Kenya Listed Commercial Banks Analysis

Cytonn Q1’2017 Banking Sector Report

‘Consolidation & prudence in a challenging operating environment’

18th June, 2017

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I. Overview of the Firm

What We Stand For

Our Mission

We deliver innovative & differentiated financial solutions that speak to our clients' needs

Our Vision

To be Africa's leading investment manager by consistently exceeding clients' expectations

Our Values

People
Passionate and self-driven people who thrive in a team context

Excellence
Delivering the best at all times

Client Focus
Putting clients' interest first at all times

Entrepreneurship
Using innovation and creativity to deliver differentiated financial solutions

Accountability
We take both corporate and personal responsibility for our actions

Integrity
Doing the right things

Strategy is straightforward – just pick a general direction and implement like hell

— Jack Welch

About Us

Cytonn Investments is an alternative investment manager with presence in East Africa, Finland and the US. We provide investors with exposure to the high growth East Africa region. Our investors include global and local institutional investors, individual high net-worth investors and the diaspora. We also service retail investors through our Cytonn Co-operative

FACT FILE

74	Over Kshs. 74 billion under mandate	**4**	Four offices across 2 continents	**150**	Over 150 staff members	**12**	12 investment ready projects

A unique franchise differentiated by:

Independence & Investor Focus

Focused on serving the interest of clients, which is best done on an independent platform to minimize conflicts of interest

Alternative Investments

Specialized focus on alternative assets - Real Estate, Private Equity, and Structured Solutions

Strong Alignment

Every staff member is an owner in the firm. When clients do well, the firm does well; and when the firm does well, staff do well

Committed Partners

Strong global and local partnerships in financing, land and development affiliate

Why We Exist

Africa presents an attractive investment opportunity for investors seeking attractive and long-term returns. Despite the alternative markets in Africa having high and stable returns, only a few institutional players serve the market. Cytonn is focused on delivering higher returns in the alternative markets, while providing the best client service and always protecting our clients' interests.

WE SERVE FOUR MAIN CLIENTS SEGMENTS:

- Retail segment through Cytonn Co-operative membership
- High Net-worth Individuals through Cytonn Private Wealth
- East Africans in the Diaspora through Cytonn Diaspora
- Global and Local Institutional clients

WE INVEST OUR CLIENT FUNDS IN:

- Real Estate
- Private Equity
- Fixed Income Structured Solutions
- Equities Structured Solutions

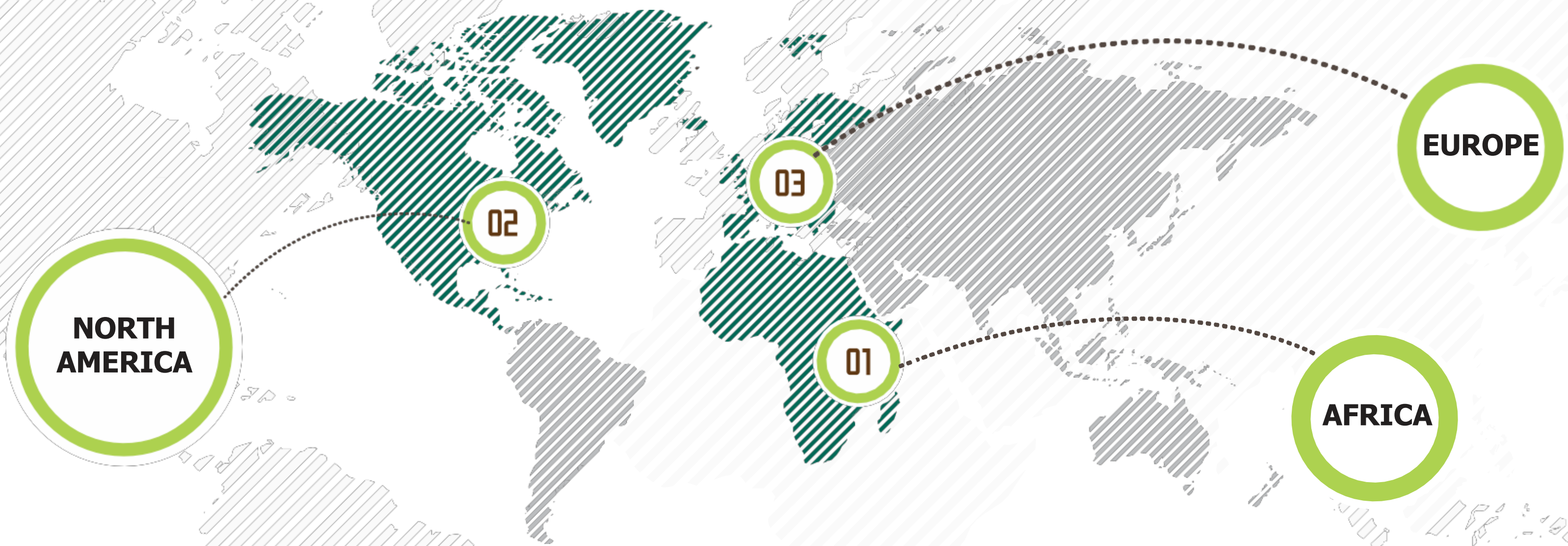
We collect funds from our clients

We invest them in high growth opportunities

We deliver the best possible returns

Our Business

Where We Operate



Our Business Lines

Investments	Real Estate	Diaspora	Technology	Co-operative
Alternative investment manager focused on private equity and real estate	We develop institutional grade real estate projects for investors	We connect East Africans in the diaspora to attractive investment opportunities in the region	We deliver world-class financial technology solutions	Provides access to attractive alternative investment opportunities for members

Our Solutions

To unearth the attractive opportunity that exists in alternative markets in Africa, we offer differentiated investment solutions in four main areas:

HIGH YIELD SOLUTIONS

Our expertise in the alternative markets enables us to offer investors high yielding investments. Our robust credit analysis coupled with our quick dealing capabilities, our extensive research coverage and our innovative structuring helps to ensure consistent and above market returns to investors.

REAL ESTATE INVESTMENT SOLUTIONS

Our comprehensive real estate capabilities enable us to find, evaluate, structure and deliver world-class real estate investment products to our investors in the East African region. Our capabilities include fundraising, market research and acquisition, concept design, project management and agency and facility management.

PRIVATE REGULAR INVESTMENT SOLUTIONS

Attractive returns in the alternative segments have typically been accessible to institutional and high net-worth investors. Our regular investment solutions provide access to the alternative investments to members of the Cytonn Co-operative.

PRIVATE EQUITY

We seek to unearth value by identifying potential companies and growing them through capital provision, partnering with management to drive strategy and institutionalizing their processes. Our areas of focus are Financial Services, Education, Renewable Energy and Technology Sectors.

Our Products

We serve three main types of clients namely, high net-worth individuals, institutions and retail, each with diverse needs. Below are the suitability criteria for the various products.

	INSTITUTIONAL CLIENTS	HIGH NET WORTH INDIVIDUALS (HNWI)	RETAIL CLIENTS
Cash Management Solutions	●	●	
Regular Investment Plan • Education Investment Plan • Regular Investment Solution • Co-op Premier Investment Plan • Land Investment Plan	●	●	●
Real Estate Development • Real Estate Developments • Sharpland	●	●	●

Our People

> If you could get all the people in an organization rowing the same direction, you could dominate any industry, in any market, against any competition, at any time.
>
> **— Patrick Lencioni**

Board of Directors

To ensure that we remain focused on the clients' interests, we have put in place proper governance structures. We have a board of directors consisting of 10 members from diverse backgrounds, each bringing in unique skill-sets to the firm.

Non-Executive Director

Chairman

Prof. Daniel Mugendi Njiru, PhD

Non-Executive Director

Madhav N. Bhalla, LLB

Non-Executive Director

Antti-Jussi Ahveninen, MSc

Non-Executive Director

Nasser J. Olwero, MPhil

For bios, visit www.cytonn.com

Board of Directors, continued…

Non-Executive Director

James M. Maina, MA

Non-Executive Director

Michael Bristow, MSc

Non-Executive Director

Rose Kimotho, M.B.S.

Executive Director

Managing Partner

Edwin H. Dande, CPA, MBA

Executive Director

Senior Partner

Elizabeth N. Nkukuu, CFA, MBA

Executive Director

Partner

Patricia N. Wanjama, CPS (K), MBA

For bios, visit www.cytonn.com

Governance

> If you have leadership without governance you risk tyranny, fraud and personal fiefdoms. If you have governance without leadership you risk atrophy, bureaucracy and indifference.
>
> — **Mark Goyder**

INVESTMENTS & STRATEGY COMMITTEE

The committee oversees and provides strategic investment direction, including the implementation and monitoring process.

The committee consists of five directors with three non-executive directors namely: James Maina (Chairman), Antti-Jussi Ahveninen, Madhav Bhalla, Edwin Dande and Elizabeth Nkukuu.

AUDIT RISK & COMPLIANCE COMMITTEE

The committee establishes and oversees risk and compliance, including the implementation and monitoring process.

The committee consists of four directors with two non-executive directors namely: Madhav Bhalla (Chairman), Nasser Olwero, Edwin Dande and Patricia Wanjama.

GOVERNANCE, HUMAN RESOURCES & COMPENSATION COMMITTEE

The committee establishes, oversees and implements governance structure, human resource policies and firm wide compensations.

The committee consists of four directors with three non-executive directors namely: Antti-Jussi Ahveninen (Chairman), Prof. Daniel Mugendi, Michael Bristow and Edwin Dande.

TECHNOLOGY & INNOVATION COMMITTEE

The committee establishes, oversees and implements technical expertise and innovative processes as a driver towards competitiveness.

The committee consists of three directors, with two non-executive directors namely: Nasser Olwero (Chairman), Michael Bristow and Patricia Wanjama.

II. Economic Review and Outlook

Summary Economic Outlook

Inflation turns negative from neutral while the Exchange rate is neutral from negative. Of the 7 indicators we track, 1 has improved while 1 has deteriorated in 2017 pointing to a stable outlook

Macro-Economic Indicators	2017 Expectations	2017 YTD Experience	Going Forward	Outlook - Beginning of 2017	Current Outlook
GDP	GDP growth of 5.4% - 5.7% in 2017	GDP growth for 2016 came in at 5.8%, in line with our expectation of a growth between 5.7% - 6.0%. The National Treasury has revised downwards its 2017 GDP growth projection to 5.7%, from 5.9% previously	We expect GDP growth for 2017 to come in at 5.4% - 5.7%, a slight decline from the 5.8% experienced in 2016	**Neutral**	**Neutral**
Interest Rates	A stable outlook on interest rates in 2017 with the CBR maintained at 10.0%	The CBK has maintained the CBR at 10.0%. The government is not under pressure to borrow in the current fiscal year, having surpassed its domestic borrowing target	The interest rate environment is expected to remain relatively stable with the CBK not accepting higher yields on treasury securities and the MPC maintaining the CBR at 10.0%	**Neutral**	**Neutral**
Inflation	Expected to average above the 2.5% - 7.5% government target	Inflation increased to 11.7% in May from 11.5% in April mainly due to a rise in food prices	We expect the inflation rate to stabilize in the second half of the year but average above the 7.5% upper bound government target in 2017	**Neutral**	**Negative**
Exchange Rate	Shilling to depreciate against major currencies	The shilling has depreciated by 0.8% against the dollar YTD on account of increased dollar demand from oil and retail importers	We expect the currency to remain relatively stable against the dollar driven suppressed global recovery of oil prices following OPECs decision to extend the deal to cut down on oil production. It is also important to note that the CBK has sufficient reserves (equivalent to 5.5 months of import cover) to support the shilling in the short term	**Negative**	**Neutral**

Summary Economic Outlook, continued…

Inflation turns negative from neutral while the Exchange rate is neutral from negative. Of the 7 indicators we track, 1 has improved while 1 has deteriorated in 2017 pointing to a stable outlook

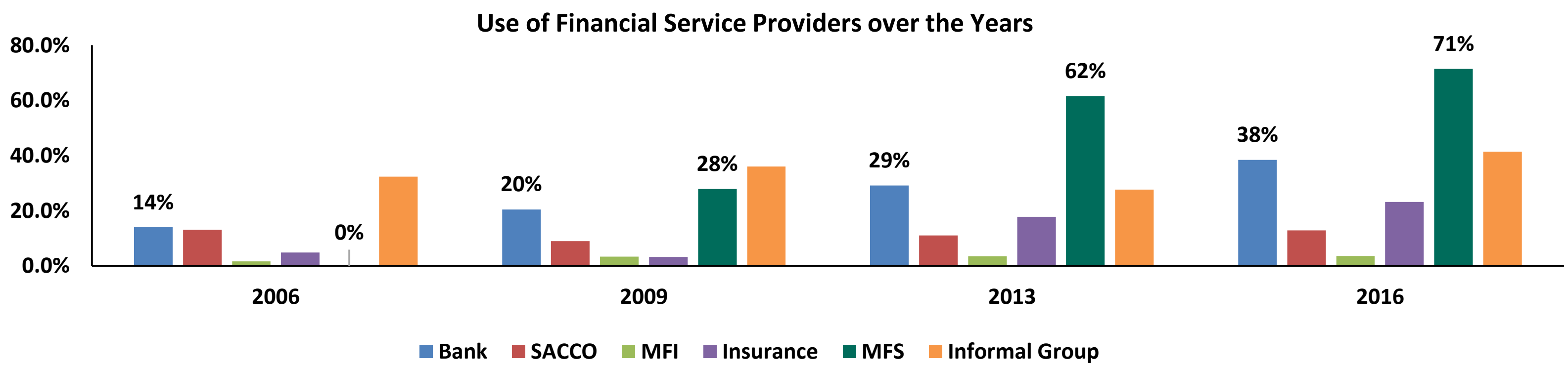
Macro-Economic Indicators	2017 Expectations	2017 YTD Experience	Going Forward	Outlook - Beginning of 2017	Current Outlook
Corporate Earnings	Corporate earnings growth of 8.0% in 2017 due to lower earnings for commercial banks attributed to the cap on interest rates	Banks have recorded a weighted average decline in core EPS of 8.7% in Q1'2017	We still expect corporate earnings to be worse than 2016, exhibiting decline in profits owing to slower private sector credit growth at 4.0% and effects of the cap on interest rates. We expect corporate earnings growth of 7.2%-8.0% in 2017	**Neutral**	**Neutral**
Investor Sentiment	Foreign investors to demand higher premiums due to political risks posed by elections and economic risk due to the planned rate hikes by the US Fed	Investor sentiment has been high with foreign investors being net buyers throughout the year with inflows of USD 1.9 mn	Political and economic risks on frontier markets still remains a risk. However, we expect long term investors to enter the market seeking to take advantage of the current low valuations	**Neutral**	**Neutral**
Security	Expect the government to put initiatives in place to ensure improved security. However, the 2017 election remains a challenge	In January, the U.S. Department of State issued a travel warning regarding threats by Al-Shabaab on the Somalia border, coastal and north-eastern counties. In March, the U.K government issued a warning due to security concerns in parts of Laikipia County	Security is expected to be tight as we head towards the elections with the government expected to keep this in check. However, uncertainty still exists due to the August elections	**Neutral**	**Neutral**

III. Kenya Banking Sector Overview

Kenya Banking Sector Overview

Financial Inclusion in Kenya continues to rise, driven by mobile and digital channels

- In Kenya there are a total of 40 commercial banks; reducing from 42 as Giro Commercial Bank has been acquired by I&M Holdings and Diamond Trust Bank Kenya is in the process of acquiring Habib Bank Limited Kenya, while Chase Bank and Imperial Bank are in receivership
- In addition there is 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
- Financial inclusion in Kenya has continued to rise, with the percentage of the population living within 3 kilometers of a financial services access point rising to 77.0% in 2016 from 59.0% in 2013. This has been driven by digitization, with Mobile Financial Services (MFS) rising to be the preferred method to access financial services in 2016



Kenya Banking Sector Overview, continued…

Consolidation in the sector is expected to gather pace in 2017, following the acquisition of Habib Bank Ltd by Diamond Trust Bank, and KCB Group's Expression of Interest to acquire National Bank

- Kenya's banking environment is already going through consolidation as evidenced by heightened M&A activity over the last 4 years
- Below is a summary of key transactions done over the last few years and their transaction multiples

Acquirer	Bank Acquired	Book Value at Acquisition (Kshs bns)	Transaction Stake	Transaction Value (Kshs bns)	P/Bv Multiple	Date
Diamond Trust Bank Kenya Limited	Habib Bank Limited Kenya	2.38	100.0%	1.82	**0.8x**	Mar-17
SBM Holdings	Fidelity Commercial Bank	1.75	100.0%	2.75	**1.6x**	Nov-16
M Bank	Oriental Commercial Bank	1.80	51.0%	1.30	**1.4x**	Jun-16
I&M Holdings	Giro Commercial Bank	2.95	100.0%	5.00	**1.7x**	Jun-16
Mwalimu SACCO	Equatorial Commercial Bank	1.15	75.0%	2.60	**2.3x**	Mar-15
Centum	K-Rep Bank	2.08	66.0%	2.50	**1.8x**	Jul-14
GT Bank	Fina Bank Group	3.86	70.0%	8.60	**3.2x**	Nov-13
Average			**80.3%**		**1.8x**	

- For local bank acquisitions, the average price-to-book multiple is at 1.8x, with an average acquisition stake of 80.3%. We expect increased M&A activity given the current low valuations, with banks that are uncompetitive in the market being bought out, and banks with common significant shareholders likely to merge
- The lifting of the moratorium on licensing new banks by the Central Bank of Kenya will also see more foreign entries into the Kenyan banking space, and currently Mayfair Bank has already been granted an "approval in principle", with Dubai Islamic Bank having been granted approval earlier

Growth in the Banking Sector

Listed bank’s Q1’2017 EPS declined by 8.6% y/y from an average growth of 13.6% witnessed in Q1’2016 following the capping of interest rates

- Kenya’s listed banks recorded declined EPS growth of 8.6% in Q1’2017, compared to an average growth of 13.6% in Q1’2016. The poor performance was on the back of a decline in Net Interest Income (NII) following the capping of interest rates. As a result, Net Interest Margin (NIM) declined marginally to 9.2% in Q1’2017 from 9.3% in Q1’2016

- Listed banks recorded gross loans and advances growth of 6.9% to Kshs 1.8 tn in Q1’2017 from Kshs 1.7 tn in Q1’2016, slowing down from the 5 year average growth rate of 14.6%, while deposits grew 11.1% to Kshs 2.3 tn in Q1’2017 from Kshs 2.0 tn in Q1’2016, also slower than the 5 year average of 14.6%

Banking Sector Growth Drivers

Alternative channels, cost containment and increased innovation support banks' growth and diversification

1) **Diversification to different revenue streams:** Banks are exploring different avenues of revenue generation such as Bancassurance, in a bid to increase non-funded income and further diversify their revenue sources, given the introduction of the interest rate cap which has negatively impacted funded income for banks
2) **Increased adoption of technology to improve on efficiency:** In a bid to minimize costs, banks have embraced technology to reduce operational costs and hence drive up efficiency. Some of these measures include integration with mobile application platforms and internet banking to facilitate increased collection of deposits and disbursement of loans with fewer operating costs
3) **Innovation:** In a bid to reduce operating expenses and improve efficiency, banks are putting an emphasis on innovation, and agency banking is expected to be key driver of diversification for banks and a distribution channel of banking products
4) **Growth of the middle class :** 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 that will require banking services

Recent Developments in the Banking Sector

The sector is promoting financial literacy and credit to MSMEs

1. **Measures aimed at improving private sector credit growth:** The president signed the Movable Property Security Rights Bill into law, which seeks to facilitate the use of movable assets as collateral for credit facilities. Kenya Institute of Management (KIM) and Kenya Bankers Association (KBA) signed a Memorandum of Understanding (MOU) to train Micro, Small and Medium Enterprises (MSMEs) in a bid to promote financial literacy and credit to MSMEs by educating these businesses on de-risking, to make it easier for banks to lend to them at the prevailing low rates brought about by the capping of interest rates. These are measures put in place in order to revive private sector credit growth, something the capping of interest rates has failed to do
2. **Licencing of commercial banks, marking the end of the moratorium:** The Central Bank of Kenya (CBK) issued an operating license to Dubai Islamic Bank Kenya Ltd (DIB), the first by the CBK since 2015 when it placed a moratorium on approving new licenses for banks. DIB's entry, which is anchored on its strategic focus of enhancing its international presence, will expand the offerings in the market, particularly in the promising sharia-compliant banking niche. In addition to DIB, the CBK is also finalizing the licensing of Mayfair Bank, which had received 'approval in principle' before the 2015 suspension of licensing

Recent Developments in the Banking Sector…Continued

Chase Bank stake sale is expected to bring the bank out of receivership

3. Chase Bank sale of majority stake: The Central Bank of Kenya (CBK) invited bids for a majority stake from local and foreign financial institutions in a bid to bring Chase Bank out of receivership through the sale of a majority stake in the bank, as KCB Group's role in managing the bank came to a close. 12 institutions expressed interest with 3 being local, 4 foreign financial institutions and 5 other financial institutions and consortia. The interest expressed by both local and foreign financial services sector players is an indication that the Kenyan banking sector remains attractive as it offers access to high returns. For CBK and KDIC, this is a historic development that sets a benchmark as it is the first time that a Kenyan bank under receivership has been re-opened

4. **Kenya Commercial Bank Expression of Interest to buy National Bank:** According to reports emerging recently, KCB Group has expressed interest to acquire the National Bank of Kenya (NBK) through a share swap, buying out 70.0% of the bank in the first phase, with a full acquisition to follow. These cases of consolidation in the banking sector are expected to lead to fewer, but larger banks, which are more stable and can withstand economic shocks. We expect this transaction to strengthen KCB's position as the largest bank in the country, especially with the anticipated introduction of the treasury single account and provide the much needed efficiency and prudence for NBK as ineffective branches controlled by NBK will be shut down and redundant staff laid off

Effects of Recent Developments in the Banking Sector

Banks have adopted technology to improve efficiency and promote financial inclusion while private sector credit growth has been on the decline as CBK keeps a close eye on banks' asset quality

1. **Adoption of technology:** Kenya Bankers Association (KBA) launched its real-time interbank switch, PesaLink, which will let customers make payments between banks in real-time without the need for intermediaries and customers will also be able to initiate transactions from diverse channels including from mobiles, banks' branches, ATMs, agency banking outlets and through the internet. In the last 4 months, the platform has transacted a little over Kshs 2.5 bn

2. **Decline in private sector credit growth:** Private sector credit growth has been on a decline coming in at 4.0% in the first quarter of 2017. The decline is attributed to structural reforms in the banking sector and strict adherence to prudential guidelines in terms of loan book quality and sufficient provisioning. This prompted banks to prefer to lend to the government as it is risk free as opposed to the private sector, which is considered riskier. The situation was also made worse by the interest rate cap, introduced in September 2016

3. **Increased consolidation through M&A activities**: The Kenya banking sector has witnessed increased consolidation through acquisition activities, with local banks such as Diamond Trust Bank acquiring Habib Bank, and I&M Holdings' acquisition of Giro Bank; while foreign banks namely M Bank's acquisition of Oriental Commercial Bank, and SBM Holdings, which is set to acquire Fidelity Commercial Bank

4. **Staff lay-offs and closure of branches:** With rising operating expenses in the sector, and the expected reduced margins owing to the enactment of the Banking (Amendment) Act 2015, 11 banks have announced plans to downsize, close to 1,340 bank employees have been laid off, and 21 branches have been closed, with the total number of branches in the sector declining to 1,082 from 1,089 in FY'16, representing the first decline since 2010

Effects of Recent Developments in the Banking Sector, continued…

Following the capping of interest rates, banks have taken to cost rationalization measures through staff lay offs and closing down redundant branches

	Kenya Banking Sector Restructuring		
	Bank	**Staff Retrenchment**	**Branches Closed**
1.	Sidian Bank	108	-
2.	Equity Group	400	7
3.	Ecobank	-	9
4.	Family Bank	Unspecified	-
5.	First Community Bank	106	-
6.	Bank of Africa	-	12
7.	National Bank	Unspecified	-
8.	NIC Bank	32	-
9.	Standard Chartered Bank Kenya	300	-
10.	KCB Group	223	-
11.	Barclays Bank	171	-

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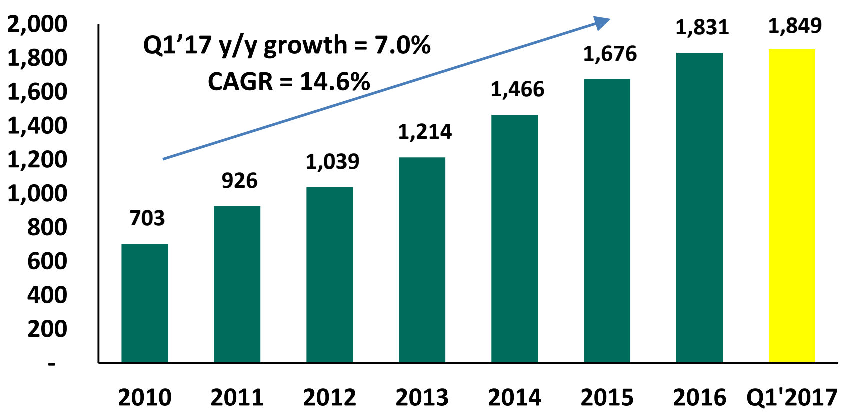
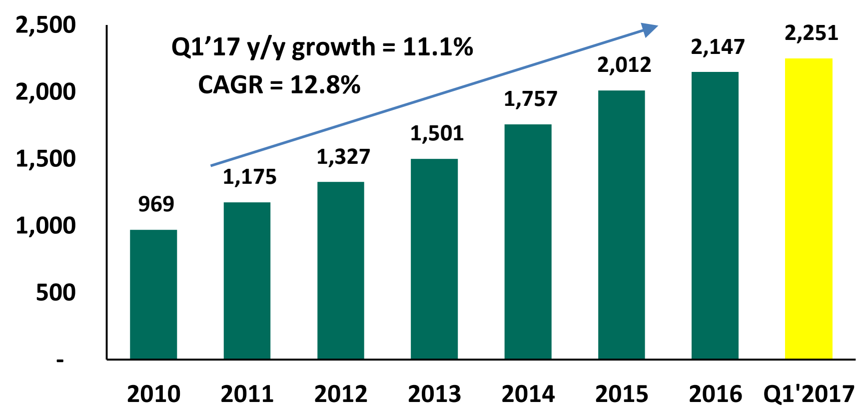
Listed Banking Sector Metrics

Deposit and loan growth remain strong, however the growth is slowing down and is currently at 11.1% and 7.0%, respectively, with bank branches declining by 2.3% as banks push for efficiency

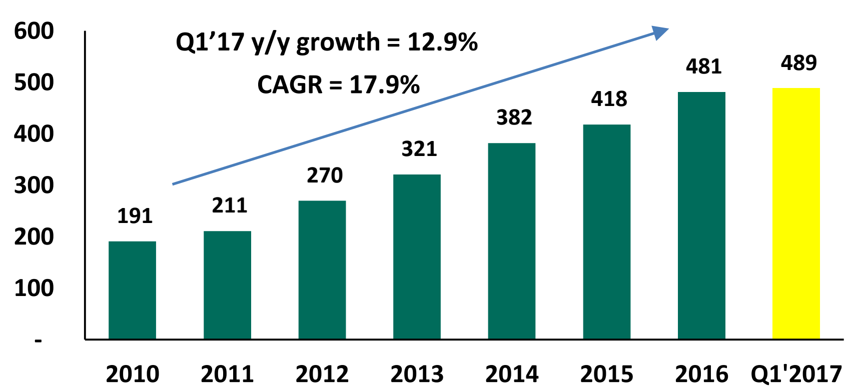
Loans and Advances (Kshs Bn)



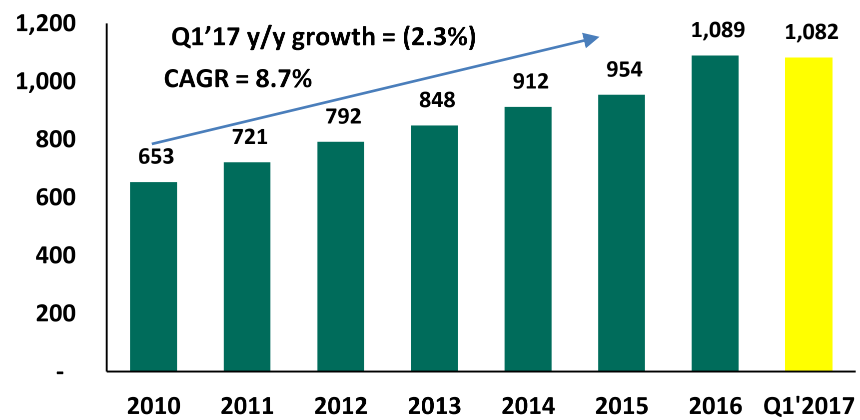
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



Bank Branches

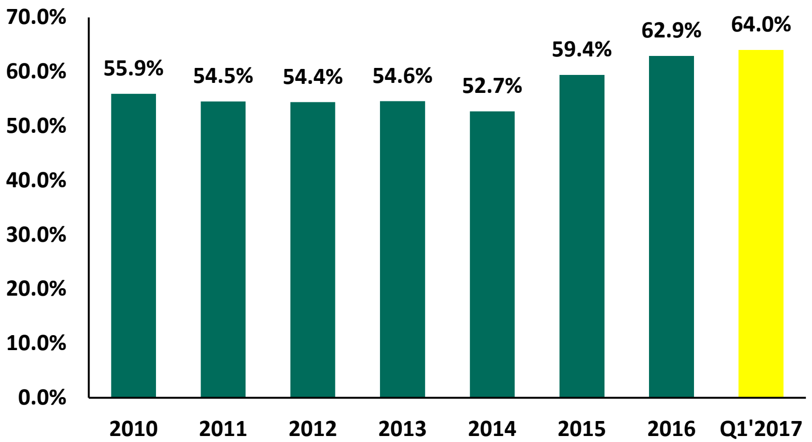


Source: Central Bank of Kenya

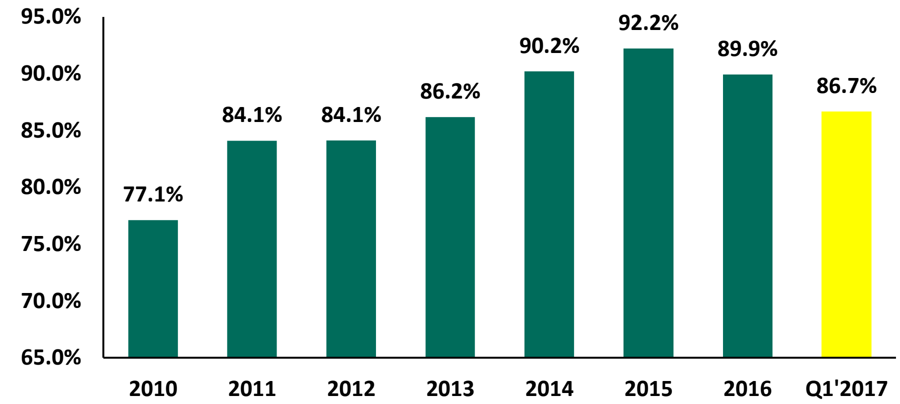
Listed Banking Sector Metrics, continued…

High levels of NPLs and rising costs remain a point of concern for the sector

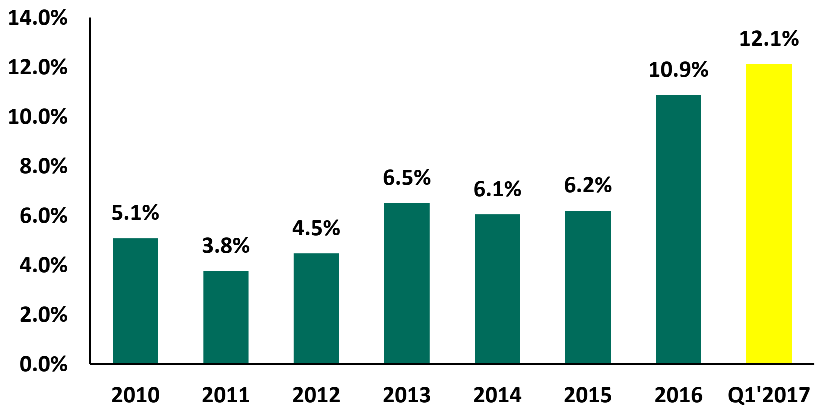
Cost to Income (%)



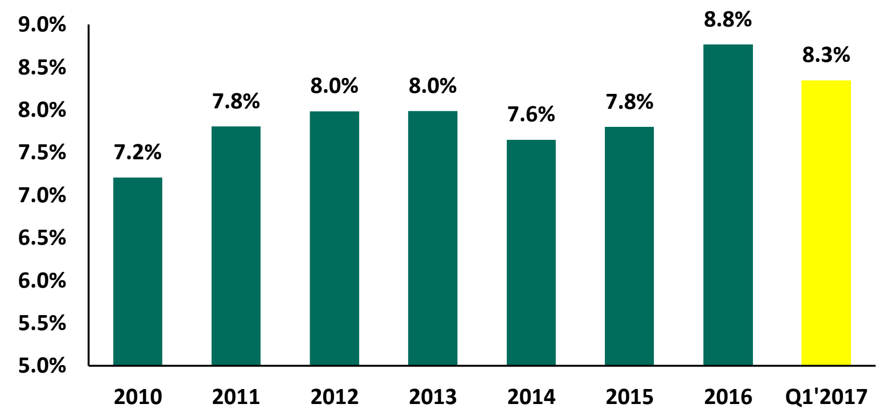
Loan to Deposits (%)



NPLs to Total Loans (%)



Net Interest Margin (%)



Source: Central Bank of Kenya

Listed Banks Q1’2017 Earnings & Growth Metrics

Kenya’s banking sector Q1’2017 core EPS declined by 8.6% compared to a growth of 13.6% in Q1’2016

Listed Banks Q1'2017 Earnings and Growth Metrics						
Bank	**Core EPS Growth**	**Deposit Growth**	**Loan Growth**	**Net Interest Margin**	**Loan to Deposit Ratio**	**Exposure to Government Securities**
Diamond Trust Bank	**8.8%**	22.1%	4.8%	7.2%	74.9%	39.1%
KCB Group	**(3.2%)**	7.9%	14.3%	9.1%	86.6%	23.2%
NIC Bank	**(3.9%)**	6.8%	3.9%	7.9%	98.7%	26.4%
Equity Group	**(5.6%)**	16.1%	(4.8%)	10.3%	75.4%	32.5%
Co-op Bank	**(6.0%)**	6.9%	15.0%	9.5%	87.9%	23.0%
Stanbic Holdings	**(9.3%)**	20.0%	11.4%	6.9%	88.4%	22.4%
I&M Holdings	**(16.9%)**	14.3%	8.8%	8.0%	86.2%	34.7%
Barclays Bank	**(19.8%)**	7.6%	10.7%	10.2%	92.8%	24.2%
Standard Chartered Bank	**(20.5%)**	11.1%	6.5%	9.0%	57.0%	47.2%
Housing Finance Group	**(73.1%)**	(6.4%)	2.2%	6.2%	142.7%	11.1%
National Bank of Kenya	**(82.2%)**	(6.7%)	(12.3%)	7.5%	62.7%	38.2%
Q1'2017 Weighted Average*	**(8.6%)**	**11.7%**	**7.1%**	**9.2%**	**81.2%**	**30.0%**
Q1'2016 Weighted Average*	**13.6%**	**10.8%**	**15.7%**	**9.3%**	**85.1%**	**26.0%**

**** The weighted average is Market Cap weighted***

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Listed Banking Sector Multiples

Kenya's banking sector is trading at an average PBV of 1.4x and a PE of 7.2x

Bank	Share Price *	No. of Shares Issued (bn)	Market Cap (bn)	PBV	P/E	Dividend Yield
National Bank of Kenya	9.9	0.3	3.0	**0.3x**	**6.1x**	**0.0%**
Housing Finance Group	10.4	0.3	3.6	**0.3x**	**4.0x**	**3.6%**
Stanbic Holdings	71.5	0.4	28.3	**0.8x**	**5.3x**	**6.6%**
NIC Bank	33.5	0.6	21.4	**0.7x**	**5.0x**	**3.8%**
Diamond Trust Bank Kenya	152.0	0.3	42.5	**1.0x**	**5.2x**	**2.1%**
I&M Holdings	101.0	0.4	39.6	**1.1x**	**5.4x**	**3.6%**
Barclays Bank of Kenya	9.6	5.4	52.1	**1.2x**	**7.5x**	**10.2%**
KCB Group	37.0	3.1	114.9	**1.1x**	**5.9x**	**8.1%**
Standard Chartered Bank Kenya	207.0	0.3	71.1	**1.5x**	**8.3x**	**5.0%**
Co-operative Bank of Kenya	17.2	5.9	100.9	**1.6x**	**8.1x**	**4.5%**
Equity Group Holdings	39.0	3.8	147.2	**1.9x**	**9.0x**	**5.1%**
Weighted Average**				**1.4x**	**7.2x**	**5.7%**
Median				**1.1x**	**5.9x**	**4.5%**

For P/E calculation for NBK we used normalized earnings over a period of 5 years

*****- Weighted on market cap***

**** - Price as at 16/06/2017***

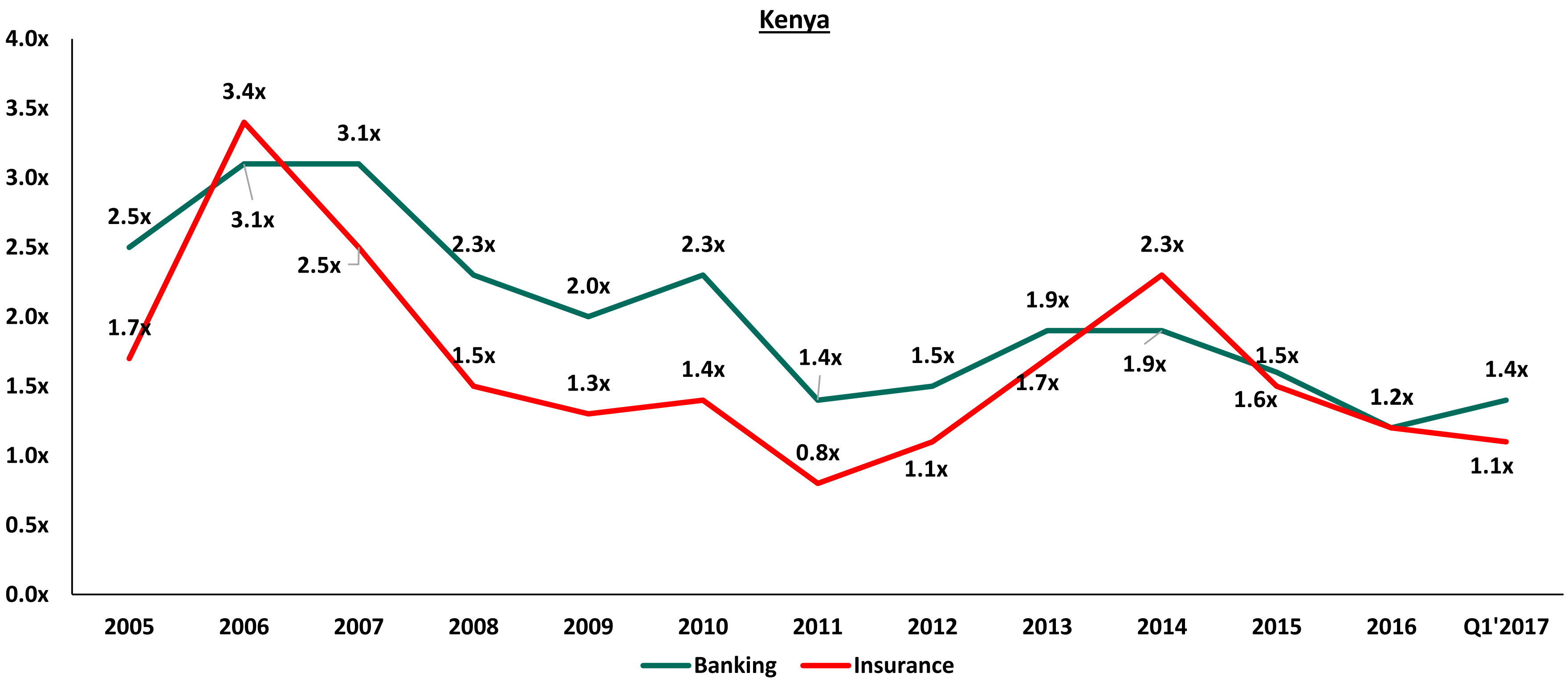
Source: NSE, Cytonn Banking Sector Report

Cytonn INVESTMENTS

Banking Sector Multiples

Listed Banks are currently priced at a PBV of 1.4x compared to listed insurance companies at 1.1x

10 year Price to book value: Banking and Insurance



On a price to book valuation, listed banks are currently priced at a PBV of 1.4x compared to the listed insurance companies at 1.1x

Source – Cytonn Research

Summary of the Q1'2017 Earnings

Banks have been adversely affected following the capping of interest rates, with the sector recording an 8.6% decline in core EPS

1. Following a decline of 8.6% in core earnings in Q1'2017 compared to a growth of 13.6% in Q1'2016, bank earnings were significantly affected by the interest rate cap in 2016, with the full effects of the cap expected to show further in FY'2017 performance
2. Deposits grew at a faster rate than loans at 10.8% compared to loans at 7.1%, but slower than the 6-year averages of 12.8% and 14.6% for deposits and loans, respectively
3. The level of NPLs remains a concern within the banking sector with loan loss provisions growing at 67.3% and 77.7% for the non-listed and listed banks, respectively. We expect the level of provisioning to increase going forward as banks adopt IFRS 9 that requires a forward looking approach to estimate credit losses
4. Growth for most banks with regional subsidiaries was driven mainly by the Kenyan business as their regional operations underperformed, notably in South Sudan that continued experiencing a devaluation of the South Sudan Pound and hyperinflation in the economy
5. With a sector valuation of 1.4x price to book and 7.2x price to earnings, against a historical average of 1.6x and 7.9x, respectively, we think that the sector has become fairly attractive for a long-term investor

IV. Cytonn's Banking Sector Report

Consolidation & prudence in a challenging operating environment

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Price controls were put in place in the industry following the enactment of the Banking Act (Amendment) 2015**	• Banks have experienced declined growth in EPS in the first quarter of the year, with a slight compression in net margins, and this has adversely affected the profitability of banks. Exposure in government securities increased with subdued loan growth, as the government crowds out the private sector from credit
	• **Transition to IFRS 9 from IAS 39:** IFRS 9 requires banks to adopt a forward looking approach in credit risk assessment	• This has led to more prudent provisioning by banks, resulting to lower profitability
Consolidation	• **Increased consolidation in the industry, mainly through acquisitions** This year, Diamond Trust Bank Kenya (DTBK) has already announced plans to acquire Habib Bank (K) Limited (HBL), while KCB has expressed interest to acquire National Bank, setting the platform for more consolidation this year	• Consolidation in the banking sector will only gather pace as stable banks target to acquire small, weaker banks. This will lead to fewer and stronger banks, hence a more stable banking sector • Entry of foreign banks into the local banking space is expected to pick up following the lifting of the moratorium to license new banks by CBK earlier in the year
Asset Quality	• **Increase in non-performing loans:** With the Gross NPL ratio currently at 11.6% from 8.1% in Q1'2016, this raises concerns around asset quality in the sector	• The increased NPLs has forced banks to adopt prudent banking based on more stringent risk assessment framework

The banking sector is primed to witness increased consolidation while remaining prudent following rising non-performing loans and the capping of interest rates.

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 take a view on the banking sector to determine 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 Q1'2017 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 local Tier 1 banks which performed well in terms of both Franchise and Intrinsic valuation

Rankings by Franchise Value

Co-operative Bank emerged top in the franchise value rankings, with HF Group coming last

Key Ranking Metrics															
Rank	Bank	LDR *	CIR **	ROACE ***	NIM ****	PEG ratio	P/TBV	Deposit/ Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Interest Income/ Revenue	Camel Rating	Corporate Governance Score	Total Score
1	Co-operative	3	5	3	3	3	8	5	2	9	2	4	2	4	**53**
2	KCB Group	2	7	2	4	2	6	7	7	2	4	3	9	1	**56**
3	DTBK	6	4	6	9	1	5	6	1	1	10	10	3	2	**64**
4	I&M	1	2	4	6	4	9	3	4	5	8	9	8	6	**69**
5	Equity	5	6	1	1	6	11	10	6	6	6	2	5	6	**71**
6	SCBK	10	3	5	5	7	10	1	9	4	5	6	7	3	**75**
7	NIC	8	1	9	7	5	3	4	8	7	1	8	6	9	**76**
8	Stanbic	4	9	7	10	9	4	2	3	8	9	1	1	11	**78**
9	Barclays	7	8	8	2	10	7	9	5	3	3	5	4	8	**79**
10	NBK	9	11	11	8	11	1	11	11	10	11	7	11	5	**117**
11	HF Group	11	10	10	11	8	2	8	10	11	7	11	10	10	**119**

- 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
- Cooperative Bank ranked 1st position on the back of low Non-performing loans at 4.5%, a high return on equity of 21.1%, and a high tangible common ratio of 16.6%, against an average of 11.1%, 16.8% and 14.6%, respectively for the industry

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

Source: Cytonn Research

Rankings by Intrinsic Value

DTB has the highest upside with a total potential return of 60.8%

Banks	Current Price*	Target Price	Upside	Dividend Yield	Total Potential Return	Q1'2017 Ranking	FY'2016 Ranking
DTB	152.0	241.1	58.6%	2.1%	**60.8%**	**1**	**10**
NIC Bank	33.5	51.2	52.8%	3.8%	**56.6%**	**2**	**9**
KCB Group	37.0	54.0	45.9%	8.1%	**54.0%**	**3**	**1**
I&M Holdings	101.0	147.5	46.0%	3.6%	**49.6%**	**4**	**5**
HF Group	10.4	13.9	34.0%	3.6%	**37.6%**	**5**	**8**
Barclays Bank	9.6	12.1	25.6%	10.2%	**35.8%**	**6**	**2**
Stanbic Holdings	71.5	77.0	7.7%	6.6%	**14.3%**	**7**	**4**
Co-op Bank	17.2	18.5	7.8%	4.5%	**12.3%**	**8**	**3**
SCBK	207.0	209.3	1.1%	5.0%	**6.1%**	**9**	**6**
Equity Bank	39.0	38.4	(1.5%)	5.1%	**3.7%**	**10**	**7**
NBK	9.9	4.0	(59.4%)	0.0%	**(59.4%)**	**11**	**11**

Prices as at 16th June 2017

- DTB and NIC Bank have the highest upsides at 60.8% and 56.6%, respectively. KCB Group dropped to 3rd on the intrinsic value ranking, while DTB & NIC Bank rose 9 & 7 positions to 1st and 2nd, respectively
- National Bank of Kenya registered the highest downside of 59.4%, maintaining its intrinsic value ranking from FY'2016

Composite Bank Ranking

Overall, KCB Group ranked highest, while 6 banks shifted positions from FY'2016

CYTONN'S Q1'2017 BANKING REPORT RANKINGS					
Bank	**Franchise Value Total Score**	**Total Return Score**	**Weighted Score**	**Q1'2017 Rank**	**FY'2016 Rank**
KCB Group	**56.0**	**3**	**24.2**	**1**	**1**
Co-operative Bank	**53.0**	**8**	**26.0**	**2**	**2**
Diamond Trust Bank	**64.0**	**1**	**26.2**	**3**	**4**
I&M Holdings	**69.0**	**4**	**30.0**	**4**	**6**
NIC Bank	**76.0**	**2**	**31.6**	**5**	**9**
Equity Group	**71.0**	**10**	**34.4**	**6**	**3**
Barclays Bank	**79.0**	**6**	**35.2**	**7**	**7**
SCBK	**75.0**	**9**	**35.4**	**T8**	**5**
Stanbic Holdings	**78.0**	**7**	**35.4**	**T8**	**8**
HF Group	**119.0**	**5**	**50.6**	**10**	**10**
NBK	**117.0**	**11**	**53.4**	**11**	**11**

- In our ranking, franchise value was assigned a weighting of 40.0% while the intrinsic value was assigned 60.0% weight
- KCB Group and Coop Bank maintained 1^{st} and 2^{nd}, respectively, Equity moved down 3 positions to 6^{th}, while NIC Bank was the biggest mover, moving 4 positions up from FY'2016

Appendix

A. Metrics Used

Banking Sector Report – Metrics Used

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

1. **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 increased their allocation to government securities following the interest rate cap, as opposed to giving out more loans. Equity Group had the highest NIM at 10.3%, with the lowest for HF Group at 6.2%

2. 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 22.0%, while the National Bank of Kenya had the lowest at (1.0%)

Banking Sector Report – Metrics Used, continued…

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

3. 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. Diamond Trust Bank had the lowest PEG ratio at 0.5x, while Barclays was the most overvalued at 1.4x

4. 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:

Standard Chartered Bank has the highest deposits per branch at Kshs 5.1 bn, while the National Bank of Kenya had the lowest deposits per branch at Kshs 1.3 bn

Banking Sector Report – Metrics Used, continued…

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

5. 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 borrowing

Output:

Taking a preferred LDR of 85.0%, we found that I&M Holdings was closest to the target at 86.2%, while HF Group was the farthest at 142.7%

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 banks have opted to restructure, and others have resorted to laying off staff in a bid to bring down costs and subsequently this ratio. NIC Bank maintained the lowest cost to income ratio of 39.3%, while the National Bank of Kenya had the highest ratio at 89.6%

Banking Sector Report – Metrics Used, continued…

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

7. 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 that the National Bank of Kenya is the most undervalued bank as per this metric at 0.2x, while Equity Bank is still the most overvalued at 2.0x

8. 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:

NIC Bank is the most solvent with a tangible common ratio of 17.3%, while the National Bank of Kenya was the least solvent at 8.5%

9. Gross non-performing 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:

DTBK had the highest quality loan book with a gross non-performing loans ratio of 4.3%, while the National Bank of Kenya had the highest non-performing loans ratio at 42.9%

Banking Sector Report – Metrics Used, continued…

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

10. 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:

Barclays Bank has the highest provisions to non-performing loans at 69.3%, while the National Bank of Kenya has the lowest at 28.6%

11. 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. Stanbic Holdings has the highest non-interest income as a percentage of revenue at 42.3%, while HF Group has the lowest at 17.8%

12. 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

13. Corporate Governance Score –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 50.0% as the base. Anything below 50.0% should be flagged as having serious corporate governance issues while anything above is skewed towards proper governance. However the variance from 100.0% gives the risk associated with corporate governance

B. Tier I Banks

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
Equity Group	• The digitization strategy of the Bank, with the roll out of Eazzy Banking App and Equitel, which is currently the 2nd largest mobile money transfer service	• Cost control: Equity bank has a big challenge to maintain their cost as they are investing highly in IT • Expansion Setbacks: Equity bank has encountered some setback in their regional expansion, having shut down most of its branches in South Sudan
KCB Group	• KCB Mpesa, is expected to be a key growth driver in terms of deposits and loans • Alternative channels including mobile banking and agency banking	• Exposure to different political, economic and regulatory environments especially the impact of South Sudan operation • The bank seems to be struggling in utilising its asset base compared to its peers in generation of returns
Co-op Bank	• It has a large Sacco banking base, and the opportunity to grow upon the model • Increased operational efficiency and cost reduction due to its recent transformation project	• Exposure to different political, economic and regulatory environments especially the impact of South Sudan operation
Standard Chartered	• Custody business will continue providing the bank with a niche when it comes to wholesale banking • Strong in corporate banking business	• High NPLs have affected their revenues but adoption of prudent screening criteria is bound to address this • Limited to Kenya as the parent company prefers to operate independently in other markets
Barclays Bank	• 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	• 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
DTB Bank	• Strong backing from financing partners, i.e. Aga Khan Fund for Economic Development and Habib bank • Best asset quality in the sector, with gross NPL ratio at 4.3% compared to an industry average of 11.1%	• Competition in the SME banking market • Exposure to different political, economic and regulatory environments

Cytonn INVESTMENTS

I. Equity Group Holdings

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 11.4%

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	34.1	41.8	38.4	47.5	54.3
Non Funded Income	21.9	22.2	23.1	25.0	28.5
Loan Loss Provision	2.4	6.6	7.1	8.5	9.6
Other Operating Expenses	29.7	32.5	31.1	36.3	40.9
Total Operating Expenses	32.1	39.1	38.2	44.8	50.6
Profit Before Tax	24.0	24.9	23.3	27.8	32.3
Profit After tax	17.3	16.6	16.3	19.4	22.6
% PAT Change YoY	**1.0%**	**(4.2%)**	**(1.9%)**	**19.3%**	**16.3%**
EPS	4.6	4.4	4.3	5.1	6.0
DPS	2.0	2.0	2.0	2.2	2.5
Cost to Income	52.9%	50.7%	50.6%	50.0%	49.4%
NIM	10.6%	11.1%	9.3%	9.6%	9.6%
ROaE	25.5%	21.5%	19.7%	21.8%	22.3%
ROaA	4.5%	3.7%	3.2%	3.4%	3.5%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	269.9	266.1	277.9	309.3	354.2
Government Securities	42.8	100.6	139.2	166.9	188.7
Other Assets	115.4	107.1	124.7	126.9	137.4
Total Assets	**428.1**	**473.7**	**541.7**	**603.1**	**680.3**
Customer Deposits	302.2	337.2	385.9	441.9	506.0
Other Liabilities	53.8	54.5	72.5	66.6	66.6
Total Liabilities	**356.0**	**391.7**	**458.4**	**508.5**	**572.6**
Shareholders Equity	72.1	82.0	83.3	94.6	107.7
Book value Per share	19.1	21.7	22.1	25.1	28.5
% Change in BPS YoY	**13.1%**	**13.6%**	**1.6%**	**13.5%**	**13.8%**

Cytonn INVESTMENTS

Valuation Summary

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

Cost of Equity Assumptions:	16-Jun-17
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	6.4%
Extra Risk Premium	1.1%
Cost of Equity	19.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.3%
Return on Average Equity	21.8%
Terminal P/B	1.8x
Shareholder Equity - FY21e	139.0
Terminal Value-(Year 2021)	255.4

Valuation Summary:	Implied Price	Weighting	Weighted Value
Intergrated DDM	43.4	40.0%	17.4
Residual Income	38.2	35.0%	13.4
PBV Multiple	29.4	20.0%	5.9
PE Multiple	35.8	5.0%	1.8
Fair Value			**38.4**
Current Price			**39.0**
Upside/(Downside)			(1.5%)
Dividend Yield			5.1%
Total Potential Return			**3.7%**

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

II. KCB Group

Financial Statements Extracts

KCB Group's PAT is expected to grow at a 5-year CAGR of 11.5%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	39.2	47.0	46.8	51.3	56.0
Non Funded Income	23.4	22.5	26.5	28.8	31.5
Loan Loss Provision	4.7	3.8	4.4	4.8	5.7
Other Operating Expenses	31.4	36.6	41.9	44.4	46.2
Total Operating Expenses	**36.1**	**40.4**	**46.3**	**49.1**	**51.9**
Profit Before Tax	26.5	29.1	27.0	31.0	35.6
Profit After tax	19.6	19.7	18.9	21.7	24.9
% PAT Change YoY	**16.5%**	**0.5%**	**(4.2%)**	**14.8%**	**14.9%**
EPS	6.5	6.5	6.2	7.2	8.2
DPS	2.1	3.1	3.1	3.2	3.6
Cost to Income	57.6%	58.1%	63.2%	61.3%	59.3%
NIM	8.6%	9.2%	8.4%	8.4%	8.5%
ROE	25.0%	22.2%	18.6%	19.3%	19.9%
ROA	3.7%	3.4%	3.0%	3.3%	3.6%

Balance Sheet	2015	2016	2017f	2018f	2019f
Net Loans and Advances	346.0	385.7	413.8	455.3	490.1
Government Securities	57.8	40.5	45.5	45.5	49.0
Other Assets	154.3	169.0	191.6	205.1	221.6
Total Assets	**558.1**	**595.2**	**650.8**	**706.0**	**760.8**
Customer Deposits	424.4	448.2	491.5	530.8	573.2
Other Liabilities	52.4	50.4	53.1	56.8	55.3
Total Liabilities	**476.8**	**498.6**	**544.6**	**587.6**	**628.5**
Shareholders Equity	81.3	96.6	106.2	118.4	132.3
Book value Per share	26.9	31.9	35.1	39.1	43.7
% Change in BPS YoY	**7.4%**	**18.8%**	**10.0%**	**11.4%**	**11.8%**

Valuation Summary

KCB Group is undervalued with a total potential return of 54.0%

Cost of Equity Assumptions:	16-June-17
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	6.4%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.6%
Return on Average Equity	21.5%
Terminal P/B	1.5x
Shareholder Equity - FY21e	167.6
Terminal Value-(Year 2021)	263.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	52.9	35%	18.5
PBV Multiple	52.3	20%	10.5
PE Multiple	54.2	5%	2.7
DDM Integrated	55.8	40%	22.3
Target Price			**54.0**
Current Price			**37.0**
Upside/(Downside)			45.9%
Dividend Yield			8.1%
Total Potential Return			**54.0%**

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

III. Co-operative Bank of Kenya

Financial Statements Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 10.7%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	23.2	29.5	28.9	31.3	34.3
Non Funded Income	13.2	12.8	13.7	15.2	16.6
Loan Loss Provision	2.0	2.6	3.0	3.0	3.3
Other Operating Expenses	19.4	22.0	22.3	23.7	25.1
Total Operating Expenses	21.4	24.6	25.3	26.7	28.4
Profit Before Tax	15.4	17.7	17.5	19.8	22.6
Profit After tax	11.7	12.7	12.2	13.9	15.8
% PAT Change YoY	**46.0%**	**8.3%**	**(3.6%)**	**13.4%**	**14.1%**
EPS	2.4	2.6	2.5	2.8	3.2
DPS	1.0	1.0	0.9	1.1	1.2
Cost to Income	58.8%	58.3%	59.3%	57.6%	55.8%
NIM	8.7%	9.9%	9.0%	8.8%	8.8%
ROE	25.0%	22.7%	18.5%	18.5%	18.7%
ROA	3.7%	3.7%	3.2%	3.2%	3.4%

Balance Sheet	2015	2016	2017f	2018f	2019f
Net Loans and Advances	213.4	236.9	258.1	285.7	309.3
Government Securities	36.2	37.2	43.8	48.5	53.5
Other Assets	93.0	77.8	103.9	113.5	132.0
Total Assets	**342.5**	**351.9**	**405.8**	**447.7**	**494.7**
Customer Deposits	265.4	260.2	298.4	332.7	369.3
Other Liabilities	26.9	30.5	36.7	35.5	36.0
Total Liabilities	**292.3**	**290.6**	**335.0**	**368.2**	**405.2**
Shareholders Equity	50.2	61.3	70.8	79.5	89.5
Book value Per share	10.3	12.5	14.5	16.3	18.3
% Change in BPS YoY	**15.9%**	**22.1%**	**15.5%**	**12.3%**	**12.5%**

Valuation Summary

Co-operative Bank is undervalued with a total potential return of 12.3%

Cost of Equity Assumptions:	16-Jun-17
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	6.4%
Extra Risk Premium	0.0%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.0%
Return on Average Equity	19.6%
Terminal P/B	1.5x
Shareholder Equity - FY21e	114.2
Terminal Value-(Year 2021)	179.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	19.59	40%	7.84
Residual income	19.28	35%	6.75
PBV Multiple	15.70	20%	3.14
PE Multiple	16.52	5%	0.83
Fair Value			**18.5**
Current Price			**17.2**
Upside/(Downside)			7.8%
Dividend Yield			4.5%
Total Potential Return			**12.3%**

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

Cytonn INVESTMENTS

IV. Standard Chartered Bank

Financial Statements Extracts

Standard Chartered's PAT is expected to grow at a 5-year CAGR of 8.7%

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	18.1	19.4	14.2	18.5	21.1
Non Funded Income	7.2	8.6	9.2	9.5	10.2
Loan Loss Provision	4.9	2.2	2.9	3.5	3.8
Other Operating Expenses	11.3	12.5	11.3	12.4	13.4
Total Operating Expenses	**16.2**	**14.7**	**14.2**	**15.9**	**17.2**
Profit Before Tax	9.2	3.3	9.3	12.0	14.1
Profit After tax	6.3	9.1	6.3	8.2	9.6
% PAT Change YoY	**(39.2%)**	**42.7%**	**(30.4%)**	**30.0%**	**17.3%**
EPS	18.5	26.3	18.3	23.8	28.0
DPS	12.5	20.0	10.3	13.3	15.7
Cost to Income	63.9%	52.5%	60.5%	57.0%	54.9%
NIM	9.6%	9.6%	6.5%	7.9%	8.4%
ROaE	16.2%	21.3%	13.8%	16.7%	18.2%
ROaA	2.8%	3.7%	2.4%	2.9%	3.2%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	115.1	122.7	125.5	136.2	147.8
Government Securities	73.6	86.9	96.6	100.4	108.9
Other assets	45.2	40.7	52.5	55.2	58.4
Total Assets	**234.0**	**250.3**	**274.6**	**291.8**	**315.1**
Customer Deposits	172.0	186.6	202.5	219.7	238.3
Other Liabilities	20.7	19.8	24.9	21.4	21.7
Total Liabilities	**192.7**	**206.4**	**227.4**	**241.0**	**260.1**
Shareholders Equity	41.3	43.9	47.2	50.8	55.0
Book value Per share	120.1	127.8	137.3	147.8	160.1
% Change in BPS YoY	**11.8%**	**6.4%**	**14.4%**	**7.6%**	**8.3%**

Valuation Summary

Standard Chartered Bank is fairly valued with a total potential return of 6.1%

Cost of Equity Assumptions:	16-Jun-17
Default Spread Adjusted Risk free rate	13.2%
Beta	0.8
Mature Market Risk Premium	6.4%
Extra Risk Premium	0.0%
Cost of Equity	18.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.4%
Return on Average Equity	21.8%
Terminal P/B	1.5x
Shareholder Equity - FY21e	66.1
Terminal Value-(Year 2021)	104.1

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	218.44	40%	87.38
Residual Income	213.80	35%	74.83
PBV Multiple	189.43	20%	37.89
PE Multiple	184.06	5%	9.20
Fair Value			**209.30**
Current Price			**207.00**
Upside/(Downside)			1.1%
Dividend Yield			5.0%
Total Potential Return			**6.1%**

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

V. Barclays Bank Kenya

Financial Statements Extracts

Barclays Bank Kenya PAT is expected to grow at a 5-year CAGR of 5.3%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	20.4	22.3	21.8	22.9	24.9
Non Funded Income	9.1	9.3	9.6	10.2	11.1
Total Operating Income	**29.5**	**31.7**	**31.4**	**33.1**	**36.0**
Loan Loss Provision	(1.8)	(3.9)	(4.3)	(4.1)	(4.4)
Other Operating Expenses	(15.6)	(16.9)	(17.6)	(18.6)	(20.1)
Total Operating Expenses	**(17.4)**	**(20.8)**	**(21.9)**	**(22.7)**	**(24.5)**
Profit Before Tax	12.1	10.9	9.5	10.4	11.5
Profit After tax	**8.4**	**7.4**	**6.7**	**7.3**	**8.0**
% PAT Change YoY	**(0.4%)**	**(11.9%)**	**(10.1%)**	**9.5%**	**10.1%**
EPS	1.5	1.4	1.2	1.3	1.5
DPS	0.2	1.0	1.0	1.0	1.0
Cost to Income	59.0%	65.7%	69.7%	68.6%	68.1%
NIM	10.4%	10.5%	9.7%	9.5%	9.6%
ROaE	21.6%	18.0%	15.5%	16.4%	17.1%
ROaA	3.6%	3.0%	2.6%	2.8%	2.9%

Balance Sheet	2015	2016	2017f	2018f	2019f
Net Loans and Advances	145.4	168.5	172.9	185.8	199.8
Government Securities	48.1	48.7	53.8	59.9	66.6
Other Assets	47.4	42.5	48.8	47.2	44.5
Total Assets	**240.9**	**259.7**	**275.5**	**292.9**	**310.9**
Customer Deposits	165.1	178.2	192.1	206.5	222.0
Other Liabilities	36.1	39.1	39.8	40.9	40.6
Total Liabilities	**201.2**	**217.3**	**231.9**	**247.4**	**262.6**
Shareholders Equity	39.7	42.4	43.6	45.5	48.3
Book value Per share	7.3	7.8	8.0	8.4	8.9
% Change in BPS YoY	**4.0%**	**6.7%**	**2.9%**	**4.2%**	**6.2%**

Valuation Summary

Barclays Bank Kenya is undervalued with a total potential return of 35.8%

Cost of Equity Assumptions:	16-June-17
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.9
Mature Market Risk Premium	6.4%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.6%
Return on Average Equity	17.5%
Terminal P/B	1.5x
Shareholder Equity - FY21e	56.1
Terminal Value-(Year 2021)	88.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	10.5	40%	4.2
Residual Income	14.0	40%	5.6
PBV Multiple	11.9	15%	1.8
PE Multiple	9.6	5%	0.5
Fair Value			**12.1**
Current Price			**9.6**
Upside/(Downside)			25.6%
Dividend Yield			10.2%
Total Potential Return			**35.8%**

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

VI. Diamond Trust Bank

Financial Statement Extracts

DTB has an estimated 5-year PAT CAGR of 10.7%

Income Statement	2014	2015	2016	2017f	2018f	2019f
Net Interest Income	12.8	15.2	20.1	21.2	22.2	25.4
Non Funded Income	3.8	4.7	5.2	5.5	6.0	6.6
Loan Loss Provision	0.9	2.2	4.3	2.9	3.0	3.8
Other Operating Expenses	4.3	4.9	6.0	7.5	7.6	9.0
Total Operating Expenses	**8.1**	**10.3**	**13.8**	**14.3**	**14.7**	**17.4**
Profit Before Tax	8.5	9.6	11.5	12.5	13.5	14.7
Profit After tax	5.7	6.6	8.0	8.7	9.4	10.3
% PAT Change YoY	**9.1%**	**15.7%**	**21.6%**	**8.8%**	**8.0%**	**8.9%**
EPS	21.4	24.8	28.7	31.2	33.7	36.7
DPS	2.4	2.5	2.6	3.1	3.4	3.7
Cost to Income	48.6%	52.0%	54.6%	53.3%	52.2%	54.2%
NIM	**7.7%**	**7.2%**	**7.6%**	**7.1%**	**7.0%**	**7.1%**
ROE	22.8%	20.9%	20.7%	19.0%	17.8%	16.6%
ROA	3.0%	2.7%	2.6%	2.5%	2.4%	2.4%
Balance Sheet	**2014**	**2015**	**2016**	**2017f**	**2018f**	**2019f**
Net Loans and Advances	137.7	177.5	190.2	203.1	224.6	251.8
Government Securities	35.1	47.1	99.6	89.2	102.1	118.3
Other Assets	38.8	47.0	50.8	75.8	82.5	89.6
Total Assets	**211.5**	**271.6**	**340.6**	**368.1**	**409.2**	**459.7**
Customer Deposits	161.0	194.1	246.3	272.1	307.4	347.4
Other Liabilities	21.5	43.4	50.8	47.3	44.6	45.9
Total Liabilities	**182.5**	**237.5**	**297.1**	**319.4**	**352.0**	**393.3**
Shareholders Equity	29.0	34.1	43.5	48.7	57.2	66.4
Book value Per share	108.8	128.2	155.5	174.1	204.5	237.5
% Change in BPS YoY	**37.9%**	**17.9%**	**21.3%**	**11.9%**	**17.4%**	**16.2%**

Source – Company Financials

Valuation Summary

DTB's stock is undervalued with a total potential return of 60.8%

Cost of Equity Assumptions:	16-Jun-17
Risk free rate *	13.2%
Beta	0.8
Country Risk Premium	6.4%
Extra Risk Premium	1.5%
Cost of Equity	19.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	21.1%
Return on Average Equity	16.1%
Terminal P/B	1.5x
Shareholder Equity - FY21e	89.0
Terminal Value-(Year 2021)	140.2

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual	261.4	40.0%	104.5
Common Ratio	277.8	40.0%	111.1
PBV Multiple	118.2	15.0%	17.7
PE Multiple	155.2	5.0%	7.8
Fair Value			**241.1**
Current Price			**152.0**
Upside/(Downside)			58.6%
Dividend yield			2.1%
Total Potential Return			**60.8%**

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

Cytonn INVESTMENTS

C. Tier II Banks

Tier 2 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
National Bank	• Introduction of Islamic Banking and the SME banking units. The SME products inlude Jenga Chama, Jenga Kilimo and Jenga Biashara • The introduction of bancassurance and custodial services has seen the bank diversify its revenue	• Capital ratios, namely total capital to total risk weighted assets, is below the regulatory requirement. However, they managed to acquire a shareholder loan from NSSF worth Kshs 2.9 bn to boost its capital position
NIC Bank	• Increased investment in digital platforms, NIC Now and Internet banking • NIC bank has maintained its pole positioning in asset financing and curved a niche in the market	• Traditional SME market now being targeted by Tier 1 banks, hence it's market share is under threat • Exposure to different political, economic and regulatory environments, especially in Kenya with the upcoming elections might slow down business
Stanbic Holdings	• The Corporate and Investment banking is a key driver for revenue as it contributes to a majority of the banks total income • Their mobile banking platform is set to reduce costs associated with branch transactions	• Political Instability in the countries they operate. The 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
I&M Holdings	• They have consistently been among the most efficient banks in Kenya from a survey released by Think Business Banking Awards • They have also fully embraced internet bank in Kenya to further help drive their efficiency	• They have not been able to aggressively market themselves as a local household bank as Equity, Co-op and KCB • They face stiff competition for clients from larger existing tier 1 bank in the SME and Retail sectors
HF Group	• Vibrant real estate market in Kenya with an annual housing supply which does not satisfy demand • The bank is the market leader in provision of mortgage financing	• Lack of a vibrant mortgage market in Kenya • Competition from larger banks with Mortgage facilities poses a risk for growth • Asset liability mismatch which forces the bank to resort to expensive financing

I. National Bank of Kenya

Financial Statements Extracts

National Bank's PAT is expected to grow at a 5-year CAGR of 5.0%

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	6.4	8.0	6.7	6.4	6.9
Non Funded Income	3.2	3.0	3.1	3.3	3.6
Loan Loss Provision	3.7	2.7	2.5	3.0	3.2
Other Expenses	7.5	8.2	7.3	6.7	7.2
Total Operating Expenses	**11.2**	**10.9**	**9.7**	**9.6**	**10.3**
Profit Before Tax	(1.6)	0.2	0.1	0.1	0.1
Profit After tax	**(1.2)**	**0.2**	**0.0**	**0.1**	**0.1**
% PAT Change YoY	**(232.5%)**	**(114.1%)**	**(78.0%)**	**113.8%**	**15.1%**
EPS	(3.7)	0.5	0.1	0.2	0.3
DPS	-	-	-	-	-
Cost to Income	78.2%	73.9%	74.4%	68.5%	68.4%
NIM	6.5%	8.2%	7.0%	6.6%	6.6%
ROaE	(9.9%)	1.5%	0.3%	0.7%	0.8%
ROaA	(0.9%)	0.1%	0.0%	0.1%	0.1%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	67.8	59.3	57.4	61.4	65.7
Government Securities	27.3	34.8	35.4	37.8	40.5
Other Assets	30.3	21.2	27.3	27.9	28.4
Total Assets	**125.4**	**115.3**	**120.0**	**127.1**	**134.6**
Customer Deposits	110.6	97.0	95.6	102.3	109.4
Other Liabilities	3.7	7.2	13.1	13.4	13.7
Total Liabilities	**114.3**	**104.1**	**108.7**	**115.7**	**123.1**
Shareholders Equity	11.1	11.2	11.3	11.4	11.5
Book value Per share	35.9	36.2	36.7	36.9	37.2
% Change in BVPS	**(9.6%)**	**0.9%**	**1.3%**	**0.7%**	**0.8%**

Cytonn INVESTMENTS

Valuation Summary

National Bank is overvalued with a total potential return of (59.4%)

Cost of Equity Assumptions:	16-Jun-17
Default Spread Adjusted Risk free rate	13.2%
Beta	1.1
Mature Market Risk Premium	6.4%
Extra Risk Premium	2.5%
Cost of Equity	23.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	22.1%
Return on Average Equity	1.8%
Terminal P/B	0.5x
Shareholder Equity - FY21e	6.1
Terminal Value-(Year 2021)	(3.1)

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	1.9	75.0%	1.5
PBV Multiple	11.3	20.0%	2.3
PE Multiple	6.1	5.0%	0.3
Target Price			**4.0**
Current Price			**9.9**
Upside/(Downside)			(59.4%)
Dividend Yield			0.0%
Total Potential Return			**(59.4%)**

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

II. NIC Bank

Financial Statements Extracts

NIC Bank's PAT is expected to grow at a CAGR of 6.9%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	9.7	12.2	11.7	12.0	12.6
Non Funded Income	4.0	4.0	4.1	4.8	5.0
Loan Loss Provision	1.7	3.7	3.4	3.7	4.0
Total Operating Expenses	7.4	10.0	10.0	10.5	11.0
Profit Before Tax	6.4	6.2	5.9	6.2	6.6
Profit After tax	4.5	4.3	4.1	4.4	4.6
% PAT Change YoY	**(61.7%)**	**(3.3%)**	**(4.6%)**	**5.4%**	**5.8%**
EPS	7.0	6.8	6.5	6.8	7.2
DPS	1.3	1.3	1.3	1.0	1.1
Cost to Income	53.6%	61.9%	62.8%	62.8%	62.5%
NIM	6.9%	8.0%	7.4%	7.2%	7.2%
ROE	18.4%	15.5%	13.2%	12.5%	11.9%
ROA	2.9%	2.6%	2.3%	2.3%	2.3%
Balance Sheet	**2015**	**2016**	**2017f**	**2018f**	**2019f**
Net Loans and Advances	116.0	114.5	120.2	128.6	137.6
Government Securities	7.5	5.8	6.1	6.6	7.0
Other Assets	42.3	49.2	58.5	62.0	61.2
Total Assets	**165.8**	**169.5**	**184.8**	**197.2**	**205.8**
Customer Deposits	112.4	111.8	122.6	131.2	140.4
Other Assets	27.5	27.9	29.3	29.4	24.9
Total Liabilities	**139.9**	**139.7**	**151.9**	**160.6**	**165.3**
Shareholders Equity	25.9	29.8	32.9	36.6	40.5
Book value Per share	5.31	6.12	6.75	7.51	8.31
% Change in BVPS	**13.1%**	**15.4%**	**10.2%**	**11.3%**	**10.7%**

Valuation Summary

NIC bank is undervalued with a total potential return of 56.6%

Cost of Equity Assumptions:	16-Jun-17
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	6.4%
Cost of Equity	19.1%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.6%
Return on Average Equity	12.7%
Terminal P/B	1.25x
Shareholder Equity - FY21e	50.1
Terminal Value-(Year 2021)	65.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
Common Ratio	58.0	40%	23.2
Residual Valuation	55.2	35%	19.3
PBV Multiple	35.3	20%	7.1
PE Multiple	32.0	5%	1.6
Fair Value			**51.2**
Current Price			**33.5**
Upside/(Downside)			52.8%
Dividend Yield			3.8%
Total Potential Return			**56.6%**

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

III. Stanbic Holdings

Financial Statements Extracts

Stanbic Holdings PAT is expected to grow at a 5-year CAGR of 5.2%

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	9.3	10.9	10.3	11.2	12.2
Non Funded Income	7.6	7.7	8.8	9.1	9.7
Loan Loss Provision	(0.9)	(1.8)	(2.1)	(2.2)	(2.3)
Total Operating Expenses	**(9.6)**	**(12.5)**	**(13.3)**	**(13.8)**	**(14.9)**
Profit Before Tax	7.4	6.0	5.8	6.5	7.0
Profit After tax	4.9	4.4	4.0	4.6	4.9
% PAT Change YoY	**(13.7%)**	**(9.9%)**	**(8.3%)**	**12.6%**	**7.0%**
EPS	12.4	11.2	10.2	11.5	12.3
DPS	6.2	5.3	4.7	5.3	5.7
Cost to Income	51.2%	57.9%	58.5%	57.0%	57.4%
NIM	**5.5%**	**5.9%**	**5.3%**	**5.3%**	**5.4%**
ROaE	13.0%	11.3%	9.6%	10.0%	10.1%
ROaA	2.5%	2.1%	1.8%	1.9%	2.0%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	128.2	132.6	135.3	141.5	151.2
Other Assets	80.3	82.1	93.1	100.7	106.7
Total Assets	**208.5**	**214.7**	**228.4**	**242.2**	**257.9**
Customer Deposits	153.7	155.8	165.2	175.1	187.4
Borrowings	6.5	4.0	4.0	4.0	4.0
Other Liabilities	9.9	14.8	14.6	16.2	16.9
Total Liabilities	**170.1**	**174.6**	**183.8**	**195.2**	**208.2**
Shareholders Equity	38.4	40.1	44.6	47.0	49.7
Book value Per share	97.0	101.5	112.7	118.9	125.6
% Change in BVPS	**4.0%**	**4.6%**	**11.0%**	**5.5%**	**5.6%**

Valuation Summary

Stanbic Holdings is undervalued with a total potential return of 14.3%

Cost of Equity Assumptions:	16-June-17
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.8
Mature Market Risk Premium	6.4%
Extra Risk Premium	1.0%
Cost of Equity	19.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.6%
Return on Average Equity	10.5%
Terminal P/B	1.0x
Shareholder Equity - FY21e	53.9
Terminal Value-(Year 2021)	56.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	79.9	40%	32.0
DDM Integrated	73.9	35%	25.9
PBV Multiple	81.5	20%	16.3
PE Multiple	56.1	5%	2.8
Target Price			**77.0**
Current Price			**71.5**
Dividend Yield			**6.6%**
Total Potential Return			**14.3%**

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

IV. I&M Holdings

Financial Statements Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 7.3%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	12.6	15.5	15.9	16.5	17.6
Non Funded Income	4.6	5.2	5.7	6.3	7.0
Total Operating Income	**17.2**	**20.8**	**21.6**	**22.8**	**24.6**
Loan Loss Provision	1.0	3.0	3.0	3.2	3.3
Other Operating Expenses	6.4	7.2	7.8	7.8	8.3
Total Operating Expenses	**7.4**	**10.2**	**10.9**	**11.0**	**11.6**
Profit Before Tax	10.2	10.6	10.7	11.8	13.0
Profit After tax	7.1	7.8	7.5	8.3	9.1
EPS	**18.2**	**19.8**	**19.1**	**21.1**	**23.3**
% PAT Change YoY	**24.6%**	**8.6%**	**(3.7%)**	**10.8%**	**10.2%**
EPS	18.2	19.8	19.1	21.1	23.3
DPS	3.5	3.5	3.6	4.0	4.4
CIR	37.2%	34.7%	36.4%	34.0%	33.6%
NIM	7.6%	8.6%	8.1%	7.9%	7.9%
ROaE	24.8%	22.7%	18.7%	17.8%	17.1%
ROaA	3.9%	3.9%	3.4%	3.5%	3.6%

Balance Sheet	2015	2016	2017f	2018f	2019f
Investment Securities	42.2	45.8	54.0	58.1	62.6
Net Loans and Advances	127.8	134.7	142.0	149.3	159.0
Other Assets	21.7	30.1	32.2	39.1	45.4
Total Assets	**191.7**	**210.5**	**228.3**	**246.4**	**266.9**
Customer Deposits	133.0	146.5	157.8	169.7	182.7
Other Liabilities	27.3	27.0	27.4	26.9	27.0
Total Liabilities	**160.3**	**173.5**	**185.2**	**196.6**	**209.7**
Shareholders Equity	31.4	37.0	43.1	49.8	57.2
Book value Per share	0.1	0.1	0.1	0.1	0.1
% BVPS Change YoY	**20.7%**	**17.7%**	**16.4%**	**15.6%**	**14.9%**

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Valuation Summary

I&M Holdings is undervalued with a total potential return of 49.6%

Cost of Equity Assumptions:	16-June-17
Default Spread Adjusted Risk free rate*	13.2%
Beta	0.8
Mature Market Risk Premium	6.4%
Extra Risk Premium	0.2%
Cost of Equity	18.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.8%
Return on Average Equity	16.4%
Terminal P/B	1.5x
Shareholder Equity - FY21e	74.7
Terminal Value-(Year 2021)	117.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	177.2	40%	70.9
Residual income	165.6	35%	58.0
PBV Multiple	70.0	20%	14.0
PE Multiple	93.3	5%	4.6
Fair Value			**147.5**
Current Price			**101.0**
Upside/(Downside)			46.0%
Dividend yield			3.6%
Total Potential Return			**49.6%**

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

V. HF Group

Financial Statements Extracts

HF Group's PAT is expected to grow at a 5-year CAGR of 5.0%

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	3.6	3.9	3.2	3.0	2.9
Non Funded Income	1.2	0.8	0.9	1.1	1.3
Loan Loss Provision	(0.5)	(0.7)	(0.8)	(0.8)	(0.8)
Other Operating Expenses	(2.6)	(0.1)	(2.3)	(2.3)	(2.2)
Total Operating Expenses	**(3.1)**	**(0.8)**	**(3.1)**	**(3.1)**	**(3.0)**
Profit Before Tax	1.8	1.4	0.9	1.1	1.2
Profit After tax	1.2	0.9	0.7	0.7	0.9
% PAT Change YoY	**22.7%**	**(24.3%)**	**(45.6%)**	**13.3%**	**16.3%**
EPS	0.0	0.0	0.0	0.0	0.0
DPS	0.5	0.5	0.4	0.4	0.5
Cost to Income	54.5%	56.3%	58.1%	54.8%	51.2%
NIM	6.0%	6.5%	5.4%	5.1%	4.7%
ROaE	13.9%	8.3%	5.6%	6.4%	7.0%
ROaA	1.8%	1.3%	0.9%	1.1%	1.2%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	53.0	54.5	50.7	53.5	54.3
Government Securities	2.2	4.1	5.4	5.9	6.9
Other Assets	16.5	13.4	14.2	10.0	10.6
Total Assets	**71.7**	**71.9**	**70.4**	**69.4**	**71.8**
Customer Deposits	41.7	38.1	39.0	41.2	43.4
Other Liabilities	19.5	22.6	19.9	16.7	15.2
Total Liabilities	**61.1**	**60.6**	**59.0**	**57.8**	**58.7**
Shareholders Equity	10.6	11.3	11.4	11.6	13.1
Book value Per share	0.03	0.03	0.03	0.03	0.04
% Change in BPS YoY	**62.0%**	**6.3%**	**7.1%**	**1.9%**	**12.9%**

Valuation Summary

HF Group is undervalued with a total potential return of 37.6%

Cost of Equity Assumptions:	16-Jun-17
Default Spread Adjusted Risk free rate	13.2%
Beta	0.9
Mature Market Risk Premium	6.4%
Extra Risk Premium	1.5%
Cost of Equity	21.4%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.6%
Return on Average Equity	8.1%
Terminal P/B	0.5x
Shareholder Equity - FY21e	14.8
Terminal Value-(Year 2021)	7.4

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	12.0	40%	4.8
Residual Income	10.3	40%	4.1
PBV Multiple	27.1	15%	4.1
PE Multiple	17.5	5%	0.9
Fair Value			**13.9**
Current Price			**10.4**
Upside/(Downside)			34.0%
Dividend Yield			3.6%
Total Potential Return			**37.6%**

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

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Thank You!

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