Kenya Listed Commercial Banks Analysis

Cytonn H1'2017 Banking Sector Report

'Transitioning to a more Disciplined and Efficient Sector'

18th September, 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 Management Plc 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

82 bn Over Kshs. 82 billion worth of projects under mandate	**5** Five offices across 2 continents	**250** Over 250 staff members	**10** 10 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**

Cytonn INVESTMENTS

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, Hospitality and Technology Sectors.

Cytonn INVESTMENTS

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**

We are focused on one agenda:

THE CLIENT

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 11 members from diverse backgrounds, each bringing in unique skill-sets to the firm.

Board of Directors, continued …

Governance Committees

We have four main board committees to ensure all of Cytonn's functions are done in a fair and transparent manner:

Investments and Strategy Committee

The committee oversees and provides strategic investment direction, including the implementation and monitoring process. The members are:-

- James Maina (Chair)
- Antti-Jussi Ahveninen, MSc
- Madhav Bhalla, LLB
- Edwin H. Dande, MBA
- Elizabeth Nkukuu,CFA

Audit, Risk and Compliance Committee

The committee establishes and oversees risk and compliance, including the implementation and monitoring process. The members are:-

- Madhav Bhalla, LLB (Chair)
- Nasser Olwero, Mphil
- Madhav Bhandari, MBA
- Dr. Nancy Asiko Onyango, DBA
- Patricia N. Wanjama, CPS

Governance, Human Resources and Compensation Committee

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

- Antti-Jussi Ahveninen, MSc (Chair)
- Prof. Daniel Mugendi Njiru, PhD
- Michael Bristow, MSc (Chair)
- Rose Kimotho, M.B.S
- Edwin H. Dande, MBA

Technology and Innovation Committee

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

- Nasser Olwero, Mphil (Chair)
- Michael Bristow, MSc
- Rose Kimotho, M.B.S
- Patricia N. Wanjama, CPS

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II. Kenya Economic Review and Outlook

Summary Economic Outlook

Currency has turned to neutral from negative. Of the 7 indicators we track, 1 has improved, while the other 6 have remained relatively unchanged 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 Q1'2017 came in at 4.7%, primarily on account of subdued performance in the agriculture sector and financial intermediation	GDP growth is expected to recover over the remaining part of 2017, from the depressed 4.7% experienced in Q1'2017, and come in at 4.7% - 5.2%, despite the depressed rainfall witnessed during the long rains season between March and May, which has served to ease the food shortage in the country	**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%. Domestic borrowing is expected to pick up in the coming weeks, with improved liquidity levels in the market, brought about by heavy maturities of government securities, and hence we don't expect the government to be under pressure to meet its borrowing targets for the fiscal year 2017/18	The interest rate environment is expected to remain relatively stable, with the CBK not accepting high 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 rose to 8.0% in the month of August from 7.5% in July, due to limited food supply to Nairobi and other urban centers in the month	We expect the inflation rate to stabilize going forward but to average above the 7.5% upper bound government target in 2017	**Neutral**	**Neutral**
Currency	Shilling to depreciate against major currencies	The shilling has depreciated by 0.4% against the dollar YTD, having appreciated by 1.0% over the last two months, with the 1.0% appreciation primarily driven by dollar inflows from investors abroad into the local debt and equity markets, amid cheap market valuations and a relatively stable business environment, brought about by a non-violent election	We expect the currency to remain relatively stable against the dollar due to a weaker USD in the global markets and It is also important to note that the CBK has sufficient reserves (USD 7.5 bn - equivalent to 5.0 months of import cover) to support the shilling in the short term	**Negative**	**Neutral**

Summary Economic Outlook, continued…

Exchange rate has turned to neutral from negative. Of the 7 indicators we track, 1 has improved the remaining 6 have remained relatively unchanged 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 13.8% in H1'2017	We still expect corporate earnings to be worse than 2016, weighed down by the Financial Services sector, owing to slower private sector credit growth at 2.1% as at May and the effects of the cap on interest rates	**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 entering the market in search of attractive valuations, amid a relatively peaceful election period	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 attractive 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 during and after the elections period, with the government expected to keep this in check. However, uncertainty still exists due to the ongoing elections	**Neutral**	**Neutral**

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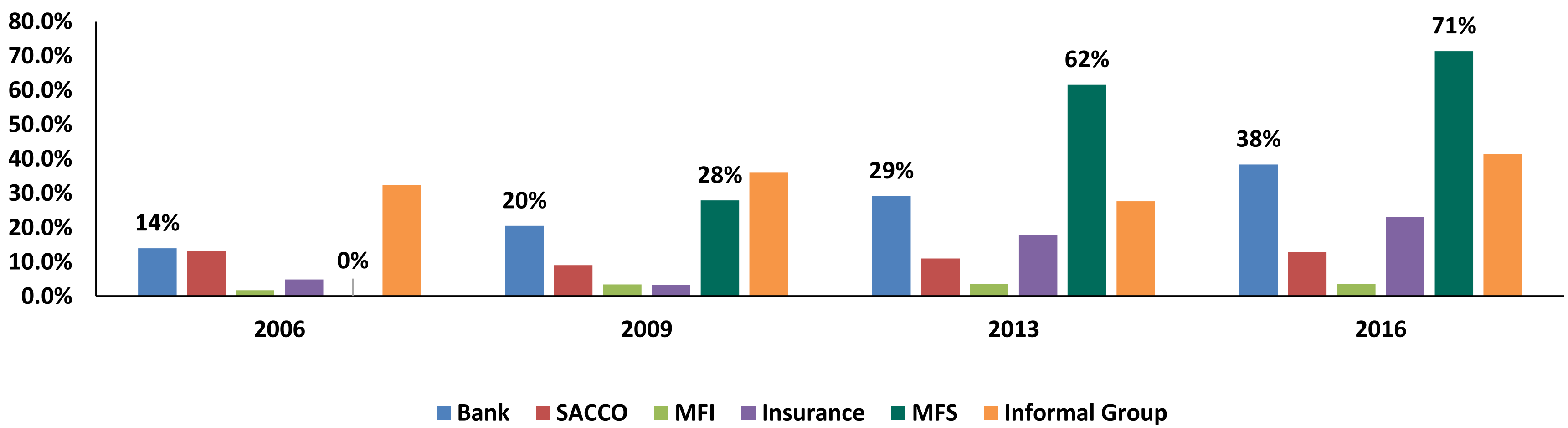
III. Kenya Banking Sector Overview

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, with Chase Bank and Imperial Bank under receivership, 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

Use of Financial Service Providers over the Years



Kenya Banking Sector Overview, continued…

The sector has witnessed several acquisitions over the past 4 years, with the most recent being the acquisition of Habib Bank Ltd by Diamond Trust Bank early this year

- 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	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%.
- 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 this year Mayfair Bank and Dubai Islamic Bank were granted operating licences to undertake banking services in Kenya
- It is notable that acquisitions are also happening at much cheaper valuations, with earlier bank acquisition announcements, such as Fina, K-Rep and Equatorial Commercial Bank having been at 3.2x, 1.8x and 2.3x P/B, respectively, while recent acquisitions are happening at between 0.8x to 1.7x P/B, and hence it is a great time to be an acquirer

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Growth in the Banking Sector

Listed bank's H1'2017 EPS declined by 13.8% y/y from an average growth of 15.5% witnessed in H1'2016, following the capping of interest rates

- Kenya's listed banks recorded a negative EPS growth of 13.8% in H1'2017, compared to an average positive growth of 15.5% in H1'2016. The poor performance was on the back of a decline in Net Interest Income (NII) following the capping of interest rates. The Net Interest Margin (NIM) declined to 7.7% in H1'2017 from 8.4% in H1'2016

- Listed banks recorded gross loans and advances growth of 9.3% to Kshs 1.9 tn in H1'2017 from Kshs 1.7 tn in H1'2016, slowing down from the 5 year average growth rate of 14.6%. On the other hand, deposits grew 14.4% to Kshs 2.4 tn in H1'2017 from Kshs 2.1 tn in H1'2016, faster than the 5 year average of 12.8%

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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 proving to be a 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 lifting of the moratorium has allowed entry of banks that serve niche market segments, like Dubai Islamic Bank's focus on sharia-compliant banking

1. **Licencing of new commercial banks, following lifting of the moratorium:** The banking sector has also experienced setting up new operations following the lifting of the moratorium to license new banks, which has seen the licensing of Dubai Islamic Bank Limited (DIB) and Mayfair Bank Ltd. This makes DIB Bank Kenya the third fully sharia compliant lender to operate in East Africa after Gulf African Bank Limited and First Community Bank. 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
2. **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

Recent Developments in the Banking Sector…Continued

CBK shortlisted potential investors for Chase Bank and has invited bids for Imperial Bank in a bid to bring the two banks out of receivership

3. **Chase Bank and Imperial Bank sale of majority stake:** The Central Bank of Kenya (CBK) shortlisted potential investors in Chase Bank, out of the 12 that expressed interest including 3 local banks, 4 foreign financial institutions and 5 other financial institutions and consortia. CBK has also invited investors to express interest in taking an equity stake in Imperial Bank. The interest in Chase Bank 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, with the return on equity being among the highest in the world, with listed banks having recorded an average return on equity of 18.1% in H1'2017, despite the introduction of the interest rate caps. Recently, the Central Bank of Kenya opened the expression of interest window for potential investors in Imperial Bank to submit bids and propose transaction structures, with the expression of interest period open up until 29th September 2017
4. **Central Bank intends to push for the repeal of the Interest Rate Cap:** The Central Bank of Kenya (CBK) has signaled its intention to push for the repeal of the interest rates cap law that has been in effect for a year now, due to the negative effect it has had on private sector credit growth and the expected negative impact to the economy. This comes after a recent credit survey by the CBK showed that most commercial banks (54.0%) revealed that interest rate capping negatively affected their lending to SMEs

Recent Developments in the Banking Sector… Continued

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

5. 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

6. Decline in private sector credit growth: Private sector credit growth has been on a decline coming to an eight-year low of 2.1% as at May 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 opposed to the private sector, which is considered riskier. The situation was also made worse by the interest rate cap, introduced in September 2016

7. 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 completed the acquisition of Fidelity Commercial Bank

8. 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 1,470 bank employees have been laid off, and 39 branches have been closed, despite the total number of branches in the sector rising to 1,176 in H1'2017 from 1,108 in H1'2016

Effects of Recent Developments in the Banking Sector, continued…

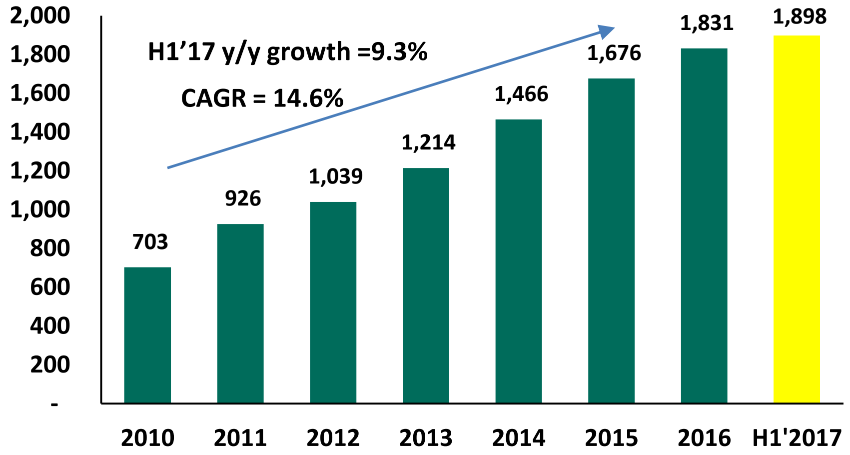
Following the capping of interest rates, banks have taken to cost rationalization measures through staff lay offs and closing down redundant branches

Kenya Banking Sector Restructuring			
No	**Bank**	**Staff Retrenchment**	**Branches Closed**
1	Bank of Africa	-	12
2	Barclays Bank of Kenya	301	7
3	Ecobank	-	9
4	Equity Group	400	7
5	Family Bank	Unspecified	-
6	First Community Bank	106	-
7	KCB Group	223	Unspecified
8	National Bank	Unspecified	-
9	NIC Bank	32	Unspecified
10	Sidian Bank	108	-
11	Standard Chartered	300	4
12	I&M Holdings	-	Unspecified
	Total	**1,470**	**39**

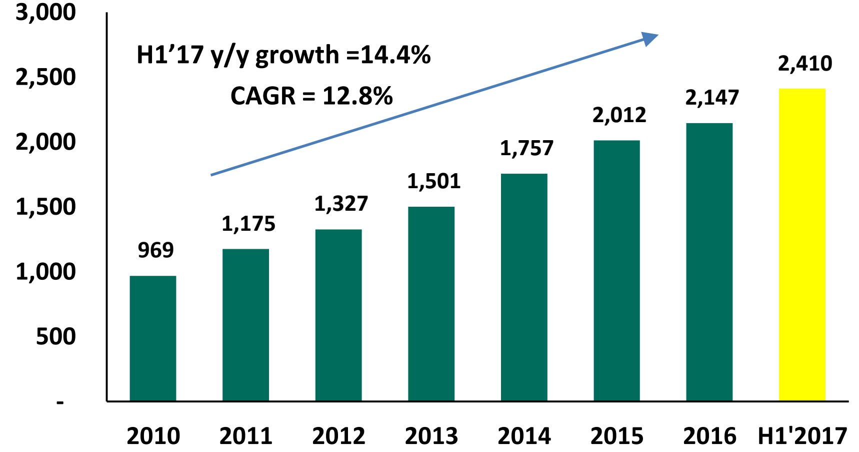
Listed Banking Sector Metrics

Deposit growth remains strong, coming in faster than historical average. Loan growth and branch opening slows down as private sector credit growth slumps and banks embrace alternative distribution channels

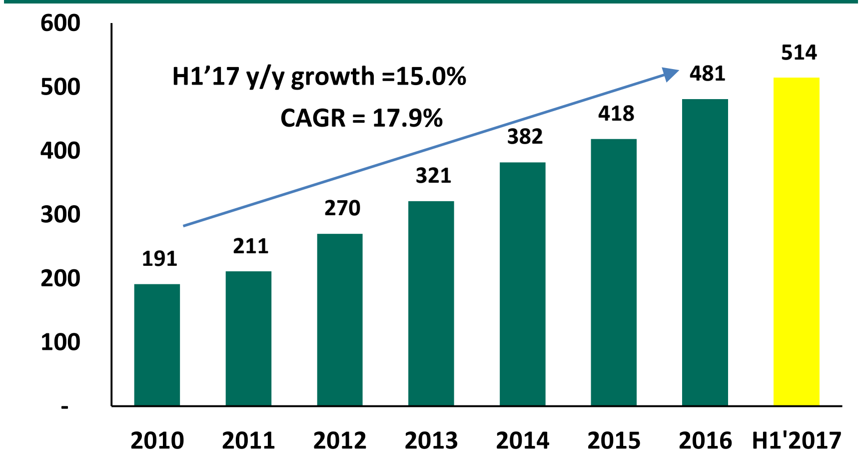
Loans and Advances (Kshs Bn)



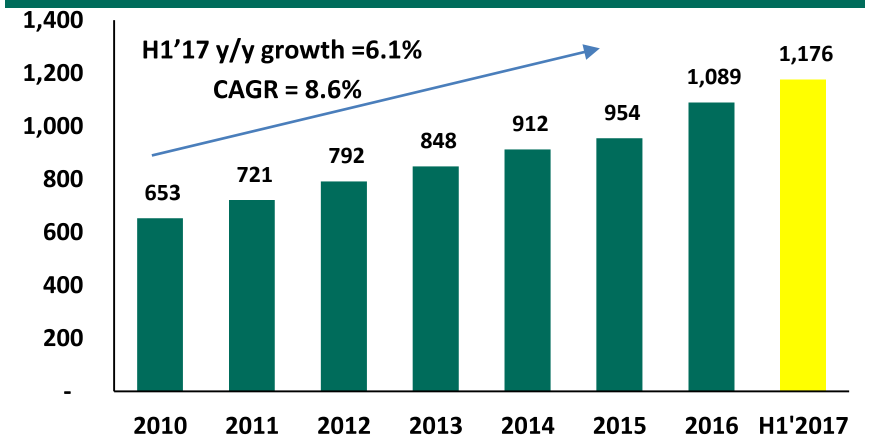
Deposits (Kshs Bn)



Shareholders Equity (Kshs Bn)



Bank Branches



Source: Central Bank of Kenya

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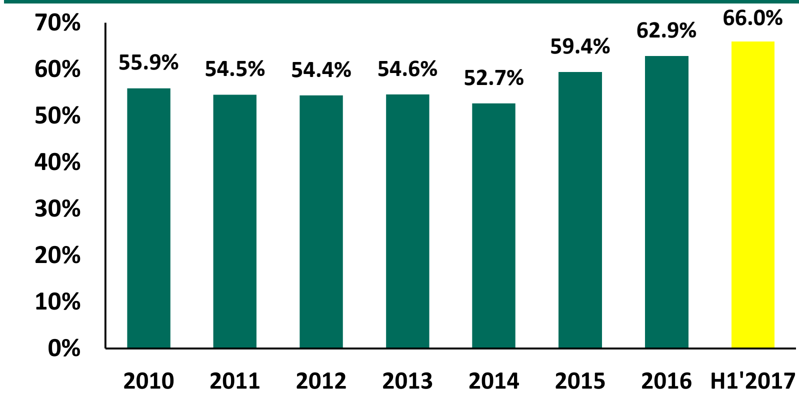
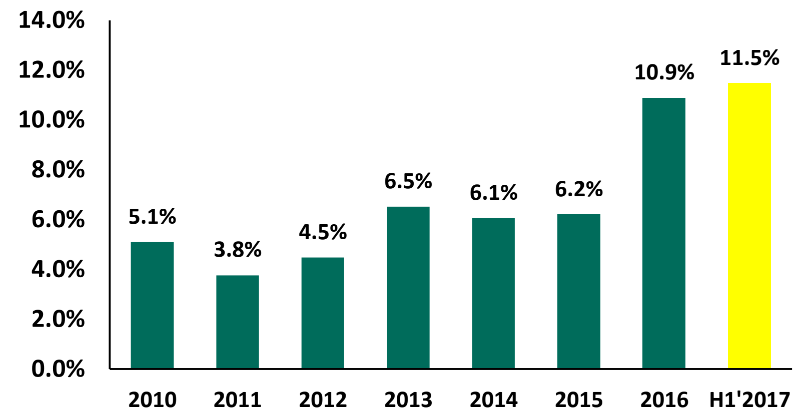
Listed Banking Sector Metrics, continued…

Under the regulated loan pricing framework, we have seen a decline in net interest margins and higher levels of NPLs; and this, coupled with the rising costs are points of concern to the sector

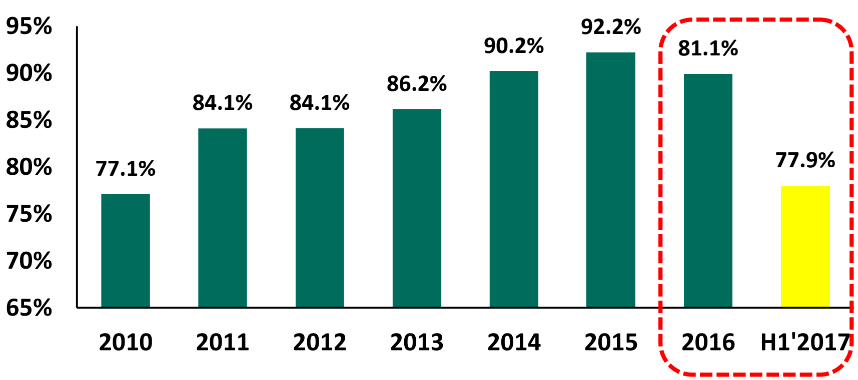
Cost to Income - with LLP (%)



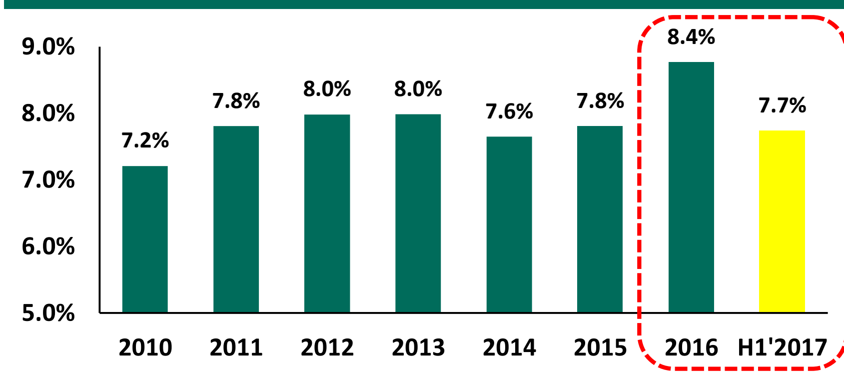
NPLs to Total Loans (%)



Loan to Deposits (%)



Net Interest Margin (%)



- The LDR has declined to 77.9% from 81.1% in 2016, with banks adopting a more prudent credit risk assessment framework to ensure quality loan books

- Bank's NIMs have declined to 7.7% from 8.4% in 2016, following the capping of interest rates, and this has affected the profitability of these banks as the current regulatory framework has compressed margins

Source: Central Bank of Kenya

Listed Banks H1’2017 Earnings & Growth Metrics

Kenya’s banking sector H1’2017 core EPS declined by 13.8% compared to a growth of 15.5% in H1’2016

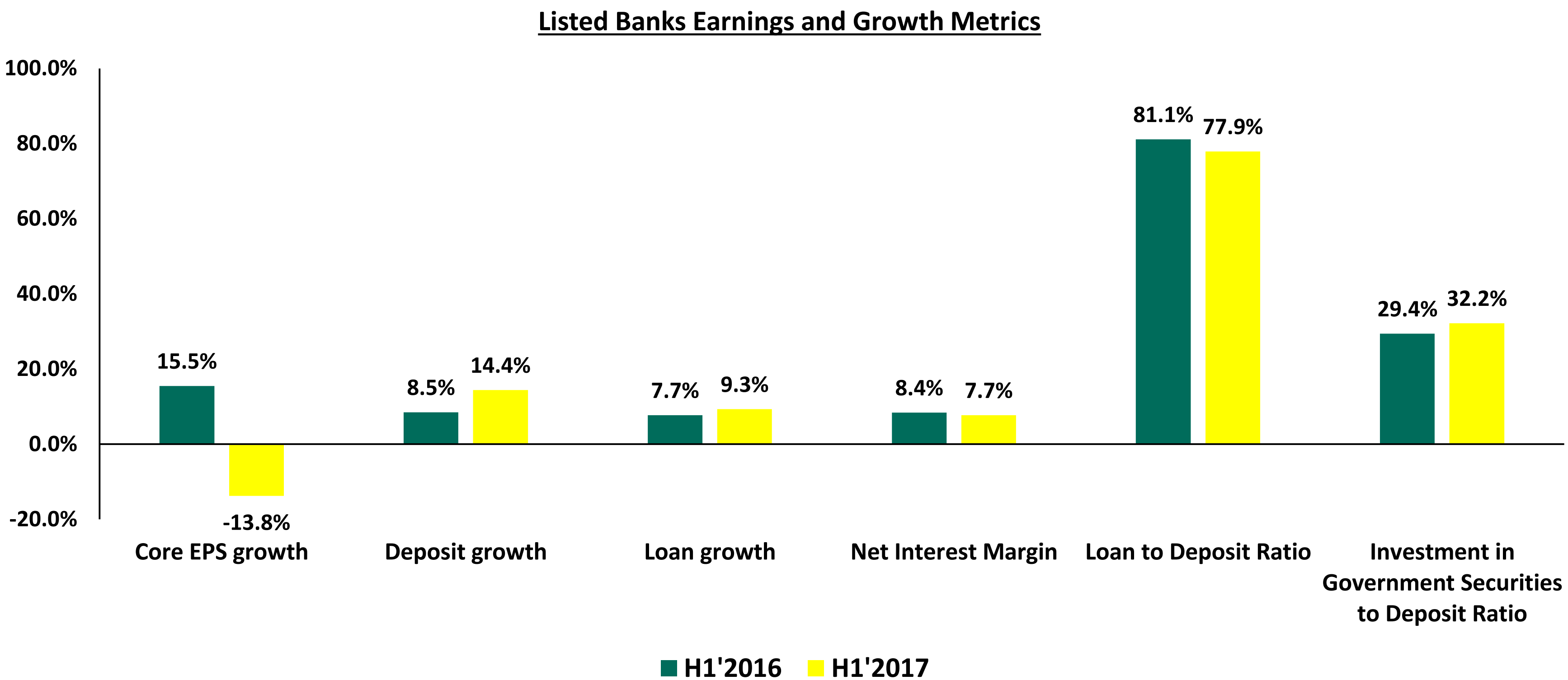
Listed Banks H1'2017 Earnings and Growth Metrics						
Bank	Core EPS Growth	Deposit Growth	Loan Growth	Net Interest Margin	Loan to Deposit Ratio	Investments in Government Securities to Deposit Ratio
	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017	H1'2017
KCB Group	**(0.2%)**	1.3%	16.7%	8.7%	84.3%	24.0%
DTB Kenya	**(5.8%)**	18.6%	7.2%	6.8%	74.7%	41.1%
Equity Group	**(7.8%)**	13.6%	(1.5%)	9.7%	73.1%	37.2%
NIC Bank	**(11.9%)**	18.9%	4.1%	7.1%	87.7%	33.3%
Stanbic Holdings	**(12.1%)**	12.5%	8.0%	5.3%	75.1%	38.6%
Barclays Bank	**(13.3%)**	3.2%	6.8%	10.1%	86.8%	27.9%
I&M Holdings	**(17.9%)**	10.3%	9.1%	7.7%	89.5%	31.3%
Co-op Bank	**(25.4%)**	2.7%	14.2%	8.8%	88.4%	26.0%
Standard Chartered Bank Kenya	**(34.4%)**	17.6%	(1.1%)	8.4%	50.4%	47.6%
National Bank of Kenya	**(42.2%)**	3.4%	(12.0%)	6.9%	57.7%	38.1%
Housing Finance Group	**(74.0%)**	(6.0%)	(1.3%)	5.7%	89.3%***	9.2%
H1' 2017 Average	**(13.8%) ***	**14.4%****	**9.3%****	**7.7%**	**77.9%**	**32.2%**
H1'2016 Average	**15.5%***	**8.5%****	**7.7%****	**8.4%**	**81.1%**	**29.4%**

The weighted average is based on Market Cap as at 31st August, 2017

*****Based on cumulative growth of listed banking sector***

******For Housing Finance, given their primary business of mortgage provision, we used the Loans to Loanable funds ratio. The Loan to Deposit ratio is at 141.3%***

Listed Banks H1’2017 Earnings & Growth Metrics… Continued



- The listed banks recorded a 13.8% decline in core EPS, compared to a growth of 15.5% in H1’2016, as a result of depressed Net Interest Income (NII), following the capping of interest rates, which also saw banks record reduced margins, with the Net Interest Margin (NIM) coming in at 7.7%, from 8.4%, previously
- The LDR has declined to 77.9% from 81.1% in 2016, with banks adopting a more prudent credit risk assessment framework to ensure quality loan books, with banks now channelling funds more actively towards government securities, with exposure in government securities as a portion of deposits coming in at 32.2%, from 29.4% previously, despite the strong deposit growth at 14.4%

Listed Banking Sector Multiples

Kenya's banking sector is currently trading at an average PTBV of 1.5x and a PE of 8.3x

Bank	Share Price *	No. of Shares Issued (bn)	Market Cap (bn)	PTBV	P/E	Dividend Yield
Equity Group Holdings	39.0	3.8	147.2	**1.9x**	**9.3x**	4.5%
Standard Chartered Bank Kenya	240.0	0.3	82.4	**1.6x**	**11.4x**	4.3%
Co-operative Bank of Kenya	16.6	5.9	97.4	**1.5x**	**8.2x**	5.6%
Barclays Bank of Kenya	10.4	5.4	56.5	**1.4x**	**8.2x**	9.6%
KCB Group	42.0	3.1	130.4	**1.4x**	**6.6x**	4.8%
I&M Holdings	129.0	0.4	53.3	**1.4x**	**8.2x**	2.4%
Diamond Trust Bank Kenya	182.0	0.3	48.5	**1.0x**	**6.5x**	1.4%
Stanbic Holdings	80.0	0.4	31.6	**1.0x**	**7.6x**	5.2%
NIC Bank	40.0	0.6	25.6	**0.8x**	**6.3x**	3.1%
Housing Finance Group	11.1	0.4	3.9	**0.4x**	**8.6x**	2.0%
National Bank of Kenya	11.0	0.3	3.7	**0.4x**	**8.5x**	0.0%
Weighted Average*				**1.5x**	**8.3x**	**4.6%**
Median				**1.4x**	**8.2x**	**4.3%**

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

Table arranged in order of highest PTBV

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

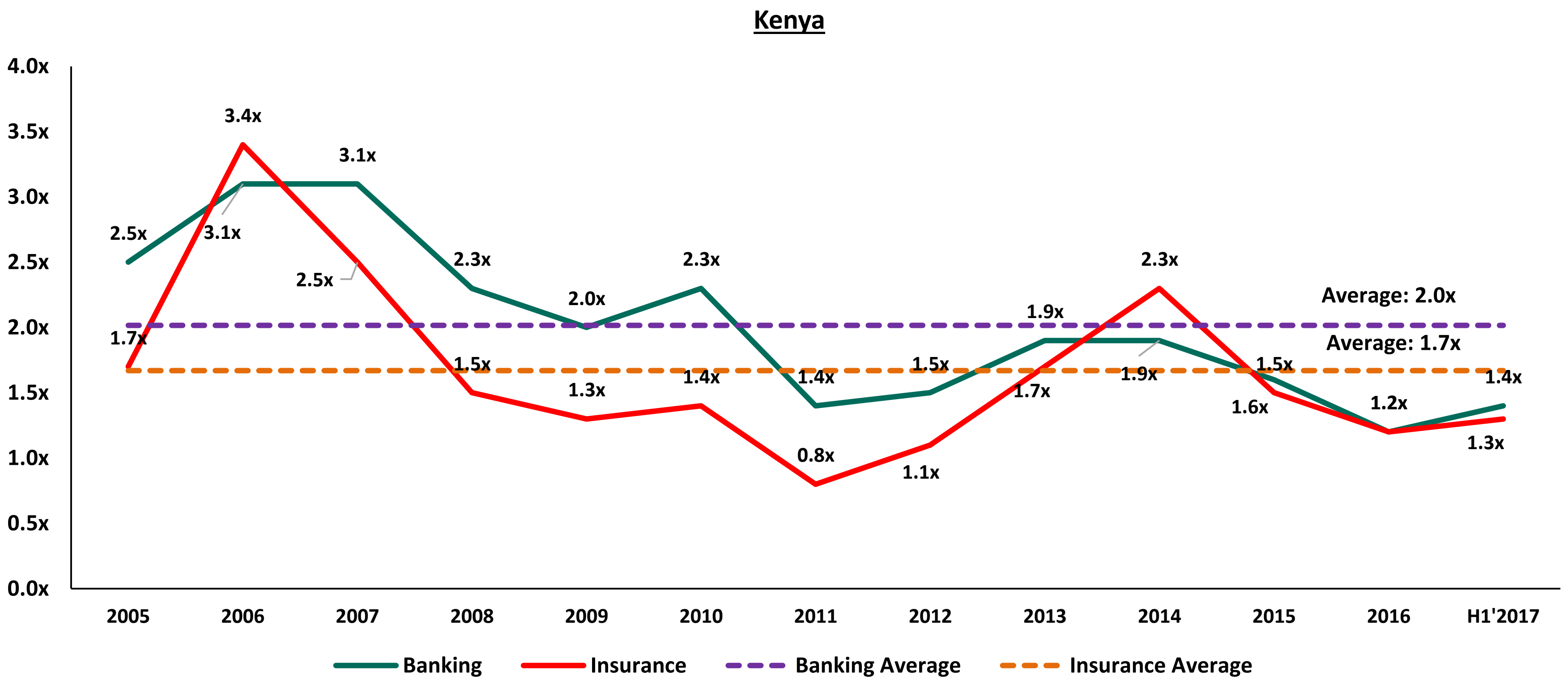
**** - Price as at 15/09/2017***

Source: NSE, Cytonn Banking Sector Report

Banking Sector Multiples

Listed Banks are currently priced at a PBV of 1.4x compared to listed insurance companies at 1.3x

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 1.3x, compared to 10-year historical averages of 2.0x and 1.7x, respectively

Source – Cytonn Research

Summary of the H1’2017 Earnings

Banks have been adversely affected following the capping of interest rates, with the sector recording a 13.8% decline in core EPS, compared to a growth of 15.5% in H1’2016

1. Following a decline of 13.8% in core earnings in H1’2017 compared to a growth of 15.5% in H1’2016, 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 14.4% compared to loans at 9.3%, but grew slower than the 5-year average of 14.6%
3. The level of NPLs remains a concern within the banking sector with the gross non-performing loan (NPL) ratio rising to 11.5%, from 10.1% in H1’2016 . 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, against 10-year and 5-year historical averages of 2.0x and 1.6x, respectively, we believe the banking sector still offers attractive valuations for long-term investors

IV. 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 H1'2017 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

Transitioning to a more Disciplined and Efficient Sector

Focus Area	Summary	Effect on Banking Sector
Regulation	• **Price controls:** Put in place in the industry following the enactment of the Banking Act (Amendment) 2015 • **Transition to IFRS 9 from IAS 39:** IFRS 9 requires banks to adopt a forward looking approach in credit risk assessment	• Banks have experienced declined growth in EPS in the first half of the year, with 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
Consolidation	• **Increased consolidation in the industry:** This year, Diamond Trust Bank Kenya (DTBK) completed the acquisition of Habib Bank (K) Limited (HBL) on 1st August 2017	• 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
Asset Quality	• **Increase in non-performing loans:** With the Gross NPL ratio currently at 11.5% from 10.1% in H1'2016, 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 • This has led to more prudent provisioning by banks, resulting to lower profitability
Cost Rationalization	• **Enhancing operational efficiency:** Following the Banking (Amendment) Act 2015, banks have taken proactive measures, aimed at increasing operational efficiency and preserving their profit margins	• The sector has witnessed measures such as laying off staff, closure of branches, reviewing operating hours for some branches, or outright sales in the case of struggling Tier III banks • Going forward, we are likely to witness banks' push for efficiency gather pace

The banking sector is shaping up to discipline in operations in the wake of increased loan loss provisioning and the capping of interest rates, as banks adjust their business models under the current regulatory framework

Rankings by Franchise Value

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

Rank	Bank	LDR *	CIR **	ROACE ***	NIM ****	PEG ratio	P/TBV	Deposit per Branch	Gross NPL Ratio	NPL Coverage	Tangible Common Ratio	Non Interest Income to Revenue	Camel Rating	Corporate Governance Score	Total Score	H1'17 Rank	Q1'17 Rank
1	Co-op	4	2	3	3	2	9	6	2	8	2	3	1	4	**49**	**1**	**1**
2	KCB	1	4	1	4	1	6	7	7	3	5	4	9	1	**53**	**2**	**2**
3	DTBK	8	5	4	8	2	5	5	1	1	10	11	2	2	**64**	**3**	**3**
4	Equity	9	3	2	2	4	11	10	6	5	4	2	3	6	**67**	**4**	**5**
5	I&M	6	1	5	6	7	7	3	4	10	1	8	8	6	**72**	**5**	**4**
6	NIC	3	6	8	7	5	3	4	8	6	3	9	4	9	**75**	**6**	**7**
7	Barclays	2	8	6	1	9	8	8	5	4	6	7	6	8	**78**	**7**	**9**
8	SCBK	11	7	7	5	9	10	2	9	2	7	5	7	3	**84**	**8**	**6**
9	Stanbic	7	9	9	11	8	4	1	3	7	9	1	5	11	**85**	**9**	**8**
10	HF Group	5	10	10	10	5	2	9	10	9	8	10	10	10	**108**	**10**	**10**
11	NBK	10	11	11	9	11	1	11	11	11	11	6	11	5	**119**	**11**	**11**

- 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
- Coop Bank ranked 1st position on the back of a low cost to income ratio of 55.3% compared to an industry average of 66.0% as well as a low non-performing loans ratio at 4.7%, compared to an industry average of 11.5%
- Equity Group climbed up 1 spot to Position 4 from Position 5, due to impressive NIM at 9.7%, above industry average of 8.6%, and a Return on average Equity of 19.7%, above the industry average of 18.1%, with the bank adequately diversified with Non-Funded income at 42.0%, higher than the industry average of 31.3%
- NBK ranked 11th on the Tangible Common Equity Ratio, coming in at 8.6% compared to an industry average of 14.4%, which might suggest the bank should look to capitalize in the near future

- **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

NIC Bank has the highest upside with a total potential return of 48.6%

Banks	Current Price*	Target Price	Upside	Dividend Yield	Total Potential Return	H1'2017 Ranking	Q1'2017 Ranking
NIC Bank	40.0	58.2	45.4%	3.2%	**48.6%**	**1**	**2**
KCB Group	42.0	57.1	35.9%	4.7%	**40.6%**	**2**	**3**
HF Group	11.1	14.2	28.6%	2.0%	**30.6%**	**3**	**5**
Barclays Bank	10.4	12.5	20.4%	9.6%	**30.0%**	**4**	**6**
DTB	182.0	234.1	28.6%	1.4%	**30.0%**	**4**	**1**
I&M Holdings	129.0	149.6	16.0%	2.3%	**18.3%**	**6**	**4**
Co-op Bank	16.6	17.5	5.6%	5.8%	**11.4%**	**7**	**8**
Equity Bank	39.0	40.5	3.9%	5.1%	**9.0%**	**8**	**10**
Stanbic Holdings	80.0	79.1	(1.1%)	5.2%	**4.1%**	**9**	**7**
SCBK	240.0	199.8	(16.7%)	4.3%	**(12.4%)**	**10**	**9**
NBK	11.0	5.2	(52.7%)	0.0%	**(52.7%)**	**11**	**11**

Prices as at 15th September 2017

- …n is computed through a combination of valuation techniques, wit… Methods and 25.0% on Relative Valuation
- NIC Bank & KCB Group have the highest upsides at 48.6% and 40.6%, respectively. DTB dropped to 4th on the intrinsic value ranking, due to slower than expected growth in NFI growth, that grew by only 1.2%, while HF Group and Barclays rose 2 positions each to 3rd and 4th, respectively, with Barclays Bank recording a dividend yield of 9.6%
- National Bank of Kenya registered the highest downside of 52.7%, maintaining its intrinsic value ranking from Q1'2017

Cytonn INVESTMENTS

Composite Bank Ranking

Overall, KCB Group ranked highest, while 4 banks shifted positions from Q1'2017

CYTONN'S H1'2017 BANKING REPORT RANKINGS					
Bank	Franchise Value Total Score	Total Return Score	Weighted Score	H1'2017 Rank	Q1'2017 Rank
KCB Group	**53.0**	**2**	**22.4**	**1**	**1**
Co-operative Bank	**49.0**	**7**	**23.8**	**2**	**2**
Diamond Trust Bank	**64.0**	**4**	**28.0**	**3**	**3**
NIC Bank	**75.0**	**1**	**30.6**	**4**	**5**
Equity Group	**67.0**	**8**	**31.6**	**5**	**6**
I&M Holdings	**72.0**	**6**	**32.4**	**6**	**4**
Barclays Bank	**78.0**	**4**	**33.6**	**7**	**7**
Stanbic Holdings	**85.0**	**9**	**39.4**	**8**	**8**
SCBK	**84.0**	**10**	**39.6**	**9**	**8**
HF Group	**108.0**	**3**	**45.0**	**10**	**10**
NBK	**119.0**	**11**	**54.2**	**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 1st and 2nd, respectively, Equity moved up 1 position to 5th, while NIC Bank moved up 1 position to 4th from Q1'2017

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. Barclays Bank had the highest NIM at 10.1%, with the lowest for Stanbic Holdings at 5.3%

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. KCB Group has the highest ROACE at 20.2%, while the National Bank of Kenya had the lowest at 0.5%

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 0.6x, while National Bank was the most overvalued at 10.9x

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 Holdings has the highest deposits per branch at Kshs 6.6 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 KCB Group was closest to the target at 84.3%, while SCBK was the farthest at 50.4%

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. I&M Holdings maintained the lowest cost to income ratio of 50.7%, while the National Bank of Kenya had the highest ratio at 93.7%

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 and HF Group were the most undervalued banks as per this metric at 0.4x, while Equity Bank is the most overvalued at 1.9x

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:

I&M Bank is the most solvent with a tangible common ratio of 16.8%, while the National Bank of Kenya was the least solvent at 8.6%

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 4.6%, while the National Bank of Kenya had the highest non-performing loans ratio at 44.2%

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:

DTBK has the highest provisions to non-performing loans at 86.8%, while the National Bank of Kenya has the lowest at 32.5%

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 45.3%, while DTBK has the lowest at 21.1%

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

Tier 1 Banks Value Drivers and Cons

Bank	Value Drivers	Cons
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 4.6% compared to an industry average of 11.5%	• Competition in the SME banking market • Exposure to different political, economic and regulatory environments
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. Equity Group

Financial Statements Extracts

Equity Group's PAT is expected to grow at a 5-year CAGR of 12.0%

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	**355.9**	**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%**

Valuation Summary

Equity Group is undervalued with a total potential return of 9.0%

Cost of Equity Assumptions:	
Risk free rate *	13.20%
Beta	0.9
Country Risk Premium	7.1%
Extra Risk Premium	0.0%
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	135.8
Terminal Value-(Year 2021)	249.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
Integrated DDM	46.4	40.0%	18.5
Residual Income	39.1	35.0%	13.7
PBV Multiple	32.6	20.0%	6.5
PE Multiple	35.2	5.0%	1.8

Fair Value	**40.5**
Current Price	**39.0**
Upside/(Downside)	3.9%
Dividend Yield	5.1%
Total Potential Return	**9.0%**

** 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 11.3%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	39.2	47.0	46.5	50.4	55.1
Non Funded Income	23.4	22.5	29.1	31.6	34.5
Loan Loss Provision	4.7	3.8	4.4	4.8	5.7
Other Operating Expenses	31.4	36.6	43.8	46.1	47.5
Total Operating Expenses	**36.1**	**40.4**	**48.2**	**50.9**	**53.2**
Profit Before Tax	26.5	29.1	27.4	31.1	36.4
Profit After tax	19.6	19.7	19.2	21.8	25.5
% PAT Change YoY	**16.5%**	**0.5%**	**(2.8%)**	**13.7%**	**16.8%**
EPS	6.3	6.4	6.2	7.0	8.2
DPS	2.0	3.0	3.0	3.1	3.6
Cost to Income	57.6%	58.1%	63.8%	62.1%	59.4%
ROE	25.0%	22.2%	19.7%	21.0%	21.7%
ROA	3.7%	3.4%	3.1%	3.3%	3.7%

Balance Sheet	2015	2016	2017f	2018f	2019f
Net Loans and Advances	346.0	385.7	420.1	455.4	493.8
Government Securities	57.8	40.5	42.8	46.1	49.7
Other Assets	154.3	169.0	187.4	202.4	219.3
Total Assets	**558.1**	**595.2**	**650.3**	**703.9**	**762.9**
Customer Deposits	424.4	448.2	502.4	542.5	585.9
Other Liabilities	52.4	50.5	50.0	51.2	52.5
Total Liabilities	476.8	498.7	552.4	593.8	638.5
Shareholders Equity	81.3	96.6	97.9	110.1	124.4
Book value Per share	26.2	31.1	31.5	35.5	40.1
% Change in BPS YoY	**7.4%**	**18.8%**	**1.4%**	**12.5%**	**12.9%**

Valuation Summary

KCB Group is undervalued with a total potential return of 40.6%

Cost of Equity Assumptions:	
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	22.5%
Terminal P/B	1.5x
Shareholder Equity - FY21e	149.1
Terminal Value-(Year 2021)	234.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	54.6	35%	19.1
PBV Multiple	53.8	20%	10.8
PE Multiple	56.5	5%	2.8
DDM Integrated	61.0	40%	24.4
Target Price			**57.1**
Current Price			**42.0**
Upside/(Downside)			35.9%
Dividend Yield			4.7%
Total Potential Return			**40.6%**

** 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 10.4%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	23.2	29.5	28.8	31.1	34.1
Non Funded Income	13.2	12.8	13.7	15.1	16.5
Loan Loss Provision	2.0	2.6	3.0	3.0	3.3
Other Operating Expenses	19.4	22.0	22.3	24.1	26.1
Total Operating Expenses	21.4	24.6	25.2	27.1	29.3
Profit Before Tax	15.4	17.7	17.4	19.3	21.4
Profit After tax	11.7	12.7	12.2	13.5	15.0
% PAT Change YoY	**46.0%**	**8.3%**	**(3.7%)**	**10.5%**	**11.1%**
EPS	2.4	2.6	2.5	2.8	3.1
DPS	1.0	1.0	0.9	1.0	1.1
Cost to Income	58.8%	58.3%	59.3%	58.5%	57.9%
NIM	8.7%	9.9%	9.0%	8.8%	8.8%
ROE	25.0%	22.7%	19.2%	19.3%	19.0%
ROA	3.7%	3.7%	3.3%	3.2%	3.2%

Balance Sheet	2015	2016	2017f	2018f	2019f
Net Loans and Advances	213.4	236.9	257.0	283.8	308.5
Government Securities	36.2	37.2	43.4	48.2	53.4
Other Assets	93.0	77.8	95.6	106.4	124.4
Total Assets	**342.5**	**351.9**	**395.9**	**438.4**	**486.3**
Customer Deposits	265.4	260.2	295.0	330.4	368.4
Other Liabilities	27.3	30.6	35.6	34.2	34.7
Total Liabilities	**292.7**	**290.7**	**330.6**	**364.6**	**403.0**
Shareholders Equity	50.2	61.3	65.5	74.0	83.4
Book value Per share	10.3	12.5	13.4	15.1	17.1
% Change in BPS YoY	**15.9%**	**22.1%**	**6.9%**	**13.0%**	**12.7%**

Valuation Summary

Co-operative Bank is undervalued with a total potential return of 11.4%

Cost of Equity Assumptions:	
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	20.4%
Return on Average Equity	20.6%
Terminal P/B	1.5x
Shareholder Equity - FY21e	96.0
Terminal Value-(Year 2021)	151.1

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	20.3	40.0%	8.1
Residual income	16.1	35.0%	5.6
PBV Multiple	15.3	20.0%	3.1
PE Multiple	15.0	5.0%	0.8
Fair Value			**17.5**
Current Price			**16.6**
Upside/(Downside)			5.6%
Dividend Yield			5.8%
Total Potential Return			**11.4%**

** 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 6.9%

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	18.1	19.4	15.6	19.1	22.4
Non Funded Income	7.2	8.6	8.7	9.0	9.7
Loan Loss Provision	4.9	2.2	2.8	3.4	3.9
Other Operating Expenses	11.3	12.5	12.2	13.0	14.7
Total Operating Expenses	**16.2**	**14.7**	**15.0**	**16.4**	**18.6**
Profit Before Tax	9.2	13.3	9.3	11.7	13.6
Profit After tax	6.3	9.1	6.3	7.9	9.2
% PAT Change YoY	**(39.2%)**	**42.7%**	**(30.2%)**	**25.9%**	**16.3%**
EPS	18.5	26.3	18.4	23.1	26.9
DPS	12.5	20.0	10.3	13.0	15.1
Cost to Income	63.9%	52.5%	61.7%	58.4%	57.8%
NIM	9.6%	9.6%	6.9%	7.6%	8.1%
ROaE	16.2%	21.3%	14.5%	17.8%	19.1%
ROaA	2.8%	3.7%	2.3%	2.6%	2.8%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	115.1	122.7	118.5	133.5	147.5
Government Securities	73.6	86.9	115.5	125.3	136.0
Other assets	45.2	40.7	62.8	58.1	57.9
Total Assets	**234.0**	**250.3**	**296.8**	**316.9**	**341.5**
Customer Deposits	172.0	186.6	227.9	247.2	268.2
Other Liabilities	20.7	19.8	26.0	23.2	22.7
Total Liabilities	**192.7**	**206.4**	**253.8**	**270.5**	**291.0**
Shareholders Equity	41.3	43.9	42.9	46.4	50.5
Book value Per share	120.1	127.8	125.0	135.2	147.0
% Change in BPS YoY	**11.8%**	**6.4%**	**(2.2%**	**8.1%**	**8.8%**

Cytonn INVESTMENTS

Valuation Summary

Standard Chartered Bank is over-valued with a total potential return of (12.4%)

Cost of Equity Assumptions:	
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	18.3%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.6%
Return on Average Equity	21.8%
Terminal P/B	1.5x
Shareholder Equity - FY21e	60.9
Terminal Value-(Year 2021)	95.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	206.62	40%	82.65
Residual Income	199.38	35%	69.78
PBV Multiple	194.61	20%	38.92
PE Multiple	166.75	5%	8.34
Fair Value			**199.8**
Current Price			**240.0**
Upside/(Downside)			(16.7%)
Dividend Yield			4.3%
Total Potential Return			**(12.4%)**

** 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	22.0	23.2	25.3
Non Funded Income	9.1	9.3	9.5	10.2	11.2
Total Operating Income	**29.5**	**31.7**	**31.5**	**33.4**	**36.5**
Loan Loss Provision	(1.8)	(3.9)	(3.7)	(4.1)	(4.5)
Other Operating Expenses	(15.6)	(16.9)	(18.1)	(19.2)	(20.7)
Total Operating Expenses	**(17.4)**	**(20.8)**	**(21.9)**	**(23.3)**	**(25.2)**
Profit Before Tax	12.1	10.9	9.7	10.2	11.3
Profit After tax	**8.4**	**7.4**	**6.8**	**7.1**	**7.9**
% PAT Change YoY	**(0.4%)**	**(11.9%)**	**(8.6%)**	**5.0%**	**10.8%**
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%	69.3%	69.6%	69.2%
NIM	10.4%	10.5%	9.8%	9.5%	9.5%
ROaE	21.6%	18.0%	16.7%	18.0%	18.9%
ROaA	3.6%	3.0%	2.6%	2.7%	2.8%

Balance Sheet	2015	2016	2017f	2018f	2019f
Net Loans and Advances	145.4	168.5	170.1	189.2	203.3
Government Securities	48.1	48.7	54.7	60.9	67.8
Other Assets	47.4	42.5	52.2	50.0	41.4
Total Assets	**240.9**	**259.7**	**277.0**	**300.1**	**312.6**
Customer Deposits	165.1	178.2	195.5	210.2	225.9
Other Liabilities	36.1	39.1	42.9	49.6	43.7
Total Liabilities	**201.2**	**217.3**	**238.5**	**259.7**	**269.6**
Shareholders Equity	39.7	42.4	38.6	40.4	43.0
Book value Per share	7.3	7.8	7.1	7.4	7.9
% Change in BPS YoY	**4.0%**	**6.7%**	**(8.9%)**	**4.6%**	**6.4%**

Valuation Summary

Barclays Bank Kenya is undervalued with a total potential return of 30.0%

Cost of Equity Assumptions:	
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	19.6%
Terminal P/B	1.5x
Shareholder Equity - FY21e	55.7
Terminal Value-(Year 2021)	87.7

Valuation Summary:	Implied Price	Weighting	Weighted Value
Integrated DDM	11.9	40.0%	4.8
Residual Income	13.7	35.0%	4.8
PBV Multiple	12.3	20.0%	2.5
PE Multiple	10.5	5.0%	0.5
Fair Value			**12.5**
Current Price			**10.4**
Upside/(Downside)			20.4%
Dividend Yield			9.6%
Total Potential Return			**30.0%**

** 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 9.0%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	15.2	19.4	18.8	20.7	23.7
Non Funded Income	4.7	5.1	5.1	5.5	6.1
Loan Loss Provision	2.2	4.3	3.4	3.4	3.8
Other Operating Expenses	4.9	5.8	6.7	7.4	8.4
Total Operating Expenses	**10.3**	**13.5**	**13.9**	**15.1**	**17.1**
Profit Before Tax	9.6	11.0	10.0	11.2	12.8
Profit After tax	6.6	7.7	7.0	7.8	9.0
% PAT Change YoY	**15.7%**	**17.0%**	**-9.8%**	**12.1%**	**14.8%**
EPS	24.8	27.6	24.9	27.9	32.1
DPS	2.5	2.6	2.5	2.8	3.2
Cost to Income	52.0%	55.1%	58.3%	57.5%	57.1%
NIM	**7.2%**	**7.4%**	**6.5%**	**6.6%**	**6.7%**
ROE	20.9%	20.5%	15.9%	15.7%	15.6%
ROA	2.7%	2.6%	2.0%	2.1%	2.1%

Balance Sheet	2015	2016	2017f	2018f	2019f
Net Loans and Advances	177.5	186.3	200.7	222.3	249.5
Government Securities	47.1	92.8	97.3	101.0	117.2
Other Assets	47.0	49.0	63.7	76.7	82.7
Total Assets	**271.6**	**328.0**	**361.7**	**400.1**	**449.4**
Customer Deposits	194.1	238.1	271.9	307.3	347.2
Other Liabilities	39.3	44.1	38.1	33.9	35.1
Total Liabilities	**233.3**	**282.2**	**310.0**	**341.2**	**382.4**
Shareholders Equity	34.1	41.0	46.6	53.9	62.0
Book value Per share	128.2	146.7	166.7	192.8	221.7
% Change in BPS YoY	**17.9%**	**14.5%**	**13.6%**	**15.6%**	**15.0%**

Source – Company Financials

Valuation Summary

DTB's stock is undervalued with a total potential return of 30.0%

Cost of Equity Assumptions:	
Risk free rate *	13.2%
Beta	0.8
Country Risk Premium	6.4%
Extra Risk Premium	1.5%
Cost of Equity	19.5%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	21.1%
Return on Average Equity	15.6%
Terminal P/B	1.5x
Shareholder Equity - FY21e	81.8
Terminal Value-(Year 2021)	128.9

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual	253.4	35.0%	88.7
Common Ratio	262.1	40.0%	104.9
PBV Multiple	156.3	20.0%	31.3
PE Multiple	185.7	5.0%	9.3
Fair Value			**234.1**
Current Price			**182.0**
Upside/(Downside)			28.6%
Dividend yield			1.4%
Total return			**30.0%**

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

Cytonn INVESTMENTS

VII. 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	9.8	10.4	11.3
Non Funded Income	7.6	7.7	8.5	8.5	9.0
Loan Loss Provision	(0.9)	(1.8)	(3.0)	(2.9)	(3.1)
Total Operating Expenses	**(9.6)**	**(12.5)**	**(13.1)**	**(13.1)**	**(13.9)**
Profit Before Tax	7.4	6.0	5.2	5.8	6.5
Profit After tax	4.9	4.4	3.6	4.1	4.6
% PAT Change YoY	**(13.7%)**	**(9.9%)**	**(18.1%)**	**12.5%**	**12.1%**
EPS	12.4	11.2	9.2	10.3	11.5
DPS	6.2	5.3	4.1	4.6	5.2
Cost to Income	51.2%	57.9%	55.0%	54.0%	53.0%
NIM	**5.5%**	**5.9%**	**5.1%**	**5.2%**	**5.3%**
ROaE	13.0%	11.3%	8.7%	9.3%	9.9%
ROaA	2.5%	2.1%	1.7%	1.8%	1.9%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	128.2	132.6	126.9	134.3	143.5
Other Assets	80.3	82.1	96.7	101.4	108.0
Total Assets	**208.5**	**214.7**	**223.6**	**235.7**	**251.6**
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	14.7	11.6	11.6	12.7
Total Liabilities	**170.1**	**174.5**	**180.8**	**190.7**	**204.0**
Shareholders Equity	38.4	40.1	42.8	45.0	47.5
Book value Per share	97.0	101.5	108.2	113.8	120.2
% Change in BVPS	**4.0%**	**4.6%**	**6.5%**	**5.2%**	**5.6%**

Cytonn INVESTMENTS

Valuation Summary

Stanbic Holdings is fairly valued with a total potential return of 4.1%

Cost of Equity Assumptions:	
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	79.0	40.0%	31.6
DDM Integrated	78.9	35.0%	27.6
PBV Multiple	82.7	20.0%	16.5
PE Multiple	67.5	5.0%	3.4
Target Price			**79.1**
Current Price			**80.0**
Dividend Yield			**5.2%**
Total Potential Return			**4.1%**

** 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 ratio, 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
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&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

I. National Bank of Kenya

Financial Statements Extracts

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

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	6.4	8.0	7.4	7.8	7.9
Non Funded Income	3.2	3.0	3.0	3.3	3.5
Loan Loss Provision	3.7	2.7	2.2	2.7	3.3
Other Expenses	7.5	8.2	7.9	8.0	7.7
Total Operating Expenses	**11.2**	**10.9**	**10.1**	**10.7**	**11.0**
Profit Before Tax	(1.6)	0.2	0.3	0.3	0.3
Profit After tax	**(1.2)**	**0.2**	**0.2**	**0.2**	**0.2**
% PAT Change YoY	**(232.5%)**	**(114.1%)**	**30.1%**	**7.1%**	**5.0%**
EPS	(3.4)	0.5	0.6	0.7	0.7
DPS	-	-	-	-	-
Cost to Income	78.2%	73.9%	76.4%	72.2%	68.1%
NIM	6.5%	8.2%	7.4%	7.3%	7.0%
ROaE	(9.9%)	1.5%	1.9%	2.0%	2.0%
ROaA	(0.9%)	0.1%	0.2%	0.2%	0.2%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	67.8	59.3	60.5	64.7	69.2
Government Securities	27.3	34.8	40.3	43.1	46.1
Other Assets	30.3	21.2	21.8	22.2	22.5
Total Assets	125.4	115.3	122.6	130.0	137.9
Customer Deposits	110.6	97.0	100.8	107.8	115.4
Other Liabilities	3.8	7.2	10.3	10.5	10.6
Total Liabilities	114.4	104.1	111.1	118.3	126.0
Shareholders Equity	11.1	11.2	11.5	11.7	11.9
Book value Per share	32.6	32.9	33.8	34.5	35.2
% Change in BVPS	**(9.6%)**	**0.9%**	**2.8%**	**2.0%**	**2.0%**

Cytonn INVESTMENTS

Valuation Summary

National Bank is overvalued with a total potential return of (52.7%)

Cost of Equity Assumptions:	
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	2.3%
Terminal P/B	0.5x
Shareholder Equity - FY21e	12.5
Terminal Value-(Year 2021)	6.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
Residual Income	(2.1)	35.0%	(0.4)
DDM Integrated	(0.87)	40.0%	(0.7)
PBV Multiple	24.2	20.0%	4.8
PE Multiple	28.8	5.0%	1.4
Target Price			**5.2**
Current Price			**11.0**
Upside/(Downside)			(52.7%)
Dividend Yield			0.0%
Total Potential Return			**(52.7%)**

** 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 7.0%

Income Statement	2015	2016	2017e	2018e	2019e
Net Interest Income	9.7	12.2	11.8	12.2	13.3
Non Funded Income	4.0	4.0	4.2	4.6	5.0
Loan Loss Provision	1.7	3.7	3.6	3.9	4.3
Total Operating Expenses	7.4	10.0	10.2	10.7	11.4
Profit Before Tax	6.4	6.2	5.8	6.1	6.9
Profit After tax	4.5	4.3	4.0	4.3	4.8
% PAT Change YoY	**(61.7%)**	**(3.3%)**	**(7.0%)**	**6.3%**	**12.6%**
EPS	7.0	6.8	6.3	6.7	7.5
DPS	1.3	1.3	1.3	1.0	1.1
Cost to Income	53.6%	61.9%	63.9%	63.7%	62.4%
NIM	6.9%	8.0%	7.3%	6.9%	7.0%
ROE	18.4%	15.5%	12.8%	12.2%	12.4%
ROA	2.9%	2.6%	2.2%	2.1%	2.2%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	116.0	114.5	120.1	136.5	147.3
Government Securities	27.8	30.5	45.2	46.9	46.5
Other Assets	21.9	24.5	33.5	32.6	28.0
Total Assets	**165.8**	**169.5**	**198.8**	**216.0**	**221.8**
Customer Deposits	112.4	111.8	136.9	146.5	155.1
Other Liabilities	27.1	27.3	27.8	31.4	24.1
Total Liabilities	**139.4**	**139.1**	**164.8**	**177.9**	**179.1**
Shareholders Equity	25.9	29.8	33.5	37.6	42.2
Book value Per share	5.31	6.12	6.88	7.72	8.66
% Change in BVPS	**13.1%**	**15.4%**	**12.3%**	**12.2%**	**12.2%**

Valuation Summary

NIC bank is undervalued with a total potential return of 48.6%

Cost of Equity Assumptions:	
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	12.6%
Terminal P/B	1.3x
Shareholder Equity - FY21e	40.0
Terminal Value-(Year 2021)	52.5

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	65.2	40%	26.1
Residual Valuation	53.4	35%	18.7
PBV Multiple	56.1	20%	11.2
PE Multiple	43.3	5%	2.2
Fair Value			**58.2**
Current Price			**40.0**
Upside/(Downside)			45.4%
Dividend Yield			3.2%
Total Potential Return			**48.6%**

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

Cytonn INVESTMENTS

III. I&M Holdings

Financial Statements Extracts

I&M Holdings PAT is expected to grow at a 5-year CAGR of 6.9%

Income Statement	2015	2016	2017f	2018f	2019f
Net Interest Income	12.6	15.5	14.0	16.5	17.6
Non Funded Income	4.6	5.2	5.8	6.5	7.2
Total Operating Income	**17.2**	**20.8**	**19.8**	**23.0**	**24.8**
Loan Loss Provision	1.0	3.0	3.1	3.4	3.5
Other Operating Expenses	6.4	7.2	7.7	8.1	8.6
Total Operating Expenses	**7.4**	**10.2**	**10.8**	**11.5**	**12.1**
Profit Before Tax	10.2	10.6	9.0	11.6	12.7
Profit After tax	7.1	7.8	6.3	8.1	8.9
EPS	**18.2**	**19.8**	**16.0**	**20.6**	**22.6**
% PAT Change YoY	**24.6%**	**8.6%**	**(19.1%)**	**28.8%**	**9.6%**
EPS	18.2	19.8	16.0	20.6	22.6
DPS	3.5	3.5	3.0	3.9	4.3
CIR	37.2%	34.7%	38.7%	35.0%	34.7%
NIM	7.6%	8.6%	6.9%	7.4%	7.4%
ROaE	24.8%	22.7%	14.7%	15.7%	15.2%
ROaA	3.9%	3.9%	2.8%	3.2%	3.2%

Balance Sheet	2015	2016	2017f	2018f	2019f
Investment Securities	42.2	45.8	57.5	61.9	66.6
Net Loans and Advances	127.8	134.7	151.2	159.0	169.3
Other Assets	21.7	30.1	36.3	43.4	49.4
Total Assets	**191.7**	**210.5**	**245.1**	**264.2**	**285.3**
Customer Deposits	133.0	146.5	168.1	180.7	194.6
Other Liabilities	25.0	24.5	26.3	26.3	26.3
Total Liabilities	**158.0**	**171.0**	**194.4**	**207.0**	**220.9**
Shareholders Equity	31.4	37.0	48.3	54.8	62.0
Book value Per share	0.1	0.1	0.1	0.1	0.2
% BVPS Change YoY	**20.7%**	**17.7%**	**30.4%**	**13.6%**	**13.1%**

Valuation Summary

I&M Holdings is undervalued with a total potential return of 18.3%

Cost of Equity Assumptions:	
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	18.7%

Terminal Assumptions:	
Growth rate	5.0%
Mature Company Beta	1.0
Terminal Cost of Equity	19.8%
Return on Average Equity	14.7%
Terminal P/B	1.5x
Shareholder Equity - FY21e	53.6
Terminal Value-(Year 2021)	84.4

Valuation Summary:	Implied Price	Weighting	Weighted Value
Integrated DDM	178.7	40.0%	71.5
Residual Income	153.2	35.0%	53.6
PBV Multiple	92.0	20.0%	18.4
PE Multiple	122.8	5.0%	6.1
Fair Value			**149.6**
Current Price			**129.0**
Upside/(Downside)			16.0%
Dividend Yield			2.3%
Total Potential Return			**18.3%**

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

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IV. 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	3.1	3.3	3.8
Non Funded Income	1.2	0.8	0.7	1.1	1.3
Loan Loss Provision	(0.5)	(0.7)	(0.8)	(0.9)	(0.9)
Other Operating Expenses	(2.6)	(2.6)	(2.4)	(2.8)	(3.2)
Total Operating Expenses	**(3.1)**	**(3.3)**	**(3.3)**	**(3.6)**	**(4.1)**
Profit Before Tax	1.8	1.4	0.6	0.7	1.0
Profit After tax	1.2	0.9	0.4	0.5	0.7
% PAT Change YoY	**22.7%**	**(24.3%)**	**(57.3%)**	**32.3%**	**31.9%**
EPS	0.0	0.0	0.0	0.0	0.0
DPS	1.5	0.5	0.2	0.3	0.4
Cost to Income	54.5%	56.3%	64.2%	63.1%	62.7%
NIM	6.0%	6.5%	5.1%	5.3%	5.7%
ROaE	13.9%	8.3%	3.4%	4.5%	5.7%
ROaA	1.8%	1.3%	0.5%	0.7%	0.9%

Balance Sheet	2015	2016	2017e	2018e	2019e
Net Loans and Advances	53.0	54.5	53.5	56.4	59.6
Government Securities	2.2	4.1	5.5	6.0	7.0
Other Assets	16.5	13.4	19.7	11.3	10.6
Total Assets	**71.7**	**71.9**	**78.7**	**73.7**	**77.1**
Customer Deposits	41.7	38.1	39.6	41.8	44.1
Other Liabilities	19.4	22.6	27.6	20.0	20.6
Total Liabilities	**61.0**	**60.6**	**67.2**	**61.8**	**64.7**
Shareholders Equity	10.6	11.3	11.4	11.3	12.4
Book value Per share	0.0	0.0	0.0	0.0	0.0
% Change in BPS YoY	**62.0%**	**6.3%**	**0.8%**	**(0.7%)**	**9.7%**

Valuation Summary

HF Group is undervalued with a total potential return of 30.6%

Cost of Equity Assumptions:	
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	8.5%
Terminal P/B	0.6x
Shareholder Equity - FY21e	12.6
Terminal Value-(Year 2021)	7.6

Valuation Summary:	Implied Price	Weighting	Weighted Value
DDM Integrated	14.6	40%	5.8
Residual Income	10.9	35%	3.8
PTBV Multiple	18.3	20%	3.7
PE Multiple	17.8	5%	0.9
Fair Value			**14.2**
Current Price			**11.1**
Upside/(Downside)			28.6%
Dividend Yield			2.0%
Total return			**30.6%**

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

Feedback Summary

During the preparation of this H1'2017 Banking Sector Report, we shared with the subject companies the operating metrics that were used in the rankings for their confirmation and verification

Below is a summary of the banks we were able to acquire feedback from and those that went unresponsive.

Bank	Operating Metrics Shared	Sent Feedback
Diamond Trust Bank Kenya	Yes	Yes
Co-operative Bank of Kenya	Yes	Yes
KCB Group	Yes	Yes
NIC Bank	Yes	Yes
National Bank of Kenya	Yes	Yes
Housing Finance Group	Yes	Unresponsive
Stanbic Holdings	Yes	Unresponsive
I&M Holdings	Yes	Unresponsive
Barclays Bank of Kenya	Yes	Unresponsive
Standard Chartered Bank Kenya	Yes	Unresponsive
Equity Group Holdings	Yes	Unresponsive

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Thank You!

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For more information or any further clarification required, kindly contact the research team at investment@cytonn.com

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