Kenya Listed Commercial Banks Analysis

Cytonn Q3'2016 Banking Sector Report

"Transition continues, to a more stable sector, in an era of increased regulation"

5th December, 2016

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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

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Cytonn INVESTMENTS

SECTION

I

Overview of The Firm

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. 73 billion under mandate
3	Three 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

Cytonn INVESTMENTS

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

Alternative investment manager focused on private equity and real estate

Real Estate

We develop institutional grade real estate projects for investors

Diaspora

We connect East Africans in the diaspora to attractive investment opportunities in the region

Technology

We deliver world-class financial technology solutions

Co-operative

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	●	●	●

Cytonn INVESTMENTS

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

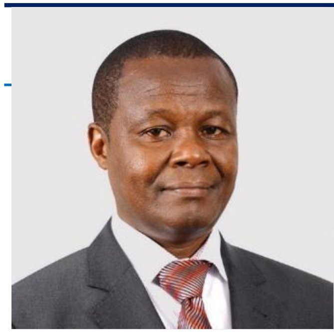
Non-Executive Director

Antti-Jussi Ahveninen, MSc

Non-Executive Director

Nasser J. Olwero, MPhil

For bios, visit www.cytonn.com



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.

Summary Financials

Consolidated Audited Financial Statements For The 15 Month Period Ended December 31, 2015

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME	GROUP	COMPANY
	Kshs	Kshs
Revenue	185,704,917	144,273,112
Cost of sales	(18,922,644)	-
Gross profit	**166,782,273**	**144,273,112**
Other income	59,064,923	2,389,125
Operating expenses	(214,645,530)	(113,061,388)
Operating profit	**11,201,666**	**33,600,849**
Investment revenue	26,337,509	780,407
Fair value adjustments	611,437,265	-
Finance costs	(4,206,735)	(2,579,399)
Profit before taxation	**644,769,705**	**31,801,857**
Taxation	(13,999,682)	(13,999,682)
Profit for the 15 months period	**630,770,023**	**17,802,175**
Other comprehensive income	-	-
Total comprehensive income for the 15 months period	**630,770,023**	**17,802,175**
Profit attributable to:		
Owners of the parent	389,276,745	17,802,175
Non-controlling interest	241,493,278	-
	630,770,023	**17,802,175**
Total comprehensive income attributable to:		
Owners of the parent	389,276,745	17,802,175
Non-controlling interest	241,493,278	-
Total profits	**630,770,023**	**17,802,175**

STATEMENT OF FINANCIAL POSITION AS AT DECEMBER 31, 2015

	GROUP	COMPANY
	Kshs	**Kshs**
Assets		
Non-Current Assets		
Property, plant and equipment	22,792,417	21,291,986
Investment property	5,756,259,819	-
Investments in subsidiaries	-	200,000
Investments in associates	10,736,600	10,736,600
	5,789,788,836	**32,228,586**
Current Assets		
Inventories	94,026,126	-
Trade and other receivables	97,089,424	129,248,232
Investments	528,304,889	30,236,572
Prepayments	3,312,051	-
Cash and cash equivalents	19,709,519	5,886,581
	742,442,009	**165,371,385**
Total Assets	**6,532,230,845**	**197,599,971**
Equity and Liabilities		
Equity		
Equity Attributable to Equity Holders of Parent		
Share capital	23,867,290	23,867,290
Accumulated profit	389,276,745	17,802,175
	413,144,035	**41,669,465**
Non-Controlling interest	3,229,808,278	-
Total Equity	**3,642,952,313**	**41,669,465**
Liabilities		
Non-current Liabilities		
Land owners contribution	175,000,000	-
Borrowings	3,313,275	3,313,275
Other financial liabilities	431,307,502	-
	609,620,777	**3,313,275**
Current Liabilities		
Trade and other payables	187,793,626	82,689,481
Borrowings	1,934,758,039	1,029,160
Current tax payable	15,106,229	15,106,229
Unalloted share capital	53,792,361	53,792,361
Other liabilities	88,207,500	-
	2,279,657,755	**152,617,231**
Total Liabilities	**2,889,278,532**	**155,930,506**
Total Equityand Liabilities	**6,532,230,845**	**197,599,971**

SECTION

II

Our Core Businesses

The key is to set realistic customer expectations, and then not just meet them, but to exceed them — preferably in unexpected and helpful ways.

— Richard Branson

Investments

> No one in his right mind would walk into the cockpit of an airplane and try to fly it, or into an operating theater and open a belly. And yet they think nothing of managing their retirement assets. I've done all three, and I'm here to tell you that managing money is, in its most critical elements (the quota of emotional discipline and quantitative ability required) even more demanding than the first two.
>
> **— William Bernstein**

ALTERNATIVES

Provides well researched investment opportunities in the alternative investment space with a bias towards Financial services, Education, Technology, Renewable Energy and Private Equity Real Estate

PUBLIC MARKETS

Provides well researched portfolio recommendations in both Equities and Fixed Income market within the Sub-saharan Africa

INVESTMENT RESEARCH

Investment coverage of all asset classes to provide actionable recommendation to investors in Kenya and the Region

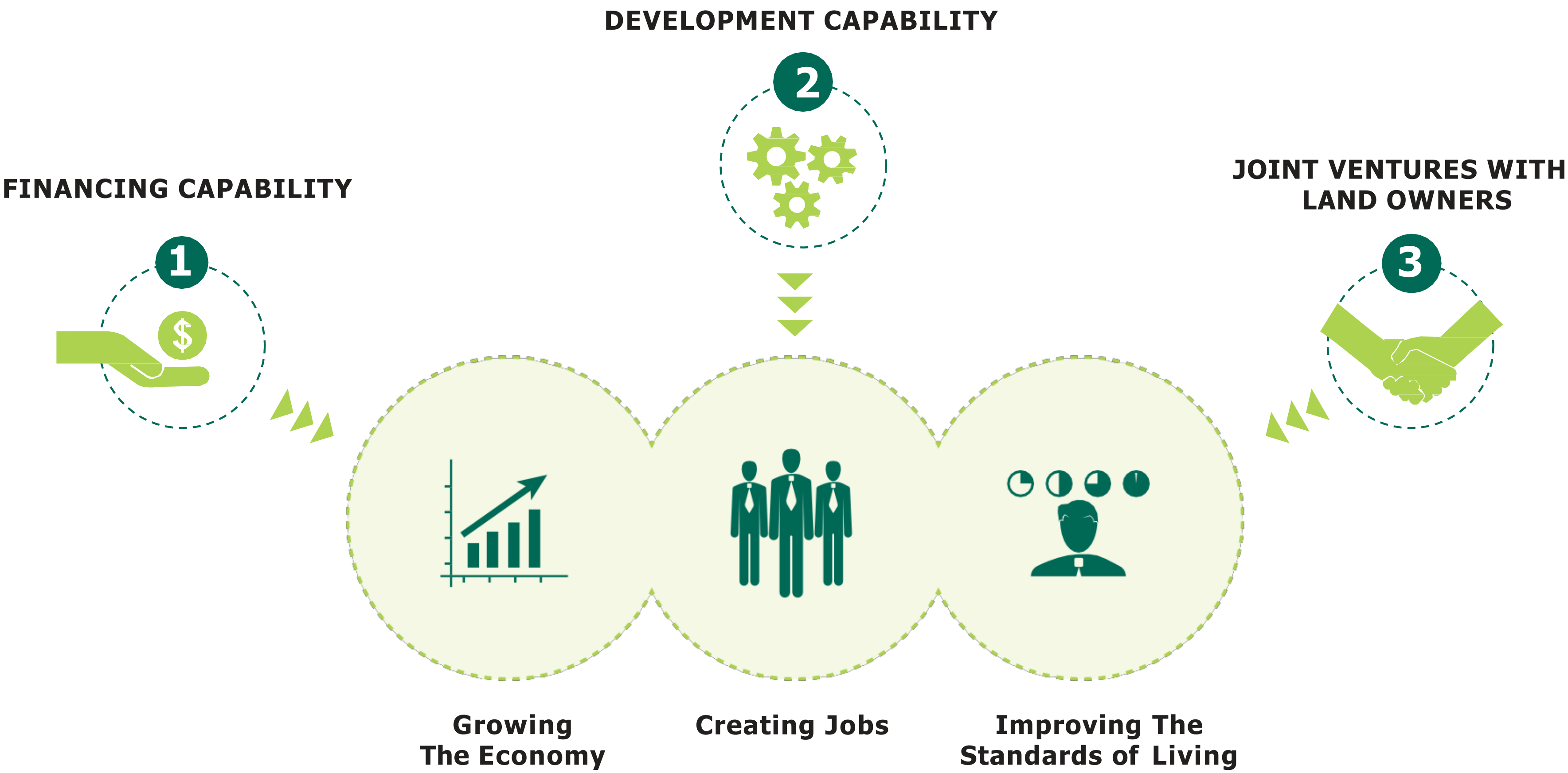
Publication of investment reports across all assets classes within the Sub Saharan Africa space

FUND OPERATIONS

The department is in charge of clients'portfolio administration, portfolio analysis and attribution

Real Estate

Cytonn's strategy brings three key pillars together:



Cytonn Real Estate's Unique Capabilities

Cytonn has all the necessary capabilities to deliver the very best Real Estate for investors.

FUNDRAISING

The strong alignment with the Investment team gives us unique capabilities to access funding;

We have strong partnerships with local banks, international institutions both Private Equity and Development Financial Institutions.

MARKET RESEARCH & SITE ACQUISITION

Research is an essential part of any investment, we aim to always research and identify the highest and best use of the land available and there after come up with the best concept for higher returns;

Our leading research team of 6 individuals carry out intensive market research for internal use and we also share with the market;

Strong conveyancing capability ensures acquisition risks are minimized.

CONCEPT DESIGN

Cytonn has unique concept designs that arise from partnerships with global institutions in countries like Dubai giving superior quality products to the market;

The internal concept team in collaboration with the project management function work tirelessly to deliver the products of the firm to the clients and investors.

PROJECT MANAGEMENT

The Project Management (PM) function is a vital part of real estate whose role is to ensure quality is delivered on time and within budget;

Cytonn boasts of a strong and experienced PM team with over 120 years of combined experience.

SALES, AGENCY & FACILITY MANAGEMENT

To enhance yield, property management is vital. Our strong property management team is able to ensure that you get quality tenants for your building and also have well maintained developments.

Cytonn INVESTMENTS


AMARA RIDGE

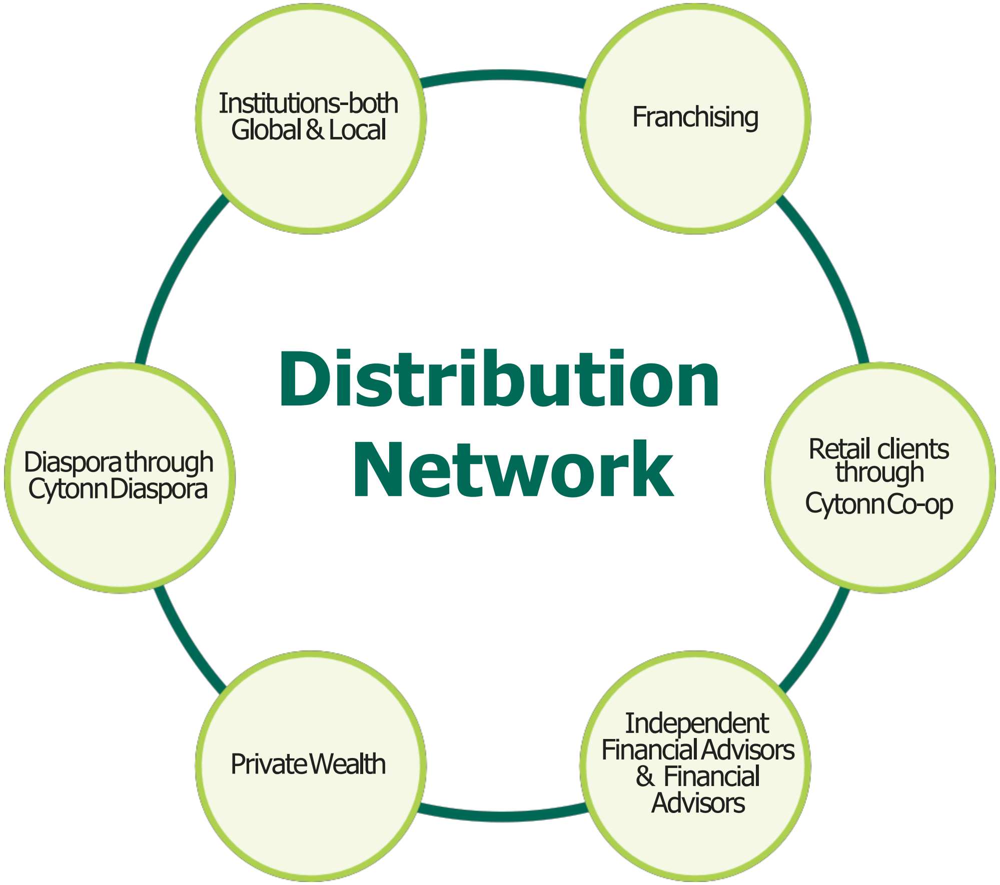

SITU VILLAGE


THE ALMA
THE alma
RUAKA CAFE
Cytonn


NEWTOWN

Comprehensive Distribution Model

Comprehensive market reach for investment and real estate solutions.



Diaspora

Diaspora remittances are a significant contributor to the growth of the economy. Cytonn Diaspora seeks to partner with East Africans in the Diaspora looking to invest safely back home.

CYTONN DIASPORA

Are You Looking For?

- Trusted partner with on ground presence
- Efficient investmentstransaction processes
- Attractive returns

Increased diaspora investor confidence

Happy diaspora clients

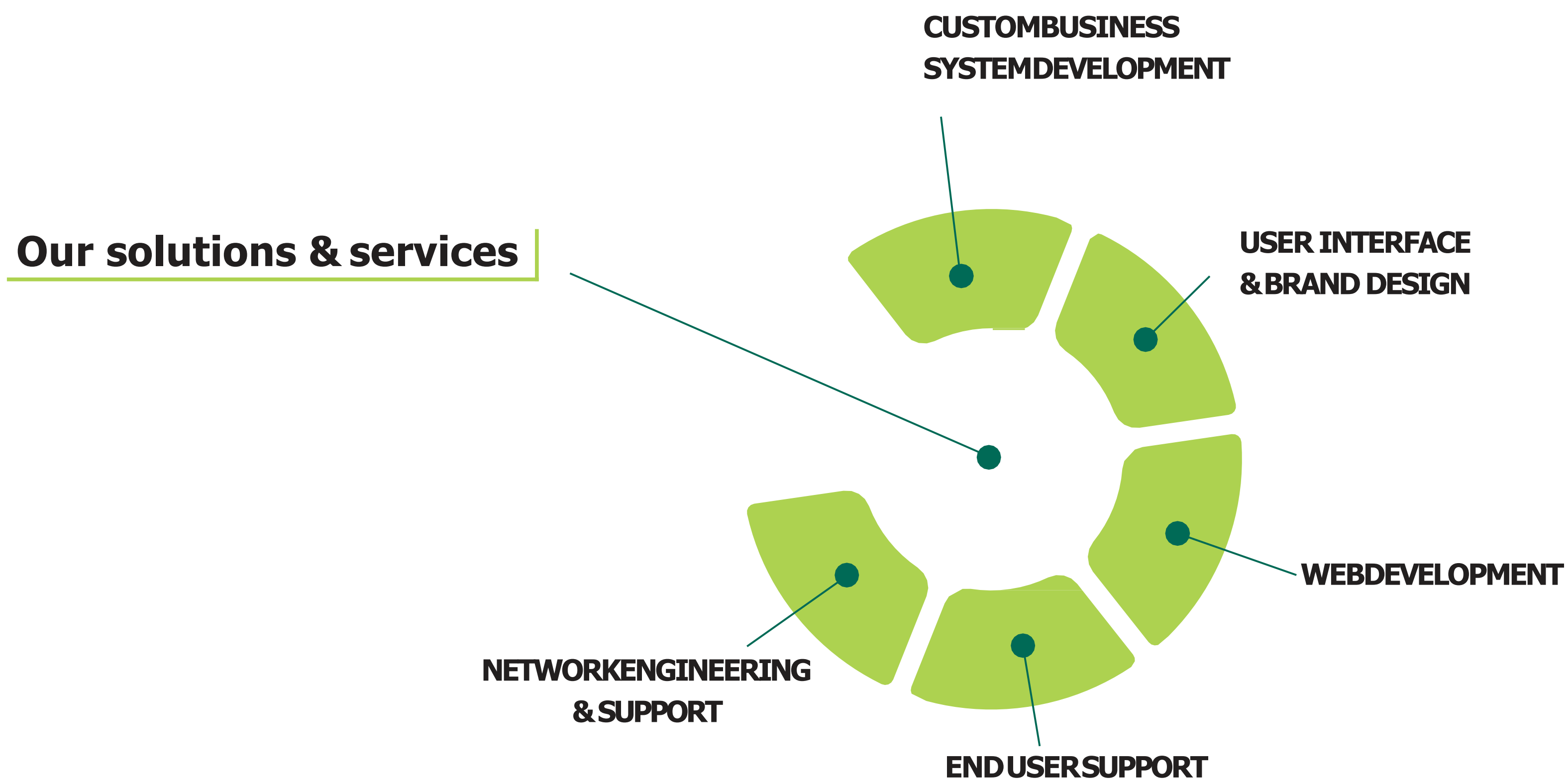
Increased diaspora remittances in the country

Cytonn DIASPORA

Cytonn INVESTMENTS

Technology

Cytonn Technologies provides design, software and networking solutions that focuses on building identities and experiences to elevate and empower organizations.



Investment Co-operative

Cytonn Investment Co-operative Society Limited (Cytonn Co-op) is a platform that brings together like-minded individuals to invest and grow their wealth.

Turning Ordinary Savings into Sharp Investments

The Benefits Include:

DELIVERINGATTRACTIVE RETURNS

Delivering stable attractive returns to members by investing in high yielding Alternative Investment.

FINANCIAL INCLUSIONFORALL

Providing financial solutions that speak to members financial needs.

NURTURINGCOMMUNITY SPIRIT

Pooling financial resources together to give members access to financial solutions with stable and attractive returns.

SECTION

III

Community & CSR

Cytonn Foundation 31

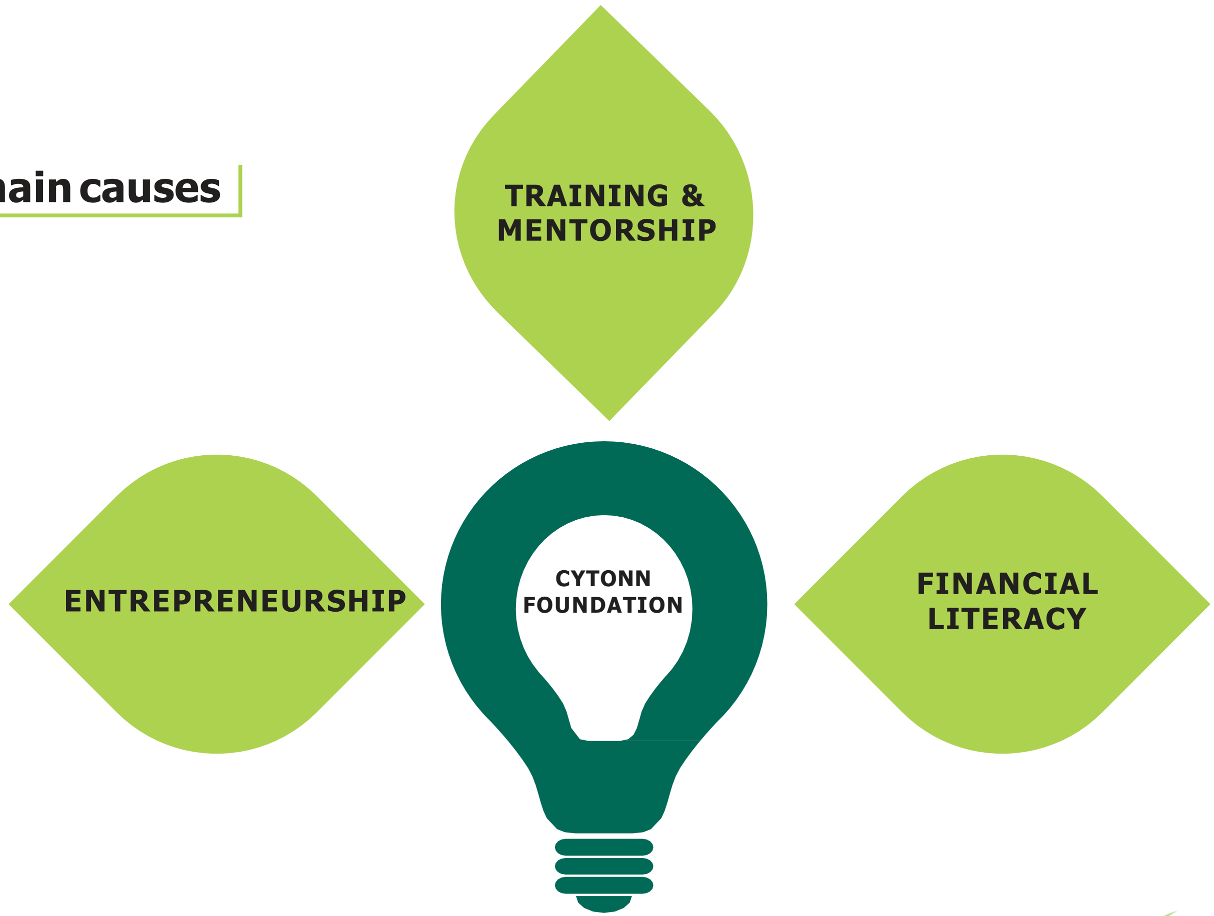
The successful companies of the future will be those that integrate business and employees' personal values. The best people want to do work that contributes to society with a company whose values they share, where their actions count and their views matter.

— Jeroen van der Veer

Cytonn Foundation

Cytonn Foundation is an initiative of Cytonn Investments focused on giving back to the society through skill development.

We have 3 main causes



Our Main Causes

Entrepreneurship

- **The Cytonn Entrepreneurs Hub (Cytonn eHub)** - This is a 12-week training and mentorship programme for young and upcoming entrepreneurs that seeks to enhance knowledge and capabilities on how to start, develop and run successful enterprises.
- **The Cytonn Entrepreneurs Forum** - This is an initiative which brings together budding and experienced entrepreneurs to learn from each other's entrepreneurial journey through periodic forums.

Financial Literacy

Cytonn Foundation aims to enhance financial knowledge and empower individuals with skills and knowledge that allow them to make informed and effective decisions with their financial resources. We do this through training sessions at universities, conferences and at our forums.

Training & Mentorship

- **Media Training** - This is an initiative aimed at training media professionals on various areas across Investments, Finance and Real Estate so as to enhance financial journalism.
- **Cytonn Young Leaders Programme (CYLP)** - This is an intensive and competitive 12-week training programme that exposes fresh university talent to the office environment and culture.

For more information, please visit http://www.cytonn.com/foundation

Cytonn Young Leaders Programme (CYLP)

At Cytonn, CYLP is our primary recruitment tool. CYLP has partnered with various universities and always takes the opportunity to mentor university students on areas revolving around career growth and leadership.

To date, we have run over 30 internship programs that had over 180 young leaders participating. We have offered employment to over 60 CYLP graduates.

II. Economic Review and Outlook

Summary Economic Outlook

Interest rates and the Exchange rate turn neutral from negative. Of the 7 indicators we track, 3 have improved while only 1 has deteriorated in 2016 pointing to a positive outlook

Macro-Economic Indicators	2015 Experience	2016 YTD Experience	Going Forward	Outlook at the beginning of 2016	Current outlook
GDP	Kenya's 2015 full year GDP came in at 5.6% despite a tough macroeconomic environment	Q2'2016 GDP growth at 6.2% Expected to improve with a conducive and stable macroeconomic environment, as tea exports and tourism improves	We expect the 2016 GDP growth to come in at an average 6.0% driven by increased infrastructure spending by the government and the recovering tourism sector	**Positive**	**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% and hitting a high of 21.0%	The CBR was lowered by 100 bps to 10.5% on account of low inflation and a stable currency and by a further 50 bps to 10.0% on account of slow private sector credit growth and fairly stable inflation	Interest rates seem to have bottomed out and are expected to persist at current levels, supported by an expected increase in government borrowing	**Negative**	**Neutral**
Inflation	December inflation at 8.0% (highest for year)	Inflation declined to a low of 5.0% in May, but begun rising reaching 6.7% in November, driven by rising food and fuel prices	Expected to rise marginally but remain below the CBK upper limit of 7.5%	**Neutral**	**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 4.5 months by Dec 2015	The shilling has appreciated by 0.4% against the dollar YTD but has recently been under pressure due to the global strengthening of the dollar as the Fed expects a rate hike in December	Shilling to remain stable in the short to medium term supported by (i) foreign exchange reserves equivalent to 4.7 months import cover, and (ii) increased dollar inflows from tourism and remittances	**Negative**	**Neutral**

Cytonn INVESTMENTS

Summary Economic Outlook, continued…

Corporate earnings turn positive, while Security and Political Environment turns neutral. Of the 7 indicators we track, 3 have improved while only 1 has deteriorated in 2016 pointing to a positive outlook

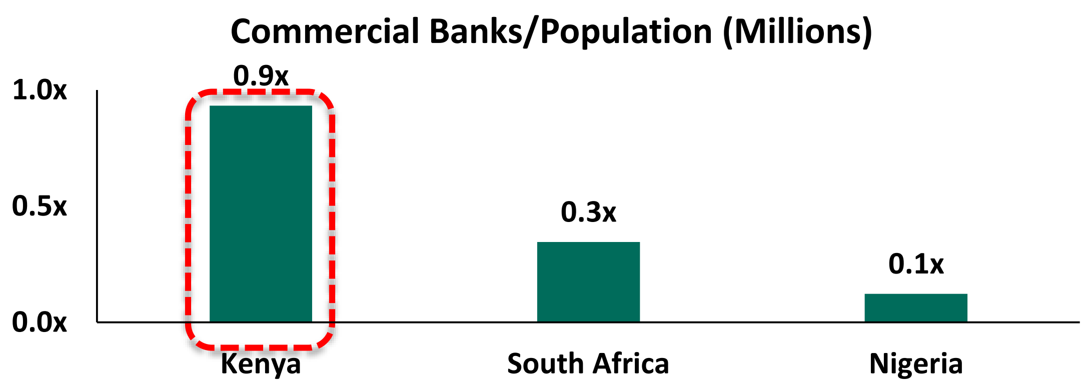
Macro-Economic Indicators	2015 Experience	2016 YTD Experience	Going Forward	Outlook at the beginning of 2016	Current outlook
Corporate Earnings	The year experienced weak earnings from the listed banking sector with Core EPS growth of 2.8% in 2015. 17 listed and 1 unlisted company issued profit warnings as a result of a tough operating environment	Several companies have released positive Q3'2016 results, mainly banking sector with weighted average growth in core EPS of 15.1%, above expectation of 12.5%. 2 companies have issued profit warnings	We expect stronger earnings growth in 2016 as compared to 2015, supported by a more favorable macroeconomic environment, with our expectations being 12.5%	**Neutral**	**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 so far with net inflows of USD 83.0 mn	We expect decreased activity in the market owing to a decline in stock prices, especially banking stocks which jointly hold a large market cap. Turnover is currently at USD 1.4 bn YTD, 30% lower than last year's turnover of 2.0 bn for a similar period last year	**Neutral**	**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	With the Government taking initiatives towards improving internal security, we expect security to be maintained despite looming concerns ahead of the general elections in 2017	**Positive**	**Neutral**

III. Kenya Banking Sector Overview

Kenya’s Banking Sector Overview

Kenya is over-banked, with 41 commercial banks (2 in receivership) serving a population of 44 mn people

- In Kenya there are a total of 41 commercial banks; reducing from 42 as Giro Commercial Bank has been acquired by I&M Holdings, 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
- 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 41 commercial banks serving of 44 mn people, compared to Nigeria's 22 for 180 mn and South Africa's 19 for 55 mn



Kenya's Banking Sector Overview, continued…

Consolidation in the sector gathers pace in 2016, with 2 foreign entries into Kenya's local banking space

- Kenya's overbanked environment has already begun leading to consolidation in the sector, and heightened M&A activity. This includes, Mauritian Bank, SBM Holdings plans to acquire 100.0% stake in Fidelity Commercial Bank, Tanzanian Bank, Bank M acquiring 51.0% of Oriental Commercial Bank, GT Bank acquiring Fina-Bank, Mwalimu SACCO acquiring Equatorial and I&M Holdings acquiring Giro Bank over the last 3 years

Acquirer	Bank Acquired	Book Value at Acquisition in Kshs (bn)	Transaction Stake	Transaction Value in Kshs (bn)	P/Bv Multiple	Date
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			**77.0%**		**2.0x**	

- For local bank acquisitions, the average price-to-book multiple is at 2.0x, with an average acquisition stake of 77%
- With the moratorium on licensing new banks still in play, all international banks and investors looking for exposure to the Kenyan banking sector will have to enter via way of acquisition. We expect to see more foreign entries into the market, following SBM Holdings and M Bank, with banks who are uncompetitive in the market being bought out

Cytonn INVESTMENTS

Transition continues, to a more stable sector, in an era of increased regulation

Transition Area	Summary	Effect on Banking Sector
Consolidation	• **Increased consolidation in the industry, mainly through acquisitions:** The CBK announced the proposed acquisition of Fidelity Commercial Bank by SBM Holdings, which is set to be the 3rd successful local bank acquisition in Kenya's local banking space this year, after the acquisition of Giro Bank and Oriental Commercial Bank by I&M Holdings and Bank M, respectively • **Entry of foreign banks into the local banking space:** Kenya's banking sector has amongst the highest return on equity in Africa, with listed banks' ROaE at 20%, attracting foreign investors, witnessed by the foreign entities in a bid to buy Chase bank that is in receivership	• Consolidation in the banking sector will only gather pace going forward, with weaker banks being forced to merger or be acquired. Local stable banks will also seek to acquire banks aligned with their strategies, as witnessed by I&M Holdings' acquisition of Giro. The likely candidates for mergers will be banks with common significant shareholders • We shall see more foreign banks targeting the Kenyan banking sector seeking value, and this will be through acquisition, following the moratorium of licensing new banks, which has put 2 banks, (i) Dubai Islamic Bank, and (ii) Mayfair Bank, which had been licensed provisionally, into a state of uncertainty
Regulation	• **Price controls have been put in place in the industry, following the enactment of the Banking Act (Amendment) 2015:** Following the enactment, we have seen banks lower the rates charged on loans to 14%, which is 4% above the Central Bank Rate (CBR), while interest paying deposits are at a minimum of 70% of the CBR.	• Banks expect a compression in net margins in 2017, following reduced yields on assets and increased cost of funding. With Net Interest Income constituting 72% of the total revenue of listed banks, we expect this to result in reduced profitability, and effectively reduced return on equity. To remain profitable, banks are resorting to cost containment initiatives, including laying off employees
Asset Quality	• **Increase in non-performing loans:** With the ratio of NPLs to total loans rising to 8.3% in Q3'2016 from 6.2% in 2015, concerns around asset quality, and the risk assessment framework currently in use arise	• Banks recorded an increase in loan loss provisioning, with an average growth of 93.8% in Q3'2016 • The increased level of provisioning will improve the level of asset quality across the sector, and force banks to adopt a more stringent risk assessment framework

The sector is still in transition. Key issues such as increased loan loss provisioning and the regulated loan and deposit pricing framework, will transition the industry into an environment where only the innovative banks with diversified revenue streams will survive, with the remaining banks forced to either merger or be acquired.

Growth in the Banking Sector

Listed bank's Q3'2016 EPS grew by 15.1% y/y on the back of improved macroeconomic conditions

- Banking sector in Kenya experienced growth in Q3'2016 in assets, deposits, profitability and products offering, leveraging on diversification to alternative channels, supported by favourable macroeconomic environment
- The listed banking sector's aggregate gross loans and advances grew by 3.5% to Kshs 1.8 trillion in September 2016 from Kshs 1.7 trillion in September 2015 while deposits grew 7.1% to Kshs 2.1 trillion in September 2016 from Kshs 2.0 trillion in September 2015
- Total assets grew 7.1% in September 2016 to Kshs 3.0 trillion, from Kshs 2.8 trillion in September 2015
- Since 2010 the aggregate of listed banks profit after tax has grown at a CAGR of 21.4%
- Since 2010, deposits have grown at a CAGR of 17.2%, with loans and advances having outpaced deposit growth at a CAGR of 20.9%
- 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**
  - **Growth of the middle class that supports an increase in consumption expenditure and an increase in the percentage of the population which will require banking services**

Banking Sector Growth Drivers

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

1) **Exploration of different revenue streams:** Banks are exploring different avenues of revenue generation such as bancassurance which involves partnering with insurance companies to form insurance agencies and distributing various insurance products. This will increase non-funded income made by banks and further diversify their revenue sources

2) **Adoption of Technology to improve on efficiency:** Banks have embraced integration with mobile application platforms and internet banking, and this has led to lots of efficiency in distribution, leading to increased uptake of banking services, particularly in the mass market

3) **Adoption of Agency Banking:** The agency banking model has led to reduction of operating expenses and improved efficiency, and is a key driver for diversification. This also ensures a wider reach in the distribution 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 which will require banking services

5) **Innovation and new product development:** With the enactment of the Banking (Amendment) Act, 2015 capping lending rates at 4.0% above the CBR and having deposit rates at 70.0% of the CBR, banks plan to be innovative and develop new products that will remain profitable in the tightening regulatory environment, hence driving growth

Recent Developments in the Banking Sector

Consolidation increased in the banking sector as foreign players enter the market through acquisition of local banks

1. **Increased consolidation through M&A activities**: The Kenya banking sector has witnessed increased consolidation through acquisition activities, with foreign banks SBM Holdings and M Bank set to acquire Fidelity Commercial Bank and Oriental Commercial Bank, respectively, while the local I&M Holdings acquiring Giro Commercial Bank

2. **Staff lay-offs in a bid to reduce operating expenses:** With rising operating expenses in the sector and lower margins due to the enactment of the Banking (Amendment) Act, 2015, banks have resorted to laying off of staff in a bid to reduce operating expenses. These banks include; (i) Standard Chartered announced plans to lay off 600 employees, (ii) Equity Bank announced it had laid off 400 employees, (iii) Sidian Bank plans to lay off 108 staff (iv) NIC Bank announced plans to retrench 32 senior employees, and (v) Family Bank, Ecobank and First Community Bank all have plans to lay off an undisclosed number of employees

3. **Chase Bank sale of majority stake set to be concluded in Q1'2017:** The Central Bank of Kenya is seeking to bring Chase Bank out of receivership through the sale of a majority stake in the bank to a credible and well-funded investor, as KCB Group's role in managing the bank comes to a close. This move would likely see a first in Kenya's history where a bank comes back to full operations after being put in receivership. However, concerns about the bank's high valuation and the recently enacted Banking Act (Amendment) 2015 have caused some would-be investors to lose interest in the bank

Recent Developments in the Banking Sector, continued…

Banks have shown preference to invest in the less risky government debt as opposed to lending to the private sector while increasing their revenue streams through bancassurance

4. **Concerns around the quality of loan book in the industry:** With the ratio of non-performing loans to total loans rising to 8.3% in Q3'2016 from 6.2% at the end of last year, there emerges concerns around asset quality, and the risk assessment framework currently in use. As a result of increased regulation, banks have been pushed to build up capital and increase provisionary requirements with the most notable being the increase in listed and non-listed banks loan loss provisions by 93.8% and 175.9%, respectively in Q3'2016. This has led to a deterioration in industry cost to income ratios, with listed banks average being 57.0% up from 47% in Q3'2015

5. **Slowdown in Private Sector Credit Growth:** Following an increase in non-performing loans and the enactment of the Banking (Amendment) Act, 2015, banks have shown preference to lending to the government as opposed to the private sector as seen by the slow growth in private sector credit, at 5.3% in September, and increased holding of government securities for both listed and non-listed banks respectively, by 35.8% to Kshs 1.0 trillion at the end of September, 2016 from Kshs 737 bn in September, 2015. Banks are limiting loans to prime clients, leading to a crowding-out of the private sector. Sub-prime clients are forced to find non-bank financial solutions

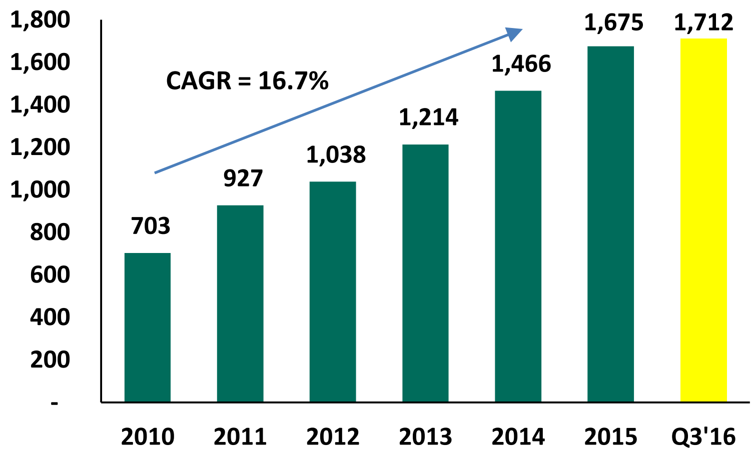
6. **Bancassurance:** We have witnessed banks leveraging on their distribution channels by partnering with insurance companies or acquiring insurance companies to offer a wide array of insurance products under a new revenue stream known as bancassurance

Cytonn INVESTMENTS

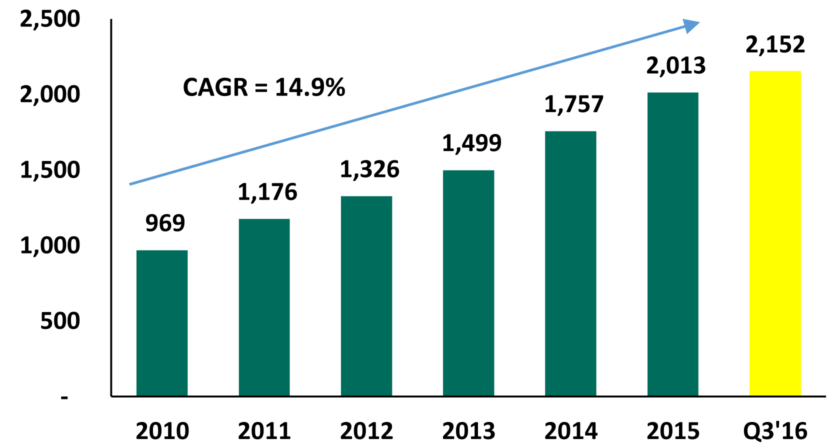
Listed Banking Sector Metrics

Deposits and loan growth remain strong, however the growth is slowing down and is currently at 14.9% and 16.7%, respectively

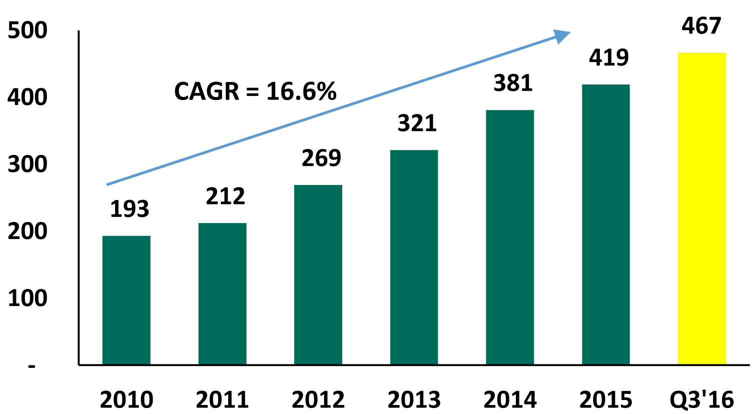
Loans and Advances (Kshs Bn)



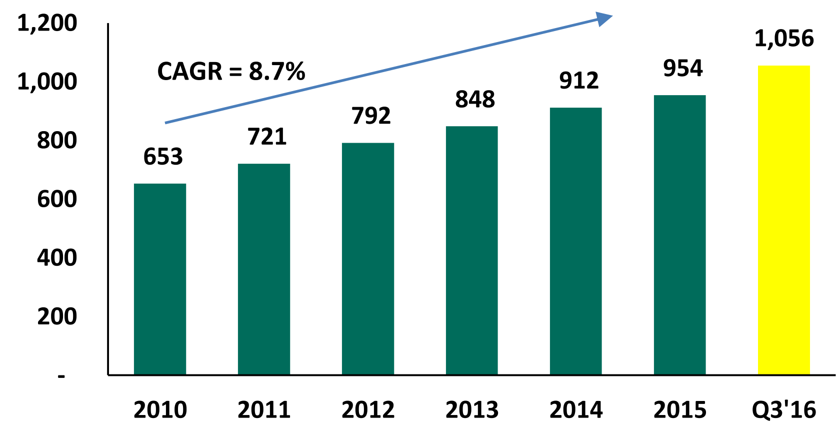
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



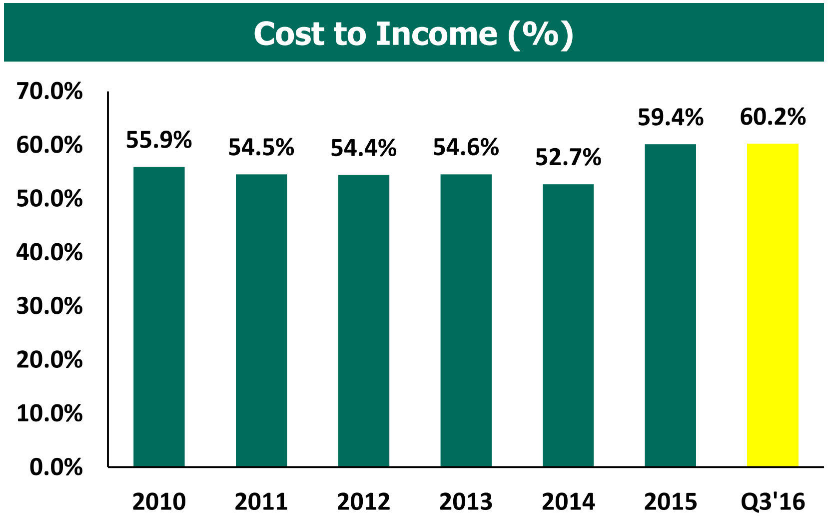
Bank Branches

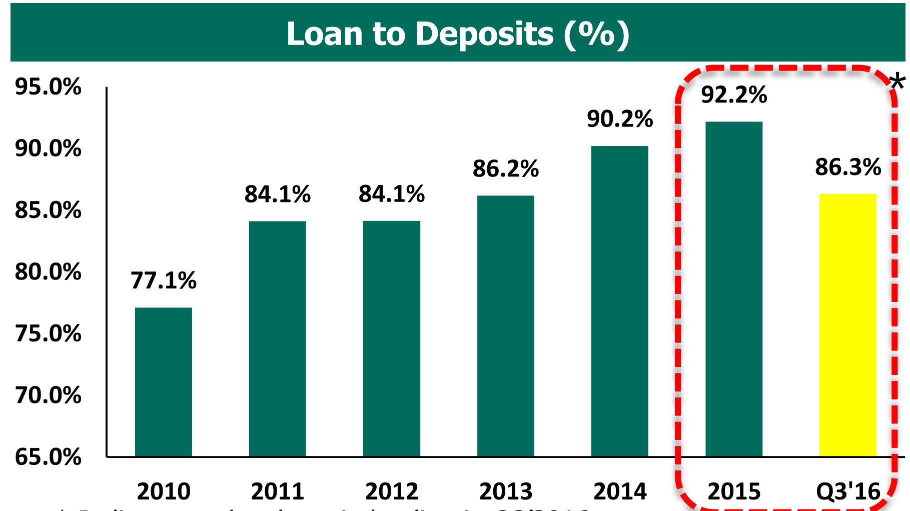


Source: Central Bank of Kenya

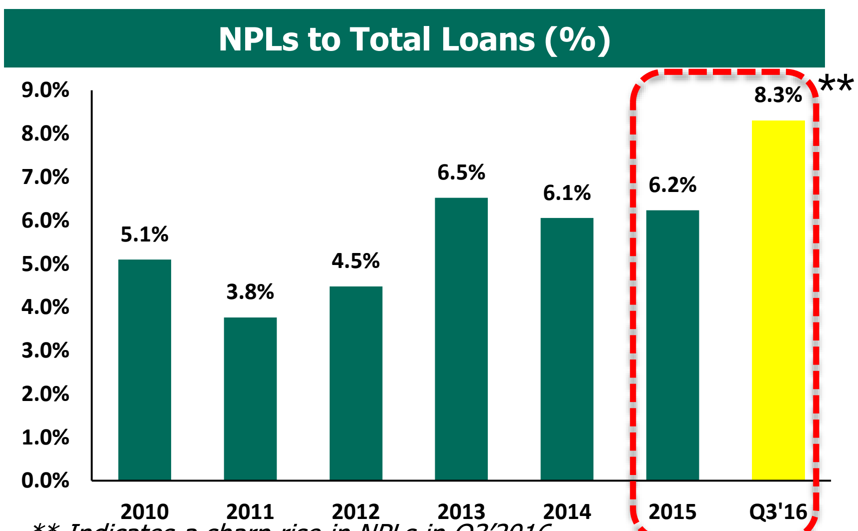
Listed Banking Sector Metrics, continued…

Net Interest Margin remains high, though high levels of NPLs and rising costs remain a point of concern for the sector

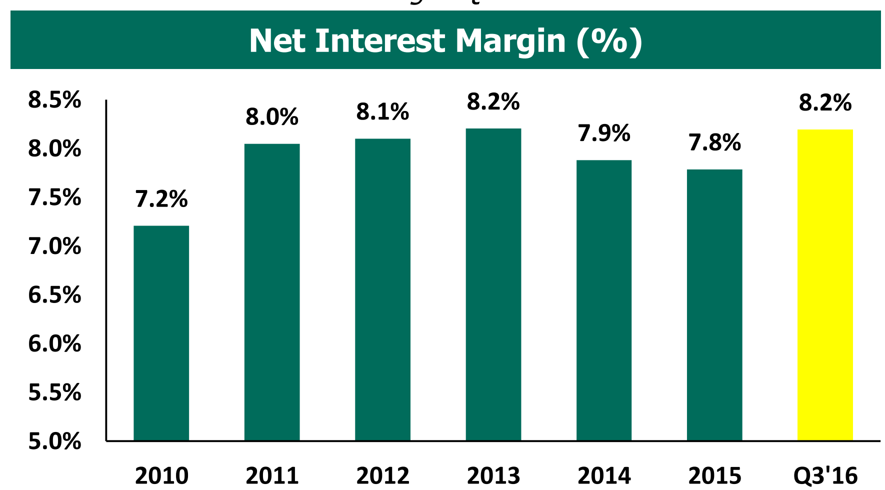




*-Indicates a slowdown in lending in Q3'2016



**-Indicates a sharp rise in NPLs in Q3'2016



Source: Central Bank of Kenya

Cytonn INVESTMENTS

Listed Banking Sector Metrics, continued…

Kenya's banking sector Q3'16 core EPS growth was 15.1%, faster than the 9.7% growth in Q3'15

Q3'2016 Listed Banking Sector Metrics								
Bank	**Core EPS Growth**	**Deposit Growth**	**Loan Growth**	**Net Interest Margin**	**NPL Ratio**	**Cost to Income***	**ROaE**	**ROaA**
Standard Chartered	**24.5%**	19.8%	14.1%	9.7%	11.3%	40.1%	18.5%	3.3%
Stanbic Holdings	**24.1%**	22.8%	1.9%	7.8%	5.9%	57.4%	22.3%	3.0%
Co-operative Bank	**22.3%**	1.7%	6.9%	9.7%	4.3%	47.2%	18.2%	3.0%
Equity Group	**17.7%**	4.8%	3.0%	11.0%	5.9%	49.2%	25.7%	4.7%
I&M Holdings	**16.5%**	9.9%	4.5%	7.9%	4.7%	33.8%	24.9%	3.8%
KCB Group	**16.1%**	(7.3%)	4.9%	9.2%	8.1%	47.7%	21.9%	3.2%
Diamond Trust Bank	**11.4%**	29.9%	5.4%	6.8%	4.2%	38.0%	16.0%	2.4%
HF Group	**7.8%**	10.8%	4.3%	6.4%	10.0%	55.0%	19.5%	3.2%
Barclays Bank	**(5.1%)**	13.4%	14.3%	10.9%	6.3%	51.5%	20.6%	3.4%
NIC Bank	**(6.4%)**	2.4%	0.7%	6.3%	12.3%	36.4%	15.5%	2.8%
National Bank	**(76.9%)**	6.2%	(15.5%)	7.5%	41.5%	68.6%	(52.4%)	(3.3%)
Q3'2016 Weighted Average	**15.1%**	**7.7%**	**6.3%**	**9.4%**	**7.0%**	**46.2%**	**21.0%**	**3.5%**
Q3'2015 Weighted Average	**9.7%**	**16.7%**	**17.9%**	**8.7%**	**5.6%**	**48.6%**	**23.6%**	**3.8%**

Average is Market cap weighted

Without Loan Loss Charge

Source: Cytonn Research

Cytonn INVESTMENTS

Banking Sector Multiples

Kenya's banking sector is trading at an average PBV of 1.0x and a PE of 5.4x

Bank	Share Price *	No. of Shares Issued (bns)	Market Cap (bns)	PBV	P/E
Equity Group Holdings	30.0	3.8	113.2	**1.4x**	**5.8x**
Standard Chartered Bank Kenya	190.0	0.3	58.7	**1.3x**	**8.3x**
Barclays Bank of Kenya	9.1	5.4	48.9	**1.2x**	**6.1x**
Co-operative Bank of Kenya	14.0	4.9	68.2	**1.2x**	**5.0x**
I&M Holdings	91.0	0.4	35.5	**1.1x**	**4.5x**
KCB Group	30.0	3.0	91.5	**1.0x**	**4.3x**
Diamond Trust Bank Kenya	130.0	0.2	31.5	**0.8x**	**4.8x**
Stanbic Holdings	69.5	0.4	27.5	**0.7x**	**5.1x**
NIC Bank	27.8	0.6	17.9	**0.6x**	**4.2x**
Housing Finance Group	14.2	0.4	5.0	**0.4x**	**4.7x**
National Bank of Kenya	7.8	0.3	2.3	**0.4x**	**6.3x**
Average				**1.0x**	**5.4x**
Median				**1.0x**	**5.0x**

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

**** - Price as at 30/11/2016***

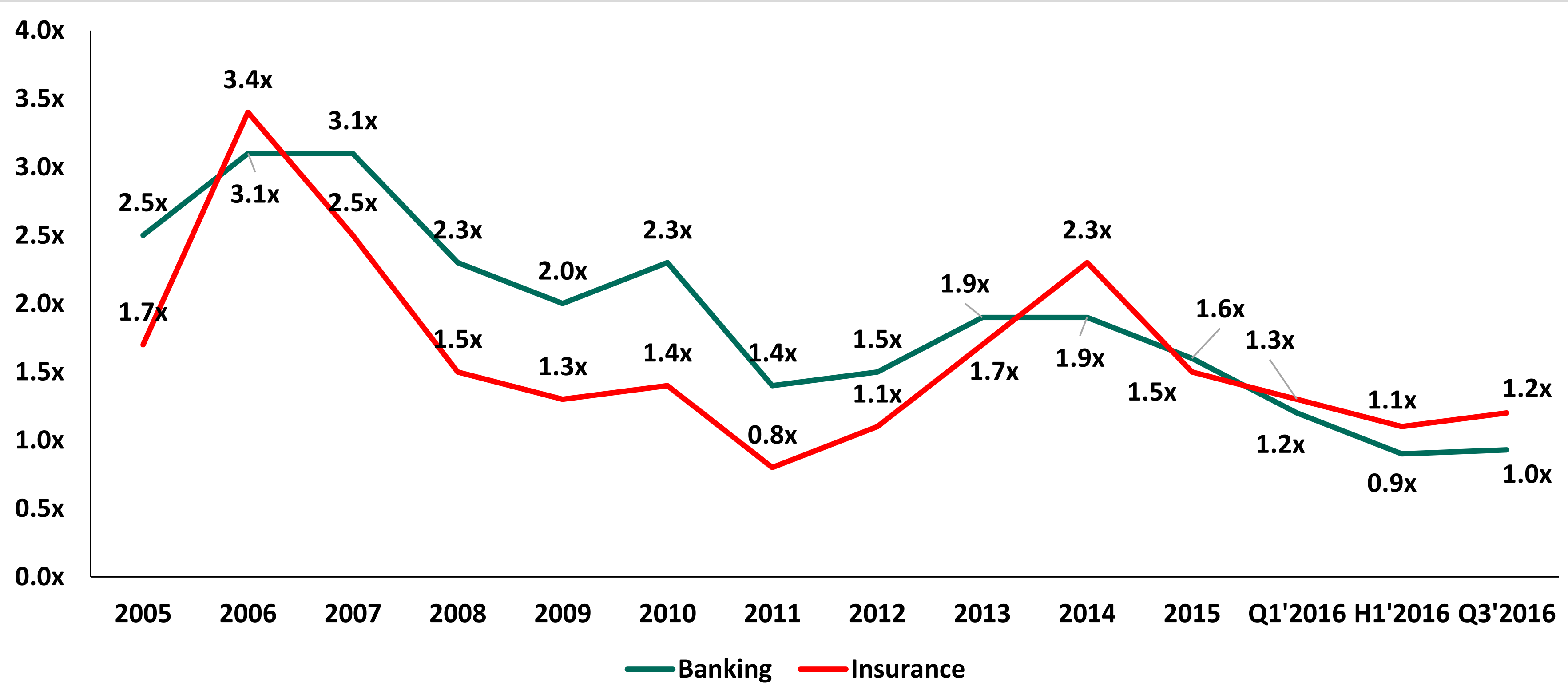
The Banking sector has remained cheap on a PBV basis having stabilized at 1.0x, slightly higher than the 0.9x at H1'2016

Source: NSE, Cytonn Banking Sector Report

Banking Sector Multiples

Listed Insurance companies are expensive compared to listed Banks 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 expensive than those in the listed banking sector

Source – Cytonn Research

Summary of the Q3'2016 Earnings

The banking sector remains attractive on a valuation basis

1. Core earnings for 2016 is likely to be higher than 2015 since as at Q3'2016, the earnings growth was at 15.1% compared to the 9.7% recorded in Q3'2015. Though there could be some negative effects as result of the interest rate cap but this is not expected to significantly affect banks' earnings for the year 2016
2. Deposits grew faster than loans at 7.7% and 6.3%, respectively, but lower than the 5-year averages of 14.9% and 16.7%, respectively
3. The levels of NPLs remains a concern within the banking sector with loan loss provisions growing at 93.8% and 175.9% for the non-listed and listed banks, respectively. We expect the level of provisioning to stabilize going forward as banks adopt more stringent risk assessment framework
4. Growth for most banks with regional subsidiaries was driven mainly by the Kenyan business as their regional operations underperformed
5. With a sector valuation of 1.0x price to book and 5.4x price to earnings from 1.6x and 7.9x at the beginning of the year, respectively, we think that the sector has become fairly attractive for a long-term investor

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 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 Q3'2016 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

Banking Sector Report Results

National Bank Ranked lowest in both franchise and intrinsic score

- Equity Group emerged top supported by a strong franchise score and total return score

- Standard Chartered Bank fell two positions to position 8, affected by a low franchise value score, being weighed down by the bank's loan to deposit ratio at 60.5%, against a preferential range of 80%-90%, and high levels of non-performing loans, with NPLs to total loans ratio of 12.2%. In addition, the bank ranked low in intrinsic value ranking, given high competition in the banking sector with its peers being more competitive and innovative in their distribution channels and product offering

- Stanbic Holdings rose 1 spot to position 7, boosted by a high intrinsic value score. On its franchise value, Stanbic had the highest revenue diversification with a revenue mix of 58:42 Funded to Non-Funded income and the highest deposit mobilization per branch with Kshs 5.2 bn per branch. However, cost containment is still an issue with the bank's cost to income ratio at 57.4%, against the industry average of 46.2%

- National Bank was ranked the lowest overall, ranking lowest in both franchise and intrinsic score. NBK has the highest cost to Income ratio at 68.6% against the industry average of 46.2%. Key to note is that NBK has the largest NPLs to loans at 41.5% against the industry average of 7.0%, with the lowest NPL coverages at 18.0% against the industry average of 33.9%

Source: Cytonn Research

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	Cytonn Camel Rating	Cytonn Corporate Governance Score	Total
1	Equity Group	2	7	1	2	5	11	10	5	1	1	2	1	5	**53**
2	Co-operative	4	5	4	3	7	7	6	2	5	2	5	2	7	**59**
3	KCB Group	1	6	3	5	1	6	7	7	4	5	6	8	1	**60**
4	DTBK	5	3	6	8	2	3	3	1	2	10	10	7	4	**64**
5	I&M Holdings	7	1	2	7	3	8	4	3	10	3	8	5	6	**67**
6	Barclays	3	8	5	1	10	9	9	6	3	8	3	3	3	**71**
7	Standard Chartered	9	4	8	4	9	10	2	9	7	4	4	4	2	**76**
8	Stanbic Holdings	6	10	7	11	8	5	1	4	8	9	1	6	11	**87**
9	NIC Bank	10	2	9	6	6	4	5	10	6	6	7	10	9	**90**
10	HF Group	11	9	10	10	4	1	8	8	9	7	11	9	10	**107**
11	NBK	8	11	11	9	11	2	11	11	11	11	9	11	8	**124**

- **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**
- **Equity Bank maintained its 1st position on the back of robust coverage of its non performing loans, a high Net Interest Margin at 10.7% and a high return on equity of 25.7%, against an average of 8.6% and 15.0%, 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

Cytonn INVESTMENTS

Rankings by Intrinsic Value

KCB Group has the highest upside with a potential return of 38.3%

Banks	Current Price	Target Price (Valuation)	Upside	Dividend Yield FY16e	Total Potential Return	Q3'2016 rank	H1'2016 rank
KCB Group	30.0	39.6	**31.8%**	6.5%	**38.3%**	**1**	**1**
Stanbic Holdings	69.5	84.7	**21.9%**	0.0%	**21.9%**	**2**	**8**
NIC Bank	27.8	30.8	**11.1%**	3.6%	**14.7%**	**3**	**7**
Equity Group	30.0	31.3	**4.4%**	6.2%	**10.6%**	**4**	**4**
HF Group	14.2	13.8	**(2.7%)**	9.8%	**7.1%**	**5**	**2**
I&M Holdings	91.0	90.7	**(0.3%)**	3.9%	**3.6%**	**6**	**6**
Co-operative	14.0	13.6	**(3.2%)**	5.8%	**2.6%**	**7**	**3**
Barclays Bank	9.1	7.6	**(15.9%)**	8.7%	**(7.2%)**	**8**	**9**
DTBK	130.0	116.8	**(10.1%)**	1.9%	**(8.2%)**	**9**	**5**
Standard Chartered	189.0	157.7	**(16.6%)**	6.6%	**(10.0%)**	**10**	**10**
National Bank	7.8	3.8	**(50.8%)**	0.0%	**(50.8%)**	**11**	**11**

- KCB Group and Stanbic Holdings have the highest upsides at 38.3% and 21.9%, respectively. KCB Group maintained its intrinsic value ranking from H1’2016, while Stanbic Holdings rose 6 positions to position 2
- National Bank registered the highest downside of 50.8%, maintaining its intrinsic value ranking from H1’2016

Composite Bank Ranking

Overall Equity Group ranked highest, while only 3 banks shifted positions from H1'2016

CYTONN'S Q3'2016 BANKING REPORT RANKINGS					
Banks	Franchise Value Total Score	Total Return Score	Weighted Q3'2016 Score	Q3'2016 rank	H1'2016 rank
Equity Group	53.0	4.0	23.6	1	1
KCB Group	60.0	1.0	24.6	2	2
Co-operative Bank	59.0	7.0	27.8	3	3
I&M Holdings	67.0	6.0	30.4	4	4
Diamond Trust Bank	64.0	9.0	31.0	5	5
Barclays Bank	71.0	8.0	33.2	6	7
Stanbic Holdings	87.0	2.0	36.0	7	8
Standard Chartered	76.0	10.0	36.4	8	6
NIC Bank	90.0	3.0	37.8	9	9
HF Group	107.0	5.0	45.8	10	10
National Bank	124.0	11.0	56.2	11	11

- In our ranking, franchise value was assigned a weighting of 40% while the intrinsic value was assigned 60% weight
- All banks except for Barclays Bank (up 1 position), Stanbic Holdings (up 1 position), and Standard Chartered (down 2 positions) remained the same as the rank in H1'2016

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 funding is towards the issuing of loans rather than the purchase of government securities. Barclays had the highest NIM at 10.9%, with the lowest for CfC Stanbic at 6.5%

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 25.7%, which was much above the industry average of the listed banks of 15.9%, while National Bank had the lowest at (42.3%) following the bank registering a loss in the Full year 2015 results

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. KCB Group had the lowest PEG ratio at 0.4x, while Barclays was the most overvalued at 1.2x

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:

Stanbic and Standard Chartered have the highest deposits per branch at Kshs. 5.2 bn and Kshs 4.9 bn, respectively, while National bank and Equity Group have the lowest deposits per branch at Kshs. 1.2 bn and Kshs. 1.4 bn, respectively. This is due to the large corporate book of 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

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:

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 83.5%, while HF Group was the farthest at 129.6%

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, and others have resorted to laying off staff in a bid to bring down costs and subsequently this ratio. I&M maintained the lowest cost to income ratio of 33.8%, while National Bank of Kenya had the highest ratio at 68.6%

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 HF Group as the most undervalued bank as per this metric at 0.5x, while Equity bank is still the most overvalued at 1.5x

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:

Equity Bank is the most solvent with a tangible common ratio of 16.3%, while National Bank was the least solvent at 3.5%

9. 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:

DTBK had the highest quality loan book with a non-performing loans to total loans ratio of 4.3%, while National Bank had the highest non-performing loans at 47.1%

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:

Equity Bank has the highest provisions to non-performing loans at 50.3%, while HF Group has the lowest at 22.6%

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 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 – 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

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
Equity Group	• Equity Bank is currently the largest insurance intermediary and Equity Investment Bank is the 2nd largest Stockbroker in the country with a market share of 16% • Equitel is the fastest growing MVNO	• 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 where they have not been as profitable as in others
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	• The bank is slow in embracing technology compared to its peers in deposit mobilisation
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 • The bank has one of highest net interest margin of 10.9% as at Q3'2016	• 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	• 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 10.7%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	CAGR
Net Interest Income	29.2	34.1	37.9	34.0	38.4	43.5	47.7	6.9%
Non Funded Income	18.5	21.9	21.4	27.6	33.3	40.5	49.9	17.8%
Loan Loss Provision	1.6	2.4	3.4	4.2	4.7	5.3	6.0	20.0%
Other Operating Expenses	24.8	29.7	30.6	31.7	37.1	42.9	50.3	11.1%
Total Operating Expenses	**26.3**	**32.1**	**34.1**	**35.9**	**41.9**	**48.2**	**56.4**	**11.9%**
Profit Before Tax	22.4	24.0	25.3	25.8	29.9	35.8	41.2	11.5%
Profit After tax	17.2	17.3	17.7	18.0	20.9	25.0	28.9	10.7%
% PAT Change YoY	**29.2%**	**1.0%**	**2.1%**	**2.0%**	**15.8%**	**19.7%**	**15.3%**	
EPS	4.5	4.6	4.7	4.8	5.5	6.6	7.6	10.7%
DPS	1.8	2.0	1.9	1.9	2.2	2.7	3.1	8.9%
Cost to Income	52.0%	52.9%	51.6%	51.4%	51.8%	51.1%	51.6%	
NIM	11.0%	10.6%	10.3%	8.5%	8.3%	8.3%	8.0%	
ROaE	29.7%	25.5%	23.7%	21.9%	22.2%	23.2%	23.2%	
ROaA	5.5%	4.5%	3.9%	3.6%	3.7%	3.9%	3.9%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	CAGR
Net Loans and Advances	214.2	269.9	302.5	341.3	385.6	436.3	494.3	12.9%
Government Securities	48.4	42.8	58.2	65.6	74.2	83.9	95.1	17.3%
Other Assets	82.0	115.4	114.3	128.6	145.1	164.7	187.2	10.2%
Total Assets	**344.6**	**428.1**	**475.0**	**535.5**	**604.9**	**684.9**	**776.6**	**12.7%**
Customer Deposits	245.4	302.2	347.9	397.6	454.5	519.5	593.7	14.5%
Other Liabilities	35.4	53.8	50.0	50.0	50.0	50.0	50.0	(1.4%)
Total Liabilities	**280.8**	**355.9**	**397.8**	**447.6**	**504.4**	**569.4**	**643.7**	**12.6%**
Shareholders Equity	63.8	72.1	77.1	88.0	100.5	115.5	132.8	13.0%
Book value Per share	16.9	19.1	20.4	23.3	26.6	30.6	35.2	13.0%
% Change in BPS YoY	**23.7%**	**13.1%**	**6.9%**	**14.0%**	**14.3%**	**14.9%**	**15.0%**	

Cytonn INVESTMENTS

Valuation Summary

Equity Group is undervalued with a total potential return of 10.6%

Cost of Equity Assumptions:	30-Nov-16
Risk free rate*	13.2%
Beta	0.8
Mature Market Risk Premium	7.1%
Cost of Equity	18.9%

Terminal Assumptions:	
Growth rate	5%
Mature Company Beta	1.00
Terminal Cost of Equity	20.3%
Return on Average Equity	23.2%
Terminal Price to Book value per share	1.1x
Shareholder Equity - FY20e	132.8
Terminal Value-(Year 2020)	166.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
Integrated DDM	34.9	40.0%	14.0
Residual Income	30.1	40.0%	12.0
PBV Multiple	25.2	15.0%	3.8
PE Multiple	30.9	5.0%	1.5
Fair Value			**31.3**
Current Price			**30.0**
Upside/(Downside)			4.4%
Dividend Yield			6.2%
Total Potential Return			**10.6%**

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

Cytonn INVESTMENTS

II. KCB Group

Financial Statements Extracts

KCB Group's PAT is expected to grow at a CAGR of 10.6%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	35.9	39.2	43.9	45.3	50.9	57.7	65.5	**10.8%**
Non Funded Income	22.0	23.4	21.6	24.1	26.8	30.5	34.5	**8.1%**
Loan Loss Provision	5.1	4.7	4.0	4.3	4.8	5.3	6.0	**4.9%**
Other Operating Expenses	29.1	31.4	32.7	34.4	38.1	42.6	47.7	**8.8%**
Total Operating Expenses	**34.2**	**36.1**	**36.6**	**38.7**	**42.9**	**47.9**	**53.7**	**8.3%**
Profit Before Tax	23.8	26.5	28.9	30.7	34.8	40.2	46.3	**11.8%**
Profit After tax	16.8	19.6	20.2	21.5	24.4	28.2	32.4	**10.6%**
% PAT Change YoY	**17.5%**	**16.5%**	**3.1%**	**6.3%**	**13.5%**	**15.5%**	**15.2%**	
EPS	5.4	6.3	6.5	6.9	7.9	9.1	10.4	**10.6%**
DPS	2.0	2.0	2.0	2.1	2.4	2.7	3.1	**9.4%**
Cost to Income	59.0%	57.6%	55.9%	55.8%	55.2%	54.4%	53.7%	
ROE	24.2%	25.0%	23.6%	22.0%	21.4%	21.3%	21.1%	
ROA	3.8%	3.7%	3.5%	3.5%	3.5%	3.6%	3.7%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Loans and Advances	283.7	346.0	373.4	412.0	458.7	513.7	575.3	10.7%
Government Securities	61.1	57.8	60.7	69.6	81.7	96.5	111.3	14.0%
Other Assets	145.5	154.3	154.8	172.3	191.8	210.4	233.5	8.6%
Total Assets	**490.3**	**558.1**	**588.9**	**654.0**	**732.2**	**820.6**	**920.2**	**10.5%**
Customer Deposits	377.3	424.4	449.9	499.4	559.3	626.5	701.6	10.6%
Other Liabilities	37.4	52.4	48.8	49.3	50.6	52.1	53.9	0.5%
Total Liabilities	414.7	476.8	498.7	548.8	609.9	678.6	755.5	9.6%
Shareholders Equity	75.6	81.3	90.2	105.2	122.3	142.0	164.7	15.2%
Book value Per share	24.4	26.2	29.0	33.9	39.4	45.7	53.0	15.2%
% Change in BPS YoY	**19.4%**	**7.4%**	**11.0%**	**16.7%**	**16.2%**	**16.1%**	**16.0%**	

Valuation Summary

KCB Group is undervalued with a total potential return of 38.3%

Cost of Equity Assumptions:	30-Nv-2016
Risk free rate *	13.2%
Beta	0.8
Country Risk Premium	7.1%
Cost of Equity	18.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.3%
Return on Average Equity	21.1%
Terminal PBV	1.1x
Shareholder Equity – FY20e	164.7
Terminal Value-(Year 2020)	182.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	41.4	40%	16.5
Residual Valuation	37.3	40%	14.9
PBV Multiple	38.6	15%	5.8
PE Multiple	46.0	5%	2.3
Fair Value			**39.6**
Current Price			**30.0**
Upside/(Downside)			31.8%
Dividend Yield			6.5%
Total Potential Return			**38.3%**

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

Cytonn INVESTMENTS

III. Co-operative Bank

Financial Statement Extracts

Co-operative Bank's PAT is expected to grow at a 5-year CAGR of 8.4%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	CAGR
Net Interest Income	21.3	23.2	24.4	22.4	26.0	29.7	34.2	**8.0%**
Non Funded Income	10.8	13.2	14.5	15.4	16.8	18.3	20.3	**9.0%**
Loan Loss Provision	1.2	2.0	2.5	2.4	2.6	2.8	3.2	**9.4%**
Other Operating Expenses	18.9	19.4	19.0	18.6	21.1	23.4	26.3	**6.3%**
Total Operating Expenses	20.1	21.4	21.5	21.0	23.7	26.2	29.4	**6.6%**
Profit Before Tax	10.9	15.4	17.4	16.8	19.1	21.8	25.0	**10.2%**
Profit After tax	8.0	11.7	12.2	11.8	13.4	15.2	17.5	**8.4%**
% PAT Change YoY	**-12.0%**	**46.0%**	**4.1%**	**-3.5%**	**13.7%**	**14.0%**	**14.8%**	
EPS	1.6	2.4	2.5	2.4	2.7	3.1	3.6	**8.4%**
DPS	0.5	0.0	0.7	0.7	0.8	0.9	1.0	**9.5%**
Cost to Income	63%	58.8%	55.2%	55.5%	55.3%	54.6%	54.1%	
NIM	10.0%	8.8%	8.7%	7.5%	7.7%	8.2%	9.2%	
ROE	20.0%	25.0%	22.6%	19.1%	18.9%	18.8%	18.9%	
ROA	3.1%	3.7%	3.4%	3.0%	3.0%	3.2%	3.2%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	CAGR
Net Loans and Advances	179.5	208.6	224.5	249.2	269.4	299.6	333.5	**9.8%**
Government Securities	24.6	36.2	24.3	40.4	48.6	58.3	69.5	**14.0%**
Other Assets	81.3	97.8	119.8	132.4	139.4	152.5	167.1	**11.3%**
Total Assets	**285.4**	**342.5**	**368.5**	**422.0**	**457.5**	**510.4**	**570.1**	**10.7%**
Customer Deposits	217.7	265.4	270.7	303.2	339.5	380.3	425.9	**9.9%**
Other Liabilities	24.3	27.3	40.8	53.3	42.8	44.0	45.4	**10.7%**
Total Liabilities	**242.0**	**292.7**	**311.5**	**356.5**	**382.3**	**424.3**	**471.3**	**10.0%**
Shareholders Equity	43.3	50.2	57.4	65.9	75.5	86.5	99.1	**14.6%**
Book value Per share	8.9	10.3	11.7	13.5	15.4	17.7	20.3	**14.6%**
% Change in BPS YoY	**17.8%**	**15.9%**	**14.3%**	**14.8%**	**14.6%**	**14.5%**	**14.6%**	

Valuation Summary

Co-operative Bank is undervalued with a total potential return of 2.6%

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate*	13.2%
Beta	0.8
Country Risk Premium	7.1%
Cost of Equity	18.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.3%
Return on Average Equity	18.9%
Terminal Price to Book Value	0.9x
Shareholder Equity – FY20e	99.1
Terminal Value-(Year 2020)	94.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	14.6	40%	5.8
Residual	12.1	40%	4.8
PBV Multiple	14.2	15%	2.1
PE Multiple	14.7	5%	0.7
Fair Value			**13.6**
Current Price			**14.0**
Upside/(Downside)			(3.2%)
Dividend Yield			5.8%
Total Upside/(Downside)			**2.6%**

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

Cytonn INVESTMENTS

IV. Standard Chartered Bank

Financial Statement Extracts

Standard Chartered PAT is expected to grow at a 5 year CAGR of 7.5%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	17.9	18.1	16.3	16.6	19.1	21.4	23.9	**4.7%**
Non Funded Income	8.2	7.2	7.7	8.4	9.3	10.2	11.3	**7.7%**
Loan Loss Provision	1.3	4.9	4.8	5.1	5.7	6.4	7.2	**6.5%**
Other Operating Expenses	10.4	11.3	9.4	9.9	11.1	12.4	14.0	**3.7%**
Total Operating Expenses	**11.7**	**16.2**	**14.3**	**15.0**	**16.9**	**18.8**	**21.2**	**4.6%**
Profit Before Tax	14.3	9.2	9.8	10.0	11.5	12.8	14.0	**7.3%**
Profit After tax	10.4	6.3	6.9	7.0	8.1	9.0	9.8	**7.5%**
% PAT Change YoY	**12.5%**	**-39.2%**	**8.2%**	**2.3%**	**15.0%**	**10.8%**	**9.5%**	
EPS	30.4	18.5	20.0	20.4	23.5	26.1	28.5	**7.5%**
DPS	11.5	12.5	13.0	13.3	15.3	16.9	18.6	**6.8%**
Cost to Income	45.0%	63.9%	59.2%	60.0%	59.4%	59.6%	60.2%	
NIM	9.6%	9.6%	12.5%	8.0%	8.4%	8.7%	9.7%	
ROaE	27.2%	15.5%	17.2%	17.6%	19.0%	19.7%	20.1%	
ROaA	4.7%	2.8%	2.8%	2.6%	2.7%	2.8%	2.7%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Loans and Advances	122.7	115.1	115.4	128.9	144.1	161.0	179.9	7.9%
Government Securities	58.8	73.6	66.1	84.6	94.6	105.7	118.1	15.0%
Other assets	41.0	45.2	73.1	71.6	70.1	73.9	78.2	13.8%
Total Assets	**222.5**	**234.0**	**254.6**	**285.2**	**308.7**	**340.6**	**376.2**	**11.1%**
Customer Deposits	154.1	172.0	192.3	214.8	240.1	268.3	299.8	14.2%
Other Liabilities	27.8	20.7	23.7	29.3	24.7	25.3	25.9	-1.4%
Total Liabilities	**181.8**	**192.7**	**216.0**	**244.1**	**264.8**	**293.6**	**325.8**	**12.4%**
Shareholders Equity	40.7	41.3	38.6	41.1	43.9	47.0	50.5	4.4%
Book value Per share	118.4	120.1	112.4	119.5	127.8	136.9	146.9	4.4%
% Change in BPS YoY	**12.3%**	**1.5%**	**-6.4%**	**6.4%**	**6.9%**	**7.1%**	**7.3%**	

Source – Company Financials

Cytonn INVESTMENTS

Valuation Summary

Standard Chartered Bank is overvalued with a total potential return of (10.0%)

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate *	13.2%
Adjusted Beta	0.5
Country Risk Premium	7.1%
Cost of Equity	16.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.3%
Return on Average Equity	20.1%
Terminal Price to Book Value	1.0x
Shareholder Equity – FY20e	50.5
Terminal Value-(Year 2020)	55.0

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	164.1	40%	65.7
Residual Valuation	154.8	40%	61.9
PBV Multiple	158.1	15%	23.7
PE Multiple	128.2	5%	6.4
Fair Value			**157.7**
Current Price			**189.0**
Upside/(Downside)			(16.6%)
Dividend Yield			6.6%
Total Potential Return			**(10.0%)**

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

V. Barclays Bank

Financial Statement Extracts

Barclays Bank's PAT is expected to grow at a CAGR of 2.4%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	19.6	20.4	19.4	18.9	19.8	21.6	23.9	**3.2%**
Non Funded Income	8.7	9.1	9.8	10.9	10.8	11.8	13.0	**7.5%**
Loan Loss Provision	(1.4)	(1.8)	(3.4)	(3.2)	(3.3)	(3.6)	(3.5)	**14.6%**
Other Operating Expenses	(14.5)	(15.6)	(15.6)	(16.2)	(16.8)	(18.2)	(19.9)	**5.0%**
Total Operating Expenses	(15.9)	(17.4)	(19.0)	(19.4)	(20.2)	(21.8)	(23.4)	**6.1%**
Profit Before Tax	12.3	12.1	10.2	10.3	10.5	11.6	13.5	**2.3%**
Profit After tax	8.4	8.4	7.2	7.2	7.3	8.1	9.5	**2.4%**
% PAT Change YoY	**10.7%**	**-0.4%**	**-14.7%**	**0.4%**	**1.8%**	**11.2%**	**16.2%**	
EPS	1.6	1.5	1.3	1.3	1.3	1.5	1.7	**2.4%**
DPS	0.0	0.2	0.8	0.8	0.8	0.9	1.0	**41.5%**
Cost to Income	56.4%	59.0%	64.9%	65.4%	65.8%	65.2%	63.4%	
NIM	**11.2%**	**10.4%**	**9.1%**	**8.5%**	**8.2%**	**8.2%**	**8.2%**	
ROaE	23.9%	21.6%	18.2%	18.6%	18.1%	18.7%	20.3%	
ROaA	3.9%	3.6%	2.9%	2.8%	2.8%	2.8%	3.2%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Loans and Advances	125.4	145.4	159.7	161.5	172.1	186.9	205.6	**7.2%**
Government Securities	57.2	48.1	50.5	56.5	64.4	73.3	80.6	**10.9%**
Other Assets	43.3	47.4	50.3	63.8	68.5	70.5	72.8	**8.9%**
Total Assets	**225.8**	**240.9**	**260.5**	**281.9**	**305.1**	**330.7**	**359.0**	**8.3%**
Customer Deposits	164.8	165.1	183.6	201.9	222.1	244.3	268.8	**10.2%**
Other Liabilities	22.9	36.1	38.7	38.8	38.9	39.0	39.1	**1.6%**
Total Liabilities	**187.7**	**201.2**	**222.2**	**240.7**	**261.0**	**283.3**	**307.9**	**8.9%**
Shareholders Equity	38.2	39.7	38.3	41.1	44.1	47.3	51.1	**5.2%**
Book value Per share	7.0	7.3	7.0	7.6	8.1	8.7	9.4	**5.2%**
% Change in BPS YoY	**18.0%**	**4.0%**	**-3.6%**	**7.5%**	**7.1%**	**7.4%**	**8.0%**	

Source – Company Financials

Valuation Summary

Barclays Bank is overvalued with a total potential return of (7.1%)

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate *	13.0%
Beta	0.8
Mature Market Risk Premium	6.7%
Cost of Equity	19.0%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.2%
Return on Average Equity	20.3%
Terminal Price to Book value per share	0.9x
Shareholder Equity - FY20e	51.1
Terminal Value – (Year 2020)	51.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	6.0	40%	2.4
Residual Valuation	8.6	40%	3.4
PBV Multiple	8.8	15%	1.3
PE Multiple	9.0	5%	0.5
Fair Value			**7.6**
Current Price			**9.1**
Upside/(Downside)			(15.9%)
Dividend Yield			8.7%
Total Potential Return			**(7.1%)**

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

Cytonn INVESTMENTS

VI. Diamond Trust Bank

Financial Statement Extracts

DTB has an estimated 5-year PAT CAGR of 10.1%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	12.8	15.2	19.5	20.7	22.6	24.2	27.0	12.2%
Non Funded Income	3.8	4.7	4.0	4.3	7.3	9.7	12.7	21.9%
Loan Loss Provision	0.9	2.2	3.4	2.5	3.0	3.2	3.8	11.7%
Other Operating Expenses	4.3	4.9	(10.2)	6.2	8.1	9.2	10.7	20.5%
Total Operating Expenses	**8.1**	**10.3**	**13.6**	**14.3**	**17.8**	**20.4**	**24.5**	**18.8%**
Profit Before Tax	8.5	9.6	9.9	10.7	12.1	13.5	15.2	9.7%
Profit After tax	5.7	6.6	6.9	7.5	8.4	9.5	10.7	10.1%
% PAT Change YoY	**9.1%**	**15.7%**	**4.9%**	**0.5%**	**12.7%**	**12.1%**	**12.6%**	
EPS	21.4	24.8	26.0	28.1	31.7	35.5	40.0	10.1%
DPS	2.4	2.5	2.6	2.8	3.2	3.6	4.0	10.1%
Cost to Income	48.6%	52.0%	57.9%	57.1%	59.6%	60.1%	61.7%	
NIM	**7.7%**	**7.2%**	**7.5%**	**7.2%**	**7.1%**	**6.9%**	**6.9%**	
ROE	22.8%	20.9%	19.0%	17.8%	17.1%	16.5%	16.1%	
ROA	3.0%	2.7%	2.5%	2.4%	2.5%	2.4%	1.9%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Loans and Advances	137.7	177.5	195.2	227.2	266.7	316.5	373.2	16.0%
Government Securities	35.1	47.1	83.7	87.6	95.2	90.4	106.6	17.8%
Other Assets	38.8	47.0	47.6	64.5	81.4	116.1	133.8	23.3%
Total Assets	**211.5**	**271.6**	**326.4**	**379.4**	**443.4**	**523.1**	**613.6**	**17.7%**
Customer Deposits	161.0	194.1	239.2	287.1	344.5	413.4	496.1	20.7%
Other Liabilities	18.3	39.3	43.7	41.6	40.6	42.8	41.1	0.9%
Total Liabilities	**179.3**	**233.3**	**283.0**	**328.7**	**385.1**	**456.3**	**537.2**	**18.2%**
Shareholders Equity	29.0	34.1	38.7	45.9	53.5	62.1	71.6	16.0%
Book value Per share	108.8	128.2	145.4	172.5	201.0	233.0	269.0	16.0%
% Change in BPS YoY	**37.9%**	**17.9%**	**13.4%**	**17.2%**	**16.5%**	**15.9%**	**15.5%**	

Cytonn INVESTMENTS

Source – Company Financials

Valuation Summary

DTB's stock is overvalued with a total potential return of (8.5%)

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate *	13.2%
Beta	0.6
Mature Market Risk Premium	7.1%
Cost of Equity	17.5%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.1%
Return on Average Equity	15.9%
Terminal Price to Book value per share	0.9x
Shareholder Equity - FY20e	71.6
Terminal Value – (Year 2020)	53.8

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	123.0	80.0%	49.2
Residual Valuation	113.9	80.0%	45.6
PBV Multiple	105.6	15.0%	15.8
PE Multiple	118.4	5.0%	5.9
Fair Value			**116.5**
Current Price			**130.0**
Upside / (Downside)			(10.4%)
Dividend Yield			1.9%
Total Potential Return			**(8.5%)**

** 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	• Bad public image following top management being let go amid claims of mismanagement • Capital ratios are below the regulatory requirements but the bank plans to raise Kshs 4.4 bn to remedy this
NIC Bank	• Increased investment in digital platforms, NIC Now and Internet banking by 29% and 41%, respectively • 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	• The Corporate and Investment banking is a key driver for revenue as it contribute 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 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
I&M Bank	• 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 is expected to grow at a 5-year CAGR of 3.3% on PAT

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	6.8	6.4	6.7	5.4	6.2	6.9	7.8	3.9%
Non Funded Income	3.1	3.2	3.4	4.1	4.5	4.9	5.1	10.2%
Loan Loss Provision	0.5	3.7	2.9	2.1	2.3	3.0	3.3	(2.6%)
Other Expenses	7.0	7.5	7.0	6.5	6.9	7.5	8.1	1.7%
Total Operating Expenses	**7.5**	**11.2**	**9.9**	**8.5**	**9.2**	**10.5**	**11.4**	0.3%
Profit Before Tax	1.3	(1.6)	0.3	1.0	1.5	1.3	1.5	2.5%
Profit After tax	**0.9**	**(1.2)**	**0.2**	**0.7**	**1.1**	**0.9**	**1.1**	3.3%
% PAT Change YoY	**-21.8%**	**-232.5%**	**-116.1%**	**275.5%**	**51.3%**	**-12.5%**	**14.3%**	
EPS	2.8	(3.7)	0.6	2.3	3.4	3.0	3.4	3.3%
DPS	-	-	-	-	-	-	-	-
Cost to Income	70.2%	78.2%	68.7%	67.9%	64.6%	63.7%	63.0%	
NIM	7.8%	6.5%	6.4%	4.9%	5.4%	5.8%	5.6%	
ROaE	7.2%	-9.9%	1.7%	6.1%	8.6%	6.9%	7.4%	
ROaA	0.8%	-0.9%	0.1%	0.5%	0.7%	0.5%	0.6%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Loans and Advances	65.6	67.8	77.9	87.0	95.7	105.3	115.8	**11.3%**
Government Securities	30.3	27.3	30.4	33.5	36.8	40.5	44.5	**10.3%**
Other Assets	27.2	30.3	26.8	27.6	30.1	32.7	35.5	**3.2%**
Total Assets	123.1	125.4	135.1	148.1	162.6	178.4	195.9	**9.3%**
Customer Deposits	104.7	110.6	121.7	133.9	147.2	162.0	178.2	**10.0%**
Other Liabilities	6.1	3.8	2.3	2.4	2.5	2.7	2.8	**-5.5%**
Total Liabilities	110.9	114.4	124.0	136.2	149.8	164.6	181.0	**9.6%**
Shareholders Equity	12.2	11.1	11.1	11.8	12.9	13.8	14.9	**6.1%**
Book value Per share	39.7	35.9	36.1	38.4	41.8	44.8	48.3	**6.1%**
% Change in BVPS	**2.8%**	**-9.6%**	**0.6%**	**6.3%**	**8.9%**	**7.2%**	**7.7%**	

Source – Company Financials

Valuation Summary

National Bank is overvalued with a total potential return of (50.8%)

Cost of Equity Assumptions:	Nov-30-2016
Risk free rate *	13.2%
Beta	1.0
Country Risk Premium	7.1%
Cost of Equity	19.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.3%
Return on Average Equity (2020e)	7.4%
Terminal Price to Book value per share	0.2x
Preference Shares	5.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	1.8	80%	1.4
PBV Multiple	14.5	15%	2.2
PE Multiple	5.3	5%	0.3
Fair Value			**3.8**
Current Price			**7.8**
Upside/(Downside)			(50.8%)
Dividend Yield			0.0%
Total Potential Return			**(50.8%)**

**-Five years average yields on a 10 year Treasury bond*
***- PE is calculated using Normalised Earnings*

Cytonn INVESTMENTS

II. NIC Bank

Financial Statements Extracts

NIC Bank's PAT is expected to grow at a CAGR of 7.1%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	8.0	9.7	11.6	12.1	12.6	13.7	15.4	9.6%
Non Funded Income	3.6	4.0	4.0	4.5	5.0	5.5	6.0	8.3%
Loan Loss Provision	0.3	1.7	3.5	4.0	4.0	4.4	4.7	23.5%
Total Operating Expenses	5.3	7.4	9.6	10.2	10.6	11.5	12.4	11.0%
Profit Before Tax	6.2	6.4	6.1	6.4	7.0	8.0	9.0	7.1%
Profit After tax	4.1	4.5	4.3	4.5	4.9	5.6	6.3	7.1%
% PAT Change YoY	**27.1%**	**-61.7%**	**-4.9%**	**5.9%**	**9.0%**	**13.5%**	**13.0%**	
EPS	6.4	7.0	6.7	7.0	8.1	8.5	9.8	7.1%
DPS	1.0	1.0	1.0	1.1	1.2	1.3	1.5	8.1%
Cost to Income	46.2%	53.6%	61.1%	61.4%	58.6%	59.2%	58.0%	
NIM	**6.8%**	**6.9%**	**7.4%**	**7.4%**	**7.3%**	**7.4%**	**7.3%**	
ROE	20.6%	18.4%	15.4%	14.4%	14.6%	13.6%	14.0%	
ROA	3.1%	2.9%	2.5%	2.5%	2.7%	2.6%	2.8%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Loans and Advances	102.0	116.0	118.1	122.7	135.0	149.9	166.4	7.5%
Government Securities	19.2	7.5	13.2	10.8	10.6	10.3	10.6	7.3%
Other Assets	24.5	42.3	42.5	50.2	54.8	55.2	59.9	7.2%
Total Assets	**145.8**	**165.8**	**173.7**	**183.8**	**200.4**	**215.3**	**236.9**	**7.4%**
Customer Deposits	100.4	112.4	114.6	120.3	132.4	146.9	163.1	7.7%
Other Assets	22.0	27.1	29.3	29.5	29.7	25.4	25.8	-0.9%
Total Liabilities	**122.4**	**139.4**	**143.9**	**149.9**	**162.1**	**172.4**	**188.9**	**6.3%**
Shareholders Equity	22.9	25.9	29.3	33.4	37.8	42.5	47.8	12.9%
Book value Per share	4.50	5.1	5.8	6.6	7.4	8.4	9.4	12.9%
% Change in BVPS	**33.0%**	**13.1%**	**13.3%**	**13.1%**	**12.6%**	**12.7%**	**12.7%**	

Cytonn INVESTMENTS

Valuation Summary

NIC bank is undervalued with a total potential return of 14.7%

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate *	13.2%
Beta	0.9
Mature Market Risk Premium	7.1%
Cost of Equity	19.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.3%
Return on Average Equity	14.0%
Terminal Price to Book value Per Share	0.6x
Shareholder Equity – FY'20e	47.8
Terminal Value-(Year 2020)	31.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
Common Ratio	33.7	40%	13.5
Residual Valuation	26.0	40%	10.4
PBV Multiple	32.8	15%	4.9
PE Multiple	38.1	5%	1.9
Fair Value			**30.8**
Current Price			**27.8**
Upside/(Downside)			11.1%
Dividend Yield			3.6%
Total Potential Return			**14.7%**

** 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 7.5%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	8.5	9.3	10.4	11.3	12.2	13.1	14.1	**8.7%**
Non Funded Income	8.4	7.6	7.7	8.3	9.1	10.0	11.0	**7.5%**
Loan Loss Provision	(0.7)	(0.9)	(1.3)	(1.4)	(1.7)	(2.0)	(2.2)	**19.7%**
Total Operating Expenses	**(9.2)**	**(9.6)**	**(10.4)**	**(11.3)**	**(12.5)**	**(13.7)**	**(15.0)**	**9.4%**
Profit Before Tax	7.7	7.4	7.6	8.3	8.8	9.4	10.1	**6.5%**
Profit After tax	5.7	4.9	5.3	5.8	6.2	6.6	7.1	**7.5%**
% PAT Change YoY	**10.9%**	**-13.7%**	**8.8%**	**9.2%**	**6.3%**	**6.4%**	**7.1%**	
EPS	14.4	12.4	13.5	14.7	15.7	16.7	17.8	
DPS	-	6.2	-	-	-	-	-	
Cost to Income	50.2%	51.2%	50.5%	50.5%	50.5%	50.5%	51.0%	
NIM	**5.4%**	**5.1%**	**5.4%**	**5.5%**	**5.5%**	**5.5%**	**5.5%**	
ROaE	16.4%	13.0%	13.5%	13.4%	12.5%	11.8%	11.3%	
ROaA	3.1%	2.5%	2.5%	2.5%	2.4%	2.3%	2.2%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019e	2020e	5-YearCAGR
Net Loans and Advances	101.2	128.2	134.6	147.6	161.8	177.5	194.7	**8.7%**
Government securities	4.8	7.8	12.1	13.2	14.5	15.9	17.5	**17.5%**
Other Assets	74.9	72.5	79.5	87.8	96.7	106.3	116.7	**10.0%**
Total Assets	**181.0**	**208.5**	**226.2**	**248.6**	**273.1**	**299.7**	**328.9**	**9.5%**
Customer Deposits	129.4	153.7	166.1	182.7	201.0	221.1	243.2	**9.6%**
Borrowings	6.5	6.5	6.5	6.5	6.5	6.5	6.5	**0.0%**
Other Liabilities	8.2	9.9	13.0	13.0	13.0	13.0	13.0	**5.6%**
Total Liabilities	**144.1**	**170.1**	**185.6**	**202.2**	**220.5**	**240.6**	**262.7**	**9.1%**
Shareholders Equity	36.9	38.4	40.5	46.4	52.6	59.2	66.2	**11.5%**
Book value Per share	93.3	97.0	102.6	117.3	133.0	149.6	167.5	**11.5%**
% Change in BVPS	**13.8%**	**4.0%**	**5.7%**	**14.4%**	**13.4%**	**12.5%**	**11.9%**	

Cytonn INVESTMENTS

Valuation Summary

Stanbic Holdings is undervalued with a total potential return of 21.9%

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate *	13.2%
Beta	0.95
Mature Market Risk Premium	7.1%
Cost of Equity	19.8%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.6%
Return on Average Equity	11.3%
Terminal Price to Book Value	0.4x

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	85.5	40%	34.2
DDM Integrated	95.1	40%	38.1
PBV Multiple	63.0	15%	9.5
PE Multiple	60.1	5%	3.0
Fair Value			**84.7**
Current Price			**69.5**
Upside/(Downside)			21.9%
Dividend yield			0.0%
Total Potential Return			**21.9%**

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

Cytonn INVESTMENTS

IV. I&M Holdings

Financial Statements Extracts

I&M Holdings PAT is expected to grow at a CAGR of 9.0%

Income Statement	2014	2015	2016f	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	10.4	12.6	13.7	15.0	16.9	19.0	21.4	**11.1%**
Non Funded Income	3.8	4.6	4.5	5.0	5.5	6.1	6.8	**8.1%**
Loan Loss Provision	0.9	1.0	1.2	1.4	1.5	1.7	1.9	**14.3%**
Other Operating Expenses	5.3	6.4	7.0	7.7	8.6	9.7	10.9	**11.2%**
Total Operating Expenses	**6.2**	**7.4**	**8.2**	**9.1**	**10.1**	**11.4**	**12.8**	**11.6%**
Profit Before Tax	8.2	10.2	10.3	11.2	12.5	14.0	15.7	**9.0%**
Profit After tax	5.7	7.1	7.2	7.8	8.8	9.8	11.0	**9.0%**
% PAT Change YoY	**15.3%**	**24.6%**	**1.1%**	**8.4%**	**12.1%**	**11.8%**	**11.8%**	
EPS	14.6	18.2	18.4	20.0	22.4	25.0	28.0	**9.0%**
DPS	2.6	3.5	3.3	3.6	4.0	4.5	5.0	**7.5%**
CIR	37.4%	37.2%	38.4%	38.7%	38.6%	38.6%	38.7%	
NIM	**6.6%**	**7.2%**	**6.2%**	**6.0%**	**6.0%**	**6.0%**	**6.0%**	
ROaE	23.9%	24.8%	21.4%	20.1%	19.2%	18.4%	17.7%	
ROaA	3.6%	3.9%	3.3%	3.0%	3.0%	3.0%	2.9%	

Balance Sheet	2014	2015	2016f	2017f	2018f	2019f	2020f	5-Year CAGR
Government Securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**N/A**
Net Loans and Advances	112.5	127.8	144.2	158.4	178.2	200.5	225.6	**12.0%**
Other Assets	64.0	63.9	100.9	117.6	132.7	149.7	168.9	**21.4%**
Total Assets	**176.5**	**191.7**	**245.1**	**276.0**	**310.9**	**350.2**	**394.5**	**15.5%**
Customer Deposits	114.2	133.0	169.7	190.9	214.7	241.6	271.8	**15.4%**
Other Liabilities	34.2	25.0	37.2	40.6	44.5	48.9	53.8	**16.5%**
Total Liabilities	**148.4**	**158.0**	**206.8**	**231.5**	**259.2**	**290.4**	**325.5**	**15.6%**
Shareholders Equity	26.1	31.4	36.0	42.2	49.4	57.4	66.6	**16.1%**
Book value Per share	0.1	0.1	0.1	0.1	0.1	0.1	0.2	**16.1%**
% BVPS Change YoY	**18.9%**	**20.7%**	**14.3%**	**17.9%**	**17.0%**	**16.2%**	**15.6%**	

Cytonn INVESTMENTS

Valuation Summary

I&M is fairly valued with a total potential return of 3.6%

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate *	13.2%
Beta	0.8
Country Risk Premium	7.1%
Cost of Equity	18.9%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.3%
Return on Average Equity	17.7%
Terminal PBV	0.8x
Shareholder Equity – FY20e	66.4
Terminal Value-(Year 2020)	57.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	100.4	40%	40.2
Residual Valuation	91.8	40%	36.7
PBV Multiple	51.2	15%	7.7
PE Multiple	119.5	5%	6.0
Fair Value			**90.6**
Current Price			**91.0**
Upside/(Downside)			(0.3%)
Dividend Yield			3.9%
Total Potential Return			**3.5%**

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

V. HF Group

Financial Statement Extracts

HF Group's PAT is expected to grow at a 5-year CAGR of 8.4%

Income Statement	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Interest Income	3.0	3.6	3.6	4.1	4.1	4.4	4.4	**4.2%**
Non Funded Income	0.8	1.2	1.3	1.4	1.7	2.0	2.3	**14.8%**
Loan Loss Provision	(0.6)	(0.5)	(0.7)	(0.9)	(0.9)	(0.9)	(1.0)	**15.6%**
Other Operating Expenses	(1.9)	(2.6)	(2.4)	(2.8)	(2.8)	(3.0)	(3.2)	**3.9%**
Total Operating Expenses	**(2.5)**	**(3.1)**	**(3.1)**	**(3.7)**	**(3.7)**	**(3.9)**	**(4.2)**	6.2%
Profit Before Tax	1.4	1.8	1.8	1.8	2.1	2.4	2.6	**7.9%**
Profit After tax	1.0	1.2	1.3	1.2	1.5	1.7	1.8	**8.4%**
% PAT Change YoY	**-2.0%**	**22.7%**	**3.4%**	**3.6%**	**14.9%**	**13.5%**	**7.4%**	
EPS	2.8	3.4	3.5	3.7	4.2	4.8	5.1	**8.4%**
DPS	1.5	1.3	1.3	1.4	1.6	1.8	2.0	**8.5%**
Cost to Income	49.2%	54.5%	49.5%	50.9%	48.7%	47.4%	46.7%	
NIM	5.6%	6.0%	5.5%	5.4%	4.8%	4.6%	4.2%	
ROaE	15.7%	13.9%	10.9%	10.3%	11.1%	11.8%	11.7%	
ROaA	1.8%	1.8%	1.7%	1.6%	1.6%	1.6%	1.6%	

Balance Sheet	2014	2015	2016e	2017f	2018f	2019f	2020f	5-Year CAGR
Net Loans and Advances	45.2	53.0	55.8	62.6	69.1	76.2	83.8	**9.6%**
Government Securities	0.3	2.2	6.9	7.9	10.3	11.8	13.6	**44.5%**
Other Assets	15.5	16.5	14.1	17.1	16.6	19.9	24.8	**8.4%**
Total Assets	**61.0**	**71.7**	**76.7**	**87.7**	**96.0**	**107.8**	**122.1**	**11.2%**
Customer Deposits	36.1	41.7	43.6	50.1	57.6	66.2	76.2	**12.8%**
Other Liabilities	18.3	19.4	21.1	24.8	24.6	26.8	30.0	**9.2%**
Total Liabilities	**54.4**	**61.0**	**64.7**	**74.9**	**82.2**	**93.0**	**106.2**	**11.7%**
Shareholders Equity	6.6	10.6	12.0	12.8	13.8	14.8	16.0	**8.3%**
Book value Per share	18.8	30.4	34.4	36.6	39.4	42.5	45.8	**8.3%**
% Change in BPS YoY	**11.9%**	**62.0%**	**12.9%**	**6.6%**	**7.1%**	**7.6%**	**7.6%**	

Source – Company Financials

Valuation Summary

HF Group is fairly valued with a total potential return of 7.1%

Cost of Equity Assumptions:	30-Nov-2016
Risk free rate *	13.2%
Beta	0.9
Country Risk Premium	7.1%
Cost of Equity	19.2%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	20.1%
Return on Average Equity	11.9%
Terminal PBV	0.7x
Shareholder Equity – FY20e	15.9
Terminal Value-(Year 2020)	7.3

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	13.8	40%	5.5
Residual Income	10.6	40%	4.2
PBV Multiple	22.9	15%	3.4
PE Multiple	18.0	5%	0.9
Fair Value			**14.1**
Current Price			**14.2**
Upside/(Downside)			(2.7%)
Dividend Yield			9.8%
Total Potential Return			**7.1%**

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

Q&A

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