnessed in levels of security with tourism levels increasing in the month of December compared to the previous year and reduced terrorist attacks	Kenya has received an upgrade in credit rating by Moody's as a positive indicator that the environment is safe to carry out business operations	Increased spending on security equipment and recruitment of more personnel will enhance the country's security, however heightened tensions before the National elections next year will weigh on the political environment	**Neutral**

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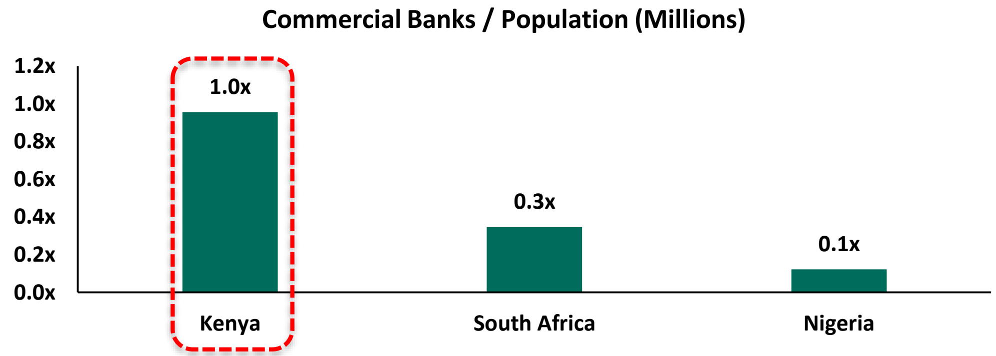
II. Kenya Banking Sector Overview

Kenya's Banking Sector Overview

Kenya is over-banked, with 42 commercial banks serving a population of 44 mn people

- In Kenya there are a total of 42 commercial banks, 1 mortgage finance company, 12 microfinance banks, 8 representative offices of foreign banks, 86 foreign exchange bureaus, 14 money remittance providers and 3 credit reference bureaus
- All banks are regulated by the Central Bank of Kenya. The Capital Markets Authority has additional oversight over the listed banks. All banks are required to adhere to certain prudential regulations such as minimum liquidity ratios and cash reserve ratios with the Central Bank
- We maintain our view that Kenya is over-banked with a relatively high ratio of banks to total population, with 42 commercial banks serving of 44 million people, compared to Nigeria's 22 for 180 million and South Africa's 19 for 55 million. This has led to the consolidation of banks through acquisitions such as Giro bank by I&M Holdings



Growth in the Banking Sector

Tough operating environment in 2015 was characterized by high and volatile interest rates, with growth underpinned by alternative banking channels and regional expansion

- Banking sector in Kenya experienced growth in 2015 in assets, deposits, profitability and products offering, leveraging on diversification to alternative channels, albeit in a tough operating environment, characterized by high interest rates in FY'2015
- The listed banking sector's aggregate gross loans and advances grew by 17.0% to Kshs 1.8 trillion in December 2015 from Kshs 1.5 trillion in 2014 while deposits grew 14.5% to 2.0 trillion in December 2015 from 1.8 trillion in 2014
- Total assets grew 14.9% in December 2015 to Kshs 2.8 trillion, from Kshs 2.4 trillion in 2014
- Since 2010 the aggregate of listed banks profit after tax has grown at a CAGR of 13.5%
- Deposits have grown at a CAGR of 13.5%, with loans and advances having outpaced deposit growth at a CAGR of 19.4%
- Growth has mainly been underpinned by:
  - **Banks responding to the needs of the Kenyan market for convenience and efficiency through alternative banking channels such as mobile, internet and agency banking**
  - **Branch network expansion strategy both in Kenya and in the East African community region**
  - **Increased use of alternative channels, such agency, mobile and internet banking. Cashless cards use has also been on the rise**

Banking Sector Growth Drivers

Alternative channels, cost containment and expansion support banks’ growth and diversification

1) **Technology to enhance cost containment initiatives**: Banks have embraced low cost operating models such as agency banking, integration with mobile application platforms and internet banking that have lead to increased uptake of banking services particularly in the mass market. The use of Alternative channels will reduce operating expenses and improve efficiency and will be a key driver for diversification

2) **Growth of the retail segment**: As the middle-class grows rapidly in Kenya, faster than majority of the countries in the region, there is an inherent increase in consumption expenditure and an increase in the percentage of the population which will require banking services

3) **Expansion both regionally and domestically**: With increased financial inclusion in Kenya at 75%, banks looking to expand in the less penetrated markets of Tanzania, Uganda, Rwanda, South Sudan and DR Congo are opening up new channels of revenue in countries with relatively attractive spreads compared to Kenya

4) **Regulatory Environmen**t: The CBK has tightened its regulations on banks with emphasis on transparency on lending rates, governance and capitalization. Banks are expected to remain stable and position themselves for stable growth

Recent Developments in the Banking Sector

The tough operating environment led to a decline in rates, and increased loan loss provisions, while moratoriums were announced on new banks licensing

1. **Decline in Interest Rates**: Interest rates have been declining in 2016 after continued increase in the fourth quarter of 2015, following volatility in the third quarter of 2015, with the interbank rate and the 91 day T-bill touching lows of 3.8% and 9.0%, respectively. The Monetary Policy Committee has currently maintained the CBR rate at 11.5% during the last two meetings in January and March which speaks to a more conservative and disciplined regulator
2. **Moratorium on the Licensing of New Banks:** The Central Bank of Kenya announced a moratorium on the licensing of new banks with the exception of cases related to amalgamation and acquisition of banks in Q3'2015 which still holds to date. With a high number of commercial banks, currently at 42, we expect a strain on the thoroughness and diligence of the regulatory supervisor, CBK
3. **Increase in Loan Loss Provisions:** As a result of the high interest rate environment in 2015 and following the exposure to Imperial Bank and Dubai Bank, banks have built up capital and other provisionary requirements with the most notable being the increase in the listed banks' loan loss provisions by 85.4%. This has led to an increase in the cost to income ratios of banks. The non-performing loans for the year also rose as a result of the expensive costs of financing loans

Recent Developments in the Banking Sector, continued…

The increased loan loss provisions and volatile environment has led to lower earnings, while CBK and Government made moves to regulate the rate environment

4. **Lower Earnings Growth:** Kenya banks recorded much lower earnings growth, driven by the challenging economic environment in 2015, with the high interest rates which reduced credit uptake especially by the private sector while at the same time having a profound effect on deposit mobilizations as most depositors preferred to invest in government securities at the time
5. **CBK Publication of Average Lending Rates:** In a bid to increase market transparency, CBK recently published the lending rates of each commercial bank which will be released every quarter going forward. Average lending rates for the fourth quarter stood at 18.2%, which is 6.7% above the Central Bank Rate. This will greatly lower net interest margins assuming deposit rates remain unchanged
6. **Capping of Lending Rates:** The government has stepped in with the proposed capping of lending rates and deposit interest rates in the Banking (Amendment) Bill to be tabled in parliament later in the year, a move that is likely to stifle the growth of the banking industry
7. **Private Equity Investments in the Kenya Banking Industry**: The banking industry has witnessed increased private equity investment activity with several funding deals and acquisitions such as Fidelity Bank by Duet Group and FEP Holdings acquiring Credit Bank. This is as a result of increased supervision which has boosted investor confidence

Recent Developments in the Banking Sector, continued…

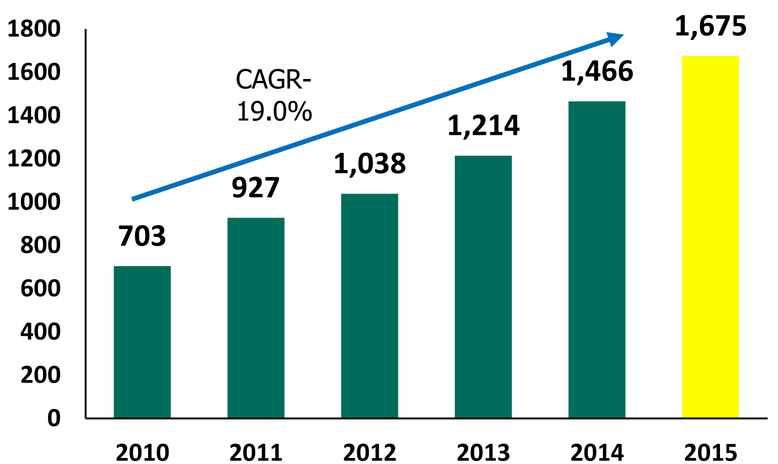
Corporate governance issues came to the fore in 2015, and have continued in to Q1'2016, with regional shocks in South Sudan exposing banks to large forex losses, while foreign banks lose competitiveness

8. **Exposure to South Sudan:** Due to the devaluation of the South Sudan pound, banks that operate in the country i.e. Equity Bank, KCB Group, Co-operative Bank and CFC Stanbic lost significant value on their assets which are mainly held in cash hence recording lower than expected return
9. **Corporate Governance & Reporting Frameworks:** The closure of Imperial Bank as a result of "unsafe and unsound practises", combined with the recent suspension of the CEO and senior executives of National Bank, pending an internal audit, has raised questions over the state of corporate governance in the Kenyan banking sector, as well as the ability of regulatory authorities such as CBK and CMA to effectively monitor banking practices
10. **Banking industry consolidation through M&A:** Increased regulation and capital base requirements increased competition driven by the overbanked situation in Kenya, which led to consolidation in the industry, namely, acquisition of Giro bank by I&M Bank and acquisition of a 51% stake of Equatorial Commercial Bank by Mwalimu SACCO
11. **Local vs foreign banks growth:** With the impending exit of Barclays Plc from Africa, it has brought to the forefront displacement of foreign banks such as Standard Chartered, Barclays and Citibank from their perch as the key providers of banking solutions, evidenced by the receptiveness of local banks to the rapidly evolving banking landscape in terms of mobile money, agency banking and informal sector banking

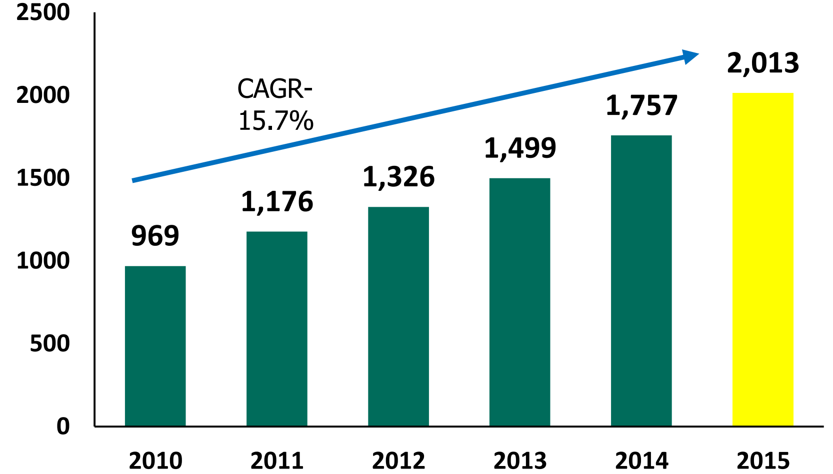
Listed Banking Sector Metrics

Banking sector continued to grow despite a tough operating environment

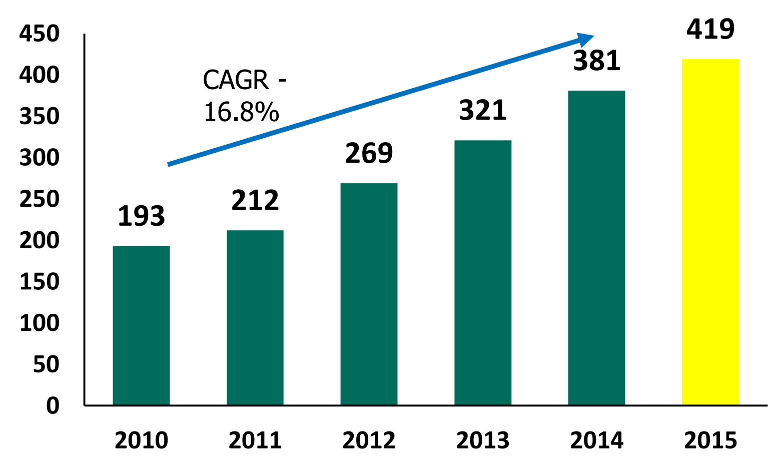
Loans and Advances (Kshs Bn)



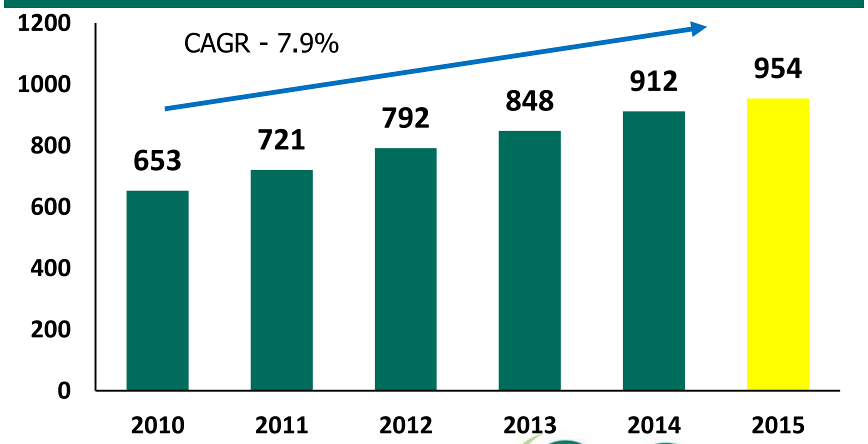
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



Bank Branches



Source: Central Bank of Kenya

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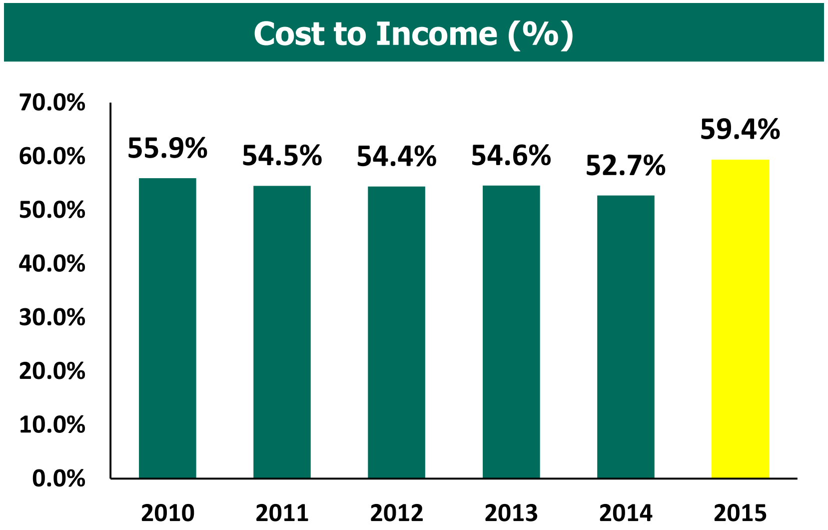
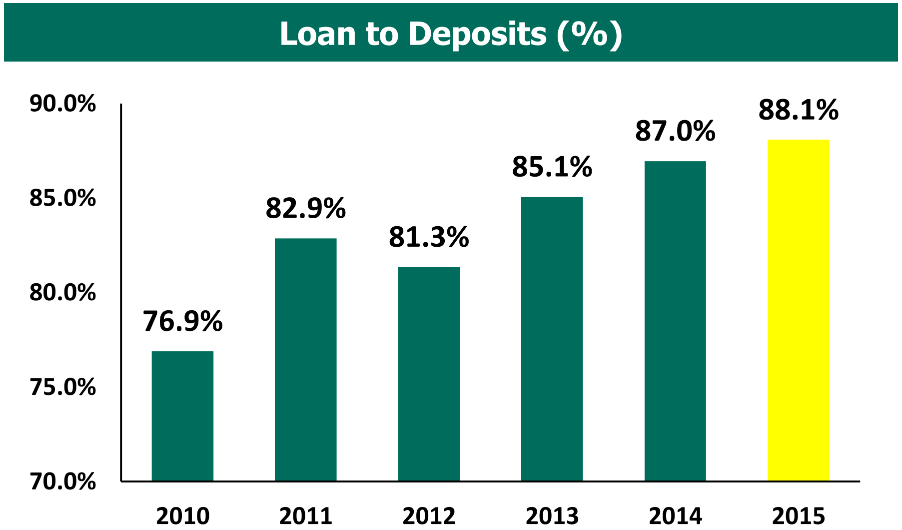
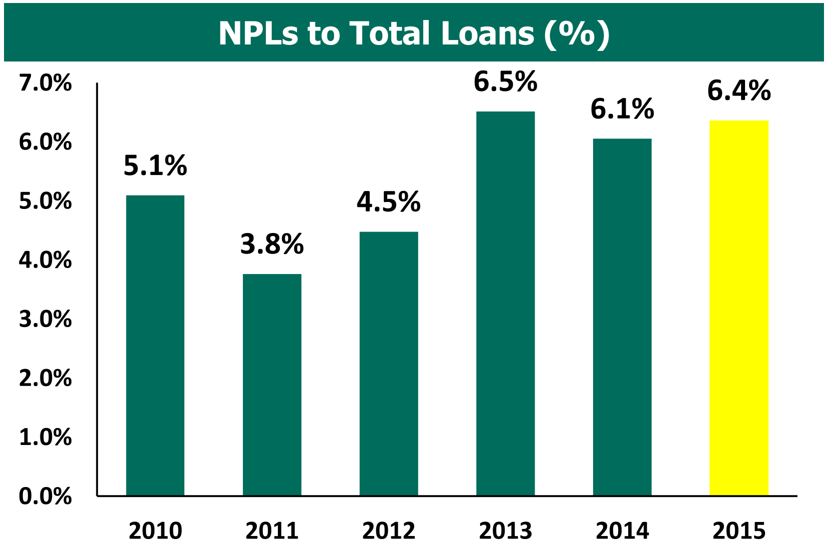
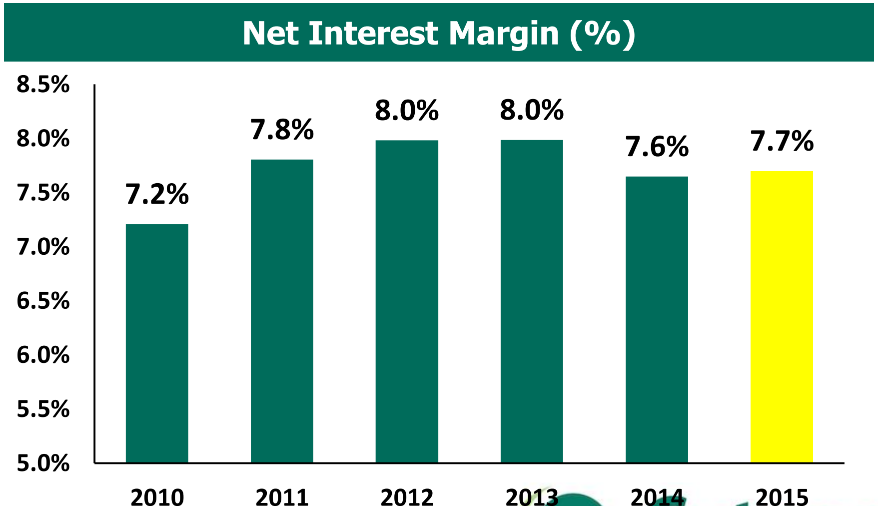
Listed Banking Sector Metrics, continued…

Tough environment reflected on earnings, with lower margins, higher provisions, costs and worrying loan to deposit ratios, which are above the 85% efficiency level









Source: Central Bank of Kenya

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Listed Banking Sector Metrics, continued…

Kenya's banking sector core EPS growth was 2.8% for FY'2015

FY'2015 Listed Banking Sector Metrics								
Bank	Core EPS Growth	Deposit Growth	Loan Growth	Net Interest Margin	Loan Loss Provision	Cost to Income**	ROaE	ROaA
I&M Bank	26.2%	16.4%	13.6%	7.2%	13.4%	35.0%	24.5%	3.7%
Co-op Bank	25.4%	21.9%	16.2%	8.8%	71.8%	53.2%	25.1%	3.7%
KCB Group	12.1%	12.5%	21.9%	7.9%	(6.8%)	50.1%	25.0%	3.7%
DTB	11.5%	20.6%	29.0%	6.5%	150.1%	41.0%	18.7%	2.9%
Equity Group	1.0%	23.1%	26.0%	6.5%	52.9%	52.9%	25.5%	4.8%
Barclays	(0.2%)	0.2%	15.9%	10.2%	25.7%	53.0%	21.6%	3.7%
NIC	(2.6%)	11.9%	13.7%	6.1%	401.4%	41.6%	18.0%	3.1%
CFC	(13.7%)	18.7%	26.6%	6.4%	24.6%	50.6%	17.1%	2.6%
HF Group	(18.5%)	15.4%	17.2%	6.3%	(8.6%)	47.4%	16.9%	2.2%
Stanchart	(28.7%)	11.7%	6.2%	9.4%	274.5%	44.6%	15.5%	2.9%
NBK	(232.5%)	5.6%	3.3%	6.4%	608.0%	78.2%	(19.3%)	(1.0%)
Weighted Average	**2.8%***	**14.3%**	**14.5%**	**7.4%**	**85.4%**	**49.8%**	**17.1%**	**2.9%**

**Averages are market cap weighted*

***Without loan loss charge*

Source: NSE, Cytonn Banking Sector Report

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Banking Sector Multiples

Kenya's banking sector is trading at an average PBV of 1.7x and a PE of 8.4x

Bank	Share Price *	No. of Shares Issued (bns)	Market Cap (bns)	PBV	P/E
Equity Group Holdings	40.3	3.7	149.0	2.1x	8.7x
Standard Chartered Bank Kenya Ltd	231.0	0.3	71.4	1.8x	7.0x
The Co-operative Bank of Kenya Ltd	21.0	4.1	88.0	1.8x	12.8x
Diamond Trust Bank Kenya Ltd	214.0	0.2	51.8	1.6x	9.8x
KCB Group Ltd	41.5	3	125.5	1.5x	7.4x
Barclays	11.2	5.4	60.8	1.5x	7.3x
I&M Holdings Ltd	104.0	0.4	40.8	1.5x	7.7x
NIC Bank Ltd	40.5	0.6	25.9	1.0x	5.7x
CfC Stanbic bank	94.0	0.4	37.2	1.0x	6.5x
Housing Finance Co. Kenya Ltd	20.3	0.3	7.1	0.7x	4.8x
National Bank of Kenya	13.0	0.3	4.0	0.3x	4.2x
Average				**1.7x**	**8.4x**
Median				**2.1x**	**12.8x**

* Share prices are as at 31st March 2016
** TTM – Trailing twelve months

The Banking sector has become more expensive on a PBV basis having gained to 1.7x, from 1.4x at the beginning of the year

Source: NSE, Cytonn Banking Sector Report

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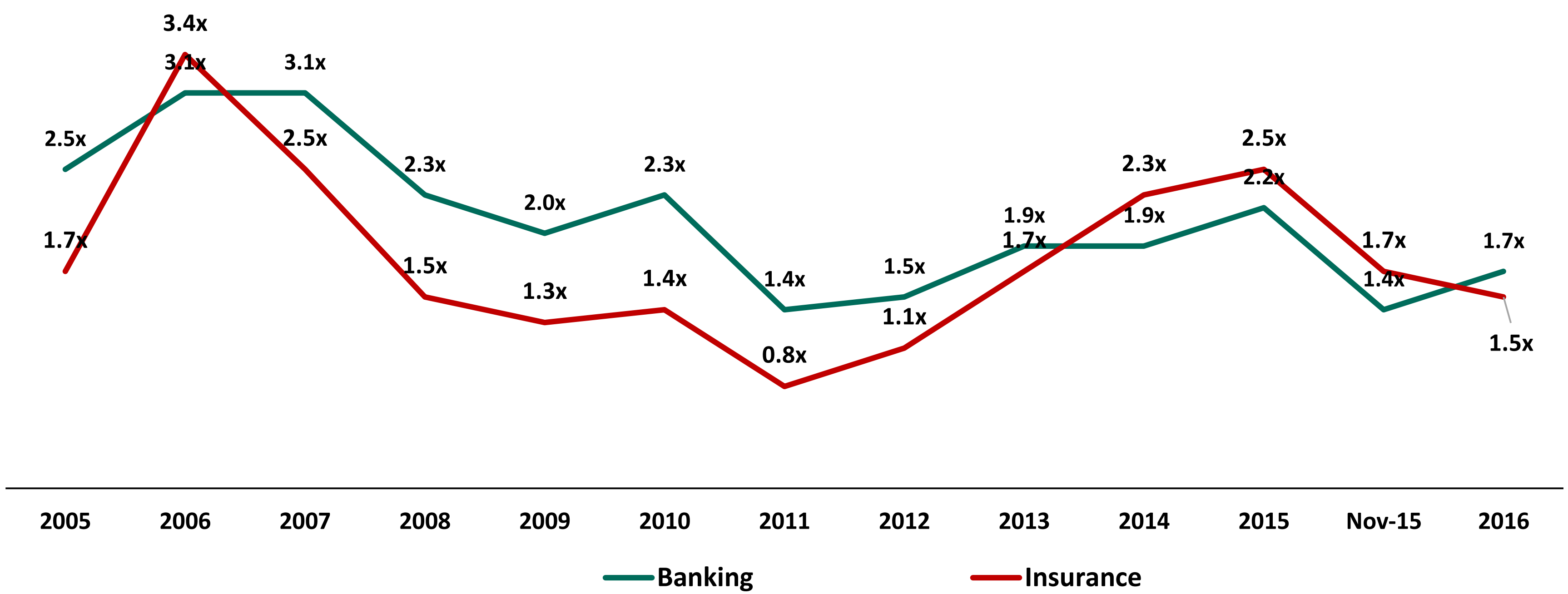
Banking Sector Multiples

Banks are an expensive investment compared to insurance companies based on P/B valuation

10 year Price to book value: Banking and Insurance



On a price to book valuation, listed insurance companies are currently cheaper than those in the listed banking sector and has normalized to historical trends

Source – Cytonn Research

III. Cytonn's Banking Sector Report

Executive Summary

Cytonn has undertaken this report to offer our investors a comprehensive view of the listed banks

- All listed banks in the Kenyan market were analysed by the Cytonn Investment Team
- The analysis was brought about by a need to be able to recommend to our investors which banks are the most stable from a franchise value and from a future growth opportunity perspective
- The analysis covers the health and future expected performance of the financial institution, by highlighting their performance using metrics to measure profitability, efficiency, growth, asset quality, liquidity, revenue diversification, capitalization and intrinsic valuation
- The analysis was undertaken using FY'2015 results (franchise value) and analyst's projections of future performance of the banks (future growth opportunities)
- For banks which are part of a group structure, the financials of the group were utilised to take into consideration the listed counter which an investor will purchase
- The overall ranking was based on a weighted average ranking of Franchise value (accounting for 40%) and Intrinsic value (accounting for 60%)
- The top rankings were dominated by Tier 1 banks which performed well in terms of both Franchise and Intrinsic valuation

Kenya's Banking Sector – *A Sector in Volatile Transition*

A sector is experiencing volatile transition to a more stable, efficient and transparent industry

Transition Area	Summary	Effect on Banking Sector
Sectoral Realignment & Strategy Clarity	• The last year has divided the industry into the "haves" and "have-nots" • Equity Group, KCB Group, Co-op, DTB and I&M have found themselves in a position of strength with a niche, ability to gather deposits and play in alternative distribution • The rest, such as Barclays have found the going tough, looking to exit, while those such as Giro and ECB happy to be acquired	• Only those who have a clear strategy and understand the local banking will weather the storm • Those who are uncompetitive, or willing to adjust global strategies to local requirements e.g. Barclays, will either exit or be bought-out • We are entering a period of natural consolidation in the banking sector, with those remaining strong enough to withstand economic changes
Better Governance	• Anticipated implementation of CMA corporate governance guidelines • Question marks over corporate governance after events of Imperial Bank and National Bank	• Greater oversight will lead to improved management structures • Increased accountability being put on performance and ethical leadership • Lead to a more stable and secure banking system
Increased Regulation	• Closure of Imperial Bank and Dubai Bank • Question marks over regulation as Imperial Bank bond was approved before bank closure • Question marks over levels of provisioning for non-performing loans	• Enhanced oversight on levels of provisioning • Increased risk-based analysis • Deeper supervision for commercial banks • Lead to a more efficiently regulated banking industry which provides confidence to investors

We expect an enhanced supervision for commercial banks, and indeed all financial institutions, including insurance and capital markets in Kenya by considering factors other than financial ratios

Rankings by Franchise Value

Equity Group emerged top in the franchise value rankings, with National Bank coming last

Rank	Bank	LDR*	CIR **	ROACE ***	NIM ****	PEG ratio	P/TBV	Deposits/ branch	NPLs/ Loans	NPL Coverage	Tangible Common Ratio	Non Interest Income / Revenue	Camel Rating	Corporate Governance Score	Total
1	Equity Group	4	5	1	2	7	11	11	2	4	2	2	1	5	**57**
1	KCB Group	1	6	3	5	2	5	8	7	3	5	3	8	1	**57**
3	CfC Stanbic	6	4	8	10	1	3	1	6	8	8	1	6	3	**65**
4	Co-operative bank	3	7	2	4	6	10	6	4	2	7	4	2	9	**66**
5	DTBK	5	2	6	7	5	8	7	1	1	9	10	3	3	**67**
6	Barclays	2	8	5	1	10	6	10	3	5	3	6	4	7	**70**
7	I&M Holdings	8	1	4	6	4	7	3	5	9	4	9	7	7	**74**
8	Standard Chartered	7	10	10	3	9	9	2	10	6	1	8	5	6	**86**
8	NIC	10	3	7	11	3	4	4	9	10	6	7	10	2	**86**
10	HF Group	11	9	9	8	8	1	5	8	11	10	11	9	10	**110**
11	National Bank	9	11	11	9	11	2	9	11	7	11	5	11	11	**118**

- **The bank ranking assigns a value of 1 for the best performing bank, and a value of 11 for the worst**
- **The metrics highlighted a bank's profitability, efficiency, growth, asset quality, liquidity, revenue diversification, capitalization and soundness**

* LDR- Loan to Deposit Ratio
** CIR- Cost to Income Ratio
*** ROACE - Return on Average Common Equity
**** NIM - Net Interest Margin

Source: Cytonn Research

Cytonn INVESTMENTS

Rankings by Intrinsic Value

KCB Group was a clear leader in intrinsic value ranking, followed by I&M Holdings

Banks	Current Price	Target Price (Valuation)	Upside	Dividend Yield FY16e	Total Potential Return
KCB Group	41.5	53.7	**29.4%**	5.2%	**34.6%**
I&M Holdings	104.0	112.0	**7.6%**	3.4%	**11.0%**
Equity Group	40.3	41.9	**4.1%**	5.1%	**9.2%**
NIC Bank	40.5	42.9	**5.9%**	2.5%	**8.4%**
DTBK	214.0	223.4	**4.4%**	1.4%	**5.8%**
HF Group	20.3	19.6	**(3.2%)**	6.9%	**3.7%**
Barclays Bank	11.2	10.3	**(8.0%)**	7.7%	**(0.3%)**
Standard Chartered	231.0	207.2	**(10.3%)**	5.4%	**(4.9%)**
Cooperative	21.0	18.5	**(11.9%)**	3.9%	**(8.0%)**
CfC Stanbic Bank	94.0	85.4	**(9.1%)**	0.0%	**(9.1%)**
National Bank	13.0	8.5	**(34.7%)**	0.0%	**(34.7%)**

- KCB Group and I&M Holdings have the highest upsides at 34.6% and 11.0%, respectively
- National Bank registered the highest downside of 34.7%

Cytonn INVESTMENTS

Composite Bank Ranking

Overall, KCB Group was ranked 1st while National Bank was ranked last

CYTONN'S FY'2015 BANKING REPORT RANKINGS					
Banks	**Franchise Value Total Score**	**Total Return Score**	**Weighted FY'2015 Score**	**FY'2015 rank**	**Q3'2015 rank**
KCB Group	**57**	**1**	**23.4**	**1**	3
Equity Group	**57**	**3**	**24.6**	**2**	1
DTBK	**67**	**5**	**29.8**	**3**	2
I&M	**74**	**2**	**30.8**	**4**	7
Co-operative bank	**66**	**9**	**31.8**	**5**	6
CfC Stanbic	**65**	**10**	**32.0**	**6**	9
Barclays	**70**	**7**	**32.2**	**7**	3
NIC	**86**	**4**	**36.8**	**8**	8
Standard Chartered	**86**	**8**	**39.2**	**9**	5
HF Group	**110**	**6**	**47.6**	**10**	11
National Bank of Kenya	**118**	**11**	**53.8**	**11**	10

- In FY'2015, franchise value was assigned a weighting of 40% while the intrinsic value was assigned 60% weight, same as in Q3'2015
- KCB Group rose to the top position from position 3 in Q3'2015 based on its robust franchise value on the back of high return on average equity of 25.0%, in addition to obtaining the highest corporate governance score of among listed banks. The bank also ranked highest in intrinsic valuation as it has the largest upside of 34.6%

Banking Sector Report Results

I&M Holdings improves by 3 positions owing to operational efficiency and revenue growth

- I&M Holdings rose 3 ranks to position 4 based on its second highest upside of 11%. This was boosted by (i) an increase in the banks' operating efficiency with the lowest cost to income ratio of 40.0%, and (ii) increased focus on more efficient channels of distribution like agency banking and internet banking

- Standard Chartered bank declined further to position 9 from position 5 based on its increase in non-performing loans that brought down its NPLs / Loans ratio and its cost to income ratio following an increase in its loan loss provisions. In addition, the bank did not provide as much for these NPLs thus affecting their NPL coverage score and bringing down their CAMEL rating score. Furthermore, the reduction of the bank's expected growth rate reduced the stock's total return score, with the stock having an downside of 4.9%

- Barclays Bank declined to position 7 from position 3 on the back of challenges in deposit mobilisation, with the bank ranking low in deposits per branch and reduced efficiency with a cost to income ratio of 59%. Barclays also scored lowly on corporate governance relative to other listed banks. However, the bank has one of the highest interest margins as a result of cheaper costs of funds and expensive loans yet sticky customer base

- National Bank was ranked the lowest overall. It registered a loss, with a negative return on equity at (9.9%) and their NIM at 6.4%, which was the third lowest in the market. In addition, NBK scored the lowest governance score among listed banks. The stock has a 34.7% downside

Source: Cytonn Research

Appendix

A. Metrics Used

Banking Sector Report – Metrics Used

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

- **Net Interest Margin -** A bank's net interest margin (NIM), is the difference between the interest paid on deposits and the interest earned on loans, relative to the amount of interest-earning assets with higher net interest margins translating into higher profits

  Output:

  Majority of Bank's funding is towards the issuing of loans rather than the purchase of government securities. Even with the introduction of the KBRR and the raising of the CBR to 11.5%, we expect banks to maintain their NIMs in 2016. Barclays had the highest NIM at 11.1%, with the lowest for CfC Stanbic at 6.6%

- **Return on Average Common Equity** - A bank's return on average common equity (ROACE), is the amount of profit the bank earns as a percentage of average common shareholders' equity. It's a profitability measure that shows how much a company generates with the money shareholders have invested

  Output:

  Banks with higher ROACEs are better at utilizing capital to generate profits. Equity Group has the highest ROACE at 25.5%, which was much above the industry average of the listed banks of 17.2%, while National Bank had the lowest at (19.3%) following the bank registering a loss in the full year results

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

- **Price/Earnings to Growth Ratio** - The price/earnings to growth (PEG) ratio is the stock's market price to earnings ratio divided by its growth in earnings for a specified period of time. The PEG ratio is used to determine the value of a stock while taking into account its growth rate, with lower PEG ratios showing the stock is undervalued given the growth in its earnings

  Output:

  To obtain this ratio, we estimated each bank's 5-year growth rate based on analysis of (i) bank's fundamentals, (ii) projections using each bank's models and (iii) management's input on a bank's strategy going forward. CfC Stanbic had the lowest PEG ratio at 0.3x, while Barclays was the most overvalued at 2.5x

- **Deposits per Branch** - A bank's deposits per branch shows the amount of deposits a bank collects from each of its branches, hence a measure of efficiency. Banks with higher deposits per branch are preferred, as it shows for each unit cost of capital expenditure required to open new branches and their subsequent operating costs, a bank receives more in deposits

  Output:

  CFC Stanbic and Standard Chartered have the highest deposits per branch at 4.5 bn and 4.3 bn, respectively, while Equity Group and Barclays have the lowest deposits per branch at 1.2 bn and 1.4 bn, respectively. This is due to the large corporate book of CfC Stanbic and Standard Chartered that enables them mobilise deposits with fewer branches

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

- **Loans to Deposits Ratio** - A bank's loans to deposit ratio (LDR) is a measure of liquidity as it shows how much of a bank's loans are being funded by its deposits. Low LDR ratios indicate that the bank may not be earning a lot of interest. Very high LDR's indicate that the bank might not have enough liquidity to cover any unforeseen funding requirements, and ratios above 1 show that the bank supplemented their loan issues with outside borrowings

  Output:

  Our analysis showed us that in Kenya, the loan to deposit ratio has been steadily increasing, showing increased uptake of loans and more aggressive use of deposits by banks. Taking a preferred LDR of 85%, we found that KCB Group was closest to the target at 81.5%, while Housing Finance was the farthest at 126.6%

- **Cost to Income Ratio** - The cost to income ratio is a measure of a bank's efficiency, showing its costs in relation to its income. A lower ratio is preferred, as it indicates a bank is more profitable. An increase in the ratio often highlights potential problems as it shows a bank's costs rose faster than its income; while a fall in the ratio could be brought by management's cost cutting measures

  Output:

  We see many Kenyan banks making an effort to be more efficient. Many Kenyan banks have opted to restructure in a bid to bring down costs and subsequently this ratio. I&M maintained the lowest cost to income ratio of 35.0%, while National Bank of Kenya had the highest ratio at 78.2%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

- **Price to Tangible Book Value** - This is a valuation ratio that expresses the bank's market price to its tangible book value. It shows the price an investor would pay for a unit amount in the event of a liquidation. A ratio of less than one indicates that the bank's assets are undervalued in the market while a ratio greater than one signifies overvaluation

  Output:

  We find Housing Finance as the most undervalued bank as per this metric at 0.9x, while Equity bank is still the most overvalued at 2.3x

- **Tangible Common Equity Ratio** - This is the ratio of a bank's common equity less intangible assets to its tangible assets. It is a common indicator of a bank's risk and capitalization and measures how much losses a bank can take before shareholder's equity is wiped out, hence solvency

  Output:

  Standard Chartered is the most solvent with a tangible common ratio of 16.6%, while National Bank was the least solvent at 3.2%

- **Non-Performing Loans to Total Loans Ratio** - This is a measure of the percentage of a bank's issued loans that are non-performing that is, in default, or close to being in default

  Output:

  Diamond Trust bank had the highest quality loan book with a non-performing loans to total loans ratio of 2.8%, while National Bank had the highest non-performing loans at 17.4%

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

- **Non-Performing Loans Coverage** - This is a credit quality metric that measures the credit risks for banks. It shows the extent to which the NPLs are covered by provisions hence the degree of stability of the bank's lending base, with higher ratios preferred

  Output:

  Diamond Trust Bank has the highest provisions to non-performing loans at 57.4%, while Housing Finance Group has the lowest at 12.3%

- **Non-Interest Income to Revenue** - The non interest income is the income earned from sources other than loans and investments. The non-interest income to revenue therefore shows the extent of diversification of a bank's operations. High levels are preferred, not exceeding the point where the bank loses focus of its primary business

  Output:

  We see that Kenyan banks' non-interest income is set to benefit from new initiatives such as banc-assurance and mobile banking. CfC Stanbic has the highest non-interest income as a percentage of revenue at 61.6%, while Housing Finance has the lowest at 21.8%

- **Camel Rating** - This is a ranking system that assesses the overall condition of a bank, that is, Capital Adequacy, Asset Quality, Management Quality, Earnings Quality and Liquidity. We also incorporated a governance score in the ranking

Banking Sector Report – Metrics Used, continued…

Cytonn has undertaken analysis of the listed banks in Kenya using 13 key metrics

- **Corporate Governance Score** – Given the recent developments in the banking sector, which include Dubai Bank, Imperial Bank and National Bank, we developed a 13th metric to measure corporate governance This is a ranking system where we analyse 25 metrics to rank listed companies on their corporate governance. Main areas of analysis are in the board composition, audit functions, CEO tenor and evaluation, remuneration and transparency

  Output: The score assumes a diffusion index with 50% as the base. Anything below 50% should be flagged as having serious corporate governance issues while anything above is skewed towards proper governance. However the variance from 100% gives the risk associated with corporate governance

B. Tier I Banks

I. Equity Group Holdings

Company Description

Equity bank ventured into Congo by acquiring Pro Credit bank

Developments During the Year

- Dr. James Mwangi, Equity Group Holdings CEO's tenure was extended for 10 years to 2025. We believe this is a good initiative as he has ran the bank successfully through its Equity 1.0 and Equity 2.0 strategy, thus making him the ideal man to complete Equity's 3.0 strategy
- Helios exited its 24.4% stake in Equity Bank, posting an annualized return of 31.0%, subsequently making Norfund, a Norwegian Private Equity firm the largest shareholder with 12.2%
- Equity Group Holdings finalized the acquisition of a 79% stake of Pro Credit bank through a share purchase agreement with the owners of Pro Credit Bank where they were issued 70,897,782 of Equity Holdings Shares
- The bank launched the Equitel Platform, which serves as a platform where the core banking services can be offered at the convenience of the customers. Since its launch, the Equitel platform has outperformed expectations;
  - Transaction numbers via mobile banking have increased 999% to 151 mn transactions in 2015 from 13.7 mn transactions in 2014. Transaction value has increased 2,353% to Kshs. 114.9 bn in 2015 from Kshs. 4.7 bn in 2014
  - 30% of the total loan portfolio is now being processed via the Equitel platform

Value Drivers

- Equity Bank is currently the largest insurance intermediary with revenues generated by Equity Insurance agency growing with a CAGR of 63.7%
- Equity Investment Bank is the 2nd largest Stockbroker in the country with a market share of 16%
- Equitel is the fastest growing MVNO (Mobile Virtual Network Operator) with a cumulative monthly growth rate of 93% and a market share of 1.9%
- Agency banking is the fastest growing platform outpacing both ATMs and branch transactions with 46% of the market share

Cons

- Cost control: Equity bank with its 3.0 strategy has a big challenge to maintain their cost to historical levels as they are investing highly in IT
- Expansion Setbacks: Equity bank has encountered some setback in their regional expansion to Uganda and S.Sudan where they have not been as profitable as in others

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statements Extracts

Equity Group has a high Return on Equity averaging 28.0% in 5 years

	2013	2014	2015	2016e	2017e	CAGR
Net Interest Income	26.5	29.2	34.1	36.5	41.0	12.8%
Non Funded Income	15.4	18.5	21.9	29.1	34.7	23.9%
Loan Loss Provision	2.4	1.6	2.4	2.9	3.8	26.8%
Total Operating Expenses	22.7	26.3	32.1	36.9	42.9	19.6%
Profit Before Tax	19.0	22.4	24.0	28.7	32.8	14.9%
Profit After tax	13.3	17.2	17.3	20.1	23.0	14.2%
% PAT Change YoY		**29.2%**	**1.0%**	**15.9%**	**14.3%**	
EPS	3.5	4.5	4.6	5.3	6.1	
DPS	1.5	1.8	2.0	2.1	2.4	
Cost to Income	48.8%	52.0%	52.9%	51.8%	51.6%	
ROaE	28.1%	29.7%	25.5%	27.8%	29.0%	
ROaA	5.1%	5.5%	4.5%	4.3%	4.2%	

	2013	2014	2015	2016e	2017e	CAGR
Net Loans and Advances	171.4	214.2	269.9	316.7	373.9	17.9%
Government Securities	44.6	48.4	42.8	43.5	49.8	14.2%
Other Assets	61.8	82.0	115.4	144.3	170.8	19.6%
Total Assets	277.7	344.6	428.1	504.5	594.5	18.0%
Customer Deposits	194.6	245.4	302.2	373.9	448.7	20.7%
Borrowings	11.4	14.8	14.9	22.7	22.3	11.5%
Other Liabilities	20.1	20.6	38.9	35.5	37.4	0.1%
Total Liabilities	226.2	280.8	355.9	432.1	508.3	18.7%
Shareholders Equity	51.6	63.8	72.1	72.4	86.2	14.2%
Book value Per share	13.7	16.9	19.1	19.2	22.8	14.2%
% Change in BPS YoY		**24%**	**13%**	**0%**	**19%**	

Cytonn INVESTMENTS

Valuation Summary

Equity Group is fairly valued with a total potential return of 9.2%

Cost of Equity Assumptions:	31st March-16
Risk free rate *	12.3%
Beta	0.8
Country Risk Premium	6.7%
Extra Risk Premium	0.2%
Cost of Equity	17.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.0%
Return on Average Equity	26.8%
Justified PBV	1.6x
Shareholder Equity – FY20e	139.9
Terminal Value-(Year 2020)	218.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	43.9	80%	35.1
PBV Multiple	31.7	15%	4.8
PE Multiple	40.7	5%	2.0
Fair Value			**41.9**
Current Price			**40.3**
Upside/(Downside)			4.1%
Dividend Yield			5.1%
Total Potential Return			**9.2%**

Cytonn INVESTMENTS

II. KCB Group

Company Description

Kenya Commercial Bank set up a Group Holding structure during the year

Developments during the year

- KCB Group launched KCB Mpesa, a partnership with Safaricom as an alternative distribution channel, enabling the bank disburse loans of Kshs 9.1 bn through the mobile platform
- KCB Group set up the Group Holding Company and KCB bank Kenya Business
- KCB Group partnered with GoSwiff to facilitate mobile payments through a high performance Bluetooth card reader, targeting SMEs and merchants
- KCB Group, along with DTBK was one of the banks tasked with paying off depositors of less than Kshs 1 mn in the bank
- Global ratings agency S&P gave KCB Group a B+ credit rating with a stable outlook, then downgraded the outlook to negative, following the downgrade of Kenya's sovereign outlook to negative

Pros

- KCB Mpesa, a partnership with Safaricom, is expected to be a key growth driver for the bank in terms of deposits and loans
- Strong growth in alternative channels including mobile banking and agency banking to enhance digital payments and more efficient delivery of services
- Launch of KCB Insurance to enhance integrated service offerings on bancassurance and investment banking

Cons

- Exposure to different political, economic and regulatory environments as the bank has regional subsidiaries in different countries hence is exposed to different changes in its operating environment
- The bank seems to be struggling in utilising its asset base compared to its peers in generation of returns (e.g. ROaA at 3.7% as compared to Equity bank at 4.8%)
- The bank seems stretched in Total capital requirements with a Total capital to risk weighted assets at 15.4%, 0.9% above the minimum requirement

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statements Extracts

KCB Group has a high return on equity at 25%, and is the most profitable bank in Kenya

Income Statement	2013	2014	2015	2016e	2017f	CAGR
Net Interest Income	32.98	35.95	39.2	50.0	57.0	18.3%
Non Funded Income	17.13	22.00	23.4	27.1	31.3	14.9%
Loan Loss Provision	2.91	5.06	4.7	6.1	7.0	17.3%
Total Operating Expenses	29.99	34.16	36.1	45.8	52.7	17.1%
Profit Before Tax	20.12	23.79	26.54	31.21	35.56	17.1%
Profit After tax	14.34	16.85	19.62	21.85	24.89	15.8%
% PAT Change YoY	**17.5%**	**17.5%**	**16.5%**	**11.3%**	**13.9%**	
CIR	60%	59%	58%	59.5%	59.7%	
EPS	4.74	5.57	6.49	7.22	8.23	15.8%
DPS	1.98	2.02	2.00	2.23	2.54	18.8%
ROaE	24.4%	24.2%	25.0%	24.6%	23.7%	
ROaA	3.8%	3.8%	3.7%	3.6%	3.5%	

Balance Sheet	2013	2014	2015e	2016f	2017f	CAGR
Net Loans and Advances	227.72	283.73	346.0	416.5	459.3	15.0%
Government Securities	47.53	61.07	57.8	81.8	91.9	18.2%
Total Assets	390.85	490.34	558.1	662.5	756.3	15.5%
Customer Deposits	305.66	377.27	424.4	496.5	575.9	15.8%
Borrowings	7.7	12.7	20.1	30.1	30.1	8.4%
Total Liabilities	327.5	414.7	476.8	566.1	642.7	15.1%
Shareholders Equity	63.35	75.63	81.3	96.4	113.6	17.4%
Book value Per share	20.94	25.00	26.9	31.9	37.5	17.4%

Cytonn INVESTMENTS

Valuation Summary

KCB Group is undervalued with an upside of 34.6%

Cost of Equity Assumptions:	31st March-16
Risk free rate *	12.3%
Beta	0.8
Country Risk Premium	6.7%
Extra Risk Premium	0.5%
Cost of Equity	17.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.5%
Return on Average Equity	24.1%
Justified PBV	1.3x
Shareholder Equity – FY20e	179.2
Terminal Value-(Year 2020)	236.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	54.2	80%	43.3
PBV Multiple	48.6	15%	7.3
PE Multiple	61.6	5%	3.1
Fair Value			**53.7**
Current Price			**41.5**
Upside/(Downside)			29.4%
Dividend Yield			5.2%
Total Potential Return			**34.6%**

* Five years average yields on a 10 year Treasury bond

III. Co-operative Bank

Company Description

Co-op Bank embarked on its transformation agenda to sustain growth and improve customer experience

Developments during the year

- In 2014, Co-operative bank embarked on an ambitious Business Transformation Agenda called the Soaring Eagle, in order to sustain and put the bank on a new trajectory for growth. Key milestones of the project include;
  (i)Increased product sales performance by 40% resulting into customers with only one bank account reducing to 70% from 75% (ii) Reduction in operating expenses by 4%, despite growth in asset base of the bank by 22% (iii)Increased alternative channels transactions to 75% up from 68% in 2014. The number of cash loans disbursed through MCo-op cash increased by 544.4% to 183,000 with the value rising by 639% to Kshs 1.6 bn, resulting in an average loan transaction of Kshs 9,100. (iv) Customer queue time has reduced drastically by up to 74% in the transformed branches, which now stand at 80 branches, the remaining 60 branches to be transformed by July 2016

- Co-operative Bank of Kenya has partnered with digital money transfer provider SimbaPay to offer international money transfer services, with SimbaPay being able to offer the transactions for free as it gains from the forex trades

- Co-operative Bank of Kenya received USD 105 mn, Kshs 10.7 bn, in long term financing from the International Finance Corporation, which will be used towards bosting loans to small and medium enterprise

Pros

- The bank is following through on its transformation agenda, and is reaping the benefits that come with it
- Co-operative bank has a large Sacco banking base, and the opportunity to grow upon the model in its regional expansion strategy
- Regional expansion that started with South Sudan with a unique joint venture with the Government of South Sudan
- Co-operative bank is a financial one-stop shop owing to its full range of financial services

Cons

- The bank is slow in embracing technology compared to its peers in deposit mobilisation
- The bank might be losing out in first mover advantage in their expansion strategy
- The bank seems to be stretched in Tier I capital requirements as compared to its peers

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statement Extracts

Co-operative Bank improved its cost to income ratio and set to deliver solid growth in earnings

Income Statement	2013	2014	2015	2016e	2017f	CAGR
Net Interest Income	18.63	21.28	23.2	26.8	29.7	14.1%
Non Funded Income	9.26	10.81	13.2	16.2	18.7	19.7%
Loan Loss Provision	0.78	1.18	2.0	2.5	2.8	17.8%
Total Operating Expenses	17.38	20.10	21.4	23.9	26.6	15.0%
Profit Before Tax	10.87	10.92	15.4	19.1	21.9	17.3%
Profit After tax	9.11	8.02	11.7	13.4	15.3	15.4%
% PAT Change YoY	**18.2%**	**(12.0%)**	**46.0%**	**14.3%**	**14.5%**	
CIR	62%	63%	58.8%	55.5%	54.9%	
EPS	1.86	1.64	2.4	2.7	3.1	15.4%
DPS	0.43	0.50	0.8	0.8	0.9	11.4%
ROE	27.4%	20.0%	25.0%	24.3%	23.4%	
ROA	4.2%	3.1%	3.7%	3.5%	3.4%	
Balance Sheet	**2013**	**2014**	**2015e**	**2016f**	**2017f**	**CAGR**
Net Loans and Advances	137.09	179.49	208.6	253.0	297.1	18.8%
Government Securities	13.98	24.64	36.2	31.6	45.4	17.3%
Total Assets	231.22	285.40	342.5	415.4	487.8	18.2%
Customer Deposits	175.43	217.70	265.4	325.7	385.9	19.1%
Borrowings	10.25	18.27	19.3	19.3	19.3	0.0%
Total Liabilities	194.08	241.98	292.7	356.0	417.3	18.1%
Shareholders Equity	36.77	43.33	50.2	59.8	70.9	18.3%
Book value Per share	7.52	8.86	10.3	12.2	14.5	18.3%

Valuation Summary

Co-operative Bank is overvalued with a downside of 7.9%

Cost of Equity Assumptions:	31st Mar-16
Risk free rate*	12.2%
Beta	0.8
Country Risk Premium	6.7%
Extra Risk Premium	0.3%
Cost of Equity	19.4%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.2%
Return on Average Equity	22.2%
Justified Price to Book Value	1.2x
Shareholder Equity – FY20e	116.6
Terminal Value-(Year 2019)	140.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	18.6	80%	14.9
PBV Multiple	17.1	15%	2.6
PE Multiple	16.3	5%	1.0
Fair Value			**18.5**
Current Price			**21.0**
Upside/(Downside)			(12.0%)
Dividend Yield			3.9%
Total Upside/(Downside)			**(7.9%)**

* Five years average yields on a 10 year Treasury bond

Cytonn INVESTMENTS

IV. Standard Chartered Bank

Company Description

Standard Chartered issued a profit warning citing increase in NPLs

Developments during the Quarter

- Standard Chartered Bank issued a profit warning for their FY'2015 results, stating that their earnings will be at least 25.0% lower than that of the previous year. They attributed the drop in earnings to (i) the rise in non-performing loans, and (ii) the Kshs. 1.5 bn one-off sale of land they booked in 2014
- Standard Chartered has partnered with Safaricom to introduce a platform that allows business customers and M-PESA agents using the Lipa na Mpesa service to convert their e-value to cash in real time

Pros

- Diversification – The bank approved the setting up and operationalisation of the bancassurance business to be carried out by Standard Chartered Insurance Agency Limited, which will lead to diversification of their revenues through a diversified product portfolio
- Custody business will continue providing the bank with a niche when it comes to wholesale banking
- Strong in SME banking business

Cons

- Recently high non performing loans have affected the revenues for Standard Chartered Bank.
- The recent mass sale of mortgage products might have taken the bank out of their niche market
- Activities are limited to the Kenyan market as the parent company prefers to operate independently in other markets

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statement Extracts

Standard Chartered has a high return on equity of 15.3%

	2013	2014	2015	2016e	2017e	CAGR
			Income Statement			
Net Interest Income	16.8	17.9	18.1	18.8	20.4	9.4%
Non Funded Income	7.1	8.2	7.2	7.6	8.5	9.0%
Loan Loss Provision	1.0	1.3	4.9	2.1	2.4	-7.8%
Total Operating Expenses	10.5	11.7	16.2	13.7	14.7	3.7%
Profit Before Tax	13.4	14.3	9.2	12.7	14.3	17.0%
Profit After tax	9.3	10.4	6.3	8.9	10.0	17.3%
% PAT Change YoY	**14.9%**	**12.5%**	**(39.2%)**	**40.2%**	**12.5%**	
EPS	30.0	33.8	18.5	25.6	28.8	
DPS	15.0	12.8	12.5	15.3	17.3	
Cost to Income	44.0%	45.0%	63.9	51.9%	50.6%	
ROaE	27.7%	27.2%	15.3%	20.0%	21.4%	
ROaA	4.5%	4.7%	2.7%	3.6%	3.7%	

	2013	2014	2015	2016e	2017e	CAGR
			Balance Sheet			
Net Loans and Advances	129.7	122.7	115.1	135.6	150.5	10.3%
Government Securities	56.2	58.8	73.6	62.1	69.9	9.6%
Total Assets	220.4	222.5	45.2	256.9	282.4	10.7%
Customer Deposits	154.7	154.1	234.0	191.0	212.0	12.9%
Total Liabilities	184.2	181.8	192.7	212.1	233.5	10.9%
Shareholders Equity	36.2	40.7	41.3	44.8	48.8	9.5%
Book value Per share	117.1	131.5	133.4	128.8	140.3	9.5%

Source – Company Financials

Valuation Summary

Standard Chartered Bank is overvalued with an downside of 4.9%

Cost of Equity Assumptions:	31st March-16
Risk free rate *	12.3%
Adjusted Beta	0.8
Country Risk Premium	6.7%
Extra Risk Premium	0.0%
Cost of Equity	17.6%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.0%
Return on Average Equity	23.0%
Justified Price to Book Value	1.3x
Shareholder Equity - FY19e	64.0
Terminal Value-(Year 2019)	82.64

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	202.4	80.0%	161.9
PBV Multiple	244.4	15.0%	36.7
PE Multiple	172.8	5.0%	8.6
Fair Value			**207.2**
Current Price			**231.0**
Upside/(Downside)			(10.3%)
Dividend Yield			5.4%
Total Potential Return			**(4.9%)**

** Five years average yields on a 10 year Treasury bond*

Cytonn INVESTMENTS

V. Barclays Bank

Company Description

Barclays managed to maintain among the highest net interest margins in 2015

Developments during the year

- BBK launched a Kshs 30 bn fund from which it will advance unsecured loans to SMEs and it also started an agribusiness unit to finance firms in the agricultural value chain with the unit loaning out money from the Kshs 30 bn kitty
- I&M Holdings announced plans to acquire 65.0% of the issued share capital of Burbidge Capital for an undisclosed price. BBK increased the minimum amount of unsecured loans that customers running a small business can borrow to Kshs 6 million based on their credit history and within the turnaround time of 48 hrs
- The fees charged to its customers on credit card services were also raised to 3.9% from 3.7% for purchases of goods not settled within the credit period

Pros

- Barclays has historically enjoyed cheaper funding from its parent company and has not had borrowings historically, this however might have to change going forward if Barclays Plc exits Africa
- The bank has one of highest net interest margin of 9.8% as at FY'2015

Cons

- Stiff competition in the retail and SME banking market
- The bank will continue lagging its peers in the capture of the retail market
- Challenges in deposit mobilization compared to its peers

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statement Extracts

Barclays Bank has a high return on equity of 21.6%

	2013	2014	2015	2016e	2017e	CAGR
		Income Statement				
Net Interest Income	18.9	19.6	20.4	21.1	21.2	2.4%
Non Funded Income	9.1	8.7	9.1	10.0	10.6	5.8%
Loan Loss Provision	1.2	1.4	1.8	1.8	1.8	3.0%
Total Operating Expenses	16.0	15.9	17.4	18.8	18.9	4.0%
Profit Before Tax	11.1	12.3	12.1	12.3	12.9	2.7%
Profit After tax	7.6	8.4	8.4	8.6	9.0	2.9%
% PAT Change YoY	**(12.8%)**	**10.0%**	**0.2%**	**2.1%**	**5.5%**	
EPS	1.4	1.5	1.5	1.6	1.7	
DPS	-	-	0.2	0.9	1.0	
Cost to Income	52.9%	51.4%	53.0%	54.6%	53.7%	
ROaE	24.6%	23.8%	21.6%	20.6%	21.8%	
ROaA	3.9%	3.9%	3.6%	3.6%	3.6%	

	2013	2014	2015	2016e	2017e	CAGR
		Balance Sheet				
Net Loans and Advances	118.4	125.4	145.4	162.1	175.3	5.5%
Government Securities	47.6	57.2	48.1	37.7	39.2	(1.7%)
Total Assets	206.8	225.8	240.9	249.7	263.9	6.1%
Customer Deposits	151.1	164.8	165.1	188.5	196.0	6.0%
Total Liabilities	174.4	187.7	201.2	206.5	217.1	5.7%
Shareholders Equity	32.4	38.2	39.7	43.1	46.8	7.9%
Book value Per share	6.0	7.0	7.3	7.9	8.6	7.9%

Source – Company Financials

Valuation Summary

BBK currently is overvalued by 0.2%

Cost of Equity Assumptions:	31st March-16
Risk free rate *	12.3%
Beta	0.8
Country Risk Premium	6.7%
Extra Risk Premium	0.5%
Cost of Equity	18.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.2%
Return on Average Equity	19.3%
Justified PBV	1.0x
Shareholder Equity – FY20e	58.1
Terminal Value-(Year 2020)	57.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	9.5	80%	7.6
PBV Multiple	13.2	15%	2.0
PE Multiple	14.3	5%	0.7
Fair Value			**10.3**
Current Price			**11.2**
Upside/(Downside)			(7.9%)
Dividend Yield			7.7%
Total Potential Return			**(0.2%)**

* Five years average yields on a 10 year Treasury bond

C. Tier II Banks

I. National Bank of Kenya

Company Description

National bank is currently facing corporate governance issues with suspension of management

Developments during the Quarter

- NBK announced plans to sell more of its non core assets after realizing Kshs. 1.2 bn from the sale of assets. This move was to raise additional capital and reduce exposure to real estate as they do not earn optimum profit
- NBK's CEO and 6 other senior executives have been suspended pending an internal audit given their books raise questions as to what has caused the governance problems that have translated to weak earnings
- NBK released a profit warning following the suspension, citing that their FY'2015 earnings will be 25% less than the previous citing a sharp increment in non-performing loans in Q4'2015 and the sale of one key low yielding asset which was not completed in the year

Pros

- Introduction of Islamic Banking that capitalized on the unbanked Islam community contributing to deposit growth
- The introduction of bancassurance and custodial services has seen the bank diversify its revenue

Cons

- High cost of funds. Despite NBK serving retail customers, it has maintained high cost of funds averaging 5.3% thus leading to lower NIMs of 6.4%
- NBK has the worst loan book among the listed banks with an NPL/Total loan ratio of 16.3% compared to 8.9% in 2014
- Despite being associated with the Government, the bank is slow in county expansion

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statements Extracts

National Bank has a negative return on equity of 9.9%

	2013	2014	2015	2016e	2017e	CAGR
		Income Statement				
Net Interest Income	5.6	6.8	6.4	7.4	6.3	4.2%
Non Funded Income	2.9	3.1	3.2	3.3	3.7	7.9%
Loan Loss Provision	0.3	0.5	3.7	1.4	1.4	(13.6%)
Total Operating Expenses	6.7	7.5	11.2	8.8	8.7	(0.6%)
Profit Before Tax	1.8	1.3	(1.6)	1.9	1.3	(200.1%)
Profit After tax	1.1	0.9	(1.2)	1.3	0.9	(200.0%)
% PAT Change YoY	**52.5%**	**(21.8%)**	**232.5%**	**(216.0%)**	**(33.2%)**	**(200.0%)**
EPS	3.6	2.8	(3.7)	4.3	2.9	
DPS	-	-	-	-	-	
Cost to Income	75.3%	70.2%	78.2%	69.2%	72.7%	
ROaE	10.0%	7.2%	(9.9%)	11.4%	7.0%	
ROaA	1.4%	0.8%	(0.9%)	1.0%	0.6%	

	2013	2014	2015	2016e	2017e	CAGR
		Balance Sheet				
Net Loans and Advances	39.6	65.6	67.8	69.7	73.9	6.5%
Government Securities	27.5	30.3	27.3	30.2	32.0	8.1%
Total Assets	92.6	123.1	125.4	138.6	145.4	10.0%
Customer Deposits	78.0	104.7	110.6	116.2	123.1	7.7%
Total Liabilities	80.7	110.9	114.4	126.2	132.1	7.0%
Shareholders Equity	11.9	12.2	11.1	12.4	13.3	23.1%
Book value Per share	38.6	39.7	35.9	40.2	43.1	7.7%

Source – Company Financials

Cytonn INVESTMENTS

Valuation Summary

National Bank is overvalued with an downside of 34.6%

Cost of Equity Assumptions:	31st March-16
Risk free rate *	12.3%
Beta	0.9
Country Risk Premium	6.7%
Extra Risk Premium	4.0%
Cost of Equity	21.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	23.0%
Return on Average Equity	7.3%
Justified Price to Book value per share	0.1x
Preference Shares	5.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	2.12	85.0%	1.8
PBV Multiple	44.42	15.0%	6.7
PE Multiple	(28.62)	0.0%	0.0
Fair Value			**8.5**
Current Price			**13.0**
Upside/(Downside)			(34.6%)
Dividend Yield			0.0%
Total Potential Return			**(34.6%)**

*Five years average yield on a 10 year Treasury bond

II. NIC Bank

Company Description

NIC Bank growth prospects lie in their NIC Now and Internet banking platforms

Developments during the quarter

- NIC Bank and the African Trade Insurance Agency have agreed to extend their SME loan cover agreement allowing the bank to keep lending to enterprise customers. Under the agreement, NIC lends up to USD 5 mn per client; with ATI able to cover single obligations worth up to USD 50 mn
- NIC Bank Group has partnered with lifestyle retailer Deacons Kenya Limited's LifeFitness brand to provide leasing facilities for gym equipment targeted at local corporates. The partnership will see NIC Leasing LLP offer financing to corporate customers looking to invest in gym equipment from LifeFitness
- NIC Bank has partnered with Kenya Red Cross Society (KRCS) Group to launch a co-branded credit card that will give customers an opportunity to give back to the Kenya Red Cross Society. The Visa enabled NIC Kenya Red Cross Credit Card automatically gives existing and non-existing members the opportunity to sign up and donate t
- NIC Bank opened three new branches, two in Kenya, Machakos and TRM and one in Uganda

Pros

- Increased investment in digital platforms, NIC Now and Internet banking by 29% and 41%, respectively
- NIC bank partnered with Post Bank Limited to offer Agency Banking services, allowing NIC customers to deposit or withdraw cash from any of the 102 Post Bank branches countrywide
- NIC bank has maintained its pole positioning in asset financing and curved a niche in the market

Cons

- Traditional SME market now being targeted by Tier 1 banks, hence it's market share is under threat
- NIC has a high cost of funding at 5.4%, due to heavy reliance on corporate deposits, resulting in a compression of the bank's net interest margins
- Exposure to different political, economic and regulatory environments, especially in Kenya with the upcoming elections might slow down business

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statements Extracts

NIC bank has an average return on equity of 18.4%

	2013	2014	2015	2016e	2017e	CAGR
			Income Statement			
Net Interest Income	7.3	8.0	9.7	11.2	12.9	18.6%
Non Funded Income	3.2	3.6	4.0	4.9	5.5	16.0%
Loan Loss Provision	1.1	0.3	1.7	1.9	2.1	56.3%
Total Operating Expenses	5.5	5.3	7.4	8.6	9.9	21.6%
Profit Before Tax	5.0	6.2	6.4	7.5	8.5	14.2%
Profit After tax	3.2	4.1	4.5	5.3	5.9	15.5%
% PAT Change YoY	**6.7%**	**27.1%**	**8.8%**	**17.4%**	**12.9%**	**(12.2%)**
EPS	5.1	6.4	7.0	8.2	9.3	
DPS	0.6	1.0	1.0	1.2	1.4	
Cost to Income	52.2%	46.2%	53.6%	53.5%	53.8%	
ROaE	20.1%	20.6%	18.4%	18.8%	18.3%	
ROaA	2.8%	3.1%	2.9%	3.0%	3.0%	

	2013	2014	2015	2016e	2017e	CAGR
			Balance Sheet			
Net Loans and Advances	81.4	102.0	116.0	133.3	150.7	16.3%
Government Securities	18.1	19.2	7.5	7.6	8.6	(8.4%)
Total Assets	121.1	145.8	165.8	189.8	212.5	15.3%
Customer Deposits	91.6	100.4	112.4	127.0	143.5	15.6%
Total Liabilities	103.5	122.4	139.4	159.4	177.1	14.6%
Shareholders Equity	17.2	22.9	25.9	30.0	35.0	18.8%
Book value Per share	3.4	4.5	5.1	5.9	6.9	18.8%

Valuation Summary

NIC bank is fairly valued with a total potential return of 4.2%

Cost of Equity Assumptions:	31st March-16
Risk free rate *	12.3%
Beta	1.03
Mature Market Risk Premium	6.7%
Extra Risk Premium	0.5%
Cost of Equity	19.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.5%
Return on Average Equity	16.7%
Justified Price to Book value Per Share	0.8x
Shareholder Equity – FY'20e	54.2
Terminal Value-(Year 2020)	43.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	40.8	80%	32.6
PBV Multiple	41.3	15%	6.2
PE Multiple	47.9	5%	2.4
Fair Value			**41.2**
Current Price			**40.5**
Upside/(Downside)			1.7%
Dividend Yield			2.5%
Total Potential Return			**4.2%**

* Five years average yields on a 10 year Treasury bond

Cytonn INVESTMENTS

III. CfC Stanbic Bank

Company Description

CfC Stanbic Holdings' acquired a USD 155 mn loan to fund the banks core business

Developments during the Quarter

- CfC Stanbic Bank announced they have signed both a 2 year and a 3-year USD 155.0 mn loan to fund the bank's core business
- The bank successfully upgraded its core banking system and digital platforms aimed at reducing the operating expenses associated with branches.
- As at FY'15, CfC had assets in excess of Kshs. 208.4 bn and shareholder's funds of Kshs. 38.4 bn and as at Q1'16, the bank operates 24 branches and is planning to open 1 more branch in the year

Pros

- The Corporate and Investment banking is a key driver for CfC Stanbic revenue as it contribute to 64% of the banks total income
- CfC is a one stop financial services shop offering investment banking, custodial and brokerage services
- The recent launch of their mobile banking platform is set to reduce costs associated with branch transactions

Cons

- Political Instability in the countries they operate. The recent instability in S.Sudan proved to be a challenge as it affected their overall income
- Their expansion strategy is limited by the presence of Standard Bank in the region
- Lack of operational efficiency owing to a high cost to income ratio of 57.0% as at FY'15

Source – Annual Reports and FY' 2015 Investor Brief

Cytonn INVESTMENTS

Financial Statements Extracts

CfC Stanbic has a return on equity of 13.0%

Income Statement	2013	2014	2015	2016e	2017F	5 yr CAGR
Net Interest Income	7.5	8.5	9.3	10.7	11.7	**11.4%**
Non Funded Income	8.7	8.4	7.6	7.9	8.9	**11.2%**
Loan Loss Provision	(0.8)	(0.7)	(0.9)	(1.3)	(1.5)	**23.9%**
Total Operating Expenses	(9.0)	(9.2)	(9.6)	(10.8)	(11.9)	**12.7%**
Profit Before Tax	7.2	7.7	7.4	7.9	8.7	**9.4%**
Profit After tax	5.1	5.7	4.9	5.5	6.1	**10.5%**
% PAT Change YoY	**70%**	**11%**	**-14%**	**12%**	**11%**	
EPS	13.0	14.4	12.4	14.0	15.4	**10.5%**
DPS	-	-	-	-	-	
Cost to Income	50.7%	50.2%	51.2%	50.5%	50.5%	
ROaE	17.2%	16.4%	13.0%	13.4%	13.0%	
ROaA	3.2%	3.1%	2.5%	2.5%	2.4%	

Balance Sheet	2013	2014	2015e	2016e	2017e	5 yr CAGR
Net Loans and Advances	103.8	101.2	128.2	141.6	160.5	**12.9%**
Government securities	6.4	4.8	7.8	9.1	10.3	**14.0%**
Total Assets	180.5	181.0	208.5	235.4	265.6	**12.9%**
Customer Deposits	130.3	129.4	153.7	175.9	200.6	**14.1%**
Borrowings	5.8	6.5	6.5	5.6	5.1	**(10.8%)**
Total Liabilities	148.1	144.1	170.1	191.5	215.6	**12.8%**
Shareholders Equity	32.4	36.9	38.4	43.9	50.0	**13.4%**
Book value Per share	82.0	93.3	97.0	111.0	126.4	**13.4%**

Cytonn INVESTMENTS

Valuation Summary

CfC Stanbic is overvalued by 9.2%

Cost of Equity Assumptions:	03-Apr-16
Default Spread Adjusted Risk free rate	12.58%
Raw Beta	0.57
Mature Market Risk Premium	6.7%
Extra Risk Premium	0.0%
Cost of Equity	18.61%
Adjusted Beta	**0.90**

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	19.28%
Return on Average Equity	11.9%
Persistency Factor	0.50
Justified Price to Book value per share	0.5x

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	83.7	0.80	66.9
PBV Multiple	96.7	0.15	14.5
PE Multiple	78.9	0.05	3.9

Fair Value	**85.4**
Current Price	**94.0**
Upside/(Downside)	(9.2%)
Dividend yield	0.0%
Total Potential Return	**(9.2%)**

* Five years average yields on a 10 year Treasury bond

IV. Diamond Trust Bank

Company Description

DTB has continued to focus on investing in alternative channels to drive growth

Developments During the Year

- DTB and KCB have been picked by the KDIC with the endorsement of the CBK, as agents to disburse funds to depositors of Imperial Bank Limited, in receivership
- DTB bank plans to launch Huduma Card, which will support payments for all services within Huduma centers and consequently to be used as a government payment platform for all rendered services
- DTB signed up Kenol Kobil on K-Card, in a bid to improve the service platform for the oil marketer supporting growth in non funded income

Pros

- Strong backing from financing partners, i.e. Aga Khan Fund for Economic Development and Habib bank
- Strong performance of subsidiaries: The regional subsidiaries in Tanzania, Uganda and Burundi contribute approx. 25% of the group's PAT
- Partnerships to drive NFI growth: DTBK has partnered with Nakumatt and Master Card to create the Nakumatt Global MasterCard which allows users to pay bills, facilitate cash withdrawals and deposits, engage in forex trading and money transfers

Cons

- Traditional SME market now being targeted by tier I banks hence market share under threat
- Exposure to different political, economic and regulatory environments, especially Burundi with their upcoming elections might slow down business and high country risk in targeted expansion regions such as DRC

Source – Annual Reports and FY' 2015 Investor Brief

Cytonn INVESTMENTS

Financial Statement Extracts

DTB has an estimated 5-year PAT CAGR of 15%

Income Statement	2013	2014	2015	2016e	2017e	5yr CAGR
Net Interest Income	11.00	12.79	15.19	18.83	22.26	20%
Non Funded Income	3.38	3.80	4.73	6.03	6.53	20%
Loan Loss Provision	(0.93)	(0.87)	(2.18)	(2.29)	(2.64)	19%
Total Operating Expenses	(7.15)	(8.07)	(10.35)	(13.29)	(15.21)	24%
Profit Before Tax	7.23	8.52	9.57	11.57	13.58	15%
Profit After tax	5.23	5.70	6.60	8.10	9.51	15%
% PAT Change YoY		**9%**	**16%**	**23%**	**17%**	
EPS	19.64	21.42	24.78	30.42	35.70	15%
DPS	1.91	2.48	2.48	3.04	3.57	15%
Cost to Income	0.43	0.43	0.41	0.44	0.44	4%
ROaE	27.9%	22.8%	20.9%	22.7%	23.5%	
ROaA	3.5%	3.0%	2.7%	3.0%	3.1%	

Balance Sheet	2013	2014	2015	2016e	2017f	5yr CAGR
Net Loans and Advances	110.90	137.65	177.54	220.03	259.81	20%
Government Securities	25.40	35.10	47.07	50.13	59.20	16%
Total Assets	166.46	211.54	271.61	328.82	387.73	19%
Customer Deposits	128.80	160.96	194.05	246.71	296.06	21%
Borrowings	5.80	12.29	26.14	26.14	26.14	0%
Shareholders Equity	21.00	28.96	34.13	41.43	49.98	19%
Book value Per share	78.85	108.75	128.17	155.55	187.68	19%

Source – Company Financials

Cytonn INVESTMENTS

Valuation Summary

DTB's stock is fairly valued with a total potential return of 5.8%

Cost of Equity Assumptions:	03-04-16
Risk free rate	12.3%
Beta	0.8
Mature Market Risk Premium	6.0%
Extra Risk Premium	0.0%
Cost of Equity	17.1%

Terminal Assumptions:	03-04-16
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	18.3%
Return on Average Equity	22.7%
Justified Price to Book value per share	1.3x
Shareholder Equity - FY20e	83.0
Terminal Value	110.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	245.5	80.0%	196.4
PBV Multiple	122.1	15.0%	18.3
PE Multiple	173.4	5.0%	8.7

Fair Value	**223.4**
Current Price	**214.0**
Upside / (Downside)	4.4%
Dividend Yield	1.4%
Total Potential Return	**5.8%**

** Five years average yields on a 10 year Treasury bond*

Cytonn INVESTMENTS

V. I&M Holdings

Company Description

I&M Holdings announced plans to acquire Giro Bank taking over their Kshs 19.0 bn worth of Assets

Developments during the Year

- On 17th September 2015, I&M Bank signed a deal to acquire 100% of Giro Bank for an undisclosed amount. The move will see it take over all its Kshs 19.0 bn worth of assets, as well as Kshs 13.5 bn of deposits, in order to increase their footprint through acquisition
- I&M Holdings announced plans to acquire 65.0% of the issued share capital of Burbidge Capital for an undisclosed price. This move by I&M Holdings was set to diversify their revenue from the core banking business to non – funded income, which currently stands at 27.0% vs. an industry average of 31.8%.
- On 19th March, I&M Bank Ltd and MobiKash partnered to launch I&M Karibu brand, a deal that saw the bank offer agency banking services through MobiKash agent outlets to widen its coverage market

Pros

- They have consistently been among the most efficient banks in Kenya from a survey released by Think Business Banking Awards
- They have a historical staff cost to loan ratio of 2.38% and a ratio of 0.46%
- They have also fully embraced internet bank in Kenya to further help drive their efficiency

Cons

- They have not been able to aggressively market themselves as a local household bank as Equity, Co-op and KCB for instance have and may even sound as a foreign bank to most individuals
- They face stiff competition for clients from larger existing tier 1 bank in the SME and Retail sectors of banking

Source – Annual Reports and FY' 2015 Investor Brief

Financial Statements Extracts

I&M Holdings has a high return on equity at 24.8%, and is one of the most profitable banks in Kenya

Income Statement	2013	2014	2015	2016e	2017e	CAGR
Net Interest Income	8.8	10.4	12.6	14.4	16.7	14.3%
Non Funded Income	3.4	3.8	4.6	4.5	5	8.9%
Loan Loss Provision	0.5	0.9	1	1.3	1.2	13.3%
Total Operating Expenses	5.1	6.2	7.4	7.9	8.7	12.2%
Profit Before Tax	7.3	8.2	10.1	11.2	13.2	13.8%
Profit After tax	5.0	5.7	7.1	7.8	9.3	13.7%
% PAT Change YoY	**20.8%**	**15.3%**	**24.6%**	**9.8%**	**18.0%**	
CIR	37.9%	37.4%	37.2%	35.1%	34.8%	
EPS	11.8	13.6	17.1	20.3	24.0	13.7%
DPS	2.5	2.9	3.5	3.8	4.5	13.7%
ROaE	25.1%	23.9%	24.8%	22.6%	22.1%	
ROaA	3.8%	3.6%	3.9%	3.7%	3.7%	

Balance Sheet	2013	2014	2015e	2016f	2017e	CAGR
Net Loans and Advances	91.9	112.5	127.8	140.0	162.4	13.9%
Total Assets	141.2	176.5	191.7	229.8	266.5	16.0%
Customer Deposits	97.1	114.2	133	155.5	180.4	15.4%
Borrowings	11.6	14.7	9.6	9.5	10.9	25.0%
Total Liabilities	117.5	148.4	158	189.5	218.5	15.1%
Shareholders Equity	21.9	25	31.4	38	45.7	17.4%
Book value Per share	56.3	55.2	80.1	96.9	116.6	14.3%

Valuation Summary

I&M is undervalued with a total potential return of 11.0%

Cost of Equity Assumptions:	31st March-16
Risk free rate *	12.3%
Beta	0.9
Country Risk Premium	6.7%
Extra Risk Premium	0.2%
Cost of Equity	18.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.2%
Return on Average Equity	19.3%
Justified PBV	1.0x
Shareholder Equity – FY20e	75.7
Terminal Value-(Year 2020)	76.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	122.4	80%	97.9
PBV Multiple	65.4	15%	9.8
PE Multiple	83.0	5%	4.2
Fair Value			**111.9**
Current Price			**104.0**
Upside/(Downside)			7.6%
Dividend Yield			3.4%
Total Potential Return			**11.0%**

* Five years average yields on a 10 year Treasury bond

Cytonn INVESTMENTS

VI. HF Group

Company Description

HF Group is the country's mortgage service provider with mandate in property development

Developments During the Year

- The bank has signed a memorandum of understanding with the Kakamega County Government to put up 1,000 housing units, providing both construction financing and mortgages on the same units
- In August 2015 the Company establish a non-operating holding company and rebranded to HF Group limited with subsidiaries (i) HFC Limited; (ii) HFDI (Property Development and Investment Solutions); (iii) HF Insurance Agency; and (iv) HF Foundation
- HFDI completed Komarock 5B residential estate and K-Mall, a retail commercial development and also launched the construction of phase one of Komarock Heights project
- The Group opened new branches in Kisii and Kitengela

Pros

- Revival of Kenya building society. This is an advantage for HF since in addition to providing mortgage financing, it can also develop the houses, hence additional revenue streams
- Vibrant real estate market in Kenya with an annual housing supply which does not satisfy demand, especially in the middle and lower income segment
- The bank is the market leader in provision of mortgage financing

Cons

- Lack of a vibrant mortgage market in Kenya
- Competition from larger banks with Mortgage facilities poses a risk for growth
- Low diversification as evidenced by the low percentage of non interest income to total revenue at 12.9% which is the lowest among the listed banks
- Asset liability mismatch which forces the bank to resort to expensive financing

Source – Annual Reports and FY' 2015 Investor Brief

Cytonn INVESTMENTS

Financial Statement Extracts

HF Group is expected to return a compounded net earnings growth of 10.9%

Income Statement	2013	2014	2015	2016e	2017e	5 yr CAGR
Net Interest Income	2,553.38	3,033.98	3,611.95	4,228.79	4,732.74	14.4%
Non Funded Income	1,368.37	842.70	1,171.09	1,263.26	1,417.22	10.8%
Loan Loss Provision	(280.89)	(551.22)	(503.77)	(586.70)	(691.42)	15.5%
Total Operating Expenses	(2,441.39)	(2,457.77)	(3,112.54)	(3,563.75)	(4,015.14)	14.6%
Cost to Income	55%	49%	55%	54%	54%	
Profit Before Tax	1,480.36	1,400.65	1,753.52	2,011.32	2,217.84	11.0%
Profit After tax	995.20	975.34	1,196.97	1,407.92	1,552.49	11.6%
% PAT Change YoY		**-2%**	**23%**	**18%**	**10%**	
EPS	2.85	2.80	3.43	4.04	4.45	11.6%
DPS	1.16	1.30	1.30	1.53	1.69	12%
ROaE	18.1%	15.7%	14.2%	12.0%	11.7%	
ROaA	2.3%	1.8%	1.8%	2.0%	1.8%	

Balance Sheet	2013	2014	2015e	2016e	2017e	5 yr CAGR
Net Loans and Advances	35,215.90	45,243.54	53,021.02	64,318.10	73,965.81	15.9%
Government Securities	288.17	264.33	2,150.98	2,614.53	3,006.71	16.3%
Total Assets	47,389.38	60,962.05	71,659.41	89,358.17	98,774.62	15.1%
Customer Deposits	26,507.20	36,105.93	41,665.09	50,644.17	58,240.80	16.3%
Shareholders Equity	5,859.61	6,558.88	10,622.64	12,760.67	13,723.21	10.2%
Book value Per share	16.79	18.80	30.45	36.57	39.33	10.2%

Source – Company Financials

Cytonn INVESTMENTS

Valuation Summary

HF Group is fairly valued with a total potential return of 3.7%

Cost of Equity Assumptions:	03-04-16
Default Spread Adjusted Risk free rate	12.3%
Beta of similar unlevered company	1.2
HF's Debt ratio	0.3
HF's Unlevered Beta	0.9
Mature Market Risk Premium	6.7%
Extra Risk Premium	0.0%
Cost of Equity	20.3%

Terminal Assumptions:	03-04-16
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	19.0%
Return on Average Equity	12.5%
Justified Price to Book value per share	0.5x
Shareholder Equity - FY20e	17,230.9
Terminal Value	9,217.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intrinsic Valuation	17.2	80%	13.8
PBV Multiple	31.2	15%	4.7
PE Multiple	22.9	5%	1.1
Fair Value			**19.60**
Current Price			**20.25**
Upside/(Downside)			(3.2%)
Dividend Yield			6.9%
Total Potential Return			**3.7%**

** Five years average yields on a 10 year Treasury bond*

Q&A